



# EU Audit Legislation in Portugal

September 2015





From June 2016 onwards important changes driven by EU Audit legislation will start to come into effect impacting audit firms and public interest entities (PIEs). This document summarises a number of key EU baseline measures and how these have been incorporated into Portuguese law. Please note this does not cover all aspects of the EU [Directive](#) or the [Regulation](#).

Should you have any questions, please consult your usual KPMG Independence or Regulatory contact



#### A reminder of the key EU baseline provisions



The key changes introduced by the EU Audit legislation are:

- **Mandatory Audit Firm Rotation (MFR):** A requirement for auditors of a PIE to rotate every ten years with a Member State option to extend audit firm tenure for either a tender or joint audit arrangement;
- **Non-Audit Services Prohibitions (NAS):** A list of prohibitions that apply to services provided by the statutory auditor and its network, in respect of services provided to the audited entity, its parent undertaking or controlled entities, based in the EU. The NAS provisions do not apply to sister entities of the EU PIE unless they themselves are EU PIEs.
- **NAS Fee Caps:** The introduction of a 70% cap on NAS fees as a percentage of the average of the audit fees for the previous three years.
- **Auditor reporting:** Introduces additional reporting requirements for the statutory auditor of EU PIEs covering the statutory audit report, audit committee reporting and reporting to supervisory bodies of PIEs.



#### Portugal – recent developments

- The transposition of EU Audit legislation was completed on 9 September 2015 with the publication of two important pieces of legislation approved by Parliament, referred to in this paper as the Portuguese Law, as follows:
- [Law 140/2015](#) - The reform of the Statute of Statutory Audit Institute which was the main legal instrument by which Portugal transposed the EU Legislation; and
- [Law 148/2015](#) - The supervision of the audit profession – full powers of supervision move to the Securities Commission from 1 January 2016.

 <b>EU Baseline</b>	 <b>Portugal</b>	<b>What does this mean in practice in Portugal?</b>
<p>The EU PIE definition is unchanged from the 2006 Statutory Audit Directive (the 8th Directive) however, the practical impact of being a PIE is broader than previously. The EU new directive defines a PIE as any <b>entity incorporated in an EU Member State</b> with:</p> <ol style="list-style-type: none"> <li>1. debt or shares admitted to trading on an <b>EU regulated market</b>; or</li> <li>2. <b>credit institutions</b> (e.g. non-listed and licenced under regulation to take deposits in the EU); or</li> <li>3. <b>insurance undertakings</b> (e.g. non-listed regulated insurance activities, irrespective of whether they are life, non-life or reinsurance undertakings); or</li> <li>4. <b>entities designated by local Member States</b> to be of public interest.</li> </ol>	<p>The Portuguese PIE definition is more extensive than the EU baseline. It includes the most important state owned companies and almost all financial sector companies. More specifically it includes:</p> <ol style="list-style-type: none"> <li>a) The issuers of securities admitted to trading on a regulated market;</li> <li>b) Credit institutions;</li> <li>c) Investment companies;</li> <li>d) The collective investment schemes in the contractual and corporate form, to the general regime of collective investment schemes, approved by Law 16/2015, of February 24;</li> <li>e) Venture capital companies, companies with investment in venture capital and capital funds risk, set out in the Legal Venture Capital Scheme, Social Entrepreneurship and Investment Specialist, approved by Law 18/2015, of March 4;</li> <li>f) Companies with specialized alternative investments and specialized alternative investment funds, set out in the Legal Venture Capital Scheme, Social Entrepreneurship and Investment Specialist, approved by Law 18/2015, of March 4;</li> <li>g) Securitization companies and securitization investment funds;</li> <li>h) Insurance and reinsurance companies;</li> <li>i) Holding companies (SGPS) that held control over credit institutions;</li> <li>j) Holding companies (SGPS) in the insurance industry;</li> <li>k) Pension funds; and</li> <li>l) Public held companies (companies held by the state) that, for two consecutive years, present a turnover of more than € 50 million or total net assets exceeding € 300 million.</li> </ol>	<p>The original PIE concept was retained and the legal references updated. In practice the number of PIEs is expected to remain at around the same level to the 8<sup>th</sup> Directive.</p>
<p>Statutory auditors of a PIE are required to:</p> <ul style="list-style-type: none"> <li>➢ Rotate at least every 10 years (subject to a Member State option);</li> <li>➢ With a Member State option to extend audit firm tenure to: <ul style="list-style-type: none"> <li>- a maximum of 20 years (subject to a public tender process being held after 10 years); or</li> <li>- a maximum of 24 years (subject to a joint audit arrangement).</li> </ul> </li> </ul>	<p>The Portuguese Law establishes:</p> <ul style="list-style-type: none"> <li>➢ A minimum initial period of two years for PIEs;</li> <li>➢ A maximum tenure period of three or two mandates where such mandates are of three or four years respectively – meaning a maximum tenure of either nine or eight years respectively, with a cooling-off period of four years;</li> <li>➢ No tender or joint audit extension is permitted/required;</li> <li>➢ Extension for a maximum of 10 years if proposed by supervisory board on reasonable grounds – requires immediate communication to National Audit Oversight Board.</li> </ul>	<p>In practical terms audit firm rotation will occur after 8 or 9 years. This is a change from current practice and we anticipate a significant increase in tendering activity</p>
<p>Requires KAPs to <b>rotate after a maximum of seven years</b>, followed by a three-year cooling-off period. Member States have the option to elect shorter KAP rotation periods.</p>	<p>Portugal is aligned with the EU baseline – seven years, with a cooling-off period of three-years</p>	<p>Note EU is broadly in line with the IESBA Code – although the Code only requires a 2-year cooling-off period.</p>
<p>The EU requirements largely align with the new ISA requirements, although there are still some additional unique EU disclosures such as an independence declaration and an indication of the length of the audit/client relationship.</p>	<p>Portugal has adopted the EU baseline for PIEs.</p>	<p>Increased transparency – the audit report will include a description of the risks identified by the auditor and the procedures performed.</p>

