Executive summary (EN)

The **introductory chapter** starts with the fact that on 13 October 2010, the European Commission launched the Green Paper "Audit policy: lessons from the crisis" in the wake of the financial crisis and in the context of the reform of financial market regulation.

After several years of debate, the European Parliament and the Council finally adopted a new Audit Directive and Regulation on 16 April 2014. The Audit Regulation sets out specific requirements for statutory audits of financial statements of public interest entities (henceforth "PIEs"), in particular listed companies, credit institutions, insurance companies, reinsurance companies, settlement institutions and institutions equivalent to settlement institutions.

According to the European Commission, the purpose of this European audit reform is to improve audit quality, counteract conflicts of interest, increase transparency and restore investor confidence in financial information.

The objective of these two different legislative initiatives is to impose stricter rules for statutory audits of PIEs, by means of a regulation which is directly applicable in all Member States of the European Union. This is the first time that this legal instrument has been used in audit-related matters. The use of a regulation is unusual to say the least, since it contains various options for Member States, thus preventing a simultaneous and uniform application in all Member States.

The adjustments relate among other things to the independence and objectivity as well as the internal organisation of audit firms. The Audit Directive also sets out new requirements for reporting, and more specifically the expansion of the scope of the auditor's report.

The main themes of the European audit reform which are contained in the Audit Regulation and which therefore include much stricter rules for the statutory auditors of PIEs are as follows: external rotation (of audit firms) and transitional provisions, prohibitions and restrictions on non-audit services, the public oversight of auditors, auditing standards and the audit report, additional reports, and the organisation and responsibilities of the audit committee. These topics are all covered in this book.

Both the Audit Directive and the Audit Regulation should have been implemented in Belgian law by 17 June 2016. Apart from an "emergency law" – law of 29 june 2016 – the federal government took a little longer to settle on the wording of the draft law itself – at present the law of 7 December 2016 – on the organisation of the profession and the public oversight of auditors which was approved by the Council of Ministers on 15 July 2016, brought before Parliament on 12 October 2016 and voted on 24 November 2016.

The consequences of this radical audit reform for the auditors and the audited companies are largely dependent on the chosen options. The impact of the new measures on both audit quality and the concentration of the audit market is as yet unclear, but the transposition into Belgian law was undertaken in a fairly realistic manner and reflects the European objectives of financial transparency and freedom of competition.

The extent to which Belgian legislator has exercised the options with sufficient flexibility for companies, is discussed in the various contributions in this book. At the moment, there are already numerous rules and standards to ensure the independence and quality of audits.

The European audit reform introduces the principle of compulsory external rotation for PIEs. This is the subject of the **second chapter**. As the Belgian legislator has opted to keep three-year terms of appointment, this implies that an audit appointment may, in the case of a PIE, be renewed two consecutive times in order to comply with the maximum period of 10 years imposed by the European Regulation. At the end of the third term (after 9 years), the extension of the current statutory auditor's appointment is still allowed for a further three terms, provided that a "public" tender process is organised by the audited entity; this thus brings the maximum period during which a PIE can be audited by the same audit firm to18 years, i.e. a total of 6 terms of appointment. The "public" nature of the tender process is required, because it ensures that the audited company can enable the incumbent statutory auditor to continue its mandate after the governing body has compare him with other auditors, even though they are not explicitly solicited. However, this does not involve a call for tenders in accordance with the requirements of the public procurement legislation of 15 June 2006 or the new public procurement law of 17 June 2016 on.

Another method that allows the maximum audit period to be extended beyond the 9-year period is to add another firm at the end of the period, so as to perform a joint audit. Under these conditions, the maximum audit period is increased to 24 years, i.e. a total of 8 consecutive terms. No steps are required on the part of the incumbent statutory auditor as regards the appointment of this second auditor. It will be up to the governing body of the audited company to initiate the search for an audit firm that will agree to perform a joint audit with the incumbent auditor. The selection procedure for this second auditor must be carried out in accordance with the private tender procedure.

