Department for Business Innovation & Skills

AUDITOR REGULATION

Discussion document on the implications of the EU and wider reforms

DECEMBER 2014

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2. Executive Summary

Effective financial reporting underpins the development of the best businesses - those that others are willing to invest in and to do business with. It informs decisions that are made, for example, by shareholders, directors, investors and suppliers. Audit is an essential safeguard to provide independent assurance that the financial reporting of businesses properly reflects their circumstances.

This discussion document asks for your views on a range of reforms to enhance confidence and strengthen the audit regime. It looks at the structure for regulation, oversight and standards taking into account new European requirements, recent Competition and Markets Authority measures and recommendations, and wider work underway to refine technical and ethical standards.

It is therefore about how the UK can put in place the best possible regime, one that will most effectively respond to the modern fast moving, highly developed business economy. At the same time we do not want to make unwarranted changes.

We will consider the issues that arise in responses, ahead of a formal consultation, next year, on detailed proposals to change the regulatory regime.

Alongside this document, the Financial Reporting Council (FRC) is consulting on some of these issues, particularly related to ethical standards for auditors. This shows how a non-legislative approach could be taken to improve standards in line with the new European provisions.

Views of all interested groups are essential to inform the approach to the implementation of the: new European Directive on Audit[1]; and to make legal provision for the application of the new EU Regulation[2] that is now applied directly under EU law.

The Regulation will apply from 16 June 2016, by which time the new Directive must also have been transposed into national law.

Both the Directive and the Regulation provide Member State options. This discussion document gives you the opportunity to contribute to the Government's thinking about how to implement the Directive; how to provide for the application of the Regulation; and how the wider framework for audit regulation could be improved in the light of these changes, those identified by the Competition and Markets Authority, and others from the FRC.

There will be a separate consultation later on the technical implementation of the EU Directive and Regulation – the intention here is to ask about how the full range of reforms should work together.

[1] Directive 2014/56/EU ("the new Directive") amending Directive 2006/43/EC ("the 2006 Directive") on statutory audits of annual and consolidated accounts. A consolidated text of the 2006 Directive as amended by the new Directive is also available.
[2] Regulation (EU) No 537/2014 on specific requirements regarding statutory audit of public-interest entities.

What we want you to consider

The focus is on identifying legislative, and non-legislative, actions necessary to:

- Strengthen standards for the audit of Public Interest Entities (PIEs);[3]
- Improve confidence in the independence of auditors;
- Avoid excessive concentration in the audit market; and
- Make audit reporting more informative.

These are not new – they were the basis for the UK approach to discussions at European level on the Audit Directive and Regulation. They provide a unifying structure for the approach in this paper. But there are tensions between competing aims. That is why we would like your comments on issues raised by the approach we have in mind.

The EU Regulation represents a step change in rigorous EU-wide regulation of audits. A number of different bodies are responsible for promoting audit quality in the UK; for oversight and penalties. The aim of the reforms is to achieve a higher level of consistency particularly, but not exclusively, in relation to audits of PIEs.

A single competent authority in each Member State is required to take ultimate responsibility for the key regulatory tasks for all audits. But for audits of PIEs in particular it must inspect the audit firms itself and itself investigate and sanction misconduct using strengthened regulatory powers.

Chapter 4.1 asks you to identify issues that arise from the increase in requirements relating to PIEs, whilst chapter 4.2 seeks comments on what a new framework for oversight might look like - the tasks involved and how these might be delegated.

It is important that audit is a sustainable business, with adequate capacity and a diversity of suppliers meeting a variety of preferences. Building on the CMA Order, the EU's framework on a maximum duration for audit engagements will make sure that, in future, PIEs will not be able retain auditors for too long. This will limit over-familiarity between the audit firm and its client; helping to maintain a healthy scepticism.

As well as assuring auditor independence, these regular changes of auditor will create a more active market for audit services. However the EU Regulation goes further in ensuring auditors judgements are not affected by conflicts of interest and their independence is seen to be free from any such threat. A more open market for non-audit services could also be expected to result.

This is dealt with in more detail in chapters 4.3 and 4.4 covering: audit fees; non-audit services; and the rotation of audit providers.

Audit committees, with their independence enhanced, will in future be required for all PIEs, including all insurers. With the audit report each year, the audit committee will also receive a new additional report, specifically for their attention, providing background and insight into audit procedures and judgements as well as assurance on auditor independence and how this has been maintained.

[3] "PIEs" must include listed companies, banks, building societies and insurers. There is also a Member State option to add other entities of major public interest to the definition.

You are encouraged to consider the points discussed in chapter 4.5 on this.

We also seek views in chapter 4.6 on **which small companies should be required to have an audit**.

Key questions

This document deliberately raises a number of questions. At the end of each chapter we ask you to tell us what you consider the best way forward. Where there are issues that have not been explored, please let us know. It would be really helpful if you could also suggest ways to address these – based on your experience and knowledge of audit.

Most importantly, are we taking the right approach in:

- maintaining the EU definition of “Public Interest Entity” rather than extending it;
- proposing that there should be a single competent authority with ultimate responsibility for audit regulatory tasks and seeking views on whether the FRC should take on this role, delegating appropriate activities to Professional Supervisory Bodies;
- implementing a new framework on mandatory retendering and rotation of auditor appointments. In particular is the balance right between retendering and rotation?
- looking to the FRC to consider the extent to which options around technical and ethical standards for auditors should be taken up?

Conclusion

This is an opportunity to consider how we can bring together European and UK reforms to develop a new auditor regulatory regime. The regime must serve the needs of companies, those who work in them and those who do business with them. It must increase confidence and trust as the basis for business growth.

3. How to respond

When responding to this discussion document please state whether you are either responding as an individual or representing the views of an organisation. If you are responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

You can respond to this discussion document online via:

https://www.gov.uk/government/consultations/auditor-regulation-effects-of-the-eu-and-wider-reforms

The response form is also available electronically via the same link (until close on the deadline date for submission of responses on Thursday 19 March 2015). The form can be submitted online/by email or by letter to:

Paul Smith
Corporate Frameworks, Accountability and Governance
Department of Business, Innovation and Skills
1 Victoria Street
London,
SW1H 0ET
Tel: 020 7215 4164
Email: pauld.smith@bis.gsi.gov.uk

This discussion document is not a formal Government consultation. That process will be conducted at a later stage in the implementation of the new Directive. However, the Government is seeking to handle and consider responses to this discussion document in line with the principles that it has stated Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation. These are set out in the following document:

http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf

Comments or complaints on the conduct of this consultation

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to:

Angela Rabess, BIS Consultation Co-ordinator, 1 Victoria Street, London SW1H 0ET
Telephone Angela on 020 7215 1661 or e-mail to: angela.rabess@bis.gsi.gov.uk

4. The proposals – The main changes

Each of the subsequent sections of this document sets out:

- the main changes that need to be made;

- what this means in practice; and,

- how the changes can be achieved.

We then go on to ask questions on the proposed implementation and issues that arise from the changes, and to obtain further evidence on their potential impacts.

In some cases the changes will require amendments to the Companies Act 2006 ("the Companies Act") or regulations made under it. In other cases it may be better to make "stand alone" regulations under the European Communities Act 1972.There will also need to be changes to the legislation affecting other bodies that are covered by the new Directive and EU Regulation.

In other cases the best means of implementation will not involve legislation, but for example, might be through professional standards for auditors.

Questions

Q1. In relation to the measures discussed in both this and the next chapter, we would welcome comments on the balance between legislative and non-legislative implementation of the requirements of the new Directive and Regulation.

Q2. In relation to all the Member State options in the Directive and the Regulation, we would welcome comments to inform our thinking on whether and how these should be taken up. Though many are discussed in this document and in specific questions, all the options in the Directive and Regulation are considered in the options tables that are being made available separately.

Q3. In relation to the measures discussed in both this and the next chapter, what issues do you think arise that have not been considered as part of the discussion? If there are any, how do you think these should be addressed?

Q4. In relation to the measures discussed in both this and the next chapter, we would welcome comments on any burdens applied to small and micro sized companies and audit firms in particular by the proposed implementation, which you consider are disproportionate to the wider benefits?

4.1 Audits of Public Interest Entities and application of the Regulation and Directive

This chapter is about which organisations are covered by the Regulation and Directive.

What are the changes?

The new Audit Regulation introduces a considerable body of directly applicable legal provisions into EU law specifically for audits of Public Interest Entities (PIEs). A Public Interest Entity is defined[4] as an entity that either:

- issues transferable securities that are admitted to trading on a regulated market in the EU[5];
- is a credit institution[6] (a bank or building society, though not a credit union);
- is an insurance undertaking[7]; or,
- is designated by a Member State as a public interest entity (for instance because of its business, size, or the number of its employees).

Some of the provisions in the new Regulation have their origin in the 2006 Directive, in particular in Chapter X, most of which is now transferred to the Regulation. However this is only a small part of the Regulation. Both the new provisions and those that have their origin in the 2006 Directive apply to all PIEs.

The Member State option in the 2006 Directive[8], which permitted implementation of the requirements of Chapter X only for listed PIEs, has been deleted. The provisions from the 2006 Directive that formerly were only applied to listed PIEs will now also need to be applied to unlisted PIEs (ie unlisted banks, building societies and insurers). These are on:

- the transparency report to be prepared by auditors of PIEs (previously Article 40 of the 2006 Directive – now Article 13 of the Regulation);
- audit committees of PIEs (previously Article 41 of the 2006 Directive – now Article 39 of the Directive as amended);
- independence of auditors of PIEs (previously Article 42 of the 2006 Directive – now Articles 5, 6 and 17 of the Regulation); and,
- the increased frequency of inspections of auditors of PIEs (previously Article 43 of the 2006 Directive - now Article 26 of the Regulation).

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[4] Article 1 paragraph 2 point (f) of the Directive replaces the definition of "Public Interest Entity" in the 2006 Directive with a new definition, containing updated references to other EU instruments and other minor changes, which applies for the purpose of the new Directive; the 2006 Directive as amended by the new Directive; and the Regulation.
[5] Within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC – the "Markets in Financial Instruments Directive" (MiFID).
[6] As defined in point 1 of Article 3(1) of Directive 2013/36/EU – the "Capital Requirements Directive (CRD IV)". Credit institutions referred to in Article 2 of that Directive (Credit Unions) are explicitly excluded.
[7] Within the meaning of Article 2(1) of Directive 91/674/EEC – the "Insurance Accounts Directive"
[8] Article 39 of the 2006 Directive was a Member State option to exempt PIEs that did not have securities admitted to trading on a regulated market from the application of the provisions of Chapter X of the Directive.

In addition to the new provisions of the Regulation that will apply to audits of all PIEs, one specific new provision in Article 38 of the 2006 Directive on the dismissal of auditors will also apply only to PIEs.

The Directive – Application to undertakings whose accounts are required to be audited by EU law

The implementation of the 2006 Directive in Part 42 of the Companies Act applied to all entities whose accounts were, at that time, required to be audited under EU law. At that time the undertakings covered by this requirement were:

- companies;
- qualifying partnerships;
- banks and building societies; and,
- insurers.

Having applied the implementation to companies the UK also applied it to Limited Liability Partnerships (LLPs).

However, under the new Directive, it is necessary to include in the implementation of the 2006 Directive for the first time all UK entities whose accounts are now required to be audited under EU law. These are:

- issuers of securities admitted to trading on a regulated market;
- electronic money institutions;
- payment institutions;
- MiFiD investment firms;
- Undertakings for Collective Investment in Transferable Securities (UCITS); and,
- Alternative Investment Funds (AIFs).

The implementation of the 2006 Directive, as amended by the new Directive, will need to include these entities, though the majority appear already to be covered as they are incorporated as companies or LLPs or structured as qualifying partnerships.

The Directive – Application to small undertakings

In recognition of the fact that the new Accounting Directive excludes all small undertakings (other than PIEs) from the audit requirement, and leaves this to national law, the Directive explicitly defines[9] statutory audits as including:

- audits required by national law in respect of small undertakings; and,
- equivalent audits of small undertakings voluntarily carried out at their request where the Member State provides these are statutory audits.

[9] Article 1 paragraph 2 point (a) of the new Directive replaces the definition of "statutory audit" in the 2006 Directive with a new definition that applies for the purpose of the new Directive; the 2006 Directive as amended by the new Directive; and the Regulation.

This approach is consistent with that already taken in the Companies Act and no further implementation will be needed in respect of this change.

What will this mean?

Definition of PIEs

Subject to the views of respondents to this discussion document, the Government is not proposing to take up the Member State option to define additional PIEs for the purpose of the application of the Regulation and the provisions of the Directive applying to audits of PIEs.

The main impact of the changes in scope results therefore from the removal of the option to exclude non-listed entities from the definition of a PIE. This means that:

- Unlisted insurers and some unlisted banks[10] will have to have an audit committee; and,
- Auditors of unlisted banks and insurance companies that do not also audit listed entities will be required for the first time to prepare an annual transparency report[11] and be subject to the tighter independence requirements in the Regulation.

What implementation is needed?

Application of the Directive to undertakings whose accounts are required to be audited by EU law

We are proposing to amend the application of Part 42 of the Companies Act so that, in addition to the audits of entities already subject to the requirements of that Part, it should also apply to:

- entities (other than companies and other entities already covered) whose securities are admitted to trading on a regulated market;
- electronic money institutions;
- payment institutions;
- MiFiD investment firms;
- Undertakings for Collective Investment in Transferable Securities (UCITS); and,
- Alternative Investment Funds (AIFs).

[10] There is an exemption for banks whose shares are not admitted to trading on a regulated market and whose debt securities admitted to trading on regulated markets have a total nominal value below €100,000,000

[11] Production of this report is required by regulations under section 1240 of the Companies Act. The power to make these is delegated to the FRC and the current requirements are set out in the FRC's Statutory Auditors (Transparency) Instrument 2008. Detailed changes to the existing regulations will be the subject of a separate consultation by the FRC in 2015.

As is already the case with the implementation of the 2006 Directive, these amendments would be intended in part to provide for forms of non-legislative implementation. For instance this could be through professional standards for auditors, or through non-legislative schemes and procedures, as are already used for investigation and discipline of statutory auditors in cases of misconduct.

We expect that further amendments will also be needed in legislation applying to each of these types of entity. These amendments would be parallel to those proposed in this discussion document as amendments to Part 16 of the Companies Act. There are parallel provisions to Part 16 in other entity specific legislation covering eg appointment and departure of auditors and their powers and reporting obligations[12], which may need to be amended.

Questions

Q5. Do you agree that the Government should not expand the definition of a PIE beyond the EU minimum requirement – that is listed companies, banks, building societies and insurers? Please provide further information in support of your answer?

Q6. What issues, if any, do you consider arise from the application of the provisions of the Regulation to audits of PIEs as defined in the Directive? How do you consider these should be addressed?

Q7. What issues, if any, do you consider arise from the need to broaden the application of the implementation of the 2006 Directive as amended to include:

- other entities whose securities are admitted to trading on a regulated market;
- electronic money institutions;
- payment institutions;
- MiFiD investment firms;
- Undertakings for Collective Investment in Transferable Securities (UCITS); and,
- Alternative Investment Funds (AIFs).

How do you consider these should be addressed?

Q8. What do you think are likely to be the familiarisation costs to auditors of PIEs arising from all the changes affecting them. In particular:

(a) how many person hours likely to be involved in an individual statutory auditor and their team understanding and preparing for the changes?

(b) what are the costs to audit firms of updating internal management systems to reflect the changes?

(c) How this is likely to vary by size of audit firm?

[12] For instance provisions in the Open Ended Investment Companies Regulations 2001 that apply to Open Ended Investment Companies that are UCITS.

4.2 Competent authorities – Designation and delegation of tasks

This is about changes to the regulatory framework in the UK.

What are the Changes?

The Regulation[13] and the new Directive[14] have considerable implications for the structure of the UK's existing framework for audit regulation. They set out a regime where:

- the Government must either be or must designate a "single competent authority" with ultimate responsibility for all the regulatory tasks provided for in the Directive; and
- as well as designating the single competent authority, the Government could authorise other authorities[15] to carry out tasks, subject to oversight by the single competent authority.

In addition, the Government may:

- delegate tasks; or
- require or allow the single competent authority to delegate tasks; to…
    - other authorities; or
    - bodies designated or otherwise authorised by law to carry out such tasks.

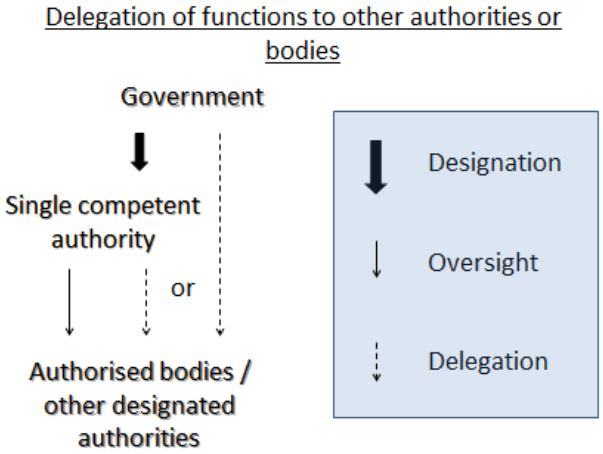
Any delegation of tasks must specify the conditions under which the tasks are to be carried out.

