European audit market reform agreement will have limited impact in the Netherlands

The European Council, Parliament and Commission reached agreement on proposals to reform the European audit market in December 2013. But for now, the agreement will not lead to any significant changes to Dutch regulation introduced last year to improve the independence of audit firms. This means that listed companies in the Netherlands will need to follow Dutch audit laws and prepare for mandatory rotation of their audit firm after 1 January 2016 if the same firm has conducted the statutory audit for eight years.

Improving auditors’ independence

Dutch rules aimed at improving auditors’ independence include mandatory rotation of audit firms at public interest entities (PIEs). These entities include listed companies, banks and insurers. Even though this mandatory rotation does not take effect until 1 January 2016, companies affected by the requirement will have to start addressing the issue at their next general meetings. The European proposals are based on a ten-year tenure, and this could be even longer in the case of a joint audit or where there is tendering for a new audit firm.

Questions have been raised in the Dutch parliament about whether the European proposals may lead to the amendment of Dutch regulation. The government recently responded that there is generally no reason to do so. And in the case of audit firm rotation, the government is not even required to follow the European ten-year tenure proposals; member states are allowed to set a shorter rotation period. An exception is the cooling-off period. Dutch regulation currently requires a two-year cooling-off period before an audit firm can be rehired. This will be amended in line with the European four-year period.

The separation of audit and non-audit services that Dutch audit firms have been subject to since 1 January 2013 is more restrictive than the European proposals in a number of ways. For example, the European proposals are based on a ‘blacklist’ of services that audit firms are banned from providing, whereas the Dutch rules prohibit firms providing audit services to a PIE from doing any other type of work for the same PIE. On this issue too, the government has indicated that it will not make any adjustments. The government argues that member states may prohibit other services than those listed as banned if they could jeopardise auditors’ independence.

There are, however, two additional requirements identified by the government that Dutch audit firms will have to meet when the European proposals take effect:

1. In principle, there is a cap on turnover from permitted audit-related services provided to PIEs. That turnover may not exceed 70% of the average annual amount invoiced for the statutory audit at the same PIE.

2. During the financial year preceding the period that the statutory audit relates to, no services may be provided to the same PIE that concern internal control or risk management procedures for financial information or financial information technology systems.

See also the October 2013 issue of In context for a summary of the current Dutch rules.

Changes to audit report and the role of the auditor to alert

The European proposals also impose further requirements on the content of the audit report for PIEs. These are set out in a regulation. The audit report must be more informative and detailed with a focus on information relevant to investors. It will have to describe the key risks of material misstatements. The auditor will also have to submit an additional report to the company’s audit committee, including information on audit principles applied. When the European proposals are adopted, Dutch legislation will need to be amended accordingly.

According to the government, the existing rules in the Netherlands do already offer scope for auditors to include more information in their reports, and it is currently ruling out further legislation on this point. The Netherlands Institute of Chartered Accountants (NBA) encourages auditors to refer in the audit report to explanatory paragraphs in the annual accounts. The NBA also started a pilot in the autumn of 2013 to achieve more informative audit reports at PIEs. Organisations representing investors’ interests, such as Eumedion and VEB, have also advocated for more extensive and business-specific reports. In practice, external auditors at some listed companies have already used a more informative reporting method for the 2013 financial year.

The auditor’s role to alert needs to be given further attention in day-to-day practice. The government has emphasised that it is primarily the responsibility of management and the supervisory board to act on problems identified by an auditor. See the December 2013 issue of In context on this issue.

The formal adoption by the European Parliament and Council of the European proposals for audit market reforms has yet to take place. With a view to imminent European elections, this is expected to happen in the next few months. For now, audit firms in the Netherlands will have to carry out their services at listed companies, banks and insurers on the basis of current Dutch regulation.