To which entities do the new rules apply – PIE definition?

Audit Firm Rotation – what are the MFR rules?



Key audit partner rotation (KAP) – new rules?

Auditor reporting – what's new?

What are the MFR transition rules – including the short runner issue?

Permissible services - what is the cap on fees?

Prohibited NAS

 <b>EU Baseline</b>	 <b>Portugal</b>	<b>What does this mean in practice in Portugal?</b>
<p>When the start of the first financial year of the audit engagement is:</p> <ul style="list-style-type: none"> <li>➤ <b>On or before 16 June 1994</b>, a PIE cannot renew or enter into an audit engagement with the auditor for the financial year beginning on or after 17 June 2020.</li> <li>➤ <b>Between 17 June 1994 and 16 June 2003</b>, a PIE cannot renew or enter into an audit engagement for the financial year beginning on or after 17 June 2023.</li> <li>➤ <b>Between 17 June 2003 and 16 June 2006</b>: PIEs need to conduct a tender and reappoint the existing auditors or appoint new auditors so that the new audit engagement takes effect for the next financial year beginning after 16 June 2016. Member States will determine whether an audit straddling 17 June 2016 could be completed.</li> <li>➤ <b>For audits commencing 17 June 2006 onwards</b>, when an audit engagement reaches a maximum duration of 10 years since first appointed, the auditor can not be reappointed other than on the basis of a tender or joint audit.</li> </ul>	<p>The Portuguese Law enters into force on 1 January 2016.</p> <p>Existing audit mandates are irrevocable until the end of the mandate (with a maximum period of 4 years). Upon renewal of the mandate after 1 January 2016, if they have already exceeded the maximum tenure period (8 or 9 years), then the mandate can no longer be renewed and the audit firm shall be rotated.</p>	<p>The transition regime may differ from the EU Baseline.</p> <p>Audit mandates cannot be interrupted and must run to completion of the full mandate, even if they have already exceeded 10 or more years at 1st January 2016.</p>
<p>Fees earned by the auditor of the PIE for <b>permissible NAS are capped at 70%</b> - though Member States have the option to establish stricter rules on the NAS fee cap, including a lower %.</p> <p>Any NAS that is not explicitly prohibited to the audited PIE, its parent undertaking or its controlled undertakings is permissible.</p> <p><b>Approval by the Audit Committee is needed</b> following an assessment of the threats to independence and the safeguards.</p> <p>Member States may introduce a list of permitted services.</p>	<p>The Portuguese Law goes beyond the EU baseline and sets the NAS fee cap at 30%.</p> <p>If a statutory auditor provides NAS for an audit client, its parent company or controlled undertaking for a <u>consecutive period of 3 years</u>, the fees received for providing NAS should not account for more than 30% of the <u>total amount of fees received by the statutory auditor from the audit client and, if applicable, from its parent company and from the entities under their control</u> (within the meaning of the old concept of control under the IAS 27) shown in consolidated accounts of this entity group for the past 3 consecutive years.</p> <p>Portugal has not introduced a list of permissible services.</p>	<p>The cap calculation will exclude any NAS required by Portuguese law to be performed by the statutory auditor.</p> <p>The new functions of the Audit Committee include the pre-approval of NAS, confirmation of the auditor's independence and handling the tender or bid to select the audit firm. For further guidance on the role of the Audit Committee see the <a href="#">KPMG Audit Committee Institute handbook</a>.</p>
<p>The list of NAS which statutory auditors and members of their network are prohibited from providing to their PIE statutory audit clients is included in Appendix 1. Member States have the option to add to this list.</p> <p>The audit firm may NOT provide such NAS during the time between the beginning of the period audited and the issuing of the audit report. There is also a 'clean period' required from the financial year preceding the start of the year to be audited for; <i>'Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems'</i>.</p> <p>Valuation and certain tax services (with the exception of customs taxes and payroll tax) are subject to Member State derogation (Appendix 1) meaning they could be permitted. In the event of such a derogation the audit committee must conclude and document that the services in question have no direct or have an immaterial effect on the financial statements and do not compromise the auditor's independence.</p>	<p>Portugal has:</p> <ul style="list-style-type: none"> <li>➤ Not added to the EU baseline list of NAS prohibitions (Appendix 1);</li> <li>➤ Not applied the Member State derogations to allow most tax services (with the exception of customs taxes and payroll tax) and valuation services meaning that the Portuguese Law prohibits most tax and valuation services.</li> </ul> <p>Legal services: The Portuguese Law has translated the concept narrowly meaning that the prohibition would only apply to those acting in the role of general counsel on resolution of conflicts. Specifically it states that <i>"negotiating on behalf of the audited company; and the exercise of representation functions under the dispute resolution"</i> is forbidden.</p>	<p>The real challenge continues to be interpreting the nature of the services that are to be prohibited.</p> <p>The auditor needs to ensure the personal independence requirements are complied with. In particular be aware of the 'clean period requirement'.</p>

