The global public policy environment for audit, reporting and tax continues to be highly volatile. This *EY News and views* provides a snapshot of key recent developments and summarizes EY’s views. We encourage investors, boards and audit committees to stay close to these developments.

**In this issue**

- European Union audit legislation enters into force
- Non-financial disclosures by companies in focus
- New proposals to enhance the auditor’s responsibilities for “other information”
- Policymakers continue to focus on tax
- Other developments in brief
European Union audit legislation enters into force

On 16 June 2014, new EU audit legislation entered into force. There is a transitional period for most provisions of at least two years. The 28 EU Member States and three European Economic Area countries (Iceland, Liechtenstein and Norway) will now work to implement the legislation into their national laws.

The legislation is generally directed at audits of EU Public Interest Entities (PIEs). PIEs are defined in the legislation as companies with transferable securities traded on an EU “regulated market” and certain other organizations viewed as acting in the public interest, such as banks and insurance companies. EU Member States can supplement the PIE definition. The legislation also applies to EU PIE subsidiaries of companies headquartered outside the EU. Therefore, all companies with EU operations, wherever headquartered, will have to review their group structure to establish the extent to which they are a PIE or have a PIE in their group. Many companies within and outside the EU will be affected.

The legislation is wide-ranging and includes:

- Mandatory audit firm rotation for PIEs after a maximum initial engagement period of 10 years, although EU Member States can require an initial engagement period shorter than 10 years. Member States also may opt to extend this period by a further 10 years where an audit tender has taken place, or 14 years in the case of a joint audit. These firm rotation requirements are to be phased in depending on the length of the existing audit relationship.
- Significant restrictions on non-audit services a PIE can obtain from its auditor, including many tax and advisory services. Member States can prohibit additional non-audit services if they wish. Member States can, however, permit certain tax and valuation services provided they are “immaterial or have no direct effect, separately or in aggregate, on the audited financial statements.” The legislation provides for the audit committee to establish guidelines as to what is or is not material.
- A cap on fees for permitted non-audit services, calculated at 70% of the average statutory audit fee for the previous three years. The cap will be calculated at the group level where the audited entity is part of a group of companies. Audit committees will also be required to approve all permissible non-audit services.
- Other provisions include:
  - An expanded auditor’s report
  - A separate report from the auditor to the audit committee

New arrangements for EU-level oversight of the audit profession, which will be carried out by a Committee of European Auditor Oversight Bodies

Our view

We will work to support the successful implementation of the legislation by Member States and to help serve the needs of investors and companies, strengthen the capital markets and enhance confidence in financial reporting. We continue to have concerns, however, as to the legislation’s long-term impact on the quality of audit, talent in the audit profession and the structure of the audit market. We also question whether the benefits outweigh the economic costs and the complexity resulting from the patchwork of different laws that will be adopted across the EU due to the large number of “options” the legislation gives to Member States.

Non-financial disclosures by companies in focus

There is increasing interest from investors and other stakeholders for companies to publish more information relating to their environmental, social and governance (ESG) performance and other non-financial information. We see this trend reflected in the work of the International Integrated Reporting Council (IIRC),1 which goes beyond ESG reporting, and certain other proposals advanced by policymakers in the EU and the UK.

In April 2014, the European Parliament adopted an EU directive to introduce new non-financial disclosure requirements for large EU PIEs with more than 500 employees. The legislation requires these entities to disclose, on a “comply-or-explain” basis, information on their policies, risks and outcomes regarding:

- Environmental matters
- Social and employee-related aspects
- Human rights, anti-bribery and corruption issues
- Board diversity

Some legislative steps remain and Member States will have two years from the date the directive enters into force to transpose it into their national law.

In the UK, new narrative reporting regulations became effective in October 2013 that require listed companies to publish a strategic report as part of their annual report. The strategic report should provide context to the financial statements and information on the company’s strategy and business model, including:

- Environmental, employee, social, community and human rights issues, to the extent necessary for an understanding of the development, performance or position of the company’s business. (Disclosures on the company’s greenhouse gas emissions have to be reported in the separate Directors’ Report.)
- The gender split by directors, senior managers and employees.

