EU Audit Legislation in Spain

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 summarizes a number of key EU baseline measures and how these have been incorporated into Spanish 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.

Spain – recent developments

- The legislative process was completed on 9 July 2015 with the Spanish Parliament’s final approval of the new Spanish Audit Law (Spanish Law), which transposes the EU Directive and reflects Spain’s approach to, and adoption of, the Member State options in the Regulation. The Spanish Law was published on 21 July 2015.

- The Spanish Law introduces many important changes, which substantially affect both non-PIEs and PIEs with a greater impact on PIEs. Note - Spain is still in the process of finalizing their PIE definition which will be subject to royal decree shortly.

- The majority of provisions of the Spanish Law will start to apply in Spain from the first financial year commencing on or after 17 June 2016. However, the provisions for personal independence require a ‘clean period’ starting at the beginning of the previous financial year. Regarding such services, the view is that the Spanish regulator will apply the clean period required in European Regulation retrospectively.
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 entity incorporated in an EU Member State with:

1. debt or shares admitted to trading on an EU regulated market; or
2. credit institutions (e.g. non-listed and licensed under regulation to take deposits in the EU); or
3. insurance undertakings (e.g. non-listed regulated insurance activities, irrespective of whether they are life, non-life or reinsurance undertakings); or
4. entities designated by local Member States to be of public interest.

Under the old 8th Directive, Spain designated many additional PIEs with a relatively small size criteria. This local definition is being updated and finalized. In addition to the EU baseline, the Spanish PIE definition is expected to include:

- Entities issuing securities (shares or debt) traded in secondary markets, as well entities in the segment of expanding companies in the Alternative Stock Market (MAB)
- Certain entities depending on their nature/size:
  - With revenues >€2,000 million and >4,000 employees for two consecutive years
  - UCITS with >5,000 investors
  - Pension funds with >10,000 investors
  - Banking foundations, payment entities and electronic money institutions
- Any Groups of companies of which the parent is a Spanish PIE - does not mean all entities within the group are considered PIEs.

The Spanish Law establishes the following:

- MFR every 10 years;
- Spain does not permit the extension of initial tenure for a tender; and
- An exception that the initial audit firm tenure period of 10 years may be extended by a further four years when there is a joint audit arrangement for those additional four years.

When the start of the first financial year of the audit engagement is:

- On or before 16 June 1994, a PIE cannot renew or enter into an audit engagement with the auditor for the financial year beginning on or after 17 June 2020.
- Between 17 June 1994 and 16 June 2003, a PIE cannot renew or enter into an audit arrangement for the financial year beginning on or after 17 June 2023.
- Between 17 June 2003 and 16 June 2006: 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.
- For audits commencing 17 June 2006 onwards, 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.

We understand that if the audit mandate straddles the 17 June 2016 application date then the auditor can complete that year end – but will need to rotate at the end of this period if the maximum duration has been reached. So for example, a 31 December 2016 audit would be the last for an audit firm with 10+ years tenure.
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<td>Requires KAPs to <strong>rotate after a maximum of seven years</strong>, followed by a three-year cooling-off period. Member States have the option to elect shorter KAP rotation periods.</td>
<td>Spain goes beyond the EU baseline – KAPs will rotate after five years, followed by a three-year cooling-off period. This is a reduction from the current rotation period of seven years.</td>
<td>Note EU is broadly in line with the IESBA Code – although the Code only requires a two-year cooling-off period.</td>
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| 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. 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; ‘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’. 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. | Spain has:  
- Not added to the EU baseline list of NAS prohibitions (Appendix 1); and  
- Applied the Member State derogations which allows most tax services (with the exception of customs taxes and payroll tax) and valuation services provided they meet the following criteria: 
  - No direct or immaterial effect;  
  - Effect on the financial statements is documented and explained to the audit committee; and  
  - Does not compromise the auditor’s independence per Directive 2006/43/EC.  
Legal services: The Spanish version of the Regulation has translated the concept literally as “the provision of general advice” which is a very broad translation of the term. Local discussions on this topic are still pending. | The real challenge continues to be interpreting the nature of the services that are to be prohibited. The auditor needs to ensure the personal independence requirements are complied with. In particular be aware of the ‘clean period requirement’. |

| Fees earned by the auditor of the PIE for **permissible NAS are capped at 70%** - though Member States have the option to establish stricter rules on the NAS fee cap, including a lower %. Any NAS that is not explicitly prohibited to the audited PIE, its parent undertaking or its controlled undertakings is permissible. **Approval by the Audit Committee is needed** following an assessment of the threats to independence and the safeguards. Member States may introduce a list of permitted services. | The Spanish Law adopts the EU baseline for the cap on audit fees such that an audit firm may perform permitted NAS provided that:  
- They do not represent more than 70% of the average fees paid in the last three consecutive years for the statutory audit.  
- The auditor’s fees (for the audit and the other NAS) in the last three consecutive years in relation to a single client and considered individually do not represent more than 15% of the auditor’s annual revenues. A dual calculation to measure fees concentration is introduced (see Appendix 1).  
Spain will not introduce a list of permitted services. | 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 [KPMG Audit Committee Institute handbook](#). |

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| 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. In addition:  
For PIEs, the audit report will need to provide:  
- 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 those risks; and  
- where relevant, key observations arising with respect to those risks.  
For ALL statutory audits in the EU the audit report will need to:  
- "provide a statement on any material uncertainty relating to events or conditions that may cast significant doubt about the entity’s ability to continue as a going concern". | Spain has adopted the EU baseline for PIEs.  
However, in addition most of the elements of the EU baseline for PIEs are also applied to non-PIE audit reports. | Increased transparency – the audit report will include a description of the risks identified by the auditor and the procedures performed. |
Appendix 1

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

1. 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 inspections 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) 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;

e) Valuation services, including valuations performed in connection with actuarial services or litigation support services*;

f) 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 organization design; and
   iii) cost control.

* Services subject to the Member State derogation

2. Fee concentration calculation

A dual calculation to measure fees concentration is introduced in Spain as follows:

a) Fees billed by the audit firm to the audited entity and its related entities compared to total revenues of the audit firm; and

b) Fees billed by the audit firm, and the whole network that the firm belongs to, to the audited entity and its related entities (in practical terms the concept of related entities under Spanish rules mirror the concept of affiliate under SEC Rules except that there is no materiality for significant influence entities and the ICC concept does not exist) compared to the revenues of the whole network.