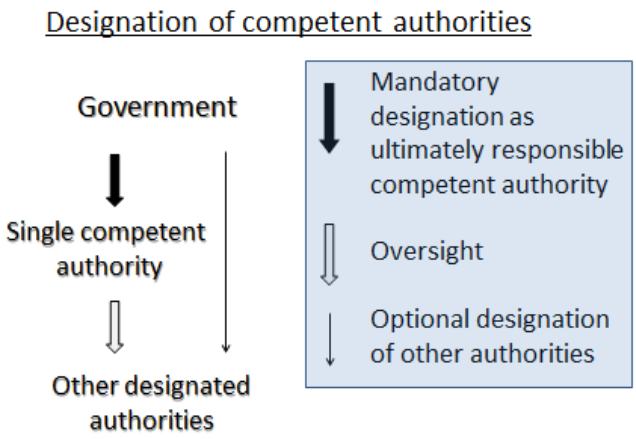
We understand the European Commission interprets the Directive to mean that the single competent authority and any other authority have to be governed wholly by non-practitioners, who are knowledgeable in areas relevant to statutory audit.

The single competent authority must have the ability to reclaim tasks it has delegated on a case by case basis. We think it is also possible to provide for the single competent authority to take over tasks where the Member State has delegated the tasks to an authority other than the single competent authority.

This is set out in the diagrams below:

[13] The provisions of the Regulation considered in this chapter are Articles 20, 21, 24 and 25. The principal relevant amendments in the Directive are made to Article 32 of the 2006 Directive
[14] Article 1(26) amends Article 32 of the 2006 though Article 1(3) and (28) are also relevant here.
[15] This is formalised in the new Article 32(4a) of the 2006 Directive





The table below compares the current UK framework with that required by the Directive and the Regulation:

Features of new EU framework	**Features of the current UK framework**
For non-PIE audits, MS must designate a single competent authority with ultimate responsibility for the regulatory tasks and for oversight..	The FRC's statutory functions extend only to exercising oversight over the regulation of statutory auditors by the recognised professional accountancy bodies
For PIE audits, MS must designate as authorities either: - the single competent authority for non-PIE audits above; or - the supervisory authority for listing etc; or, - both.	For PIE audits, the FRC exercises most of the functions envisaged in the Regulation but does so on the basis of an arrangement with the accountancy bodies reflected in the rules as they apply to statutory auditors. This arrangement has some statutory underpinning, though it does not extend to giving the FRC itself statutory authority. We doubt whether the framework currently enables FRC to exercise ultimate responsibility for these tasks.
Member States may designate other authorities to carry out tasks, subject to oversight. However, in combination or as an alternative, the Member State may: • delegate tasks; or • allow the single competent authority to delegate tasks;.. …to: ○ other authorities; or	The Recognised Supervisory Bodies (RSBs) are effectively designated[16] for the purposes of most of the regulatory tasks in the Directive. As such the RSBs are "authorised by law to carry out" those tasks.

[16] See http://ec.europa.eu/internal_market/auditing/docs/dir/100201_competent_authorities_SAD_en.pdf

Features of new EU framework	Features of the current UK framework
○ bodies designated or otherwise authorised by law to carry out such tasks.	
For PIEs, the single competent authority may not delegate the following tasks in respect of PIEs: • inspections; and • investigations and disciplinary cases arising from those inspections or from a referral by another competent authority.	The Companies Act[17] requires the RSBs to enter into arrangements such that: • technical and ethical standards for all audits are set by an independent body; • inspections of audits of PIEs and other major audits are by an independent body; • investigation and disciplinary action for any case in which there is a major public interest, is taken by an independent body. In each case the FRC and the RSBs have entered into arrangements for the FRC to carry out these tasks.
Rather than the general "system of public oversight" being required to be governed by **a majority of** non-practitioners, the single competent authority must be governed wholly by "non-practitioners". A "non-practitioner" is a person who for three years preceding their involvement in the governance of the authority has not: held voting rights in an audit firm; has not been a member of the management body of an audit firm and has not been employed by or otherwise associated with or contracted by an audit firm. Practitioners also may not be involved in the decision making of the competent authority, though they may carry out specific tasks where this is essential to fulfilling them. We understand that the European Commission interprets these provisions also to apply to other authorities (but not to other bodies designated or otherwise authorised by law to carry out such tasks .	Currently the FRC provides in its articles of association that no practising auditor can be a member of the Board and that a majority of the members of the Board must not be individuals who have been practising auditors within the last five years. Additionally no practising auditors (or officer of a professional accountancy body) can be a member of the FRC's Conduct Committee, one of its principal regulatory committees.

What Will This Mean?

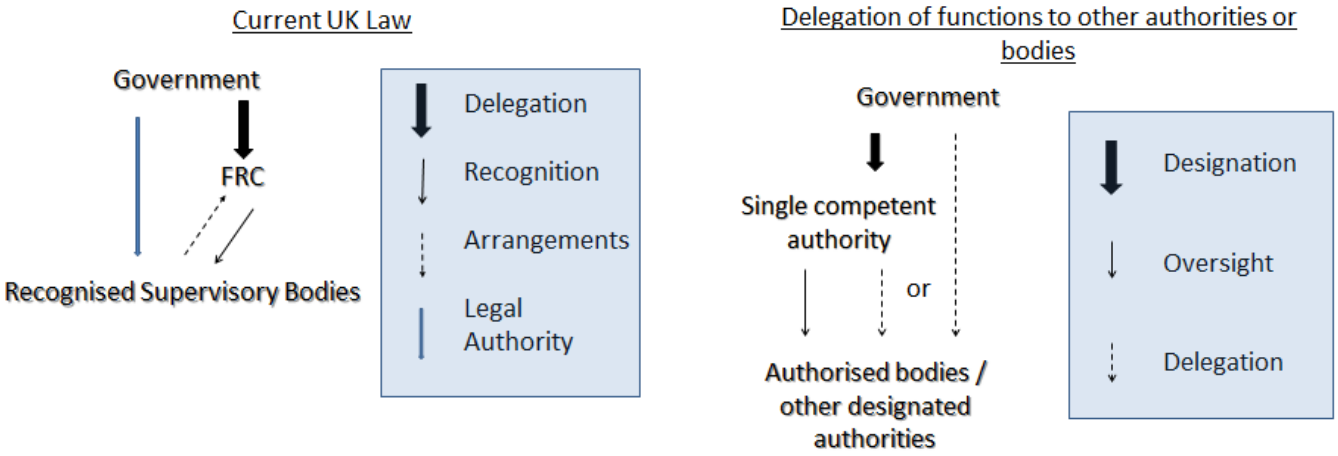
Mandatory changes

[17] Schedule 10 Parts 2 and 3.

Having considered the new framework, we consider the following changes may be needed:

- The current provision of powers to the FRC via the rules of the RSBs is not consistent with the concept of the single competent authority having ultimate responsibility for the regulatory tasks or with it having the ability to delegate tasks to other bodies. We think the competent authority's responsibilities, in particular in respect of inspections, investigations and discipline, and standard setting will need to be allocated directly in legislation. This would require a new statutory framework on *audit regulation* in these areas.

  The diagrams below illustrate the change that would be needed:



- The FRC's current ability to determine its remit for the purpose of audit inspections would also need to change to align with the EU requirements, as all auditors of PIEs must be subject to inspection by the single competent authority and this task cannot be delegated to the supervisory bodies.

- The current approach, where all investigations and disciplinary functions are allocated to the RSBs will no longer be possible for audits of PIEs. Potential exceptions to this are discussed later.

- Under the Directive and Regulation the single competent authority and any other authorities would need to be governed by non-practitioners (as opposed to a majority thereof) and be subject to new requirements as to the capacity in which they may engage practitioners. The FRC has indicated it is willing to make such a change if required.

The new framework would be separate from the current arrangements, under the RSBs' rules, on the FRC's investigation and discipline of other accountants. If these continued, they would have to be in dedicated accountancy arrangements.

Reconciling the UK framework with that in the EU

The UK has a range of options for giving effect to the new EU framework. Our intended approach is to introduce new requirements alongside amending the current law to achieve an

overall simplification. We consider that the following are the main considerations in identifying the best way of meeting the overall direction of the EU measures towards greater independence of audit regulation and the specific requirements of the Directive and Regulation.

- improving the effectiveness of the regulatory regime to reinforce confidence in audit;
- simplifying the regulatory structure; and,
- minimising the costs of audit regulation.

The Government will endeavour to balance these considerations in reaching conclusions following consideration of responses to this discussion document. As a first step we need ot consider the various options available under the Directive and the Regulation for each regulatory task.

We are therefore seeking views on the issues relating to the regulatory tasks set out in the table below:

Key tasks in audit regulation	**Public Interest Entities**	**Non-public interest entities**
Inspections of statutory audits and auditors	Currently the FRC is responsible, under an arrangement with the RSBs, for the inspections relating to audits of listed companies and of other bodies in which there is a major public interest ("major audits"). The FRC then delegates to the RSBs the inspection of those auditors who conduct ten or fewer major audits [18]. "Major audits" include all Public Interest Entities (PIEs) within the scope of the Directive other than some unlisted insurers. In future this responsibility must be allocated to the single competent authority, Any auditor of any PIE will need to be subject to inspection by the single competent authority.	Currently the RSBs inspect auditors of non-PIEs, other than non-PIE "major audits". We would want to continue to provide the single competent authority with inspection powers in respect of non-PIE major audits, including the ability to determine the scope of its inspection remit for these each year. The most direct way of achieving this is to allocate the task of inspecting all audits to the single competent authority. It would then retain responsibility for inspecting non-PIE major audits. We would expect the single competent authority to delegate most inspections of audits of non-PIEs [19] and only to use its power to reclaim the delegation on a case-by-case basis in

[18] This framework is provided in paragraph 23 of Schedule 10 to the Companies Act 2006. "Major audit" is defined in paragraph 13 as audits of entities "in whose financial condition there is a major public interest". The FRC publishes a list each year of the entities whose audits it deems should be viewed that year as major audits.
[19] This could include delegating inspections of non-PIE major audits where the auditor only audited a small number of such entities.

Key tasks in audit regulation	Public Interest Entities	Non-public interest entities
		exceptional circumstances. The alternative approach is for the Government to designate the RSBs as competent authorities for this purpose or otherwise authorise them by law to inspect most non-PIE audits.
Investigations and discipline	Currently the FRC may take independent investigation and disciplinary action in relation to any case which raises important issues affecting public interest. Where no such interest exists the case is a matter for the relevant RSB. In future, for audits of PIEs, all investigations and discipline resulting from audit inspections and referrals from other authorities will need to be allocated to the single competent authority. However it would still be possible for the initial assessment of complaints about auditors to be considered by the professional supervisory bodies provided there are adequate arrangements to enable the single competent authority to exercise its responsibility to decide whether to investigate a case involving the audit of a PIE or another case raising important issues affecting the public interest.	Currently the RSBs are responsible for cases that do not raise important issues affecting the public interest, subject to FRC oversight. There are similar options and considerations for investigations and discipline as discussed above for inspections of non-PIEs. Again, were overall responsibility allocated to the single competent authority, we would expect it would delegate the investigation and discipline of most non-PIE audit cases to the professional supervisory bodies. The investigation and discipline powers the FRC currently has in respect of auditors of non-PIEs would need to be available to the single competent authority under the new framework in any case in compliance with Article 32(5). This would provide a means of initiating any case raising important issues affecting the public interest. The questions consider alternative approaches.

Key tasks in audit regulation	All entities subject to statutory audit under the 2006 Directive as amended
Approval of individuals and firms as eligible for appointment as statutory auditors	Currently the practical implementation of the approval framework for individual auditors and for audit firms is a matter for the RSBs, by virtue of their continued recognition by the FRC, and subject to FRC oversight against the requirements of the Companies Act. The substance of the present system consists of: • the requirement for membership of an RSB (ie being subject to its rules) as a precondition for approval; • statutory underpinning of the RSBs' rules on approval and continuing professional development is provided by FRC oversight but there is no express approval framework for the rules made by the RSBs; • all powers on the registration of approved statutory auditors are exercised by the RSBs in accordance with FRC regulations, though these do not currently cover removal from the register; • approval of all statutory auditors is on the same basis (so there are no additional preconditions for approval of auditors conducting certain audits such as major audits). The new Directive and the Regulation provide an opportunity to reconsider the current framework and whether there are opportunities to improve its operation. We would intend to retain the current arrangements where approval of statutory auditors is based on the auditor being both a member or affiliate of a professional supervisory body and registered as eligible for appointment as a statutory auditor. The questions seek views on changes that might be made to the current framework. One option would be to provide a framework in which overall responsibility for approval and registration of auditors was allocated to the single competent authority on the understanding this task would be delegated to the professional bodies. This would include the possibility that the task could be reclaimed by the single competent authority, including on a case by case basis. The questions raise this possibility. An alternative would be to give the responsibility directly to the professional bodies by law, subject to oversight by the single competent authority, and if they were provided, powers to reclaim these responsibilities. Separately, we note there is currently no express requirement for the rules of the bodies on the approval and registration of auditors to be approved by the FRC. At present there are no additional approval requirements for auditors conducting certain audits such as major audits.
Continuing Professional Development	This is currently a responsibility of the RSBs. It meets a specific requirement of Schedule 10 of the Companies Act 2006 and in practice is closely integrated with the CPD requirements for members of the professional body generally.

Key tasks in audit regulation	All entities subject to statutory audit under the 2006 Directive as amended
	Responsibility for this task could be given to the single competent authority with the expectation it would delegate it to the professional supervisory bodies; or it could be given directly by law to the professional supervisory bodies. Either way we would expect day to day responsibility for CPD would remain with the professional bodies.
Setting technical and ethical standards	Under the existing arrangements, ethical standards for auditors, quality control standards and technical standards for auditing are set by the FRC. However, the only statutory underpinning of this is the requirement in Schedule 10 to the Companies Act, that RSBs must have arrangements in place for such standards to be set independently of the body. In practice this is met by the bodies placing obligations on auditors to follow FRC standards. We do not consider these arrangements are adequate in the context of the amended Directive and the new Regulation. This function should be the direct responsibility of the single competent authority, and statutory auditors should be required by law to comply with the standards.

Some issues arising from the discussion above may be common to all of the tasks considered in the table. However we are also keen to hear about specific issues that arise in relation to each regulatory task, though we recognise there may be merit in a consistent approach as between regulatory tasks. Respondents to this discussion document are encouraged to consider the questions with this in mind.

Questions

Q9. Do you agree the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under the 2006 Directive as amended by the new Directive and under the Regulation?[20]

Q10. What issues, if any, do you consider arise from the need to implement a new statutory framework for the setting of auditing standards and for audit inspections, investigations and discipline by the single competent authority to replace the current framework that requires the bodies' rules to provide for this? If there are any, how should they be addressed?

Q11. What issues, if any, do you think might arise for the current investigation and disciplinary arrangements between the professional supervisory bodies and the FRC, that apply to accountants generally as opposed to only auditors, given the changes in relation to audit? If there are any, how should they be addressed?

[20] In answering this question, it may help in particular to consider the tasks of audit inspection, investigations and discipline, auditor approval and continuing professional development and the setting of technical and ethical standards for statutory audits and auditors.

Q12. In relation to each of the tasks provided for in the Directive and Regulation, do you consider that responsibility should be allocated to the single competent authority, for it to delegate to the professional supervisory bodies as appropriate and to the extent permitted in the Directive and Regulation? Please provide further information in support of your answer.

Q13. For any tasks where responsibility is allocated to the single competent authority for it to delegate, what limitations, if any, do you consider would needed to ensure that authority only retained responsibilities or reclaimed delegated responsibilities in appropriate circumstances? What do you consider these circumstances should be?

Q14. In relation to each of the tasks provided for in the Directive and Regulation, are there any tasks, or any aspects of those tasks, that you consider it is important should continue to be covered by provisions in legislation on the content of the rules of the supervisory bodies? Please provide further information in support of your answer.

Q15. Do you consider that both the registration of statutory auditors and their removal from the register should be covered by regulations under the Companies Act[21]? If so, which body or bodies do you think should have statutory powers for the removal of statutory auditors from the register?

Q16. Do you consider that, for consistency with a framework of ultimate responsibility, single competent authority approval should be required for the rules of the supervisory bodies?

Q17. What do you consider are the costs and benefits in monetary terms and in terms of the effectiveness of audit regulation of the proposals in this chapter and of your preferred approach to implementation of these provisions?

[21] The Statutory Auditors (Registration) Instrument 2008 currently applies for this purpose, having been made by the FRC using powers in section 1239 of the Companies Act, which are delegated to it.

4.3 Audit fees and non-audit services

This chapter is about the amount of, and types of, non-audit services that statutory auditors of PIEs will be able to provide to those audit clients.

What are the changes?

Both Articles 4 and 5 of the Regulation represent considerable changes for PIEs in the UK who make considerable use of their auditors to obtain additional non-audit services[22]:

- Audit firms are prevented altogether from offering services that are considered to give rise to too great a conflict of interest and compromise the auditor's independence.
- The fee income from the remaining permitted non-audit services is capped at 70% of the average audit income over the 3 preceding financial years.
- Non-audit services required by legislation are not subject to the cap.

Finally, the Regulation sets out, the steps that must be taken where the total fee income to an auditor from a PIE exceeds 15% of the auditor's overall fee income. There are already more stringent requirements in the UK's ethical standards for auditors.

Article 5 – the "blacklist"

So called "blacklisted" non-audit services[23] are prohibited for the whole of the period from the start of the accounting year for which the audited accounts will be prepared until the filing of

[22] Using data from the FAME database for listed companies BIS found that of the 86% of listed companies whose auditors also provide non-audit services, on average each company pays between £590k pa and £690k pa for those non-audit services. We have not yet established any estimate for how much this would be reduced by the blacklist. However, if the blacklist had had no effect, 26% (or 3/10 of the 86%) would have breached the 70% cap on non-audit service fees paid to their auditor in the last accounting year for which data was available.