When the maximum renewal limits have been exhausted (after 18 years or 24 years, as the case may be), the audited entity must appoint a new statutory auditor, via a private call for tenders in which the incumbent auditor may not participate. The law provides for a 4-year cooling-off period for the incumbent statutory auditor and its network within the European Union, corresponding generally to 2 audit mandates.

However, exceptionally, even when the maximum renewal limits have been exhausted, derogation may be requested by the audited entity from the Supervisory Board of Registered Auditors, to appoint the incumbent auditor for a new audit engagement. This new term of appointment may not exceed 2 years. This is clearly a system with a unique character that differs from the 3-year mandate provided for in the Companies Code (CC).

The **third chapter** covers the prohibition and limitation of non-audit services. By means of Articles 4 and 5 of the Audit Regulation, the European Union has compiled a list of prohibited non-audit services with options for the statutory audit of the financial statements of PIEs. Articles 108 to 113 of the law of 7 December 2016 on the organisation of the profession and the public oversight of auditors, implement the aforementioned articles of the Audit Regulation.

Despite scientific findings, the national and international normative framework and the concerns of the audit profession and SMEs obliged to appoint a statutory auditor, the Belgian legislator considered it necessary to maintain the seven existing prohibited services for non-PIEs, and to tighten even more their definition. The seven existing services whose definition has been tightened up are prohibited for the statutory auditor and any member of its network in the case of both PIEs and non-PIEs (Art. 133/1, § 2 CC), as are five new additional services for PIEs (Art. 133/2, § 3 CC), apart from valuation services in both PIEs and non-PIEs and certain tax services for PIEs, which are authorised under the following three conditions (Art. 133/1, § 4 CC) :

1) they have no direct or material effect;
2) the estimation of the effect is documented; and
3) the general principles of independence are complied with.

The audit committee gives its approval after assessing any threats to independence and the safeguards applied (Art. 133/1, § 5 CC).

Moreover, quantitative restrictions must be respected, except in the case of services required by European or national legislation (Art. 133/2, § 1 and § 3 CC).

If the audited company is not a PIE and is not part of a group that is obliged to publish consolidated accounts, there are no quantitative restrictions. If the audited company is not a PIE but is part of a group that is required to publish consolidated accounts, the "one-to-one" rule still applies (Art. 133/2, § 3 CC), albeit with exemptions under the following conditions (Art.133/2, § 4 CC) :

1) a favourable decision by the audit committee;
2) the establishment of a college of statutory auditors; and
3) authorisation by the Supervisory Board of Registered Auditors for a maximum of two financial years.

Acquisition and due diligence audits remain an exception to this rule (Art. 133/2, § 5 CC).

If the audited company is a PIE, the 70 % rule applies, although an exemption may be granted by the Board for a maximum of two years (Art. 133/2, § 1 and § 2 CC).

The audit committee plays a central role in assessing and monitoring the independence of the statutory auditor, verifying whether the provision of non-audit services to the audited entity is appropriate under Article 5 of the Audit Regulation. The provision of non-prohibited and hence authorised non-audit services in PIE is subject to a prior approval decision by the audit committee after it has assessed the threats to independence and the safeguards.

However, the cross-border impact of the divergence in national legislation as a result of the options in the Audit Regulation raises doubts about which legislation is applicable.

The descriptions of the prohibited non-audit services are rather broad and open to interpretation because of a lack of any more detailed explanation. There is a real danger that prohibited non-audit services will be interpreted differently across Europe.

The **fourth chapter** deals with the powers delegated by the Supervisory Board of Registered Auditors to the Belgian Institute of Registered Auditors (IRE-IBR), which will be entrusted from now on with the task of organising the granting of status of auditor, the keeping and updating of the public register and the organisation of continuing education, subject to the Board's power to object to a decision taken by the Belgian Institute concerning the granting the status of auditor. The Board also has the power to request that the delegation of these powers be terminated by means of a royal decree considered in the Council of Ministers.

