



## Monitoring the fee cap of non-audit services

### Preliminary remarks

In order to enhance independence and objectivity of the auditor, the Audit Regulation has defined under its Article 4 (2) a cap for the provision of non-audit fees. This note, intended for the main categories of stakeholders involved (e.g. audit firms, audit committees, oversight bodies, professional bodies, PIEs...), defines the guidelines adopted by the CEAOB on that matter.

They are non-binding, but Member States are encouraged to roll them out in their respective countries for the purpose of ensuring a consistent approach across the EU. Consequently, this would lead to a consistent application of several requirements in the Audit Regulation (e.g. Articles 13, 14, 27). The guidelines for application are limited to the European legislation and must be adapted, if necessary, to national specificities. It is also the reason why they do not contain examples. However, when evaluating a practical case, it is important that the intention to limit provision of non-audit services is given due consideration.

This note, drawn up by the CEAOB, is without prejudice to the Q&As published by the European Commission.

This note starts with the definitions from the Audit Regulation and European Directives and is followed by frequently asked questions.

### Definition of the fee cap (Article 4(2) of Regulation 537/2014/EC)

“When the statutory auditor or the audit firm provides to the audited entity, its parent undertaking or its controlled undertakings, for a period of three or more consecutive financial years, non-audit services (hereafter “NAS”) other than those referred to Article 5 (1) of this Regulation, the total fees for such services shall be limited to no more than 70% of the average of the fees paid in the last three consecutive financial years for the statutory audit(s) of the audited entity, where applicable, of its parent undertaking, of its controlled undertakings and of the consolidated financial statements of that group of undertakings.

For the purposes of the limits specified in the first subparagraph, NAS, other than those referred to in Article 5(1), required by Union or national legislation shall be excluded.”

### Definitions as per European Directives

#### Statutory auditor (Article 2(2) of Directive 2006/43/EC)

Means a natural person who is approved in accordance with this Directive by the competent authorities of a Member State to carry out statutory audits;

#### Audit firm (Article 2(3) of Directive 2006/43/EC)

Means a legal person or any other entity, regardless of its legal form, that is approved in accordance with this Directive by the competent authorities of a Member State to carry out statutory audits.

**Statutory audit** (Article 2(1) of Directive 2006/43/EC)

Means an audit of annual financial statements or consolidated financial statements in so far as:

- (a) Required by Union law;
- (b) Required by national law as regards small undertakings;
- (c) Voluntary carried out at the request of small undertakings which meets national legal requirements that are equivalent to those for an audit under point (b), where national legislation defines such audits as statutory audits.

**Parent undertaking** (point (9) of Article 2 of the Accounting Directive 2013/34/EU)

Is defined as an undertaking which controls one or more subsidiary undertakings.

**Controlled undertaking** (point (f) of Article 2(1) of the Transparency Directive 2004/109/EC)

Is defined as any undertaking (i) in which a natural person or legal entity has a majority of the voting rights; or (ii) of which a natural person or legal entity has the right to appoint or remove a majority of the members of the administrative, management or supervisory body and is at the same time a shareholder in, or member of, the undertaking in question; or (iii) of which a natural person or legal entity is a shareholder or member and alone controls a majority of the shareholders' or members' voting rights, respectively, pursuant to an agreement entered into with other shareholders or members of the undertaking in question; or (iv) over which a natural person or legal entity has the power to exercise, or actually exercises, dominant influence or control.

## Frequently asked questions

**What is the scope of the cap?**

The basic requirement is that the cap applies solely at the level of the statutory auditor or audit firm that audits the respective PIE and not to the whole network. If NAS are provided by affiliated entities from a same network even within the same Member State, the cap will not apply to NAS provided by these firms. However, Article 4 (4) of the Regulation provides that Member States may apply more stringent requirements.

Even if the other members of the network were also audit firms, NAS provided would not be included in the cap calculation (although they would have to calculate a separate cap in case they also audit public interest entities (hereafter "PIE")).

**How is the 70% NAS fee cap calculated?**

Calculation of the cap applies to all PIEs. Therefore, if there are more than one PIE within a group of undertakings, a cap shall be determined for each PIE.

