EU Audit
Legislation in the Czech Republic

September 2016
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 the Czech 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 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.

Czech Republic – recent developments

- The Czech Parliament approved the Act on Auditors on 25 August 2016. The effective date is 01 October 2016.

- The new legislation in the Czech Republic requires mandatory firm rotation every ten years, with an option to extend for a further 10 years following a tender. No extension is permitted for joint audit.

- Overall, no additional or stricter requirements beyond the baseline requirements have been introduced and tax and local rules have taken up the derogation to permit certain tax and valuation services.
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| 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.  
| The Czech Republic legislation expands the definition of PIE beyond the EU baseline to include the following additional entities:  
- health insurance companies; and  
- pension fund management companies.  
| Due to the change in the definition of PIE, it is estimated that the number of PIEs in the Czech Republic will reduce from approx. 300 entities to 150 entities. |
| Statutory auditors of a PIE are required to:  
- Rotate at least every 10 years (subject to a Member State option);  
- With a Member State option to extend audit firm tenure to:  
  - a maximum of 20 years (subject to a public tender process being held after 10 years); or  
  - a maximum of 24 years (subject to a joint audit arrangement).  
| The Czech Republic has enacted a MFR period of 10 years and taken up the derogation to permit extension of the MFR period, following a tender, to a maximum of 20 years.  
However, no MFR extension is permitted for a joint audit.  
| This is a change from current practice and we anticipate an increase in tendering activity.  
Joint audit is not prohibited but it is not used at all. |
| **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 engagement 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.  
| The MFR transition periods are aligned with the ‘EU baseline’.  
| We understand that if the audit mandate straddles the 17 June 2016 application date then the auditor can complete that year end. It will need to tender at the end of this period if the 10 year duration has been reached. So for example, a 31 December 2016 audit could be the last for an audit firm with 10+ years tenure.  
Local regulator intends to issue a specific interpretation of renewals of long-term contracts. It may require to tender 31 December 2017 audit engagements as well for those in place for 11+ years at 17 June 2014. |
| **Requires KAPs to rotate after a maximum of seven years,** followed by a three-year cooling-off period. Member States have the option to elect shorter KAP rotation periods.  
| Local legislation is aligned with the ‘EU baseline’ requirements in terms of Key Audit Partner rotation requirements.  
<p>| No impact as consistent with current practice. |</p>
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<th>Prohibited NAS</th>
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<td>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.</td>
<td>The Czech Republic follows the ‘EU baseline’. It fully uses the member state derogations regarding tax and valuation services. Legal services: The Czech 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.</td>
<td>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’.</td>
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<td>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.</td>
<td>The Czech Republic follows the ‘EU baseline’ with no changes to the cap. There is no list of permitted services in Czech Law.</td>
<td>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.</td>
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<td>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’.</td>
<td>Local legislation is aligned with the ‘EU baseline’ requirements.</td>
<td>The new reporting requirements are targeted at increasing transparency. The audit report will include a description of the risks identified by the auditor and the procedures performed in order to address such risks.</td>
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Appendix 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. 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