A part is devoted to the reform of the public oversight of the audit profession, the most visible manifestation of which is the creation of the Supervisory Board of Auditors and the exclusion of the bodies of the Belgian Institute from the entire process relating to the oversight and quality control of auditors. The Chamber of Referral and Preparation of a case (CRME-KVI), the Prosecutor General and the disciplinary bodies will also no longer be involved in the process.

After a brief description of the organisation and governance of the Board, the procedure for quality control and oversight is reviewed.

It is shown that the new procedure is distinguished notably by the reinforcement of the Board's supervisory powers; the latter will not only be able to draw on information from the auditor's working papers, of course, but also from third parties, namely the audited entity or even the judicial authorities. The law further states that the Board may disclose information to both the supervisory authorities and the court prosecutors.

These new arrangements for organising the procedure raise questions about whether the proceedings are criminal in nature, and, for example, about the application of the provisions in the European Convention for the Protection of Human Rights regarding such matters (the right to remain silent and not to incriminate oneself, etc.).

Subsequently, the text highlights the decisions, sanctions and measures that may be imposed by the Board, or by the FSMA's Sanctions Committee. The introduction of the penalty and the administrative fine into the legislative arsenal relating to oversight is emphasised. The only such measures previously available were the possibility that the disciplinary bodies had to impose administrative fines for breaches of obligations on the prevention and combating of money laundering and the financing of terrorism.

The examination of the part of the law on remedies points to the risk of more actions for suspension and annulment before the Council of State or applications for interim measures to the courts of the judicial system.

Finally, before concluding, the last part is devoted to the implications of the new provisions on professional secrecy for auditors and the new exceptions introduced by the law.

The Audit Regulation's requirements with regard to the audit report revolve around two objectives: strengthening external communication regarding independence and making the auditors' report more informative.

The provisions of the Audit Regulation and the Audit Directive with regard to the auditor's report have been transposed into Belgian law by the amendment of Articles 144 and 148 of the Companies Code and is the subject matter of the **fifth chapter**. In line with the proposal of the Higher Council for the Economic Professions (CSPE-HREB), all the requirements of the Regulation have also been made applicable to entities other than public interest entities, with the exception of the most significant assessed risks of material misstatement.

The revised ISAs relating to the auditor's report are applicable to audits of financial statements for financial years ending on or after 15 December 2016 at international level. However, in Belgium we are undergoing a process of endorsement. As a result, the revised ISAs will only be applicable when and to the extent that they are adopted by the Higher Council for the Economic Professions and the Minister of the Economy. If such an adoption does not occur before 31 December 2016, the reports issued by statutory auditors on financial statements for periods ending from that date onwards will no longer be able to refer to the ISAs; instead, they must refer to the ISAs as adopted in Belgium.

The most significant developments at both European and ISA level relate to the disclosure of the most significant assessed risks of material misstatement in the audit report. It is generally accepted that this concept is equivalent to the key audit matters covered by ISA 701. The key audit matters are those which, according to the auditor's profes

sional judgement, were the most significant in the audit of the (consolidated) financial statements. The key audit matters are chosen from the points communicated to the audit committee, but do not include all the elements communicated to it.

The new requirements do not change the scope of an audit of the financial statements, and, therefore, should not affect the underlying auditors' work. However, for those entities where the key audit matters must be provided in the auditor's report, the most experienced members of the audit team will need to put more time into identifying, defining in detail and examining these key matters with management and those responsible for governance.

Thanks to the publication of the key audit matters, investors and other stakeholders will have access to information previously reserved for the management body and the audit committee. However, a balance needs to be struck in terms of the volume and relevance of the disclosed information: the auditor's report must be informative but, above all, relevant and readable.