[23] Blacklisted non-audit services, as listed in Article 5(1) subparagraph 2 of the Regulation are:

(a) tax services relating to: preparation of tax forms; payroll tax; customs duties; identification of public subsidies and tax incentives; and support regarding tax inspections by tax authorities (unless support from the statutory auditor or the audit firm in respect of such inspections is required by law); calculation of direct and indirect tax and deferred tax; and provision of tax advice;
(b) services that involve playing any part in the management or decision-making of the audited entity (Recital (8) states that these "might include working capital management, providing financial information, business process optimisation, cash management, transfer pricing, creating supply chain efficiency and the like";
(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: the provision of general counsel; negotiating on behalf of the audited entity; and 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: 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,

those audited accounts. In addition services advising on accounting, internal control and risk management systems at the audited entity are also prohibited for the year before that for which the audited accounts are prepared.

There are several significant Member State options relating to the blacklist:

- a Member State may add to the blacklist or impose stricter conditions on the provision of any non-blacklisted services;
- the Member State may also provide that certain services[24], that would otherwise be blacklisted under the Regulation, are permitted where they only have an immaterial or indirect effect on the financial statements and where this is documented as part of the auditor's additional report to the audit committee. The audit committee can issue guidelines on this.

The blacklist only applies to the provision of non-audit services to the PIE, and to members of the same group as the PIE incorporated in the EU, by the auditor, or a member of their network. Outside of the EU, the Regulation[25] applies the "threats and safeguards" approach that is applicable under the UK's ethical standards for auditors in any case - involving an assessment by the auditor of threats to their independence and the identification of safeguards to be put in place to address those threats. However, for certain non-audit services there is a presumption that the threats to the auditor's independence would be incapable of being addressed by safeguards[26].

As already required by the 2006 Directive, the auditor must subject any permitted non-audit services they provide to an assessment of "threats and safeguards" to their independence and report this to the audit committee[27]. However, under the Regulation, the audit committee must then approve the provision of the services.

Total non-audit fee income and the "cap"

Unless they are required by legislation, the remaining permitted non-audit services following application of the blacklist are subject to a cap of 70% of the average audit fees, received by the auditor over the three years preceding the year in which the cap is applied. The cap applies to total fees for services provided by the auditor to any member of the group. In addition:

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- services required by legislation (including those required under mandatory regulatory codes that are enforced under statutory powers) are excluded from the calculation.
- The cap only applies if audit and non-audit services have been provided by the same auditor in all of those three years.

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where such services involve: searching for or seeking out candidates for such position; or undertaking reference checks of candidates for such positions; structuring the organisation design; and cost control.

[24] The blacklisted services that are subject to the option for Member States to permit them are those listed under point (a) of the second subparagraph of Article 5(1) of the Regulation above (though not tax services relating to payroll tax and cutoms duties) and point (f) of that subparagraph.
[25] Article 5(5)
[26] These services, which are effectively also blacklisted for group members in "third countries" are: those listed under points (b), (c) and (e) of the second subparagraph of Article 5(1) of the Regulation.
[27] This is already required under Article 42(1)(b) of the 2006 Directive as .

- The cap excludes non-audit service fees paid to other auditors in the same network.

Member States can:

- give the competent authority the power on an exceptional basis to exempt an auditor from the cap for a period of up to two years.
- make the cap more stringent, for example to decrease the level of the cap and / or to include additional amounts in the calculation;
- set more stringent requirements where the fee income from the audit of a PIE exceeds 15% of the auditor's total fee income for each of the last three years. This option will be necessary for the UK if the more stringent provisions in the FRC's current ethical standards for auditors are to be maintained.

Other ethical standards requirements for all audits

The Directive[28] either restates with amendments, recasts or adds to the framework in the 2006 Directive on ethical standards and independence applying to all audits. The previous requirement that the auditor should assess "threats" to their independence and introduce "safeguards" accordingly, is recast so as to include consideration of issues arising from the activities of other auditors in the same network. However, we understand this and other new requirements in the relevant Articles will require only limited further implementation in the UK's ethical standards for auditors.

Information on compliance

Article 6(1) of the Regulation and new Article 22b of the 2006 Directive require the auditor to document certain matters before taking up a new or renewed appointment as statutory auditor. The matters to be documented are:

- compliance with the Directive framework on independence and ethical standards;
- identification of any threats to the auditor's independence and the safeguards introduced;
- in relation to the audit of a PIE:
    - compliance with the blacklist and the cap on non-audit services;
    - the compliance of the auditor's appointment with the mandatory rotation framework;
    - the availability of appropriate resources and qualified personnel to complete the audit; and,
    - the auditor's due diligence on the integrity of the directors of the PIE client.

A Member State Option provides that simpler requirements as to documentation may be provided for audits of small non-PIEs.

Enforcement of the cap

Article 14 of the Regulation requires auditors to submit information to the single competent authority on audit and non-audit fees for each of the PIEs that they audit, with the non-audit fees

[28] Article 1, paragraph 14 amends Article 22 of the 2006 Directive, while Article 1, paragraph 15 inserts a new Article 22a.

broken down into fees for services required by legislation and those that are not required by legislation. This is to facilitate enforcement of the cap on non-audit service fees by the competent authority.

What will this mean?

The non-audit services listed in Article 5 of the Regulation will be prohibited for all accounting years beginning on or after the application of the Regulation on 17 June 2016. It is arguable that services designing and implementing certain internal control or risk management systems[29] will also be prohibited for the previous accounting year (ie the first accounting year ending on or after 16 June 2016). In any event it is unlikely under existing UK ethical standards that a firm could accept an audit engagement where it had provided such services in the preceding year.

Given the cap only applies where an auditor has provided relevant non-audit services for each of the preceding 3 years, we consider the first calculation for the cap must be done in respect of the accounting year beginning on or after 17 June 2019 (ie the 4th accounting year beginning after the application of the Regulation). The cap would then be set in that year at 70% of the average of audit fees paid by the audited entity over three preceding years.

What implementation is needed?

The provision of non-audit services to audit clients is already regulated by the FRC's ethical standards for auditors to a greater degree than in many EU Member States. The effect is that in practice some significant non-audit services are prohibited in the UK. More generally there is a detailed framework within which audit firms must work. The Regulation is directly applicable so Articles 4 and 5 will have legal effect from 17 June 2016 onwards without the need for any transposing UK legislation. But existing UK legislation and the FRC's ethical standards framework will need to be consistent with these provisions. And to the extent that these Articles provide some discretion or choice for Member States, UK legislation and/or the standards framework will need to give effect to this. We therefore consider it would make sense for the detailed rules on non-audit services to be addressed by the FRC through development of the ethical standards framework.

We are therefore seeking views on whether, in a revised statutory framework on the setting of ethical standards for auditors, the FRC should be given the specific responsibility to address the subject matter of these Articles, including the ability to exercise all the associated Member State options, in accordance with its usual processes for setting such standards.

Given that the timetable for implementation is relatively short we have agreed with the FRC that they will publish at the same time as this document a consultation document on the changes to the ethical and auditing standards that could give effect to the EU requirements. In the event that we conclude, having considered responses to this discussion document, that implementation should be primarily through legislation, then we would expect to be able to draw on the results of that consultation in determining the detailed changes to make.

[29] point (e) in the second subparagraph of Article 5(1) of the Regulation.

We think this approach is also appropriate for the implementation of the provisions of the ethical framework in the 2006 Directive, as amended by the new Directive, though some changes are likely to be needed in legislation to the existing provisions[30] to underpin the contents of the revised ethical standards. We also consider that separate provision may be needed for some documentation requirements applying to the auditor, although we would also want to identify, or provide for the ethical standards to identify, simpler documentation requirements for audits of small companies.

Meanwhile we are considering whether the existing framework on the disclosure, in the notes to the accounts of companies and other undertakings, of fees paid for audit and non-audit services, should include the disclosures required by Article 14 of the Regulation.

This would ensure public disclosure of the information required to be provided to the competent authority under Article 14 of the Regulation. A separate disclosure of all this information aggregated across all the audits of PIEs conducted by the auditor each year will also have to be disclosed in the auditor's transparency report, which is provided for in regulations issued by the FRC. These require amendment accordingly.

Questions

Q18. Do you agree that the provisions of Article 4 of the Regulation on the cap on non-audit services should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

Q19. What issues, if any, do you consider arise from the application of the provisions on the cap on non-audit services? If there are any, how do you consider these should be addressed?

Q20. Do you agree that the Member State options in Article 4, to set more stringent requirements on the cap and on the auditor's independence where their total fee income from a PIE exceeds 15% of their total fee income overall, should be capable of being applied by the FRC in its ethical standards for auditors? Please provide information to support your answer.

Q21. Do you agree that the FRC should have the ability to exempt an audit firm from the 70% cap for up to two financial years on an exceptional basis and on application by the firm?

Q22. Do you agree that the subject matter of Article 5 of the Regulation on the blacklist of non-audit services, including the possibility of setting more stringent requirements, should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

Q23. What issues, if any, do you consider arise from the application of the provisions on the blacklist of non-audit services? If there are any, how do you consider these should be addressed?

[30] Existing underpinning provisions along these lines are currently included in the paragraphs 9, 10B and 10C of Schedule 10 to the Companies Act.

Q24. Do you agree that implementation of the revised requirements on ensuring and documenting auditor independence in the 2006 Directive should be implemented primarily via the ethical standards, with amendments to the existing legislation as necessary only to:

- underpin the standards? And,
- introduce simplifications for audits of small non-PIEs?

Please provide further information to support your answer.

Q25. Do you agree that the existing framework on disclosure by PIEs in notes to their accounts of the audit and non-audit fees they paid their auditor should be adapted, to ensure public disclosure of the information the auditor is required to provide to the competent authority under Article 14 of the Regulation? Please provide information to support your answer.

Q26. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the blacklist?
(b) the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor?
(c) the extent to which these additional costs vary by the size of PIEs?
(d) the person hours likely to be involved in a non-audit team at an audit firm understanding and preparing for the changes given that they will not be able to provide certain non-audit services to the firm's audit clients?

4.4 Tendering and duration of audit engagements

This chapter is about new rules for PIEs regarding how often they will be required to put audit services out to tender, and how long they will be able to retain the same auditor or audit firm.

What are the changes?

Articles 16, 17 and 41 of the Regulation relate to the appointment and continuing engagement of auditors by public-interest entities (PIEs). This includes provision prohibiting the use of clauses in contracts with third parties restricting a client's choice of auditor. However paragraph 30 of the Directive prohibits the use of clauses in contracts with third parties restricting any statutory audit client's choice of auditor.

Article 16 – Appointment of auditors

Article 16 specifies the following:

- the Audit Committee (AC) must submit a recommendation to the board for the appointment of an auditor. However, this does not apply where, under Article 37(2) of the 2006 Directive (which is unchanged), the Member State has provided an alternative system for the appointment of the auditor ensuring the auditor's independence.

- Unless the recommendation is to reappoint the current auditor, the AC recommendation should offer at least two choices for the audit engagement and state a justified preference for one of them.

- In cases where the AC is not reappointing the current auditor, the recommendation of the AC must follow a selection procedure which must be conducted fairly and must include a tender process. The AC must also consider any inspection reports that have been published by the competent authority on the auditor.

- The directors' proposal for the appointment of the auditor that is made to the general meeting of shareholders of the PIE, must include information on the AC's recommendations to the board.

- Member States may decide that a minimum number of statutory auditors or audit firms must be appointed by PIEs (ie require joint audits).

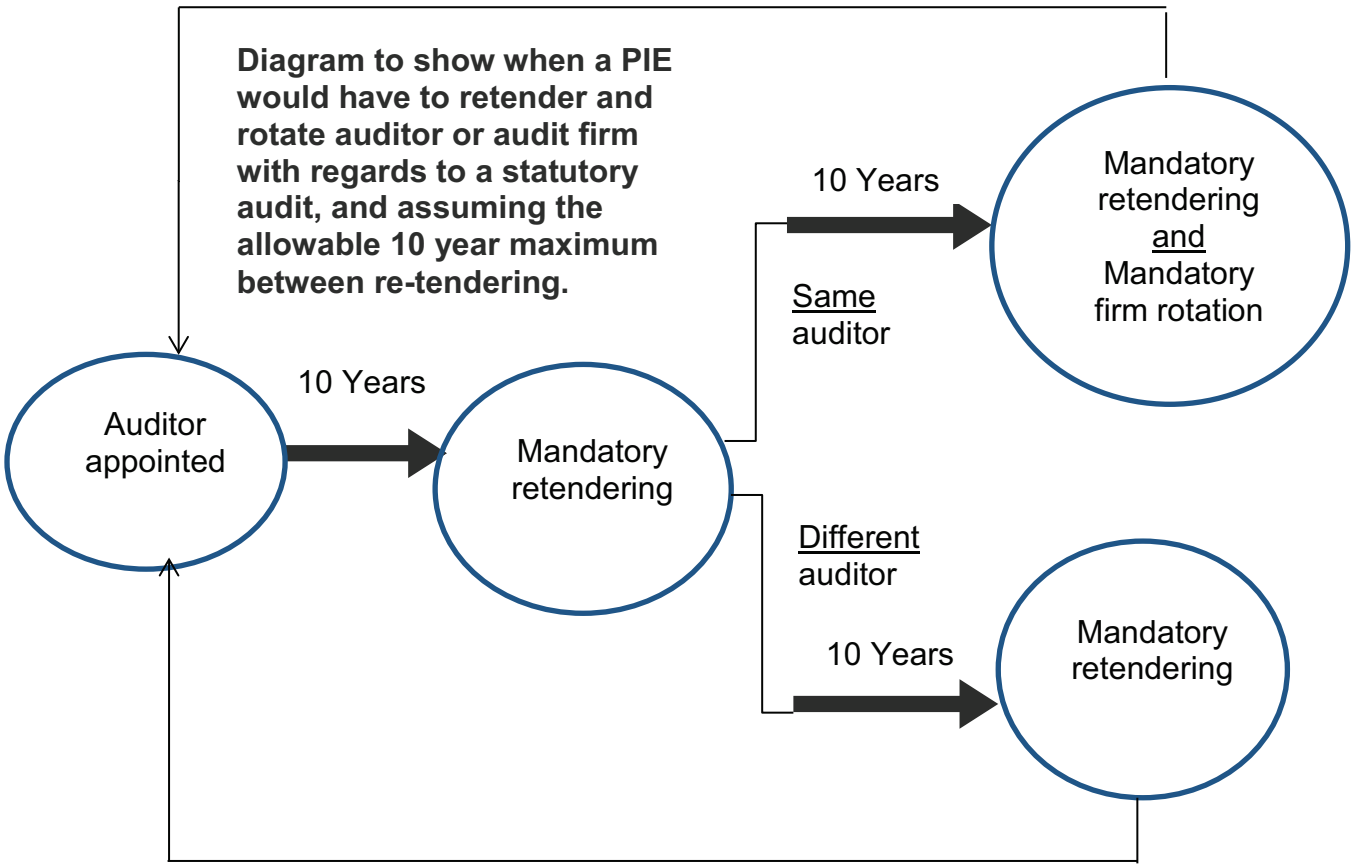
Article 17 – Duration of audit engagement

Article 17 of the Regulation specifies the duration of the engagement of a statutory auditor or audit firm by a PIE:

- the auditor must be appointed for at least a year. Member States may increase that minimum period. The Government does not intend to take this option up, as we would want to continue to provide for annual reappointment of auditors in the UK.

- There is also a maximum duration of 10 years after which neither the auditor nor any member of their network shall undertake the audit, whether individually or as a joint auditor, for four years.

- Member States may extend this maximum duration to a maximum of:
    - twenty years where a tendering process is conducted, or;
    - twenty four years where there is a joint audit.



- To enable the extension of the maximum duration:

    - the retender of the audit must take effect upon the expiry of the initial maximum duration;
    - similarly, a joint auditor would have to be engaged after the expiry of the initial maximum duration.

  The Government does not propose to make any special provision for joint audits. In other words, where joint auditors are reappointed following a tender at the ten year point the maximum duration would remain at twenty years; and, the replacement of a single auditor by joint auditors would also have to be on the basis of a retender.

- The competent authorities may grant an extension to re-appoint the statutory auditor for up to two years beyond the twenty years maximum, but only on an exceptional basis and following a further retender.

- The PIE must replace the auditors on the basis of a tender process at or before the end of the final maximum duration (including any extension(s)). After this neither the original auditor of the PIE nor any members of their network can undertake the audit for the following four years.

Article 17 – Rotation of key partners

Article 17 requires the key audit partners responsible for carrying out a statutory audit to cease their participation in the statutory audit of the audited entity not later than seven years from the date of their appointment. They shall not participate again in the statutory audit of the audited entity before three years have elapsed following that cessation. By way of derogation, Member States may require that key audit partners responsible for carrying out a statutory audit cease their participation in the statutory audit of the audited entity earlier than seven years from the date of their respective appointment.

Under the 2006 Statutory Audit Directive the required period off after acting as a key audit partner is two years. This is an area covered by the FRC's Ethical Standards, which sets more stringent requirements in some areas (see below).

Article 41 – Transitional arrangements

Article 41(1) and (2) set out transitional provisions for an auditor that has been in place for 11 or more years at the entry into force of the Regulation, that is 16 June 2014.

- Where the audit engagement has continued for 20 years or more on that date, the PIE cannot enter into or renew that audit engagement beyond 6 years after the date of entry into force of the Regulation (ie from 17 June 2020 onwards);

- Where the audit engagement has continued for 11 years or more on that date, but less than 20 years, the PIE cannot enter into or renew that audit engagement beyond 9 years after the date of entry into force of the Regulation (ie from 17 June 2023 onwards);

Article 41(3) applies to audit engagements not covered by Article 41(1) and (2), which were entered into before 17 June 2014 and are still in place on 16 June 2016, when the Regulation becomes applicable.

Following discussions with the European Commission we have concluded that duration of the audit engagement should be calculated from the first financial year for which the auditor was appointed.