Calculation of the cap shall be done not only including the audited PIE but also, where applicable, its parent undertaking and its controlled undertakings whether these entities are PIEs or not.

For the calculation of the cap, undertakings to be considered can be established either inside or outside the European Union.

**What is the first financial year for the purpose of calculating the cap?**

The Regulation establishes that when a statutory auditor or an audit firm has been providing NAS to the audited PIE for an uninterrupted period of three or more consecutive financial years, the total fees for such services in the fourth year shall be limited to the cap.

It should be understood by an uninterrupted period of three years that both audit services and NAS services must have been provided by the same statutory auditor or audit firm for at least three consecutive years. If this condition is not met, the cap provision will not be applicable.

If the first financial year starts on or after 17 June 2016, for example where a PIE has a 31 December year end, the cap would first apply to the financial year commencing on 1<sup>st</sup> January 2020.

If an entity qualifies as a PIE during the course of an audit engagement, the calculation of the cap should start from that financial year the entity qualifies as a PIE. If there are several PIEs in a group, the first financial year shall be determined individually for each of them.

**Which financial year to consider for the calculation of the cap?**

The financial year to consider shall be the one of the audited PIE even if its parent undertaking or if its controlled undertakings have different closing dates.

If the parent undertaking or a controlled undertaking have different closing dates, fee for the statutory audit should be included based on the financial year of the audited PIE.

**What is the basis of calculation of statutory audit and NAS fees?**

Statutory audit fees to be considered for the calculation of the cap should be the ones corresponding to the audit of the financial statements paid on average during the three financial years of reference of the PIE.

Regarding the NAS, reference should be made to the time of realization, irrespective of when these fees are billed or paid.

**Are any NAS excluded from the cap by EU Directive or Regulation?**

NAS other than those referred to in article 5(1), required by Union or national legislation shall be excluded.

As a frequent example for Union legislation, the prospectus Directive provides for requirements to be fulfilled by statutory auditors and audit firms in reference to Commission Regulation N° 809/2004 as regards information contained in prospectuses. These services are excluded from the cap.

**What should be understood by “national law” under article 4 (2)?**

Regulation 537/2014 applies to each Member State. Therefore NAS required by national legislation of any Member State shall be excluded from the cap regardless where the service is rendered, as long as the national law is applicable to the specific statutory auditor or audited entity.

**What is the primary source of information to calculate the cap?**

The financial records of the audit firm should be used as basis for calculation of the cap as the monitoring of the fee cap remains in first instance with the audit firm and because this monitoring does not only encompass the audited entity. If the PIE and audit firm have different closing date, the financial year to consider shall be the one of the audited PIE (as indicated above).

It is recommended that the audit firm provides the relevant fee and the outcome of the fee cap calculation information to the audit committee for the purpose of article 39 (6) e) of the Directive 2006/43/EC.

**How to handle with NAS required by third country authorities?**

NAS required by a third country authority are not NAS required by Union or national law. In general, those services are to be included in the calculation of the cap.

However, embedded audit procedures performed according to for example PCAOB standards cannot be separated from audit procedures performed for the statutory audit according to European Directive or Regulation. Even if PCAOB standards might require a higher or more extensive level of controls testing, these audit procedures will also be used for the audit of financial statements according to European Directive or Regulation. Therefore, if audit procedures are used at the same time for the statutory audit according to the EU framework and for the purposes of the PCAOB, the corresponding fees can be regarded as statutory audit fees.

**Are fees related to the audit of reporting packages to be included in the denominator for the purpose of calculation of the cap?**

If the reporting packages prepared by the statutory auditor or the audit firm of the PIE are either due for the audit of the consolidated financial statements of an audited parent undertaking located in the EU and/or are used also in the context of the statutory audit of the entity, fees should be regarded as statutory audit fees. In all other cases, they would be considered as NAS.

**Are fees related to Audit of financial statements voluntarily carried out in a controlled undertaking (outside the definition of a statutory audit) to be included in the denominator for the purpose of calculation of the cap?**

These audits are to be classified as NAS.

However, if the audited information and thus the audit procedures performed are used as part of the statutory audit of annual and/or consolidated financial statements of the audited parent undertaking located in the EU to fulfil a legal obligation, the fees paid for these services could be categorized as statutory audit fees.