Integrated reporting, with its broader focus on business strategy, continues to gain some momentum, with more than 100 companies globally participating in the IIRC’s pilot program. The IIRC framework covers how an organization’s strategy, governance, performance and prospects, in the context of its external environment, lead to the creation of value in the short, medium and long term. Most recently, in June 2014, the IIRC introduced the Corporate Reporting Dialogue (CRD), which brings together organizations with significant international influence on corporate reporting, with the aim of responding to market calls for better alignment and reduced burden on corporate reporting.

Our view

We recognize the desire of investors for meaningful non-financial information from companies, and support innovation and efforts to evolve corporate reporting so that it remains relevant to the needs of investors and other users. Many companies are already disclosing certain non-financial information, including information about their environmental performance, and a number of policymakers have introduced non-financial disclosure requirements. As the trend toward enhanced non-financial disclosures increases, international standard setters will need to work together to develop a single set of robust global standards to support effective and comparable reporting. It will also be important to consider whether such disclosure should be subject to some degree of assurance and comparability. The costs and potential benefits of this additional non-financial information and how it impacts investors’ views remain to be seen.

1 The IIRC is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. It was established in August 2010 with a mission to develop a globally accepted International Integrated Reporting Framework, published in December 2013.
New proposals to enhance the auditor’s responsibilities for “other information”

In April 2014, the International Auditing and Assurance Standards Board (IAASB) re-proposed its standard on the auditor’s responsibilities relating to “other information” that accompanies the audited financial statements in an annual report (e.g., management commentary). The proposed standard requires the auditor to read and consider whether the other information is consistent with the audited financial statements. The auditor also would be required to consider whether there is a material inconsistency between the other information and the auditor’s knowledge obtained during the course of the audit, and to remain alert for other indications that the other information appears to be materially misstated.

The US PCAOB also has proposed changes to its standard relating to “other information” to clarify the auditor’s responsibilities related to other information accompanying the audited financial statements as part of its proposed enhancements to the auditor’s report. The PCAOB proposal would require the auditor to “read and evaluate” other information in certain documents containing audited financial statements, including selected financial data, management’s discussion and analysis, and other information incorporated by reference, such as proxy statements. The auditor’s “evaluation” would consider whether the other information contained material misstatements of fact or material inconsistencies with amounts or information in the audited financial statements. The auditor’s report would communicate the auditor’s responsibilities for evaluating this information and the results of the evaluation.

Our view

We support clarifying the auditor’s performance responsibilities related to “other information” and describing this responsibility in the auditor’s report. At the same time, we are concerned that the language in the PCAOB proposal regarding the auditor’s responsibility to “read and evaluate” the other information and report the “conclusion” of that evaluation in the auditor’s report could widen the expectations gap between what the auditor would actually be required to do and what financial statement users might think the auditor is doing.

To address this concern, we have encouraged the PCAOB to clarify the procedures to be performed as well as the manner in which they are described in the auditor’s report while maintaining the PCAOB’s objective of increasing transparency in this area. We are in the process of evaluating the IAASB’s re-proposal and will be issuing our comment letter later this month. We also have encouraged both standard setters to work together align reporting standards to the extent possible to minimize complexity for users of the financial statements.

For more information

Point of view, “Auditor reporting,” EY, February 2014
IAASB Exposure Draft, Proposed International Standard on Auditing (ISA) 720 (Revised), April 2014
PCAOB Docket 034: Proposed Auditing Standards on the Auditor’s Report and the Auditor’s Responsibilities Regarding Other Information and Related Amendments

Policymakers continue to focus on tax

Policymakers in a number of countries are continuing to scrutinize how much tax multinational companies pay, where they pay it and how much tax information they disclose. Many countries are assessing their tax laws and considering reform, some of which has already been influenced by the OECD’s base erosion and profit shifting (BEPS) project.

In this environment, 81% of 830 global tax and finance executives surveyed recently by EY expect tax risks to accelerate in the next two years.