As a result, 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 that extends beyond 16 June 2020;

- Between 17 June 1994 and 16 June 2003: a PIE cannot renew or enter into an audit engagement with the auditor that extends beyond 16 June 2023;

- Between 17 June 2003 and 16 June 2006: PIEs will need to conduct a tender and either reappoint the existing auditors or appoint new auditors so that the new audit engagement takes effect on or before 16 June 2016, ie by the date of application of the Regulation.

Directive Article 1 paragraph 30 - Contractual clauses restricting the choice of auditor

Paragraph 30 of Article 1 of the Directive inserts into Article 37 of the 2006 Directive a paragraph prohibiting any contractual clause restricting the choice by shareholders to categories or lists of auditors.

Though the Directive applies to all audits, Article 16(6) of the Regulation has a similar provision specifically for audits of PIEs. However, the Regulation also requires PIEs to inform the single competent authority of any attempt by a third party to impose such a contractual clause. In addition, the audit committee, in making its recommendation to the directors on the appointment of auditors, must state that its recommendation is free from influence and no such clause has been imposed upon it.

The specific prohibition in the Regulation does not come into force until 17 June 2017, whilst the Directive prohibition must be implemented and in force by 17 June 2016.

What will this mean?

Appointment of auditors and duration of engagement

The Government is proposing to take up the option to provide for the extension of the maximum duration of the audit engagement to up to 20 years, subject to retendering at least every 10 years.

The framework in Articles 16 and 17 of the Regulation on appointment and retendering is consistent with the Order published on 26 September 2014[31] by the Competition and Markets Authority (CMA) on mandatory tendering and the responsibilities of Audit Committees. That Order will apply to FTSE 350 listed companies from 1 January 2015.

BIS has been working with the CMA to ensure consistency as far as possible between the Order and EU reforms. The Order was drafted on the basis that the UK will take up the option in the EU Regulation to permit the extension of the maximum duration of the audit engagement subject to retendering. This could allow the audit engagement to last up to 20 years subject to retendering of the appointment at least every 10 years.

The Government and the CMA are concerned to:

- remove any disincentive from tendering the audit engagement more frequently than every ten years;

[31] Both the CMA Order and the report of the Competition Commission investigation are available at: www.gov.uk/cma-cases/statutory-audit-services-market-investigation.

- prevent companies from being burdened by a tender process that must take effect at 10 years, even where they have already conducted one to take effect earlier in the 10 year period; and to,
- allow PIEs that are part of multinational groups and that might be obliged to retender the audit of their consolidated accounts more frequently than once every 10 years, to do so.

We are therefore seeking views on the implementation of a framework for mandatory tendering at 10 years whilst allowing the Audit Committee to specify a shorter period in the annual report. Such a reporting requirement would be intended to encourage consideration of retendering earlier than 10 years.

We are also considering provisions so that, where a PIE has stated that it will complete a tender process before the expiry of the maximum duration of 10 years, the PIE could still take advantage of an extension of the maximum duration following that tender. One possible example of the operation of such a framework is set out in the diagram on the following page.

In the example in the diagram, the audit committee consistently reports its intention that the audit appointment in 7 years will be based on a retender. We are seeking views on a framework where this would be possible for any period of less than 10 years in such a way as to ensure that there did not then need to be a further retender again to take effect at the end of year 10 (ie in 3 years' time in the example).

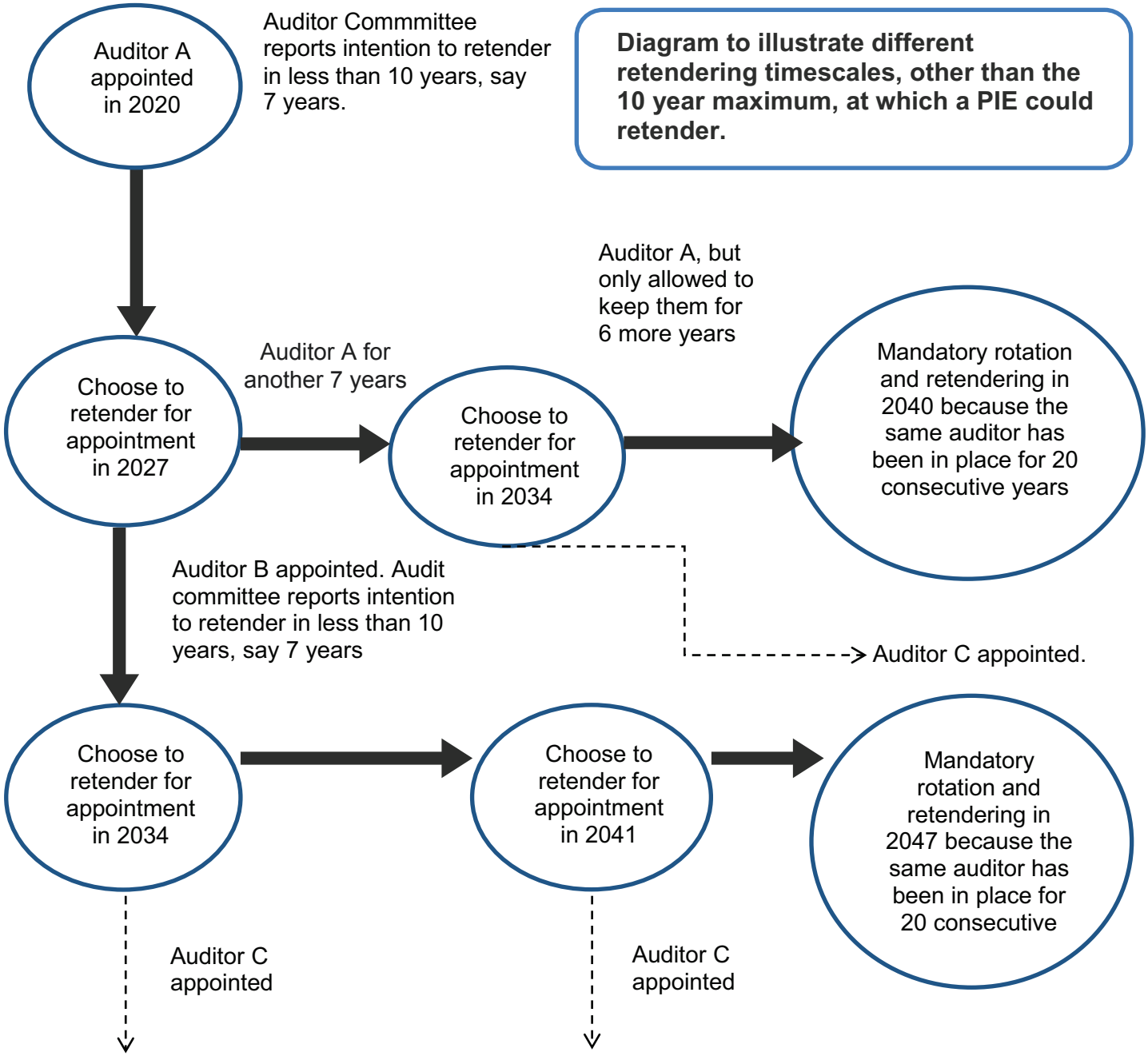
This potential difficulty arises because the Regulation[32] states, as a condition for extending the maximum duration to 20 years, that the "[results of the tender must] take effect upon the expiry of the [10 year period]".

Instead we are considering whether, in the case of a retender taking effect after 7 years, the appointment need only be based on a retender again at one of the following points (we are still considering which of these should apply):

- year 14 (after the same period had expired again);
- year 17 (after a further 10 years had expired, assuming a change in the audit committee's policy); or
- year 14, though with the potential, in advance of the conclusion of this period, to extend it to year 17 via further notice from the audit committee in the annual report.

The questions below seek views on which of these maximum durations should apply.

[32] Article 14(4)(a)



We are also considering whether it would be possible to extend the maximum duration above further, to 20 years, via a second retender. This would be expected to take effect at the end of whichever of the time periods above is preferred following consideration of responses to this discussion document. However, as we have proposed for the first retender, we are considering whether, for this second retender, the audited entity should have flexibility to determine the year in which that retender should take effect before the expiry of that preferred period. This would again be by virtue of the ability of the entity to notify the planned timing of its tender in its annual report.

We would not intend that there should ever be a continuous engagement period of more than 10 years that did not include a tender process.

Our proposal

We are seeking views on a framework to make it possible for a company to retender the auditor appointment earlier than 10 years, but still be able to extend the maximum duration of the audit engagement beyond ten years. Our proposal is that:

- Each year after the auditor's initial engagement, the audited entity states in its annual report when it next intends that the auditor appointment should be based on a retender.
- Where a PIE reports that it intends that the auditor's appointment in relation to the next but one accounting year following that covered by the report should be based on a retender, this would be binding on the PIE.

We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the Directors' report setting out key matters for the audit committee on the appointment of auditors. The report could include the following:

- when the current auditor took up the audit engagement at that company;
- when the audit engagement was last retendered;
- the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender; and,
- the directors' reasons for considering that the proposed year is in the best interests of the company's members.

While the third point above would then form part of the retendering framework for extending the maximum duration of the audit engagement, the other disclosures would be intended to enable shareholders and others to engage more effectively with directors on auditor appointment proposals.

What implementation is needed?

Implementation will require some limited amendments to Part 16 of the Companies Act 2006. However, we are also considering whether some of the implementation should be outside of the Companies Act in freestanding provisions in regulations under European Communities Act 1972.

We are also seeking views on whether, if we were to take the approach above, there would be merit in an approach comparable to that already taken in the CMA Order on mandatory use of tender processes for audit engagements. Provisions included in regulations could at times be similar to those in the CMA Order, for instance the implementing regulations could:

- set out the applicable periods of years that would apply under the Member State options on the mandatory retendering and rotation; and,
- provide how these periods are linked to disclosures by the audit committee.

However:

- the implementing regulations would also need to include signposting to the directly applicable provisions of the new EU Regulation; and,

- unlike the approach in the CMA Order, we would not propose that the auditor's appointment should be ineffective if it was not made in compliance with the regulations.

We are continuing to consider what sanctions should apply in cases where the resulting retendering and rotation framework is breached by a PIE and its auditor.

Given that the CMA Order only applies to a subset of PIEs and only applies requirements on retendering of audit appointments, and in order to apply the rotation requirements to both FTSE 350 auditors and auditors of other PIEs in a consistent way, we envisage that such an approach would apply to all PIE audits. It would then be a matter for the CMA to consider whether its Order should also continue to apply. These proposals are covered further in the questions below.

We are also considering whether implementation outside of the Companies Act, in regulations under European Communities Act 1972, would be an appropriate mechanism for the prohibition of contractual clauses limiting a company's choice of auditor.

Article 17(7) of the Regulation - Rotation of key partners

The FRC's Ethical Standards currently require that, for audits of listed companies:

(a) no one shall act as audit engagement partner for more than five years; and

(b) anyone who has acted as the audit engagement partner for a particular audited entity for a period of five years, shall not subsequently participate in the audit engagement until a further period of five years has elapsed.

Other periods are established for partners in other roles. We are therefore seeking views on whether, in a revised statutory framework on the setting of ethical standards for auditors, the single competent authority should be given the specific responsibility to make provisions to give effect to this Article, including the ability to exercise the associated Member State options.

Matters the single competent authority would need to address include how their requirements will apply to PIEs, rather than just listed entities, and to ensure that appropriate requirements apply to all 'key audit partners' as defined for the purpose of the Audit Regulation.

Questions

Q27. Audit Committees must submit a recommendation to the board for the appointment of an auditor. However, under Article 16(1) sub-paragraph (2) of the Regulation, this does not apply where the Member State has provided an alternative system for the appointment of the auditor. The current alternative systems set out in the Companies Act 2006 are where:

- the directors appoint the auditor before the company's first accounts meeting;
- the directors appoint the auditor to fill a casual vacancy in the office of auditor; and where,
- the Secretary of State appoints the auditor because a public company failed to do so.

Do you consider that all of these alternative systems for the appointment of an auditor should continue to operate in the UK as they do at present? Are there any other systems that should

also be provided for on the grounds that a competitive tender process is not appropriate? Please provide further information to support your answer.

Q28. Where the PIE is exempted from having an audit committee (eg because it is an unlisted bank), there is no provision as to which body should fulfil the audit committee's role. Do you agree that in this situation the directors should determine the recommendations that should be put to shareholders of the audited entity? Please provide information in support of your answer.

Q29. The Government does not intend to take up the option to provide for an extension of the maximum duration of the engagement beyond 10 years where a joint auditor is engaged. Do you agree that the replacement of a single auditor with two joint auditors, one of whom was the original auditor, should be made on the basis of a retender? Please provide further information in support of your answer.

Q30. We are considering whether provision should be made so that, where a PIE has stated in its annual report it will appoint an auditor based on a tender process before the expiry of the maximum duration of 10 years, it should still be able to take advantage of an extension of the maximum duration beyond ten years, following that tender. Do you agree?

Q31. We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the annual report setting out key matters for the audit committee on the appointment of auditors. Do you agree that the report should include:

a) when the current auditor took up the audit engagement at that company? (Yes / No)
b) when the audit engagement was last retendered? (Yes / No)
c) the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender? (Yes / No)
d) the directors' reasons for considering that the proposed year is in the best interests of the company's members? (Yes / No)

Do you consider that any other information should be included in addition the above? Please provide further information to support your answer.

Q32. We are considering whether, where the statement under point (c) above is included in the company's annual report, and the incumbent auditor is reappointed on the basis of the planned tender process before the expiry of the 10 year maximum duration (eg at 7 years), the next tender process should be expected to take effect:

(a) after the same period has expired again (ie year 14 in this example);
(b) after a further 10 years has expired (ie year 17 in this example); or,
(c) after the same period has expired again, though with the potential to extend it by the full 10 years via further notice from the audit committee in the annual report (ie in this example at year 14 though this could be extended to year 17)?

Which option would you prefer? Please provide further information in support of your answer.

Q33. What issues, if any do you consider arise from the UK's obligation to apply effective, proportionate and dissuasive sanctions for failure to comply with the UK's implementation of the

framework on mandatory rotation and retendering? If there are any such issues, how should they be addressed?

Q34. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) resources that are likely to be deployed by PIEs to tender audit appointments?
(b) resources that are deployed by auditors to tender for audit work?
(c) additional familiarisation costs that arise for both auditors and the audit client when a new auditor takes up an audit engagement?
(d) the extent to which this varies by the size of the PIE?

4.5 Audit reporting and additional reporting to the audit committee

This chapter is about the content of audit reports for all companies, including some additional requirements for PIEs, and the content of the additional report that auditors of PIEs will have to submit to audit committees.

What are the changes?

Audit report

Article 1, paragraph 23 of the Directive inserts a revised Article 28 into the 2006 Directive further amending the version inserted by the new Accounting Directive[33]. The main changes are:

- a modification to the requirements for the auditor's opinion and statement on the management report under Article 34(1)(a) and (b) of the new Accounting Directive. The opinion and statement need only be based on the work undertaken in the course of the audit. This change has already been discussed in the Government's consultation of the new Accounting Directive[34], in which we proposed to implement it as part of the implementation of that Directive. No further discussion of that proposal is included here.

- The report must provide a statement where necessary 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. This requirement is consistent with that which already applies under International Standards for Auditing (UK and Ireland) as issued by the FRC but we now propose to make legislative provision by amending the Companies Act 2006.

- It is made clear that Member States may lay down additional requirements on the content of the audit report. We consider that changes beyond those set out above would usually be made via amendments to the FRC's auditing standards.

- Where more than one auditor has been engaged, the audit report must be a joint report signed by an individual auditor on behalf of each audit firm. Where the auditors do not agree as to the content of the report they should report separately in the same document, setting out the reasons for the disagreement.

Article 10 of the Regulation requires that statutory auditors of PIEs include in the audit report a number of additional disclosures, the most notable of which is a description of the most significant assessed risks of material misstatement, a summary of the auditor's response to those risks, and key observations arising with respect to those risks.

Additional report to the audit committee

[33] Directive 2013/34/EU
[34] The Government's consultation on UK Implementation of the EU Accounting Directive: Chapters 1 to 9 – "financial statements and general requirements for audit" is available at: https://www.gov.uk/government/consultations/eu-accounting-directive-smaller-companies-reporting .

Article 11 of the Regulation requires that auditors of PIEs submit an additional report to the audit committee of the audited entity (or if there is no audit committee to the body performing equivalent functions) no later than the date of submission of the auditor's report. The Article sets out the required content of the report but also allows a Member State to "lay down additional requirements in relation to the content of the additional report to the audit committee".
The additional report is required to explain the results of the statutory audit and to report under a further 14 headings on the operational procedures and principles of the audit in order to help the audit committee understand the findings and judgements made. The auditor must:

- describe the methodology used, including which categories of the balance sheet have been directly verified and which categories have been verified based on system and compliance testing;

- disclose the quantitative level of materiality applied and the qualitative factors which were considered when setting the level of materiality;

- report and explain judgements about events or conditions identified in the course of the audit that may cast significant doubt on the entity's ability to continue as a going concern and whether they represent a material uncertainty, and provide a summary of all guarantees etc that have been taken into account when making a going concern assessment;

The report must also include two items that were previously provided for in the 2006 Directive[35]:

- any significant deficiencies in the audited entity's (or in the case of consolidated financial statements, the parent undertaking's) internal financial control system, and / or in the accounting system; and,
- a declaration of the independence of the auditor from the audited entity in line with Article 6(2) of the Regulation.

What will this mean?

Audit report

The additional material in the audit report is intended to improve communication between auditors and shareholders, investors, creditors and potential investors and creditors as well as with audit committees.

Some of the requirements, particularly those included in the Directive, are already reflected in ISA 700 (UK and Ireland) which sets out requirements on the content of the auditor's report on financial statements. Whilst a significant number particularly those in the Regulation are new, adding them should not require more audit work and individually they do not have a significant effect on the audit.

