



HM Government

Framework for the UK-EU partnership

Company law (accounting and audit)

JUNE 2018

This presentation is **part of a series produced by the UK negotiating team** for discussion with the EU, in order to inform the development of the future framework.

It **focuses on an element of the vision for our future relationship** set out by the Prime Minister in Munich and at Mansion House.

The **future framework will set out the terms of our future relationship**, to be translated into legally binding agreements after the UK's withdrawal.

The **UK and the EU will conclude the future framework alongside the Withdrawal Agreement** later this year.

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Our vision for the future partnership

The United Kingdom wants to build a **new, deep and special partnership** with the European Union.

A partnership that **protects our shared interests and values**, ensuring we can act together for our mutual benefit.

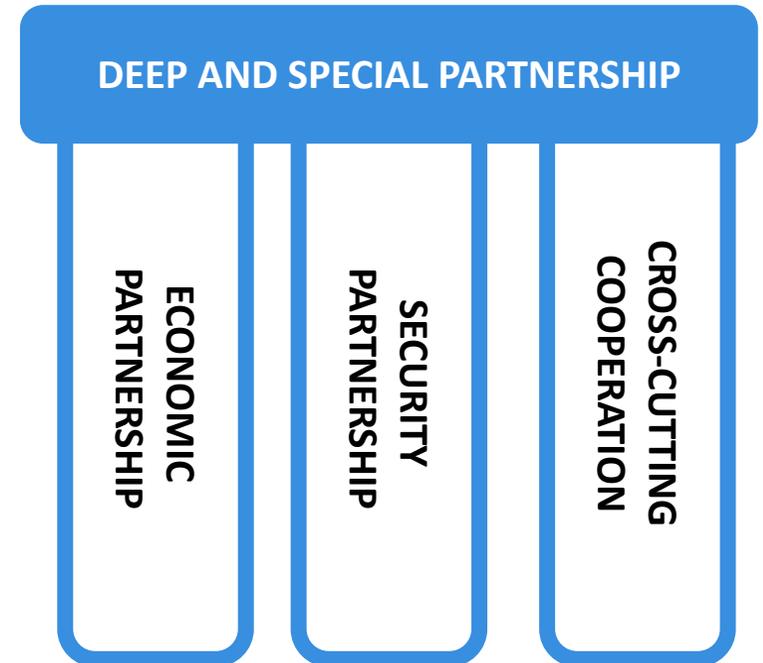
An approach that delivers for **the whole United Kingdom** and its Overseas Territories and Crown Dependencies, as well as for the EU.

We believe this partnership should have **two core parts**.

An **economic partnership**, that goes beyond any existing FTA, covering more sectors and with deeper cooperation.

And a **security partnership**, maintaining and strengthening our ability to meet the ever evolving threats we both face.

These will sit alongside **cross-cutting areas** such as data protection.



Structure of discussions on the future framework

The UK and EU negotiating teams have jointly published the **structure for discussions on the future framework**, reflecting the breadth of the partnership both sides want to build.

BASIS FOR COOPERATION

Structure, governance, interpretation and application, dispute settlement, non-compliance and participation and cooperation with EU bodies

ECONOMIC PARTNERSHIP

Aims of the economic partnership, goods, agricultural, food and fisheries products, customs, services and investment, financial services, digital and broadcasting, transport, energy, horizontal measures and mobility framework

SECURITY PARTNERSHIP

Aims of the security partnership, law enforcement and criminal justice, foreign, security and defence and wider security issues

CROSS-CUTTING/STANDALONE

Data protection, cooperative accords (science and innovation/culture and education) and fishing opportunities