- Reputation risk is top of mind: 89% of surveyed companies with more than US$5 billion in annual revenues are “somewhat” or “significantly” concerned about negative media coverage of tax.
- Many companies surveyed fear changes in how tax laws are enforced. Almost three-quarters (74%) say they believe some countries see the very existence of the OECD’s BEPS project as a reason to change their enforcement approach before any recommendations become law.
- There is some apprehension that greater inconsistency could be on the horizon. Nearly one-third (31%) of companies surveyed predict that OECD’s BEPS project will result in relatively limited coordinated action and increased unilateral legislation by national governments.

Countries need economic growth to generate tax revenue. And, in the slow-growth environment we have been living through, they are under pressure to find ways to collect more tax. Moreover, tax has become a topic of broad public interest due to fiscal austerity measures and the increased perception of growing income inequality. These very real social dynamics will keep corporate tax politicized for the foreseeable future.

Our view

We share the concern of many that elements of the systems for taxing multinational corporations are outdated. Countries need to review both their national laws and the international treaties to which they are signatories, and ensure that they remain relevant to today’s global business models. Tax directors will need to engage more with their corporate boards, tax authorities, stakeholders and the public on corporate tax policy issues.

For more information

Bridging the divide: highlights from the 2014 Tax risk and controversy survey, EY, May 2014
Other developments in brief

Indian Companies Act takes effect
The Indian Government adopted final rules in April 2014 to implement the 2013 Companies Act. The Act is wide-ranging and reflects extensive corporate governance improvements for companies and their investors. It also mandates audit firm rotation every five years, with a possible five-year extension, and contains significant restrictions on non-audit services a company can obtain from its auditor. The Act applies to all companies incorporated in India, including private companies and Indian subsidiaries of a foreign-owned parent company. (For more information, see EY News and views, January 2014.)

Audit committees in focus
Policymakers in several countries continue to focus on the role of the audit committee in enhancing investor confidence in the audit and financial reporting. For example, the Australian Securities and Investment Commission (ASIC) published in March 2014 a guide for directors on the role of audit committees in driving audit quality. Last year, the Canadian auditor oversight body, together with the accounting profession, concluded an initiative focused on improving audit quality, including the role of the audit committee.

More women on boards in the EU and UK
In April 2014, the European Commission published its annual gender equality report. In March, Lord Davies published his third annual review of women on UK boards. Both report improvements in the representation of women on corporate boards in the EU and UK.

Audit quality factors
The US Center for Audit Quality (CAQ) recently published its approach to communicating a set of potential Audit Quality Indicators (AQIs). The CAQ approach includes a set of potential AQIs across four key elements of audit quality identified by the CAQ: firm leadership and tone at the top; engagement team knowledge, experience and workload; monitoring; and auditor reporting. The approach will be pilot-tested by CAQ member firms with select audit committees over the 2014 audit cycle. Earlier this year, the IAASB also published its final Audit Quality Framework, which describes the many contributing factors and necessary interactions that contribute to and influence audit quality.

China proposes restrictions on overseas auditors auditing Chinese companies
May 2014, the Chinese Ministry of Finance proposed rules preventing Hong Kong and overseas auditors from auditing mainland Chinese companies listed overseas unless they partner with a mainland Chinese audit firm. Under the proposal, the relevant overseas accounting firm must cooperate with a qualified local accounting firm, and the overseas accounting firm must expressly agree to assume responsibility for issuing the audit report and the liabilities arising therefrom.

For more information
For more information on any of these issues and our views, please speak to a member of the EY public policy team or your usual EY contact.

Public Policy Executive
Beth Brooke-Marciniak
+1 202 327 8050
beth.brooke@eyg.ey.com
Felice Friedman
+1 202 327 6253
felice.friedman@eyg.ey.com

Americas
Les Borsen
+1 202 327 5968
les.borsen@ey.com

Asia-Pacific
Tony Smith
+61 2 6267 3997
tony.smith@au.ey.com

EMEIA
Jeremy Jennings
+32 2 207 1472
jeremy.jennings@be.ey.com

Japan
Kimihiro Izawa
+81 3 3503 1100
izawa-kmhr@shinnihon.or.jp

For information on other public policy developments and EY’s views, visit www.ey.com/publicpolicy.