Additional report to the audit committee

[35] Article 42(1)(a) to (c) and Article 41(4) of the 2006 Directive which were implemented in paragraph 10B(2)(a) and (c) to (e) of Schedule 10 to the Companies Act.

The existing requirements for communications by the auditor to audit committees are set out in ISA 260 (UK and Ireland) (communication with those charged with governance).

Many of the specific requirements in Article 11 of the Regulation are new but none should require additional audit work and none individually is expected to have a significant impact on the audit.

What implementation is needed?

We propose to implement the additional requirements for the audit report via amendments to Part 16 of the Companies Act 2006 and to comparable legislation on audit reporting for other entities subject to the requirements of the 2006 Directive.

However, we are proposing that the new requirements on the audit report in the Regulation and all the requirements on the additional report to the audit committee should be reflected in changes to ISAs (UK and Ireland). This would have a number of implications:

- we would make legislative provision as necessary to make sure that the FRC as the single competent authority with responsibility for setting technical standards for auditing could exercise the Member State option to add to the content of the audit report.

- In combination with provisions being made by the FRC on the additional report to the audit committee we would also legislate in so far as necessary to make the FRC able to add to the content of the additional report by being able to implement the Member State option to do so under the Regulations;

- the requirements currently implementing the provisions in the 2006 Directive on the auditor's letter to the audit committee [36], would be repealed.

Questions

Q35. What issues, if any, do you consider arise from the inclusion in legislation on audit reporting of a requirement for the auditor to include a statement in the audit report where there is a material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern? How do you consider these should be addressed?

Q36. Do you agree that the provisions of Article 10 of the Regulation on the audit report should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

Q37. What issues, if any, do you consider arise from the application of the provisions of the Regulation on the audit report? If there are any, how do you consider they should be addressed?

[36] Article 42(1)(a) to (c) and Article 41(4) of the 2006 Directive which are implemented in paragraph 10B(2)(a), and (c) to (e) of Schedule 10 to the Companies Act.

Q38. Do you agree that the provisions in Article 11 of the Regulation on the additional report to the audit committee should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

Q39. What issues, if any, do you consider arise from the application of the provisions of Article 11 of the Regulation on the additional report to the audit committee? If there are any how should they be addressed?

Q40. For our impact assessment on the changes, we should particularly welcome data on:

(a) additional resources are likely to be needed by the auditor to produce the additional report for the audit committee?
(b) the additional annual cost of the audit committee considering the additional report?
(c) how these costs vary by size of PIE?

4.6 Further consultation – The small companies audit exemption thresholds

This chapter is an opportunity for further consultation on the audit exemption thresholds aligning with the increase in small companies accounting regime thresholds.

What are the changes?

BIS' consultation on the new Accounting Directive[37] showed general support for the idea we should consult later on increasing the thresholds for audit exemption in line with those for the small companies accounting regime. We are therefore taking the opportunity to consult now.

One option would be to maintain the current approach where the audit exemption thresholds automatically track those for the small companies accounting regime.

The simplest alternative would be for the small companies audit exemption thresholds in the UK to remain as they are, at least until the EU next increases the small companies accounting thresholds probably in three years' time[38]. This would mean that different thresholds would apply for small companies accounting and audit exemption purposes and also that further amendments would be needed to the Companies Act to insert a framework on specific audit exemption thresholds into Part 16 of the Act.

What will this mean?

The Government is of the view that the small companies audit exemption thresholds in the UK should be allowed to increase in line with those for the small companies accounting regime. This reflects:

- the longstanding process to align the thresholds;
- the view that even those companies between the current and increased thresholds would typically only have a small number of shareholders, who would normally be expected to take sufficient interest in the company to secure an audit when one was needed and to know, in any case, how the board had sought to prepare the accounts;
- the view that the value of audit, as a signal to lenders and investors that can reduce the cost of capital to the undertaking, is increased where that audit is voluntary rather than mandatory;

[37] Article 34 of the new Accounting Directive (2013/34/EU) requires that Member States ensure the accounts of "Public Interest Entities" (as defined for the purpose of that Directive) and of medium-sized and large companies and qualifying partnerships are audited by one or more statutory auditors or audit firms approved by Member States to carry out statutory audits on the basis of the 2006 Directive.

[38] The Accounting Directive was adopted in June 2013. Under the Directive a company is small if (using the maximum permitted values) it meets at least two of three criteria: Balance sheet total ≤ £5,100,000, Turnover ≤ £10,200,000, number of employees ≤ 50. The thresholds for balance sheet and turnover would represent an increase from those currently applicable in the UK which are: Balance sheet total ≤ £3,260,000, Turnover ≤ £6,500,000. Article 3(13) requires that the Commission review the thresholds used to determine a company's size at least every five years.

- the comparatively small number of undertakings that we think are affected – for the impact assessment on this change we identified approximately 7,400 companies.

What implementation is needed?

Implementation of the new Accounting Directive is continuing quickly in order to lay regulations on the mandatory changes to the Companies Act necessary for compliance. In the light of the consultation on the Accounting Directive and subject to final approval, those regulations will increase the thresholds for the small companies accounting regime to the EU maximum. If no further regulations are made the effect of that increase will also be to increase the thresholds that apply for the purpose of the small companies audit exemption. This is because the small companies audit exemption currently refers to the definition of a small company for accounting purposes.

We are now seeking views on whether to make further amendments, before the application date of 1 January 2016, to introduce separate and different thresholds for the purpose of the small companies audit exemption. We anticipate these amendments could be made by the end of 2015 if it was concluded this was the right thing to do following consideration of responses to this discussion document.

Questions

Q41. Do you consider that the small companies audit exemption thresholds should:

(a) remain aligned with those for the small companies accounting regime, so that the number of audit exempt small companies will increase in line with the increase in the small companies accounting thresholds;
(b) remain unchanged so that the turnover and balance sheet thresholds are considerably lower than the thresholds for access to the small companies accounting regime; or,
(c) be amended in some other way (please set this out)?

Please provide further information in support of your answer.

5. The proposals – Other changes

The new Directive and Regulation also make a number of more detailed changes to the audit regulatory framework to be implemented by the Government and the FRC via legislative and non-legislative changes.

Questions

In this chapter we have only asked specific questions under each section where the measures considered give rise to specific questions where your views would be particularly helpful. The following general questions apply in relation to all the measures discussed in this chapter.

Q42. What issues, if any, do you consider arise from the measures considered in this chapter? If there are any, how do you consider these should be addressed?

Q43. For our impact assessment, we would welcome any information you can provide on the expected costs and benefits of the measures considered in this chapter?

In addition we remind you that the general questions asked at the start of chapter 4 also apply to the measures discussed in this chapter.

5.1 Technical standards for statutory audits

This chapter is about changes in various technical standards for audit to strengthen the quality of audit and auditor scepticism.

What are the changes?

There are a number of provisions in the new Directive and Regulation[39] introducing new EU requirements on technical standards to be applied to statutory audits. Although many of the requirements already apply in the UK, some provisions will be needed in legislation for the purpose of implementation.

Regulation

Article 7 sets out the procedures to be followed by a statutory auditor who suspects irregularities in relation to the financial statements of a PIE. The FRC's International Standard for Auditing (ISA UK and Ireland) 240 ('The auditor's responsibility to consider fraud in the audit of financial statements') already addresses this issue, though some detailed changes are likely to be needed.

Article 8 requires the auditor of a PIE to undertake an Engagement Quality Control Review (EQCR) before issuing the report on the audit of a PIE and sets out detailed requirements in relation to that review. ISA (UK and Ireland) 220 ('Quality control for an audit on financial statements') and ISQC1 (UK and Ireland), which already reflect most of the requirements, are likely to require some amendment, for example on who can undertake the EQCR, on the documentation requirements and on changing some guidance material into standards.

Directive

Paragraph 18 of Article 1 of the Directive inserts new Article 24a into the 2006 Directive and sets out detailed provisions on the internal organisation of audit firms. There are already similar requirements in ISQC1 (UK and Ireland), though some changes are likely to be necessary to give full effect to the EU requirements.

Paragraph 19 of Article 1 of the Directive inserts new Article 24b into the 2006 Directive and sets out detailed provisions on the organisation of statutory audit work. Once again ISQC1 (UK and Ireland) already provides for most of the requirements now included in the Directive, though some changed, relating for example to the recording and documentation of information, are likely to be needed.

What will this mean?

The changes in the Regulation and Directive to the requirements for the conduct and organisation of statutory audits are substantial but the practical effect is likely to be modest, as

[39] Articles 7 and 8 of the Regulation set out new requirements for the conduct of the statutory audit of PIEs. Paragraphs 18, 19 and 20 of Article 1 of the Directive insert new Articles 24a, 24b and 25a into the 2006 Directive which set out requirements for the organisation and work of audit firms and for the scope of statutory audits. Most of the requirements are already reflected in the standards that apply in the UK.

the great majority of the new requirements are already reflected in UK auditing standards. That said, giving proper effect to the EU requirements will require some changes to auditing standards, the most significant of which are likely to be to the recording and documentation of specific information relating to the audit.

What implementation is needed?

Our preference is to follow the existing overall approach, under which the detailed standards and rules are made by an expert body and the law provides an effective framework for implementation. For the provisions inserted into the 2006 Directive, some underpinning provisions may be needed in legislation. The alternative approach - detailed regulations under the Companies Act requirements in a statutory instrument - is likely to be less efficient and more confusing. The FRC has carried out an initial assessment of EU requirements against UK auditing standards and will include detailed proposals as part of its forthcoming consultation on ethical and auditing standards.

Questions

Q44. Do you agree that the implementation of EU requirements on technical standards should be primarily through changes to the FRC's ISAs (UK and Ireland)? Please provide further information in support of your answer.

Q45. For the purpose of our impact assessment on the changes we would welcome any estimate you could provide of the percentage of PIE audits for which the quality control review will now have to be undertaken by an individual auditor from outside the appointed audit firm (where there is a lack of detachment from the audit or knowledge of the client sector) where this was not previously required?

5.2 Technical standards – International auditing standards

This chapter is about the adoption of international auditing standards in the EU and what changes could be made for their application in the UK.

What are the changes?

Article 1 Paragraph 21 of the Directive and Article 9 of the Regulation set out the framework for the adoption into EU law of international auditing standards.

"International auditing standards" are defined to mean International Standards on Auditing (ISAs), International Standard on Quality Control (ISQC 1) and other related Standards issued by the International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB) in so far as they are relevant to the statutory audit.

The new framework replaces Article 26 of the 2006 Directive. That framework provided for the EU-wide adoption of ISAs under delegated powers granted to the Commission, but adoption did not progress and is now expected under the new framework.

The changes can be summarised as follows:

- Member States must require statutory audits to be carried out in compliance with international auditing standards adopted by the Commission when their adoption occurs.

- Member States may apply national auditing standards, procedures or requirements as long as the Commission has not adopted an ISA covering the same subject-matter. This is the situation at present.

- However, Member States may impose procedures or requirements in addition to international auditing standards adopted by the Commission, if these national procedures or requirements are necessary to give effect to national legal requirements relating to the scope of statutory audits; or to the extent necessary to add to the credibility and quality of financial statements.

- Where a Member State requires the statutory audit of small undertakings, it may provide that application of the auditing standards is to be proportionate to the scale and complexity of the activities of such undertakings. Member States may take measures in order to ensure the proportionate application of the auditing standards to the statutory audits of small undertakings.

- The Commission may adopt international auditing standards for application within the EU in the area of audit practice, independence and internal quality controls of statutory auditors and audit firms. The Commission's adoption of international auditing standards is subject to a delegated acts procedure, set out in Article 48a of the Directive, and subject to agreement by the European Parliament and Council.

- The Commission may adopt the international auditing standards only if certain requirements are met; for instance, if the international auditing standards are conducive to the EU public good. The adopted international auditing standards will only be able effectively to amend or supplement certain specified requirements of the new EU Directive and Regulation (otherwise they cannot be adopted).

What will this mean?

Currently in the UK, ISAs and ISQC 1, as issued by the IAASB, are already adopted in practice by the FRC. This adoption includes some adaptations to augment the standards with additional requirements to address specific UK and Irish legal and regulatory requirements; and additional guidance that is appropriate in the UK and Irish national legislative, cultural and business context..[40]

The Directive and the Regulation oblige the Commission to convene meetings to seek the views of representatives of the EU Member States prior to adoption of ISAs. We and the FRC intend to assess whether further consistency will be needed between the ISAs (UK and Ireland) and the ISAs adopted in the EU during that process and in the light of the final ISAs as adopted by the Commission.

Further implementing measures, including in UK law, will also be developed, if needed at the time of adoption of ISAs by the Commission. In the meantime, the FRC will continue to have the discretion as to when and how to adopt new ISAs and any amendments to existing ISAs.

What implementation is needed?

There is no timetable for the adoption of international auditing standards. Implementation of the standards as adopted will only be possible when the Commission has adopted a delegated act in accordance with the procedures in the 2006 Directive[41] as amended.

We anticipate that, following any adoption, the FRC should continue to have the discretion it now has to apply standards where the (adopted) ISAs do not cover the same subject-matter; and to impose procedures or requirements in addition to adopted ISAs. However in future any additional procedures or requirements will only be applicable where the conditions in the Directive are met. The questions below seek views on this, as it may influence any amendments we make to the framework in which the FRC applies auditing standards.

Questions

Q46. What issues do you consider arise from the implementation of EU adopted ISAs in the UK that UK representatives should raise with the European Commission?

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[40] ISA 700 'Forming an Opinion and Reporting on Financial Statements', as issued by the IAASB has not been issued by the FRC. The applicable standard issued by the FRC is ISA (UK and Ireland) 700, 'The Independent Auditor's Report on Financial Statements' The main effect of this is that the form of auditor's reports may not be exactly aligned with the precise format required by ISA 700 issued by the IAASB. However, ISA (UK and Ireland) 700 has been drafted such that compliance with it will not preclude the auditor from being able to assert compliance with the ISAs issued by the IAASB.

[41] Article 48a of the 2006 Directive as inserted by Article 1 paragraph (37) of the new Directive.

Q47. Do you agree that following any adoption of ISAs by the European Commission, the FRC should have the discretion to:

(a) apply standards where the Commission has not adopted an ISA covering the same subject-matter; (Yes / No) and,
(b) impose procedures or requirements in addition to adopted ISAs if these national procedures or requirements are necessary to give effect to national legal requirements or to add to the quality of financial statements? (Yes / No)

Please provide further information in support of your answer.

5.3 Statutory audits of consolidated accounts

This chapter is about the processes for the preparation of consolidated accounts.

What are the changes?

Paragraph 22 of Article 1 of the Directive amends Article 27 of the 2006 Directive which sets out provisions for audits of the consolidated accounts of groups of undertakings.

These amendments clarify and extend the requirements in the 2006 Directive on audits of consolidated accounts. The main changes are:

a. the group auditor is required to document the nature, timing and extent of the audit work performed by other auditors for the purposes of the group audit;

b. the group auditor is required to seek the agreement of other auditors to the transfer of relevant documentation, as a condition of placing reliance on their work;

c. the group auditor must take appropriate action (e.g. carry out additional work) where they are unable to review the work performed by other auditors and must inform the relevant competent authority;

d. the group auditor must make available to the competent authority, in relation to an inspection or an investigation concerning the audit of the consolidated financial statements, audit working papers or other documentation relating to the work of other auditors for the purposes of the group audit.

e. the competent authority must have the ability to request additional documentation on the audit work performed by another auditor either from another EU competent authority or from the competent authority in a third country with which it has a cooperation agreement. Where there is no cooperation agreement the group auditor is responsible for ensuring that the relevant documentation can be obtained on request.

What will this mean?

Most of the changes in revised Article 27 are already reflected either in ISA 600 (UK and Ireland) (Special considerations - Audit of group financial statements (including the work of component auditors)), although the specific documentation requirements will need to be amended, or in rules made and applied by the professional supervisory bodies. However, there is currently no explicit requirement to inform the competent authority if the group auditor is unable to review the work performed by other auditors.

Our initial view is that the changes should not have a significant impact on individual group audits.

What implementation is needed?

Article 27 of the 2006 Directive is implemented at present by placing obligations on Recognised Supervisory Bodies to have in place rules and practices that ensure that group auditors meet the specific requirements of the Directive[42]. We propose to amend those provisions to reflect the changes to Article 27, within the revised framework for audit regulation. We also need to confirm that legislation gives the relevant UK competent authority adequate powers to request additional information from competent authorities in the EU and in third countries, and also to obtain necessary information from statutory auditors.

We also consider that it will be necessary to review ISA 600 (UK and Ireland) and the Regulations that apply to statutory auditors in the light of the detailed changes to Article 27.

[42] Paragraph 10A of Schedule 10 to the Companies Act.

5.4 Audit committees

This chapter is about changes to strengthen the effectiveness of audit committees of PIEs including of some non-listed PIEs.

What are the changes?

Article 1, paragraph 32 of the Directive sets out a new framework for audit committees, replacing that under Article 41 of the 2006 Directive with a new Article 39.

The new audit committee requirements apply to all PIEs ie to undertakings with securities admitted to trading on a regulated market and to other banks, building societies and insurers[43]. This is because the previous Article 39 of the 2006 Directive provided a Member State option to exempt PIEs that did not have securities admitted to trading on a regulated market from all the provisions of Chapter X of the Directive including Article 41 on audit committees. The whole of Chapter X is now replaced with a chapter containing this single new Article 39 framework on audit committees.

What will this mean?

For the implementation of the 2006 Directive, the requirements on the appointment and scope of the audit committees in Article 41(1) to (3) and (5) and (6)[44] were implemented via amendments to the Disclosure and Transparency Rules (DTRs) in the FCA Handbook[45]. This fitted with the scope of application of the requirements at that time in that they to undertakings with securities admitted to trading on a regulated market.