It is essential to avoid the key audit matters becoming a "generic" section of the auditor's report in which technical and risk management considerations take precedence over the informative value of the communication. That communication should therefore focus on the entity's specific situation, and the points developed in it should be treated in a manner that is not merely technical; they should also be updated annually in order to ensure their relevance.

The Audit Regulation requires statutory auditors to disclose in their report their main observations concerning the most significant assessed risks of material misstatement. However, statutory auditors will need to be careful when drafting these observations in order to avoid giving the impression of providing a separate opinion on these risks or key audit matters. For this reason, the auditor's report does not include a section on key audit matters when the auditor refrains from issuing an opinion.

The new requirements for the auditor's report represent a fundamental development. This development meets the expectations of investors and other stakeholders who want more than a simple binary opinion and expect the auditor's report to provide a key to reading the financial statements and a tool facilitating the understanding of the most significant matters to judge the entity's financial situation.

On order to ensure a high-quality audit, the functions assigned to the audit committee have been extended in several ways by the European audit reform. With a view to improving communication between the statutory auditor or audit firm (henceforth "the statutory auditor") and the audit committee, the Audit Regulation, in addition to its provisions on the report that the auditor must issue following the audit of the annual

accounts, provides for a number of new or more extensive reporting obligations, without public character. These topics are discussed in the **sixth chapter**.

The fifth chapter considers the statutory auditor's additional report to the audit committee as envisaged by Article 11 of the Audit Regulation (to which the statutory auditor, under Article 10 of the Audit Regulation, must refer in his auditor's report), the annual written confirmation to the audit committee of the statutory auditor's independence and the assessment of threats to independence and, finally, the reporting of irregularities, including fraud affecting the financial statements, and the auditor's professional scepticism.

These reporting requirements are essentially a confirmation of what has often already been applied as best practice or what is stipulated in the ISAs. By strengthening the information provided by the statutory auditor of the PIE, the audit reform aims to reduce the "expectation gap" that often exists about what a statutory auditor can and must do.

The additional report to the audit committee is in this context probably the most important and far-reaching change. Before the audit reform, Article 526*bis*, Section 5 of the Companies Code already stated that the statutory auditor must report to the audit committee on key audit matters that have come to light in the course of its statutory audit of the financial statements. How this communication was supposed to occur, however, was not specified. The Audit Regulation describes the contents of this additional report in detail and it is complemented by the new Article 526*bis*, Section 6, Paragraph 3 of the Companies Code. Although most of the points mentioned, previously already discussed in other words between the auditor and the audit committee (*inter alia* in light of ISA 260, *Communication with those charged with governance*, and ISA 265 *Communicating deficiencies in internal control to those charged with governance and management*), and may even have been included in a written document, this is now formalised by European regulations. The additional report will undoubtedly be the most important document on the basis of which the audit committee will perform certain of his roles.

The European regulations and the new Belgian audit legislation resulting from their transposition, have brought about a number of significant changes to the audit committee regime that has been in place for years and is dealt with in the **seventh chapter**.

In accordance with the "comply or explain" principle of the corporate governance code, half of the audit committee's members should be independent directors.

The independent directors themselves no longer need to have the required expertise in the field of accounting and auditing. It is sufficient for *one* member of the audit committee to have the necessary expertise in this field.

Moreover – and this is completely new – the audit committee must also have collective expertise in the company's field of activities.

Remarkably, the chair of the audit committee is no longer chosen by the board of directors but by the members of the audit committee; this is in order to emphasise its autonomy from the board of directors.

One of the crucial tasks of an audit committee is to formulate a recommendation to the board on the appointment of the statutory auditor. This power, too, is further elaborated by the new audit legislation.

Moreover, the entire procedure for appointing the statutory auditor has been rewritten in Article 130 of the Companies Code.

The right of initiative of the board of directors in connection with the appointment procedure, namely the requirement that it must make a recommendation to the general meeting, is now also explicitly included in Article 130, § 2 of the Companies Code.

