Stockholm 15 June 2016

Implementation of the EU Audit Reform in Sweden

On 18 May 2016 the Swedish Parliament voted on the implementation of the EU audit reform. The new rules will come into effect 17 June 2016, but most of the provisions are to be applied to the first financial year that begins after 16 June 2016.

In April 2014 the EU Council of Ministers decided on the audit reform that includes a regulation on specific requirements regarding statutory audit of Public Interest Entities (PIEs) and a directive amending an earlier audit directive. The main objective with the reform is to strengthen the quality of statutory audit and the independence of statutory auditors.

PIEs refers to entities whose transferable securities are admitted to trading on a regulated market, as well as some financial institutions.

The objective of this letter is to bring attention to some of the key provisions of the audit reform.

Audit Firm Rotation
All PIEs must apply firm rotation, i.e. change audit firm after a certain length of time.

For listed entities which are not financial institutions, a tendering process must be carried out after 10 years with a possible extension of the audit engagement by another 10 years. After a maximum of 20 years, rotation to another audit firm must take place. If yet another audit firm is selected after the first 10 years, the audit engagement may be extended by 14 years.

Maximum duration of the audit engagement for a financial institution is 10 years without possibility of renewal. This applies regardless of whether the financial institution is listed or not.

If a PIE (irrespective of whether it is a listed entity or a financial institution) has a physical person as elected auditor, maximum duration of the engagement is 7 years.

The regulation contains a number of transitional arrangements for audit firm rotation. Where the first financial year covered by the engagement began before 17 June 1994, the entity may not enter into or renew the engagement after 16 June 2020. For engagements that began between 17 June 1994 and 16 June 2003, the entity may no longer enter into or renew the engagement after 16 June 2023.
For audit engagements for listed entities which are not financial institutions, and which began during the period 17 June 2003 until 16 June 2006, a decision shall be taken at the first Annual General Meeting following 17 June 2016 – subject to a tendering process or joint audit – on possible extension of the audit engagement. For financial institutions, there is no possibility of extension.

Audit engagements for listed entities which are not financial institutions, and which have not yet reached 10 years per 17 June 2016, can be renewed after 10 years, subject to tendering process or joint audit. For financial institutions there is no possibility for renewal after 10 years.

**Provision of Non-Audit Services**

The EU audit reform allows the auditor and the audit firm to continue to provide non-audit services to PIEs. These services are limited by a so-called black list of some services. In general, the new rules essentially codify the practice developed in recent years.

The rules also contain an upper limit for the size of fees for non-audit services provided. The restriction applies only if the services have been provided for a period of at least three consecutive years. The fee for such non-audit services may not exceed 70 percent of the audit fee.

**The Audit Committee**

The requirement that the Board shall have an audit committee has been expanded to include financial institutions. All PIEs have, however, the option of allowing the duties of the audit committee to be performed by the entire Board. The audit committee shall:

- approve the auditor’s and the audit firm’s provision of non-audit services
- submit recommendations and suggestions to ensure the reliability of financial reporting
- inform the Board about the outcome of the audit and explain how the audit contributed to the reliability of financial reporting
- stay informed about findings made by the Swedish Supervisory Board’s (Revisorsnämndens) quality control of the current auditor/audit firm.

The EU audit reform also means that the audit committee shall be responsible for the selection of the statutory auditor or the audit firm and submit a recommendation of who should be elected as the auditor of the audited entity. The entity’s nomination committee may continue to propose to the Annual General Meeting who should be elected as auditor. The audit committee is expected to assist the nomination committee in its work.

**New Audit Report**

The EU audit reform introduces extended reporting from the auditor. The auditor must provide more information in the audit report, and also submit a comprehensive report on various issues to the audit committee.
The audit report for a PIE shall include:

- a description of the most significant assessed risks of material misstatement, including assessed risks of material misstatement due to fraud
- a summary of the auditor's response to these risks, and
- where relevant, key observations arising with respect to those risks.

Parallel to the development of the EU audit reform, the global audit standard setter – IAASB – has adopted a new audit report. The content has been strongly affected by the provisions of the EU audit reform, but instead of "the most significant assessed risks of material misstatement" IAASB refers to "key audit matters".

FAR members must apply both IAASB’s audit report and the provisions in the EU audit reform, which is why FAR has developed a template for the audit report that takes into account both sets of regulations. The IAASB’s audit report applies to financial years ending 15 December 2016 or later, i.e. from the financial year 2016. The new EU rules on the audit report shall apply to the first financial year that begins after 16 June 2016. If the entity’s financial year is the same as the calendar year, it means that EU rules on the audit report shall first apply for financial year 2017. The introduction of the new audit report in two steps is explained by the fact that it would otherwise have been a premature application of the EU provisions.

The new rules will soon be brought into force and FAR intends to continue in various ways to provide guidance for the practical application.

FAR

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