The implementation of the EU minimum requirements in the handbook was supported by the FRC's *Guidance to Audit Committees*. This approach was supported in response to public consultations conducted by the Government and the FSA (now the FCA). We are therefore considering the implications of continuing with that approach for listed entities..

The changes introduced by the audit committee framework are as follows:

a) Audit committees will be able effectively to be "stand alone committees" or a committee of the company board.

[43] Subject to the exemptions for certain PIEs provided previously in Article 41(6) of the 2006 Directive and now in Article 39(3) as inserted by the new Directive. These cover PIEs that are: subsidiary undertakings that fulfil the requirements of audit committees at group level; Undertakings for Collective Investment in Transferable Securities (UCITS); issuers of asset-backed securities; and banks whose shares are not admitted to trading on a regulated market and whose debt securities, if admitted to trading on a regulated market, have a total nominal value below €100,000,000. The only change in the exemptions under the new framework is that PIEs that are Alternative Investment Funds are exempted in the same way as for PIEs that are UCITS.

[44] Article 41(4) was implemented in the Companies Act rather than the DTRs as it placed obligations on the auditor rather than the audit committee. This requirement is now provided in Article 11 of the Regulation (see discussion on the new additional report to the audit report for the audit committee above.

[45] See DTR 7.1 in the Disclosure and Transparency Rules at http://fshandbook.info/FS/html/FCA/

b) Audit Committees may be composed of members who are either non-executive members of the board; others (who are not members of the board) who have been appointed by a general meeting of shareholders; or a combination of these.

c) A majority of members of the audit committee (including the chair) will be required to be independent (as opposed to the requirement for only one independent member in the previous Article 41), though this is subject to a new Member State derogation.

d) There is also a new requirement for the chair of the audit committee to be appointed either by the members of the committee, or by the board of the audited entity, although the MS may also require the chairman to be elected annually by a general meeting of shareholders.

The following changes are also introduced:

e) The committee members as a whole will need to have competence in the sector in which the audited entity operates.

f) The Member State derogation allowing PIEs that are Undertakings for Collective Investment in Transferable Securities to be exempted from the Audit Committee requirements is extended so that PIEs that are Alternative Investment funds may also be exempted.

g) The non-exhaustive list of responsibilities of the Audit Committee has been widened to include responsibilities to: inform the board of the outcome of the statutory audit and how it contributed to the integrity of financial reporting and what the committee's own role had been in the process; submit recommendations and proposals to ensure the integrity of the financial reporting process; and, while monitoring the audit, to take into account findings by the competent authority resulting from inspections of previous audits.

h) The list is clarified in that the audit committee's responsibility for monitoring the effectiveness of internal control and risk management systems, as well as where applicable the internal audit, need only cover those aspects relating to financial reporting and only in so far as would not breach the committee's independence.

Finally, the non-exhaustive list discussed in points (g) and (h) above is expanded to include responsibilities relating to requirements elsewhere in the reformed audit regulatory framework:

i) As it did under the 2006 Audit Directive, the audit committee must review and monitor the independence of the auditor. However this must be done in accordance with the enhanced requirements on auditor independence. The Regulation in particular places certain further responsibilities on audit committees relating to non-audit services.

j) The audit committee must also be responsible for the procedure (set out in Article 16 of the Regulation) for the selection of a statutory auditor under the new framework on tendering and selection of auditors of PIEs.

What implementation is needed?

For audit committees of entities with securities admitted to trading on a regulated market we have considered with the Financial Conduct Authority (FCA) whether it could implement the changes discussed above. FCA will therefore consult on implementing the changes as an update to the Disclosure and Transparency Rules (DTRs) in the FCA handbook. The amendments would be to DTR 7.1 in particular. We have agreed with the FCA and the FRC that the DTRs on Audit Committees would continue to be supported by the Guidance on Audit Committees, which the FRC issues under the Corporate Governance Code.

However, the DTRs only apply to entities with securities admitted to trading on a regulated market. Another mechanism will therefore need to implement the changes for other banks, building societies and other insurers. We have discussed with the Prudential Regulation Authority (PRA) whether it could include provisions on audit committees to implement the requirements in its rules. 2We have also discussed the Member State option in the 2006 Directive, as amended, to exclude unlisted banks and building societies from these provisions[46]. The PRA will be consulting separately in due course on these proposals.

Questions

Q48. What issues, if any, do you consider arise from the implementation of the new requirements on audit committees via amendments to the existing DTR 7.1 in the FCA Handbook (for companies with securities admitted to trading on a regulated market)?

Q49. What issues, if any, would you consider arise from the implementation via provisions in PRA rules of the new requirements on audit committees for those banks, building societies and insurers that are not required to have an audit committee under DTR 7.1?

Q50. For our impact assessment on the changes, we would welcome data on:

(a) the numbers of non-listed PIEs that currently do not have an audit committee?
(b) the cost of recruiting members to be part of an audit committee?
(c) the annual cost of attendance of a member?
(d) the auditor's fees for attending audit committee meetings?
(e) how these costs vary by size of PIE?

[46] The Member State option at Article 39(3)(d) enables the exemption from the audit committee requirements of any credit institution whose shares are not admitted to trading on a regulated market; for whom any debt securities issued on such a market have a total nominal value below 100,000,000 Euros; and which has not been subject to a requirement to publish a prospectus.

5.5 Regulatory reporting and information - Report to supervisors of PIEs

This chapter is about what information should be reported by auditors of PIEs to supervisory authorities of PIEs.

What are the changes?

Article 12 of the Regulation sets out information which auditors of PIEs must report to the competent authority supervising the entity (either the PRA or FCA) in the UK.

Article 12 of the Regulation confers a duty on auditors to report to supervisory authorities any information concerning a legal breach or breach of administrative rules by a PIE, doubt over the continuous functioning of an audited PIE or on the issue of a qualified auditor's report. This duty extends to auditors of entities with close links to the PIE.

It also provides the framework for communication between competent authorities supervising credit institutions and insurers and the auditors of those entities, as well as the auditors of systemically important financial institutions and the European Systemic Risk Board (ESRB)[47] and the Committee of European Audit Oversight Bodies (CEAOB) in Article 12(2).

What will this mean?

Auditors of PIEs will need to report the following eventualities to the PRA and FCA in relation to any PIE they audit, if and when they arise:

- a breach of the listing rules, licensing rules, or other provisions governing the "authorisation" of a PIE;
- a material threat or doubt about the continuous functioning of the PIE;
- the issuing of qualified audit report.

What Implementation is needed?

For banks, building societies and insurers, we consider these requirements are already implemented via a combination of:

- the Financial Services and Markets Act 2000 (Communications by Auditors) Regulations 2001 (SI 2587/2001), which are made under section 342 of the Financial Services and Markets Act 2000 (FSMA); and,

[47] A high level group established by the European Commission to monitor the financial system within the EU and provide information to the council. For more information see: https://www.esrb.europa.eu/about/tasks/html/index.en.html

- the PRA Code for auditor-supervisor engagement issued under section 339A(2) of the Financial Services and Markets Act 2000.

We are considering what implementation of these requirements will be needed for other PIEs that are not banks, building societies or insurers.

As these requirements are included in a directly applicable Regulation, no legislative implementation is needed. However, we are considering whether legislative provision is needed in order to allow the single competent authority to receive this information along with the PRA and FCA.

Questions

Q51. Do you consider that the single competent authority with responsibility for regulation of audit should be designated to receive the information required to be provided to supervisors of PIEs when it is provided to:

(a) the PRA for banks, building societies and insurers?
(b) the FCA for other PIEs? or
(c) both?

Q52. For the purpose of our impact assessment on these changes we should be grateful for any estimates you can provide of:

(a) the costs of the auditor providing this information to supervisors of PIEs?
(b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?
(c) the frequency with which the FCA is provided with this information for other PIEs in practice already?

5.6 Transferring information and confidentiality of information

This chapter is about the transfer of information between incumbent auditors and their successors, and confidentiality requirements on competent authorities.

What are the changes?

Article 18 of the Regulation requires the auditor of a PIE on leaving office to make information on the audit available to the successor firm. This reflects existing requirements in the 2006 Directive but extends them so that information included in the additional report to the audit committee, the transparency report and reports by the auditors to supervisors of PIEs must also be made available to the successor firm.

Article 22 of the Regulation imposes a confidentiality requirement on competent authorities, authorities to which tasks have been delegated and their employees and associates.
It reflects a similar provision in Article 36(2) of the 2006 Directive, though makes clear this applies both to competent authorities (and their employees and associates) and to a body to which tasks have been delegated.

Paragraph 17 of Article 1 of the Directive amends existing provisions in Article 23 of the 2006 Directive, to clarify the position on information transfers in the circumstances of a group audit and of an audit of a company which has issued securities in a third country. The amendments make clear that:

(i) the general rules on confidentiality do not prevent the transfer of information to a third country to enable the group auditors to carry out their work; but,

(ii) any transfer of audit working papers to a third country must be in accordance with the rules on such transfers in Article 47 of the 2006 Directive.

What will this mean?

We consider that these provisions make only minor changes to the existing position in the UK:

- There are already obligations in rules applied to auditors in the UK on outgoing auditors to make all relevant information available to incoming auditors; and on record keeping. Schedule 10 to the Companies Act imposes an obligation on RSBs to have rules on handover files and a similar provision may be needed on record keeping.

- The detailed provisions in Section 1224A of the 2006 Act address this specific issue and we consider it is unlikely that the new requirements will have a substantive effect.

- The clarifications made to Article 23 of the 2006 Directive are helpful but reflect the UK interpretation and we consider it unlikely that they will have a substantive effect in practice.

What implementation is needed?

We consider that providing for and implementing these changes requires only minor changes to the 2006 Act, related regulations and regulatory requirements.

We will consider:

- whether a minor change is needed to the requirement in Schedule 10 to the Companies Act, to make it fully consistent with Article 18 of the Regulation;
- whether detailed changes are needed to Section 1224A of the 2006 Act to make it fully consistent with Article 17 of the Regulation;
- whether a specific provision should be made the 2006 Act to make it clear that broader confidentiality restrictions do not prevent the transfer of information for the purposes of carrying out a group audit.

Finally, in relation to Article 15 of the Regulation, which requires statutory auditors to keep all the documentation related to a statutory audit of a PIE for a period of at least five years and allows Member States to set a longer period, we will consider whether provision is needed to make sure breaches of Article 15 of the Regulation can result is sanctions under the rules applied to statutory auditors by the professional supervisory bodies.

5.7 Dismissal of auditors

This chapter is about which groups, and the circumstances in which these groups, can seek the dismissal of auditors.

What are the changes?

Article 1 Paragraph 31 of the Directive[48] introduces new rights for minority shareholders and regulators to seek the dismissal of statutory auditors of PIEs.

The paragraph sets out that Member States are to ensure that it is possible for certain groups to bring a claim before a national court for the dismissal of statutory auditors of PIEs where there are proper grounds for doing so. These groups are:

- Shareholders representing five per cent or more of the voting rights or of the share capital.
- Other bodies of audited entities when this is provided by national legislation.
- Members States' competent authorities.[49]

What will this mean?

The changes set out in Article 1 Paragraph 31 of the Directive create new powers for shareholders and 'competent authorities' to go to court to seek the dismissal of the auditor of a PIE where there are 'proper grounds'.

The issue of what constitutes 'proper grounds' is important as the intention is not put at risk the independence of the auditor by enabling claims to be brought by PIEs seeking to secure a more favourable audit report. In this context it should be noted that Article 38 of the existing Directive 2006/43/EC sets out that divergence of opinions on accounting treatments or audit procedures shall not be 'proper grounds' for dismissal.

What implementation is needed?

The Government is considering amending the Companies Act 2006 to include the changes set out by the Directive in relation to public-interest entities. In doing so, the Government does not propose to go beyond the terms of the Directive, or to prescribe what may constitute 'proper' or 'improper' grounds for the dismissal of auditors, other than to state that divergence of opinions on accounting treatments or audit procedures shall not be 'proper grounds'.

The present position in UK law, which will be unchanged, is that the auditor can be removed from office for any reason, but only by ordinary resolution (simple majority) at a meeting of shareholders.

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[48] This provision inserts a new paragraph 3 into Article 38 of the 2006 Directive.
[49] As defined in Article 32 of the 2006 Directive, as amended by the new Directive, or designated in accordance with Article 20 of Regulation (EU) No 537/2014.

Furthermore, the Government does not consider that the provisions of Article 38(3) of the 2006 Directive, as amended by the new Directive, need be applied in the UK for any “other bodies of audited entities” beyond “shareholders representing five per cent or more of the voting rights”.

5.8 Recognition of statutory auditors from another Member State

This chapter is about the circumstances in which an auditor approved in one Member State can provide audit services in another Member State

What are the changes?

The Directive makes changes to the arrangements for the registration of both audit firms and individual auditors from another Member State.

Audit firms

New Article 3a[50] of the 2006 Directive provides for an audit firm already approved in one Member State (the home Member State) to provide audit services in another Member State (the host Member State) but only where:

i. The firm registers in the host Member State in accordance with the Directive requirements

ii. The individuals responsible for carrying out statutory audits on behalf of the firm in the host Member State meet the requirements in the host Member state for registration as an individual statutory auditor.

The amended Article 34 of the 2006 Directive makes the host Member State responsible for oversight of any audit carried out in the host Member State by such an auditor.

Individual auditors

The new Directive amends the framework in the 2006 Directive[51] for the approval of an individual already approved in another Member State as a statutory auditor. The amended framework retains the requirement for the individual to register. However it gives Member States the option of allowing or requiring that individual to complete an adaptation period rather than to pass an aptitude test, which is the existing requirement.

An adaptation period is a period of supervised practice and training under the responsibility of a qualified auditor in the host Member State of no more than three years and is subject to an assessment. The aptitude test is a test of the professional knowledge, skills and competences of the applicant, carried out by the competent authorities of the host Member State to assess the ability of the individual to pursue a regulated profession in that Member State. It tests in particular the individual's knowledge of UK company law and tax law.

What will this mean?

Audit firms

[50] Inserted by paragraph 4 of Article 1 of the new Directive
[51] Paragraph 10 of Article 1 amends existing requirements in Article 14 of the 2006 Directive

The changes facilitate an audit firm from one Member State to carry out statutory audits in another Member State. However, this stops short of providing a full freedom to provide audit services across EU borders.

Individual auditors

At present a small number of individual EU statutory auditors gain approval in the UK by taking an aptitude test. Providing for the alternative of an adaptation period brings the requirements in the 2006 Directive more closely into line with the provisions of Directive 2005/36/EC on the recognition of professional qualifications but is unlikely to have a significant effect on the registration of individual EU auditors in the UK

What implementation is needed?

Audit firms

We propose to provide for the registration of an audit firm approved in another Member State by amending the statutory provisions on eligibility for appointment as a statutory auditor, at present in paragraph 6 of Schedule 10 to the 2006 Act.

Individual auditors

We are considering whether the single competent authority should be able to determine, following consultation, whether, in order to register as eligible for appointment as a statutory auditor, an EEA auditor should be subject to an aptitude test or to an adaptation period, or whether the auditor should be able to choose which process to follow. We are also considering what the implications would be for the operational provision of aptitude tests and / or potentially adaptation periods.

This will facilitate a common approach in the UK and enable the single competent authority, as the UK member of the Committee of European Audit Oversight Bodies (CEAOB), to cooperate within the framework of the CEAOB "with a view to achieving a convergence of the requirements of the adaptation period and the aptitude test", as required by Article 14.3 of the amended 2006 Directive.

Questions

Q53. Do you agree that we should enable the single competent authority to exercise the choices of aptitude test and/or adaptation period for the approval in the UK of individual statutory auditors from other Member States? Please provide further information in support of your answer.

Q54. Were the single competent authority to have this role, what do you consider would be the implications for the operational provision (currently by the professional supervisory bodies) of:

(a) aptitude tests; and
(b) adaptation periods (if these were to be provided for)?

How do you think this would be affected by CEAOB discussions “with a view to achieving a convergence of the requirements of the adaptation period and the aptitude test” across the EU?

5.9 Quality assurance of statutory auditors

This chapter is about the regime for inspection of auditors and changes to who conducts inspections and their frequency.

What are the changes?

Article 26 of the Regulation sets out requirements for the inspection of audits of PIEs, whilst Article 29 of the 2006 Directive, as amended by Article 1, paragraph 24 of the Directive, continues to apply to the inspections of audits of non-PIEs[52]. The changes to what must be included as a PIE (see Section 6) and the new requirements on the responsibilities of competent authorities (see Section 7) also affect the respective inspection responsibilities of the FRC and the recognised professional bodies.

The main changes are:

- inspections of all audits of PIEs will have to be conducted by the single competent authority with ultimate responsibility for the regulation of auditors;
- with the removal of the option to exclude unlisted entities from the definition of a PIE, the range of entities within the scope of the PIE inspection regime is increased to include unlisted banks and insurers;
- the frequency of inspections is unchanged for an auditor of a large PIE (at least every 3 years);
- the increased range of PIEs is likely to bring more audit firms within this three year cycle;
- on the other hand, the required frequency of inspections of auditors of those PIEs that come within the EU definitions of small[53] and medium sized companies[54] is reduced (from at least once every 3 years to at least once every 6 years);
- Article 29 of the 2006 Directive, as amended, which applies only to non-PIE audits, excludes from the six year inspection cycle those firms that audit only small undertakings. The frequency of inspections needs to be determined on a risk basis;

[52] Article 1 paragraph 1 of the Directive amends Article 1 of the 2006 Directive to make clear that Article 29 of the 2006 Directive on inspections of statutory auditors no longer applies to audits of PIEs.
[53] Under the EU Accounting Directive (2013/34/EU) a company is small if (using the maximum permitted values) it meets at least two of three criteria: Balance sheet total ≤ £5,100,000, Turnover ≤ £10,200,000, number of employees ≤ 50. We are seeking views in this discussion document on whether the these increased turnover and balance sheet thresholds should be implemented in the UK for the purpose of the small companies audit exemption in the Companies Act.
[54] Under the EU Accounting Directive (2013/34/EU) a company is medium-sized if it meets at least two of three criteria: Balance sheet total ≤ £18,000,000, Turnover ≤ £36,000,000, number of employees ≤ 250.