With the exception of a first appointment or an appointment which does not exceed a maximum period of nine years, a selection procedure as set out in Article 16 of the Audit Regulation must to be followed for PIEs. This is a kind of tender process where several statutory auditors from an audit firm are invited to participate in a selection process. The audit committee is responsible for ensuring compliance with this selection process is compliant.

In companies with a works council, the proposal by the board of directors must also be approved by the works council, which has a de facto right of veto. This provision is not new; however, Article 156 of the Companies Code has now also explicitly added the role of the audit committee.

Because the shareholders' rights may not be limited in any way, Article 130, 5° of the Companies Code prohibits the inclusion of contractual provisions that would restrict the choice of the general meeting to a particular category or lists of statutory auditors or audit firms.

Non-compliance with this the appointment process still makes the decision taken by the general meeting null and void.

In the last ten years, the role of the audit committee in both listed and non-listed companies has evolved significantly. This is due to not only the extensive legislation and regulation, but also the increasing complexity of the environment in which companies operate, which has required adaptation of the audit committee's composition, organisation and activities. The practical issues and monitoring are the subject matter of the **eighth chapter**.

In addition to its primary role with regard to the company's financial information, the audit committee's field of activity has expanded significantly. This has increased not only the audit committee's workload, but also the range of skills needed to perform this role. Including directors with additional skills in the audit committee is one possible way to meet this challenge, but additional information sessions by members of the management or the use of external experts can also help.

The recent European audit reform strengthens the role of the audit committee with regard to the selection of the external auditor. Combined with the introduction of external rotation and the tightening of the rules relating to non-audit services, this undoubtedly leads to a greater number of audit tenders and more intensive interaction between the audit committee and the external auditor.

For an audit committee, it is extremely important not just to obtain an audit opinion based on a high-quality audit, but also to gain insight into the quality of the process leading to the financial reporting, and the quality of the company's financial organisation. The external auditor can provide useful insights here.

It is expected that the recent change in the law on non-audit services will further increase the complexity of this matter and the need for reporting and monitoring. In particular in companies active in several countries in Europe and beyond, monitoring compliance with various local regulations regimes is extremely complex and very time-consuming.

Although the change of auditor is often perceived as disruptive and time-consuming, this process can yield helpful insights as a result of matters being looked at afresh by the management, the auditor and the audit committee.

Some aspects in the recent change in the law increase the focus on the role and responsibility of the audit committee, as a result of which there is a danger that the role and responsibility of the board of directors as a collegial body may be compromised.

The Belgian reform is part of the European framework adopted following the financial crisis of 2008. The impact on the enterprises and directors is discussed in the **ninth chapter**.

Whether one is a supporter or an opponent of the new European regulations, they have to be implemented in our country. The Belgian legislator is required to comply with this very complex and detailed framework. However, amid this maze of provisions, he has demonstrated a realistic and pragmatic approach. In many cases, he has implemented a large number of options contained in the European regulations on the basis, first, of a sense of flexibility and second, of the need to take into account the characteristics of Belgian companies. A third factor was a consistent theme during the transposition: the credibility of the performance of the audit assignments in the eyes of the company and the stakeholders, ranging from employees to creditors and suppliers.

For the head of the company, the objective of the audit must be to provide reasonable assurance about the veracity of the company's financial health and the reliability of its financial statements. How does the audit reform meet these requirements?

First, the principle of *proportionality of the rules* is applied, with more stringent requirements being set for listed companies than for unlisted counterparts. This means taking into account not only the nature and the usually greater size and complexity of listed companies, but also the needs of the financial markets.

Second, a fundamental element of the reform is the *revision of the rules on the auditor's independence*. For the head of the company, the independence of the auditor is essential, as it is a fundamental sign of his or her professional integrity. The auditor's independence should be conducive to his or her "professional scepticism" which is characterised by a critical mind and constant attention to the various elements of audit evidence.