# Appendix 1

## Prohibited Non-Audit Services as per Art 5 (1) of the Regulation

A statutory auditor or an audit firm carrying out the statutory audit of a public-interest entity, or any member of the network to which the statutory auditor or the audit firm belongs, shall not directly or indirectly provide to the audited entity, to its parent undertaking or to its controlled undertakings within the Union any prohibited non-audit services in:

- a) the period between the beginning of the period audited and the issuing of the audit report; and
- b) the financial year immediately preceding the period referred to in point (a) in relation to the services listed in point (e) of the second subparagraph.

For the purposes of this Article, prohibited non-audit services shall mean:

- a) Tax Services relating to:
  - i) *preparation of tax forms\**;
  - ii) payroll tax;
  - iii) customs duties;
  - iv) *identification of public subsidies and tax incentives unless support from the statutory auditor or the audit firm in respect of such services is required by law\**;
  - v) *support regarding tax inspection by tax authorities unless support from the statutory auditor or the audit firm in respect of such inspection is required by law\**;
  - vi) *calculation of direct and indirect tax and deferred tax\**;
  - vii) *provision of tax advice\**;
- b) Services that involve playing any part in the management or decision-making of the audited entity;
- c) Bookkeeping and preparing accounting records and financial statements;
- d) Payroll services;
- e) Designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;
- f) *Valuation services, including valuations performed in connection with actuarial services or litigation support services\**;
- g) Legal services, with respect to:
  - i) the provision of general counsel;
  - ii) negotiating on behalf of the audited entity; and
  - iii) acting in an advocacy role in the resolution of litigation
- h) Services related to the audited entity's internal audit function;
- i) Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity;
- j) Promoting, dealing in, or underwriting shares in the audited entity;
- k) Human resources services, with respect to:
  - i) management in a position to exert significant influence over the preparation of the accounting records or financial statements which are the subject of the statutory audit, where such services involve:
    - searching for or seeking out candidates for such position; or
    - undertaking reference checks of candidates for such positions
  - ii) structuring the organisation design; and
  - iii) cost control.

*\* Services subject to the member state derogation*