- for all inspections, there is a move to a "risk based" assessment of the frequency of inspections, reflecting existing FRC practice; and

- There are additional requirements, in respect of both inspections of PIE and non-PIE audits, on the detail of how inspections are to be organised and what they must cover.

What will this mean?

The main points are:

- auditors of unlisted insurance companies that do not also audit listed entities will come within the scope of inspection by the single competent authority, where they have not previously been subject to FRC inspection. However, auditors of unlisted banks and large private insurance companies[55] are already within the scope of FRC inspection because they are at present classified by the FRC as "major audits"[56];

- it will not be open to the single competent authority to delegate to the recognised professional bodies the inspections of auditors of less than ten PIEs, as presently permitted for the FRC under the Companies Act[57];

- it will, however, be open to the single competent authority to lengthen the inspection cycle from 3 to 6 years for auditors that only audit PIEs that come within the EU thresholds for small and medium sized undertakings. This may present a suitable opportunity to revisit the inspection cycle for auditors of non-PIE major audits, which at present is at least once every three years;

- the Regulation does not otherwise affect the existing arrangements for the inspection of non-PIEs that come within the definition of "major audit";

- removing the requirement for the minimum six year inspection cycle for firms that audit only small non-PIE undertakings, if applied in the UK, would provide greater flexibility to the professional supervisory bodies to apply a risk-based model to their inspection programmes.

- the additional requirements on the conduct and scope of inspections are unlikely to have a significant effect on current UK practice.

If it is concluded that the FRC should take on the role of the single competent authority, then we would expect it to consult in in due course on the scope of application of the revised framework.

[55] Turnover greater than £500 million
[56] See definition in paragraph 13 of Schedule 10 to the Companies Act. These are entities "in whose financial condition there is a major public interest".
[57] Paragraph 23(1C) of Schedule 10 to the Companies Act

What implementation is needed?

We propose, in the context of changes to the overall statutory framework of audit regulation, to make provision to ensure that the framework is:

- compatible with Article 26 of the Regulation; and
- gives effect to specific new requirements in Article 29 of the 2006 Directive, as amended.

5.10 Competent authorities – Investigations, sanctions and powers

This chapter is about measures to investigate and deter inadequate execution of statutory audits

What are the changes?

Article 1 paragraph 25 of the new Directive inserts seven new articles into the Directive (Articles 30 to 30f) which replace the existing Article 30.

Currently, the 2006 Directive requires simply that Member States ensure that there are "effective systems of investigation and penalties to detect, correct and prevent inadequate execution of the statutory audit"[58]. As amended, the 2006 Directive continues to include this but goes on to specify minimum requirements in terms of sanctioning powers, sanctions guidance, publicity, appeals and reporting of breaches.

These requirements apply to statutory auditors and audit firms in respect of all statutory audits.

There are a number of Member State options:

i. Member States may decide not to lay down rules for administrative sanctions for infringements that are already subject to national criminal law (Article 30(2))

ii. Member States may confer on the relevant competent authorities sanctioning powers in addition to those specified in the Directive (Article 30a(3)).

iii. Member States may specify in law "factors" that competent authorities may take into account in determining the type and level of administrative sanctions imposed on auditors. These factors would be additional to "all relevant circumstances", which must be taken into account (Article 30b subparagraph 2).

iv. Member States may permit the publication of sanctions which are subject to appeal. (Article 30c(1))

v. Member States may provide that the disclosure / publication of sanctions and measures imposed on audit firms and statutory auditors, and any related public statements, shall not contain personal data (Article 30(3) and Article 30c(3))

Article 23 of the Regulation applies only to audits of PIEs. It sets out the powers the single competent authority must have in respect of auditors of PIEs and related third parties. These powers include the power to access data from statutory auditors and audit firms and to obtain information relating to a statutory audit from any person. It refers to taking administrative measures and imposing sanctions by cross-referring to the provisions in the Directive and does not impose additional or separate requirements in this area.

[58] Article 30(1) of the 2006 Directive both before and after amendment by paragraph 1(25) of the new Directive.

Article 23's main purpose is to grant specific powers to the single competent authority in respect of statutory audits of PIEs. It enables the single competent authority to carry out onsite inspections and investigations, to refer matters for criminal prosecution and request experts to carry out verifications of investigations.

These new powers can not only be used in relation to those carrying out statutory audits of PIEs, but also their affiliates, related third parties and those to whom certain functions in relation to the statutory audit have been outsourced.

What will this mean?

Under the existing arrangements for audit regulation both the FRC and the professional supervisory bodies have responsibilities for the investigation and sanctioning of statutory auditors. Whilst there may be significant changes to the structure of audit regulation following implementation of the Directive, it is likely that both the single competent authority, and the professional supervisory bodies will continue to have such responsibilities, either directly by law or, in the case of the bodies, as a result of a delegation by the single competent authority, to them.

We expect therefore that both the single competent authority, and the relevant bodies will need to ensure that their arrangements for investigating and sanctioning statutory auditors meet the Directive requirements.

Our initial view is that the new Articles are unlikely to require major changes to the existing arrangements but each relevant body will need to review its rules, regulations and guidance against the requirements of Articles 30a to 30d, in particular:

- The administrative measures and sanctions that must be available (Article 30a)
- The relevant circumstances that must be taken into account in determining the type and level of sanctions (Article 30b)
- The requirements on publication (Article 30c)
- The requirement for a right of appeal (Article 30d)

Auditors of PIEs

The single competent authority will need to be provided with all the powers set out in Article 23 of the Regulation to enable it to exercise all the supervisory and investigatory functions in relation to audits of PIEs under the Regulation.

What implementation is needed?

Articles 30 to 30f of the Directive

The possible changes to this part of the regulatory structure are discussed above. However, regardless of those changes, we need to consider:

- how best to set out the detailed provisions in Articles 30 to 30f in legislation; and,

- whether to give effect to the Member State options.

Our initial view is that proper implementation of the Directive requires that the detailed Directive requirements are reflected in legislation, as setting the minimum requirements which the systems of investigation and sanctions of both the single competent authority and the professional supervisory bodies must meet.

While implementation of most of the new provisions would appear to be possible through additional provisions on inspections, investigations and discipline, we are considering what further provision if any is needed for Article 30e on reporting of breaches. Our initial view is that any further provision for this Article is already in place through a combination of the provisions on confidentiality of audit regulatory information[59] and the framework on employee protections for public interest disclosures[60].

On the Member State options:

i. We are not persuaded of the merits of excluding infringements that are already subject to criminal law from the scope of administrative sanctions. However, we should welcome views on this.

ii. Our understanding is that the sanctions set out in the Directive are not comprehensive and that we should ensure that competent authorities or other authorised bodies retain the ability to apply other sanctions. We would welcome views on this point.

iii. We do not consider it will be necessary to specify in law "additional factors" that may be taken into account in determining administrative sanctions (as provided for in Article 30b of the 2006 Directive, as amended) but should welcome views on this point.

iv. Our understanding is that the current publications policies, for example those of the FRC, currently allow for the publication of sanctions that are subject to appeal. We propose to retain the current position.

v. We do not consider that there is need to make specific provision on the publication of personal data, as this is covered by legislation of general application on protection of such data.

Article 23 of the Regulation

Although Article 23 is contained in a directly applicable EU regulation, in order to create "an effective system of public oversight for statutory auditors and audit firms" the powers mentioned in Article 23 will need to be provided for in legislation.

[59] Sections 1224A and B of the Companies Act and Schedule 11A to that Act.
[60] Part IVA of the Employment Relations Act 1996 and the Public Interest Disclosure (Prescribed Persons) Order 2014 (SI 2014/2418), which specifically covers disclosures to the FRC on audit matters – see http://www.legislation.gov.uk/uksi/2014/2418/introduction/made .

The UK has mostly implemented the existing Directive in Part 42 of the Companies Act 2006 and related secondary legislation. However it is also possible that these powers could be implemented in “stand alone” regulations implementing the new EU legal requirements.

In either case these powers will need to be available to the single competent authority to enable it to carry out all the supervisory and investigatory responsibilities under the Regulation, particularly in relation to quality assurance of audits of PIEs and for investigations and discipline of auditors of PIEs in the new statutory framework we are proposing to introduce for these regulatory tasks.

5.11 Cooperation between competent authorities within EU

This chapter is about the formation and role of a new committee to act as a pan European body to facilitate cooperation between competent authorities within the EU

What are the changes?

Regulation

Articles 29 to 33 of the Regulation set out new arrangements for cooperation amongst the competent authorities of Member States responsible for the tasks in the Regulation and for cooperation between those authorities and other European supervisory authorities.

The principal change made is to establish a new Committee of European Auditing Oversight Bodies (CEAOB). The CEAOB, which comprises the competent authorities (one of whose representatives will chair it), a vice-chair appointed by the European Commission and a representative of the European Securities and Markets Authority, replaces the existing Commission chaired European Group of Auditor Oversight Bodies.

Article 29 places a general obligation on competent authorities to cooperate with one another; Article 30 sets out the arrangements for the CEAOB and its detailed responsibilities; Article 31 sets out requirements for cooperation between competent authorities in respect of quality assurance reviews and investigations, which broadly mirror existing requirements on cooperation in Article 36 of the 2006 Directive; Article 32 enables competent authorities in a number of Member States to establish colleges of regulators for the purposes of quality assurance reviews or investigations within the framework of the CEAOB; Article 33 provides for a competent authority in the home Member State to delegate a task to a competent authority in another Member State, though it must retain overall responsibility.

Directive

The Directive makes minor changes to the requirements on cooperation between competent authorities, largely to align those requirements with other changes in the new Directive:

i. Paragraph 5 of Article 1 makes a consequential amendment to Article 5(3) of the 2006 Directive, which requires a competent authority to notify other Member States in which an auditor is registered if the approval of that auditor is withdrawn for any reason. The amendment adapts that notification of a withdrawal, in the light of changes to cross border registration of audit firms.

ii. Paragraph 27 of Article 1 amends Article 34 of the 2006 Directive which sets out requirements for mutual recognition of regulatory arrangements in other Member States and the principle of home country regulation and oversight. The amendment provides, in the case where an audit firm is approved in one Member State and performs audit services in another Member State (in accordance with provisions in the new Article 3a of the 2006 Directive), that the host Member State shall exercise oversight over any audit carried out there.

iii. Paragraph 29 of Article 1 amends Article 36 of the 2006 Directive, which places responsibilities on competent authorities to cooperate with competent authorities in other Member States. The amendment (i) ensures that the obligation of professional

secrecy applies to anyone to whom a competent authority has delegated tasks and (ii) gives a Member State the option of allowing a competent authority to share otherwise confidential information with European financial authorities.

What will this mean?

Establishing the CEAOB in place of the EGAOB marks a step change in the practical cooperation on audit within the EU beyond that which has taken place since 2006 under the EGAOB arrangements. The main responsibilities of the CEAOB will be to:

> (a) facilitate the exchange of information, expertise and best practices for the implementation of this Regulation and of Directive 2006/43/EC;
>
> (b) provide expert advice to the Commission as well as to the competent authorities, at their request, on issues related to the implementation of this Regulation and of the 2006 Directive as amended.

The Government welcomes this further enhancement to the contribution that cooperation amongst European audit regulators makes to delivering high quality statutory audit across the EU. Setting up the CEAOB so that it is in a position to start work effectively from 17 June 2016 is a matter for the competent authorities across the EU and the European Commission. The FRC is already closely engaged in this process.

The other changes made by the Regulation and the Directive that affect cooperation between competent authorities are minor or are consequential on other changes and do not change the essential basis for and nature of regulatory cooperation.

What implementation is needed?

Regulation

No provision in UK law is necessary to provide for the establishment of the CEAOB or for other provisions in Articles 29 to 33, all of which are addressed to the competent authorities. However, we need to ensure that no existing statutory requirement prevents the competent authority from cooperating in accordance with the Regulation.

Our initial view is that the existing provisions on cooperation (sections 1253A to 1253C of the 2006 Act) and the restrictions on disclosure (section 1224A and Schedule 11A of the 2006 Act) do not require amendment to enable the competent authority to meet its obligations under Articles 29 to 33. However, we would welcome views on whether any changes are necessary.

Directive

We propose to make only minor changes to the Companies Act to implement the changes on cooperation in the Directive.

i. **Notification of Withdrawal of Registration to another Member State**. At present the law requires the Recognised Supervisory Body to notify this information to the FRC

(Section 1223A) and the transmission of this information to the EU competent authority is then its responsibility (Section 1253C). We do not propose to change this approach, to make it clear it is subject to the requirements of the Directive in so far as it applies to PIEs.

ii. **Oversight over audit carried out by auditor approved in another Member State** Our view is that no change to the Companies Act is needed, as an audit firm approved in another Member State must nevertheless register in the UK in order to be able to undertake statutory audit work.

iii. **Member State Option to enable sharing of information with European financial authorities.** We propose to provide for this by an amendment to Part 2 of Schedule 11A to the Companies Act.

5.12 Cooperation of competent authorities with third countries

This chapter is about cooperation agreements between EU competent authorities and competent authorities in third countries, and requirements on the audit of third country issuers

What are the changes?

Regulation

Articles 36 to 38 of the Regulation set requirements in respect of cooperation agreements entered into between the single competent authority and competent authorities in third countries.

Article 36 of the Regulation allows a competent authority to enter into a cooperation agreement with a third country only if (i) information disclosed under such an agreement is subject to strict confidentiality requirements, (ii) information exchanged is necessary for the tasks under the Regulation, (iii) any transfer of information meets EU requirements on the transfer of personal data and (iv) any transfer of audit working papers and other related documents is in accordance with the requirements of the 2006 Directive, as amended.

Article 37 allows an EU competent authority in receipt of confidential information received under such a cooperation agreement to disclose it to another party only (i) with the agreement of the third country authority and for purposes agreed by that authority, or (ii) where disclosure is required by law. Article 38 sets broadly equivalent requirements for information that is transferred by an EU competent authority to a third country authority.

Directive

Paragraphs 33, 34 and 35 of Article 1 of the Directive make limited changes to Articles 45,46 and 47 of the 2006 Directive on the regulation and oversight of auditors from outside the European Economic Area[61] (EEA) and set requirements for the transfer of audit working papers and other related documents to competent authorities in third countries. .

i. Paragraph 33 makes minor and consequential amendments to Article 45 of the 2006 Directive, which sets requirements for the registration and oversight of auditors of third country[62] issuers The most significant change is to raise the threshold for a large debt securities issuer, above which the issuer is outside the scope of the EU regulatory requirements. This brings this into line with a similar exemption in the Transparency Directive.

ii. Paragraph 34 makes minor changes to Article 46, which allows the disapplication of regulatory requirements on third country auditors where they are subject to regulatory requirements in their home country assessed as equivalent to those applied in the EU.

iii. Paragraph 35 amends Article 47 of the 2006 Directive, which sets out the preconditions for the transfer of audit working papers and related documents to the competent

[61] The European Economic Area comprises the Member State of the EU + Norway, Iceland and Lichtenstein.
[62] Third country = non-EEA country.

authorities of a third country. The amendments (i) expand the scope of the papers covered under Article 47 to include inspection and investigation reports on specific statutory audits and (ii) add a requirement that cooperation agreements must ensure that the commercial interests of an audited entity are protected.

What will this mean?

The changes in the Directive to Articles 45 and 46 of the 2006 Directive will have only a minor effect on the regulation of third country auditors. Setting a higher threshold for third country debt issuers that are outside the scope of Article 45 will increase the number of issuers and auditors subject to the EU requirements. Our initial estimate is that the effect is small, bringing only a small number of issuers into scope, all of which are established outside the EU, along with their auditors.

The new provisions on cooperation and the sharing of information in the Regulation are largely consistent with existing arrangements in the UK for such cooperation and for entering into cooperation agreements with third countries. However, the restrictions on the onward sharing of confidential information may necessitate the FRC as the competent authority renegotiating some existing cooperation agreements with third countries.

The only significant effect of the changes to Article 47 of the 2006 Directive will be to prevent the FRC from sharing inspection reports and reports on investigations of statutory auditors with competent authorities in third countries in the absence of a cooperation agreement.

What implementation is needed?

We consider that only minor changes are needed to the existing statutory framework set out in Sections 1253A to 1253F on the 2006 Act.

We propose:

i. to amend Regulation 43 of the Statutory Auditors and Third Country Auditors Regulations 2007 (SI 2007/3494) to reflect the revised threshold for a large debt securities issuer;

ii. to amend Section 1253E of the 2006 Act to bring it into line with the requirements of Article 37 of the Regulation (onward transfer of confidential information) and the changes to Article 47 of the Directive (to bring inspection and investigation reports within scope, to require cooperation arrangements to ensure that the commercial interests of an audited entity are protected, and to align the grounds for refusing a request for a transfer of information).

5.13 Monitoring market quality and competition

This chapter is about the role of competent authorities in relation to the functioning and progression of a competitive audit market for PIEs.

What are the changes?