Concerning the requirement of *external rotation,* mandatory for listed companies, the rotation of audit firms is meant. This is a novelty for the head of the company. The legislator has taken a realistic approach by implementing the options provided for by the European regulations. These make it possible to renew the auditor's mandate for up to either 18 years or 24 years, subject to compliance with certain conditions. Judicious use of the same pragmatic approach is demonstrated by the legislators in determining the *non-audit services* that can be provided by auditors to companies they audit. The reform implements virtually all the options provided for by the European framework and allows statutory auditors, within the limits described in it, to provide certain tax services, such as the preparation of tax forms.

Third, the auditor's report is the very essence of the auditor's assignment, and an essential document for the head of the company. What is new about the reform is the increased emphasis on the risks and in particular the key audit matters, i.e. the risks assessed by the auditor to be the most significant risks of material misstatement, including those relating to fraud, the synthesis of the responses to these risks and, where appropriate, the main observations relating to these risks.

Finally, the reform overhauls the *audit committee*. It also reinforces its role by assigning it additional roles and expanding its involvement both in the process of selecting the statutory auditor and in the monitoring of the auditor's independence. However, the audit committee remains an advisory body created within the board of directors, and is required to report to the board of directors, which is responsible for the decisions taken.

The business community requires auditors to assume responsibility and carry out their assignments. It is important to avoid a proliferation of letters relieving auditors of their liability.

The head of the company and the auditor are two important players in the economy. Each party has a role to play. Our hope is that the new regulations will be operated in an affective way whereby all stakeholders will be able to play their role in the best conditions

As a **conclusion**, how to characterise this European audit reform and its implementation in Belgium?

We, registered auditors, must humbly acknowledge that this reform results from a strong need felt by public authorities and stakeholders to enhance the degree of confidence users of financial statement have in corporate financial reporting.

One is tempted to say that now the real work begins for registered auditors, audited companies and the new public oversight bodies, that is implementing of the adopted regulatory framework.

This implementation requires, in a first stage, a significant effort to inform and train both the registered auditors and the companies they audit.

Even now, another question already arises: what will be the reform's impact on the various stakeholders involved?

The answer to this question is not obvious and will only become apparent after a few years.

At the level of the audited entities, the reform will have a more significant impact on PIEs than on other entities.

Some PIEs will have to review the composition of their audit committee. More generally, the audit committee should devote more resources to the monitoring process for statutory auditors. For example, particular attention will be paid to the identification and treatment of key audit matters and to the way they were related in the statutory auditor's report, or to the materiality threshold.

However, few real changes are expected for audited companies other than PIEs. They will note at most some additional statements in the statutory auditor's report and a few immaterial changes in the independence rules relating to permissible non-audit services. Concerning the companies belonging to a group required to prepare and publish consolidated financial statements, the cap on fees for permissible audit services for the statutory auditor will no longer be extended to the other entities of his network.

The changes will be much more noticeable for the registered auditors.

Finally, there is no point in trying to ignore a likely impact on small and medium-sized firms auditing PIEs; they are currently about 19 in Belgium.

All firms must adapt their procedures to reflect detailed requirements introduced by the new law, more specifically those relating to compliance with independence rules. In

addition, firms will need to keep track of any material breach of the new provisions, of the consequences of these breaches and of the measures taken to address them. Another example consists in setting up an internal reporting system in order to report violations to the legislative and regulatory framework.

Finally, thorough consideration will be given to the impact of changes in external supervision and of the objective of enhancing audit quality which should be pursued by the Supervisory Board of Registered Auditors.

A final impact – already mentioned here and there, but too often overlooked or ignored – remains to be analysed: will the audit reform increase the audit costs for audited companies?

The road to achieve this third audit reform was long and is far from reaching its end. The remaining challenges to face are significant and some of them are new.

It will be up to the Supervisory Board of Registered Auditors and to the Belgian Institute of Registered Auditors, acting together in some respect, to meet these challenges in a most effective manner in the general interest.