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EU Audit Changes Expected in 2016: U.S. Companies With Operations in Europe Must Update Their Practices
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Chief financial officers take heed: the European Audit Reform (EAR), expected to be adopted by European Union member states by June 17, 2016, affects American companies with a presence in the EU.

The reform requires that publically-traded subsidiaries registered in an EU member state conform to new audit rotation rules and restrictions on non-audit services. They must also verify that their audit firms are adhering to EU independence requirements.

American companies must anticipate sweeping changes and coordinate with their European subsidiaries, as well as getting professional guidance from an accounting firm with EAR experience.

The changes in audit firms' service terms and limits on the services they can provide came about as a result of the perception that auditors had some culpability for the 2008 financial crisis.

The European Commission found in a review that overconcentration among the larger, more well-known firms created adverse consequences from their dominant position and, in some cases, may have compromised the quality of audits.

Some firms were tarred with scandal when Enron and WorldCom went bankrupt. Investigations revealed that audit firms failed to report auditing errors, and passed on limited, and sometimes unreliable, information to investors. Also, because these firms offered other services that generated more revenue than the audit, the integrity of the audit was compromised. They tended to operate with the goal of reducing costs and avoiding legal proceedings at the expense of relaying accurate data so that investors could make informed decisions.

These reforms introduce more players into the marketplace and work towards reestablishing trust in financial reporting, enhancing audit quality, and encouraging a multi-player audit market.

First, the EU proposes that auditors be rotated after 10 years for all public interest entities. If a company issues a tender that results in the original auditing firm being selected, its engagement may be extended an additional 10 years, for a total tenure not to exceed 20 years. If a joint audit is adopted, the audit firm may be retained for an additional 14 years, for a total 24-year engagement. Individual member states may enact even more rigorous rotation rules.

Another component of the regulation is limitations on non-audit services. Fees for non-audit services may not exceed 70 percent of the average total statutory audit fees paid during the last three fiscal years. Member states may impose stricter requirements.

The reform may also be construed as an endorsement of the concept of joint audit, and provides advantages to those companies that employ two auditors: joint auditors may remain engaged for a total of 24 years, without the obligation to tender.

The EAR also includes elements expanding the role of the audit committee and making the actual audit report more informative. There are also provisions for increasing supervision and promoting cooperation among entities who oversee audits by creating a Committee of European Audit Oversight Bodies.

Though the EAR has not yet been fully adopted, non-European countries are keeping a close eye on its progress as it could serve as an alternative model for others to follow.

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