Article 27 of the Regulation sets out that the European Competition Network (ECN)[63], and Member States' competent authorities, shall regularly monitor the developments in the market for providing statutory audit services to public-interest entities (PIEs). The relevant competent authority in the UK would be the single competent authority under the Directive and Regulation. In particular, the Article states that the ECN and competent authorities shall assess:

(a) the risks arising from high incidence of quality deficiencies of a statutory auditor or an audit firm, including systematic deficiencies within an audit firm network, which may lead to the demise of any audit firm, the disruption in the provision of statutory audit services whether in a specific sector or across sectors, the further accumulation of risk of audit deficiencies and the impact on the overall stability of the financial sector;

(b) the market concentration levels, including in specific sectors;

(c) the performance of audit committees (ACs);

(d) the need to adopt measures to mitigate the risks referred to in point (a).

The Article also states that by 17 June 2016, and at least every three years thereafter, each competent authority and the ECN shall draw up a report on developments in the market for providing statutory audit services to PIEs.

What will this mean - what implementation is needed?

As a requirement in an EU Regulation Article 27 is directly applicable and does not require any implementation in UK law.

[63] The ECN has been established as a forum for discussion and cooperation of European competition authorities. Link to ECN website: http://ec.europa.eu/competition/ecn/more_details.html.

6. What happens next?

The Government will consider responses to this discussion document after the closing date for responses on **19 March 2015**.

We will then develop detailed proposals for the implementation of the Directive and to provide for the application of the Regulation via regulations under the European Communities Act 1972 and other powers. The regulations will include amendments to primary legislation including the Companies Act 2006.

A formal consultation on draft regulations will be published in summer 2015.

Annex A: Table linking discussion document chapters to Regulation and Directive Articles

Chapters 4 and 5 have been set out in a way that combines similar topics in the Directive and Regulation. But some of these topics are more substantial than others. To make it easier to navigate chapters 4 and 5, the table below shows which Articles of the Regulation and paragraphs of Article 1 of the Directive are covered by each of the sections of chapters 4 and 5.

Chapter	Topic	Regulation Article	New Directive Paragraph (of Article 1)	2006 Directive Article amended
4.1	Audits of Public Interest Entities and application of the Regulation and Directive	1, 2	1, 2	1,2
4.2	The proposals – Audit fees and non-audit services	4, 5, 13 + 14	14, 15 + 16	22, 22a + 22b
4.3	The proposals - Tendering and duration of audit engagements	16, 17 + 41	30	37
4.4	Competent authorities – Designation and delegation of tasks	20, 21, 24, 25, 26	3, 26, 28	3, 32 + ~~35~~
4.5	Audit reporting and additional reporting to the audit committee	10 + 11	23	28
5.1	Technical Standards for Statutory Audit	7 + 8	18, 19 + 20	24a, 24b + 25a
5.2	Technical Standards – International Standards for Auditing	9	21	26
5.3	Statutory audits of consolidated accounts		22	27
5.4	Audit Committees		32	39 + ~~41~~
5.5	Regulatory Reporting and Information – Report to Supervisors of PIEs	12		
5.6	Transferring information and Confidentiality of Information	15, 18 + 22	17	23

Chapter	Topic	Regulation Article	New Directive Paragraph (of Article 1)	2006 Directive Article amended
5.7	Dismissal of auditors	19	31	38
5.8	Recognition of statutory auditors from another Member State		4 + 10	3a + 14
5.9	Quality Assurance	26	24	29
5.10	Competent authorities – Investigations, sanctions and powers	23	25	30 to 30f
5.11	Cooperation between Competent Authorities within EU	29, 31 + 33	5, 27 + 29	5, 34 + 36
5.12	Cooperation of competent authorities with third countries	36, 37 + 38	33, 34 + 35	45, 46 + 47
5.13	Monitoring Market Quality and Competition for PIEs	27		

Note: Chapter 4.6 “Further consultation – The small companies audit exemption thresholds” covers Article 34(1) of the new Accounting Directive (2013/34/EU)

Annex B: Questions asked in this discussion document

Questions from chapter 4

Q1. In relation to the measures discussed in both this and the next chapter, we would welcome comments on the balance between legislative and non-legislative implementation of the requirements of the new Directive and Regulation.

Q2. In relation to all the Member State options in the Directive and the Regulation, we would welcome comments to inform our thinking on whether and how these should be taken up. Though many are discussed in this document and in specific questions, all the options in the Directive and Regulation are considered in the options tables that are being made available separately.

Q3. In relation to the measures discussed in both this and the next chapter, what issues do you think arise that have not been considered as part of the discussion? If there are any, how do you think these should be addressed?

Q4. In relation to the measures discussed in both this and the next chapter, we would welcome comments on any burdens applied to small and micro sized companies and audit firms in particular by the proposed implementation, which you consider are disproportionate to the wider benefits?

Q5. Do you agree that the Government should not expand the definition of a PIE beyond the EU minimum requirement – that is listed companies, banks, building societies and insurers? Please provide further information in support of your answer?

Q6. What issues, if any, do you consider arise from the application of the provisions of the Regulation to audits of PIEs as defined in the Directive? How do you consider these should be addressed?

Q7. What issues, if any, do you consider arise from the need to broaden the application of the implementation of the 2006 Directive as amended to include:

- other entities whose securities are admitted to trading on a regulated market;
- electronic money institutions;
- payment institutions;
- MiFiD investment firms;
- Undertakings for Collective Investment in Transferable Securities (UCITS); and,
- Alternative Investment Funds (AIFs).

How do you consider these should be addressed?

Q8. What do you think are likely to be the familiarisation costs to auditors of PIEs arising from all the changes affecting them. In particular:

(a) how many person hours likely to be involved in an individual statutory auditor and their team understanding and preparing for the changes?

(b) what are the costs to audit firms of updating internal management systems to reflect the changes?

(c) How this is likely to vary by size of audit firm?

Q9. Do you agree the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under the 2006 Directive as amended by the new Directive and under the Regulation?[64]

Q10. What issues, if any, do you consider arise from the need to implement a new statutory framework for the setting of auditing standards and for audit inspections, investigations and discipline by the single competent authority to replace the current framework that requires the bodies' rules to provide for this? If there are any, how should they be addressed?

Q11. What issues, if any, do you think might arise for the current investigation and disciplinary arrangements between the professional supervisory bodies and the FRC, that apply to accountants generally as opposed to only auditors, given the changes in relation to audit? If there are any, how should they be addressed?

Q12. In relation to each of the tasks provided for in the Directive and Regulation, do you consider that responsibility should be allocated to the single competent authority, for it to delegate to the professional supervisory bodies as appropriate and to the extent permitted in the Directive and Regulation? Please provide further information in support of your answer.

Q13. For any tasks where responsibility is allocated to the single competent authority for it to delegate, what limitations, if any, do you consider would needed to ensure that authority only retained responsibilities or reclaimed delegated responsibilities in appropriate circumstances? What do you consider these circumstances should be?

Q14. In relation to each of the tasks provided for in the Directive and Regulation, are there any tasks, or any aspects of those tasks, that you consider it is important should continue to be covered by provisions in legislation on the content of the rules of the supervisory bodies? Please provide further information in support of your answer.

Q15. Do you consider that both the registration of statutory auditors and their removal from the register should be covered by regulations under the Companies Act[65]? If so, which body or bodies do you think should have statutory powers for the removal of statutory auditors from the register?

Q16. Do you consider that, for consistency with a framework of ultimate responsibility, single competent authority approval should be required for the rules of the supervisory bodies?

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[64] In answering this question, it may help in particular to consider the tasks of audit inspection, investigations and discipline, auditor approval and continuing professional development and the setting of technical and ethical standards for statutory audits and auditors.

[65] The Statutory Auditors (Registration) Instrument 2008 currently applies for this purpose, having been made by the FRC using powers in section 1239 of the Companies Act, which are delegated to it.

Q17. What do you consider are the costs and benefits in monetary terms and in terms of the effectiveness of audit regulation of the proposals in this chapter and of your preferred approach to implementation of these provisions?

Q18. Do you agree that the provisions of Article 4 of the Regulation on the cap on non-audit services should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

Q19. What issues, if any, do you consider arise from the application of the provisions on the cap on non-audit services? If there are any, how do you consider these should be addressed?

Q20. Do you agree that the Member State options in Article 4, to set more stringent requirements on the cap and on the auditor's independence where their total fee income from a PIE exceeds 15% of their total fee income overall, should be capable of being applied by the FRC in its ethical standards for auditors? Please provide information to support your answer.

Q21. Do you agree that the FRC should have the ability to exempt an audit firm from the 70% cap for up to two financial years on an exceptional basis and on application by the firm?

Q22. Do you agree that the subject matter of Article 5 of the Regulation on the blacklist of non-audit services, including the possibility of setting more stringent requirements, should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

Q23. What issues, if any, do you consider arise from the application of the provisions on the blacklist of non-audit services? If there are any, how do you consider these should be addressed?

Q24. Do you agree that implementation of the revised requirements on ensuring and documenting auditor independence in the 2006 Directive should be implemented primarily via the ethical standards, with amendments to the existing legislation as necessary only to:

(a) underpin the standards? And,
(b) introduce simplifications for audits of small non-PIEs?

Please provide further information to support your answer.

Q25. Do you agree that the existing framework on disclosure by PIEs in notes to their accounts of the audit and non-audit fees they paid their auditor should be adapted, to ensure public disclosure of the information the auditor is required to provide to the competent authority under Article 14 of the Regulation? Please provide information to support your answer.

Q26. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the blacklist?
(b) the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor?

(c) the extent to which these additional costs vary by the size of PIEs?
(d) the person hours likely to be involved in a non-audit team at an audit firm understanding and preparing for the changes given that they will not be able to provide certain non-audit services to the firm's audit clients?

Q27. Audit Committees must submit a recommendation to the board for the appointment of an auditor. However, under Article 16(1) sub-paragraph (2) of the Regulation, this does not apply where the Member State has provided an alternative system for the appointment of the auditor. The current alternative systems set out in the Companies Act 2006 are where:

- the directors appoint the auditor before the company's first accounts meeting;
- the directors appoint the auditor to fill a casual vacancy in the office of auditor; and where,
- the Secretary of State appoints the auditor because a public company failed to do so.

Do you consider that all of these alternative systems for the appointment of an auditor should continue to operate in the UK as they do at present? Are there any other systems that should also be provided for on the grounds that a competitive tender process is not appropriate? Please provide further information to support your answer.

Q28. Where the PIE is exempted from having an audit committee (eg because it is an unlisted bank), there is no provision as to which body should fulfil the audit committee's role. Do you agree that in this situation the directors should determine the recommendations that should be put to shareholders of the audited entity? Please provide information in support of your answer.

Q29. The Government does not intend to take up the option to provide for an extension of the maximum duration of the engagement beyond 10 years where a joint auditor is engaged. Do you agree that the replacement of a single auditor with two joint auditors, one of whom was the original auditor, should be made on the basis of a retender? Please provide further information in support of your answer.

Q30. We are considering whether provision should be made so that, where a PIE has stated in its annual report it will appoint an auditor based on a tender process before the expiry of the maximum duration of 10 years, it should still be able to take advantage of an extension of the maximum duration beyond ten years, following that tender. Do you agree?

Q31. We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the annual report setting out key matters for the audit committee on the appointment of auditors. Do you agree that the report should include:

a) when the current auditor took up the audit engagement at that company? (Yes / No)
b) when the audit engagement was last retendered? (Yes / No)
c) the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender? (Yes / No)
d) the directors' reasons for considering that the proposed year is in the best interests of the company's members? (Yes / No)

Do you consider that any other information should be included in addition the above? Please provide further information to support your answer.

Q32. We are considering whether, where the statement under point (c) above is included in the company's annual report, and the incumbent auditor is reappointed on the basis of the planned tender process before the expiry of the 10 year maximum duration (eg at 7 years), the next tender process should be expected to take effect:

(a) after the same period has expired again (ie year 14 in this example);
(b) after a further 10 years has expired (ie year 17 in this example); or,
(c) after the same period has expired again, though with the potential to extend it by the full 10 years via further notice from the audit committee in the annual report (ie in this example at year 14 though this could be extended to year 17)?

Which option would you prefer? Please provide further information in support of your answer.

Q33. What issues, if any do you consider arise from the UK's obligation to apply effective, proportionate and dissuasive sanctions for failure to comply with the UK's implementation of the framework on mandatory rotation and retendering? If there are any such issues, how do should they be addressed?

Q34. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) resources that are likely to be deployed by PIEs to tender audit appointments?
(b) resources that are deployed by auditors to tender for audit work?
(c) additional familiarisation costs that arise for both auditors and the audit client when a new auditor takes up an audit engagement?
(d) the extent to which this varies by the size of the PIE?

Q35. What issues, if any, do you consider arise from the inclusion in legislation on audit reporting of a requirement for the auditor to include a statement in the audit report where there is a material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern? How do you consider these should be addressed?

Q36. Do you agree that the provisions of Article 10 of the Regulation on the audit report should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

Q37. What issues, if any, do you consider arise from the application of the provisions of the Regulation on the audit report? If there are any, how do you consider they should be addressed?

Q38. Do you agree that the provisions in Article 11 of the Regulation on the additional report to the audit committee should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

Q39. What issues, if any, do you consider arise from the application of the provisions of Article 11 of the Regulation on the additional report to the audit committee? If there are any how should they be addressed?

Q40. For our impact assessment on the changes, we should particularly welcome data on:

(a) additional resources are likely to be needed by the auditor to produce the additional report for the audit committee?
(b) the additional annual cost of the audit committee considering the additional report?
(c) how these costs vary by size of PIE?

Q41. Do you consider that the small companies audit exemption thresholds should:

(a) remain aligned with those for the small companies accounting regime, so that the number of audit exempt small companies will increase in line with the increase in the small companies accounting thresholds;
(b) remain unchanged so that the turnover and balance sheet thresholds are considerably lower than the thresholds for access to the small companies accounting regime; or,
(c) be amended in some other way (please set this out)?

Please provide further information in support of your answer.

Questions from chapter 5

In this chapter we have only asked specific questions under each section where the measures considered give rise to specific questions where your views would be particularly helpful. The following general questions apply in relation to all the measures discussed in this chapter.

Q42. What issues, if any, do you consider arise from the measures considered in this chapter? If there are any, how do you consider these should be addressed?

Q43. For the purpose of our impact assessment, we would welcome any information you can provide on the expected costs and benefits of the measures considered in this chapter, particularly any estimates of costs or benefits that you consider it would be possible to quantify?

In addition we remind you that the general questions asked at the start of chapter 4 also apply to the measures discussed in this chapter.

Q44. Do you agree that the implementation of EU requirements on technical standards should be primarily through changes to the FRC's ISAs (UK and Ireland)?

Q45. For the purpose of our impact assessment on the changes we would welcome any estimate you could provide of the percentage of PIE audits for which the quality control review will now have to be undertaken by an individual auditor from outside the appointed audit firm (where there is a lack of detachment from the audit or knowledge of the client sector) where this was not previously required?

Q46. What issues do you consider arise from the implementation of EU adopted ISAs in the UK that UK representatives should raise with the European Commission?

Q47. Do you agree that following any adoption of ISAs by the European Commission, the FRC should have the discretion to:

(a) apply standards where the Commission has not adopted an ISA covering the same subject-matter; (Yes / No) and,
(b) impose procedures or requirements in addition to adopted ISAs if these national procedures or requirements are necessary to give effect to national legal requirements or to add to the quality of financial statements? (Yes / No)

Please provide further information in support of your answer.

Q48. What issues, if any, do you consider arise from the implementation of the new requirements on audit committees via amendments to the existing DTR 7.1 in the FCA Handbook (for companies with securities admitted to trading on a regulated market)?

Q49. What issues, if any, would you consider arise from the implementation via provisions in PRA rules of the new requirements on audit committees for those banks, building societies and insurers that are not required to have an audit committee under DTR 7.1?

Q50. For our impact assessment on the changes, we would welcome data on:

(a) the numbers of non-listed PIEs that currently do not have an audit committee?
(b) the cost of recruiting members to be part of an audit committee?
(c) the annual cost of attendance of a member?
(d) the auditor's fees for attending audit committee meetings?
(e) how these costs vary by size of PIE?

Q51. Do you consider that the single competent authority with responsibility for regulation of audit should be designated to receive the information required to be provided to supervisors of PIEs when it is provided to:

(a) the PRA for banks, building societies and insurers?
(b) the FCA for other PIEs? or
(c) both?

Q52. For the purpose of our impact assessment on these changes we should be grateful for any estimates you can provide of:

(a) the costs of the auditor providing this information to supervisors of PIEs?
(b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?
(c) the frequency with which the FCA is provided with this information for other PIEs in practice already?

Q53. Do you agree that we should enable the single competent authority to exercise the choices of aptitude test and/or adaptation period for the approval in the UK of individual statutory

auditors from other Member States? Please provide further information in support of your answer.

Q54. Were the single competent authority to have this role, what do you consider would be the implications for the operational provision (currently by the professional supervisory bodies) of:

(a) aptitude tests; and
(b) adaptation periods (if these were to be provided for)?

How would this be affected by the CEAOB progressing discussions “with a view to achieving a convergence of the requirements of the adaptation period and the aptitude test” across the EU?

7. Confidentiality & Data Protection

Information provided in response to this discussion document, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

8. Help with queries

Questions about the policy issues raised in the document can be addressed to:

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Team: Corporate Frameworks, Accountability and Governance
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This discussion document is not a formal Government consultation and that process will be conducted at a later stage in the implementation of the new Directive. However, the Government is seeking to handle and consider responses to this discussion document in line with the principles that it has stated Government departments and other public bodies should adopt for engaging stakeholders when developing policy and legislation. These are set out in the following document: http://www.cabinetoffice.gov.uk/sites/default/files/resources/Consultation-Principles.pdf

This publication is available from www.gov.uk/bis

Any enquiries regarding this publication should be sent to:

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BIS/14/1285