PART I BACKGROUND

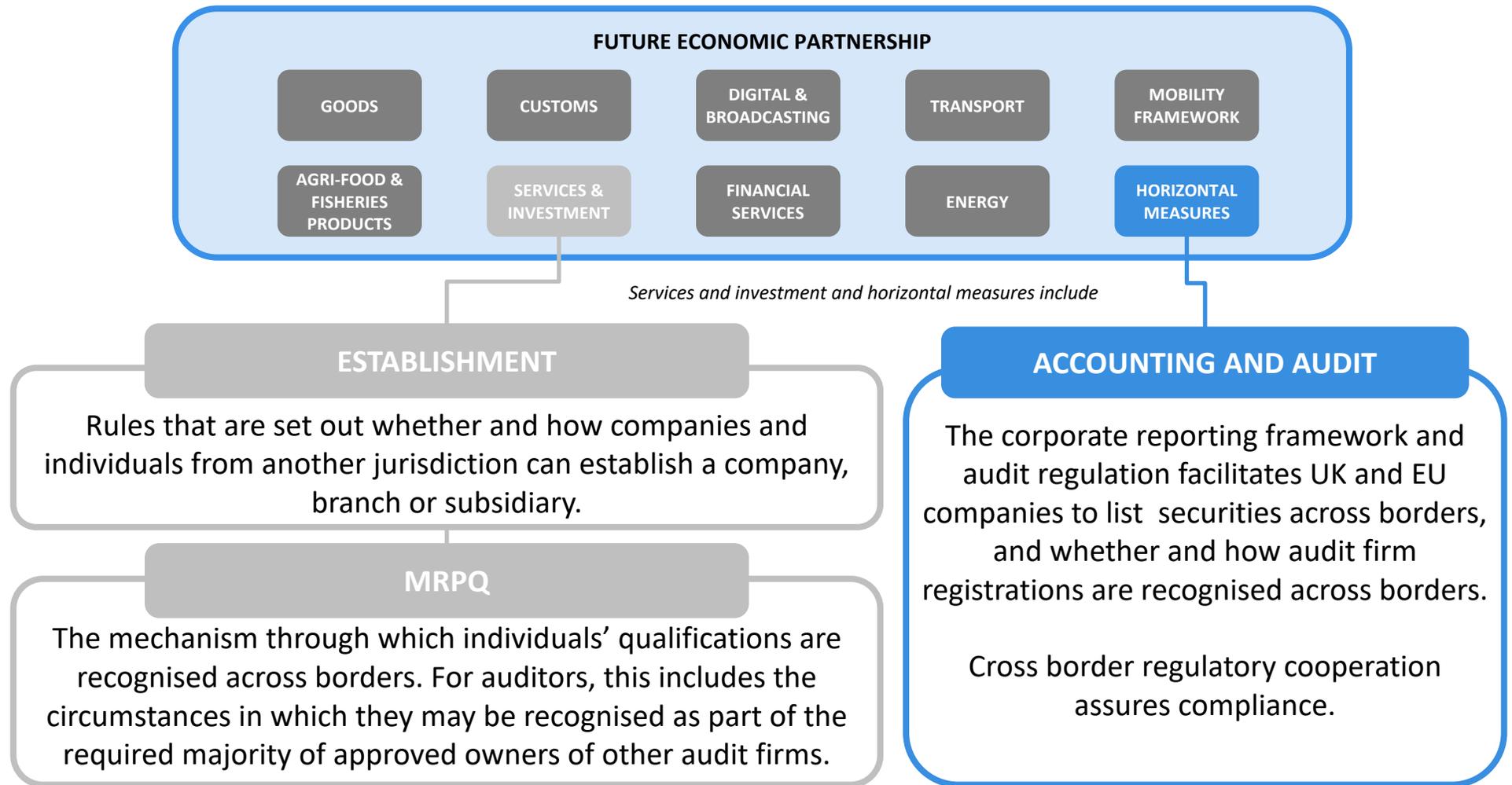
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Company law in the economic partnership

Company law underpins successful UK and EU economies. A common approach would contribute to a deep and special future economic partnership.



Accounting and audit in the EU: the importance for the UK and EU economies

UK and EU markets are closely connected, with companies across the EU benefiting from access to capital markets in both the UK and the rest of the EU as well as a common regulatory framework.

CONNECTED MARKETS

Holding companies of multinational groups located in the UK, EU and elsewhere can issue securities in both the UK and EU.

For example, UK regulated markets are home to around 300 EEA issuers of securities with equity issuers accounting for nearly £600bn of market capitalisation.

The EEA markets are used by around 800 UK companies to list equities and debt securities.

WORKING ACROSS BORDERS

In 2016 the UK was a destination of audit services from across the EU, including:

- 22% (€230m) from Germany
- 18% (€280m) from Netherlands
 - 17% (€72m) from Italy

In return, UK firms provided over 14% of EU27 audit and accounting imports (2016) and made up approximately half of audit firm capacity for Public Interest Entities (PIEs).

Accounting and audit: underpinning regulatory cooperation

Risks of audit and accounting failure at multinational groups and cross border listed companies can only be managed by working together – via joint inspections and collaboration on investigations.

UK COMPETENT AUTHORITY

- The Financial Reporting Council (FRC) is the UK's designated competent authority for Audit, and is a hub for Accounting and Audit expertise.
- FRC provides a strong basis for future cooperation. It contributes to the development and assessment of International Financial Reporting Standards (IFRS).
- It has longstanding relationships with audit authorities in Member States.
- The FRC has strong cooperation links with the Commission and its Supervisory Authorities. Working together they have effectively influenced the development of international standards as well as cooperating on the delivery of its statutory regulatory functions to enforce those standards effectively.
- The UK has commissioned an independent review of the FRC to ensure it is fit for the future.

EU provisions on accounting and audit relationships with third countries

EU rules provide for third country equivalence provisions in certain areas:

ACCOUNTING - IFRS

Holding companies from third countries that list equity on EU markets must prepare accounts for the relevant Member State either using EU-adopted IFRS or standards that have been determined as equivalent by the Commission. This enables those companies to access investment and capital on EU markets.

AUDIT REGULATORY EQUIVALENCE

Companies from third countries that list securities on EU markets must be audited by EU statutory auditors or by auditors from the third country that have registered in the relevant Member State. Work on these audits by registered third country auditors must be inspected unless the third country is deemed equivalent.

COMPETENT AUTHORITY ADEQUACY

EU competent authorities may only transfer audit working papers and investigation reports to a third country competent authority that is deemed adequate. This enables joint inspections and investigations to maintain audit and accounting quality and ensure consistent standards of auditor independence.

The future UK accounting and audit regime

The EU (Withdrawal) Bill will bring EU law into UK law. The UK's future regime will be consistent with the current regulatory framework and will provide continuity.

WHAT?

We will introduce a full UK corporate reporting and audit framework which will be transparent and will be policed by the UK's independent regulator, the Financial Reporting Council (FRC).

We will transpose the EU-adopted IFRS, and have already transposed the Accounting and Audit Directives in full.

WHY?

The UK has committed to proper disciplines in corporate reporting and audit frameworks. This protects our own internal market and creates a fair basis for our companies to compete internationally.

Consistency with existing practices for on-going monitoring and enforcement by an independent regulator will ensure continuing clarity on compliance for companies and auditors.

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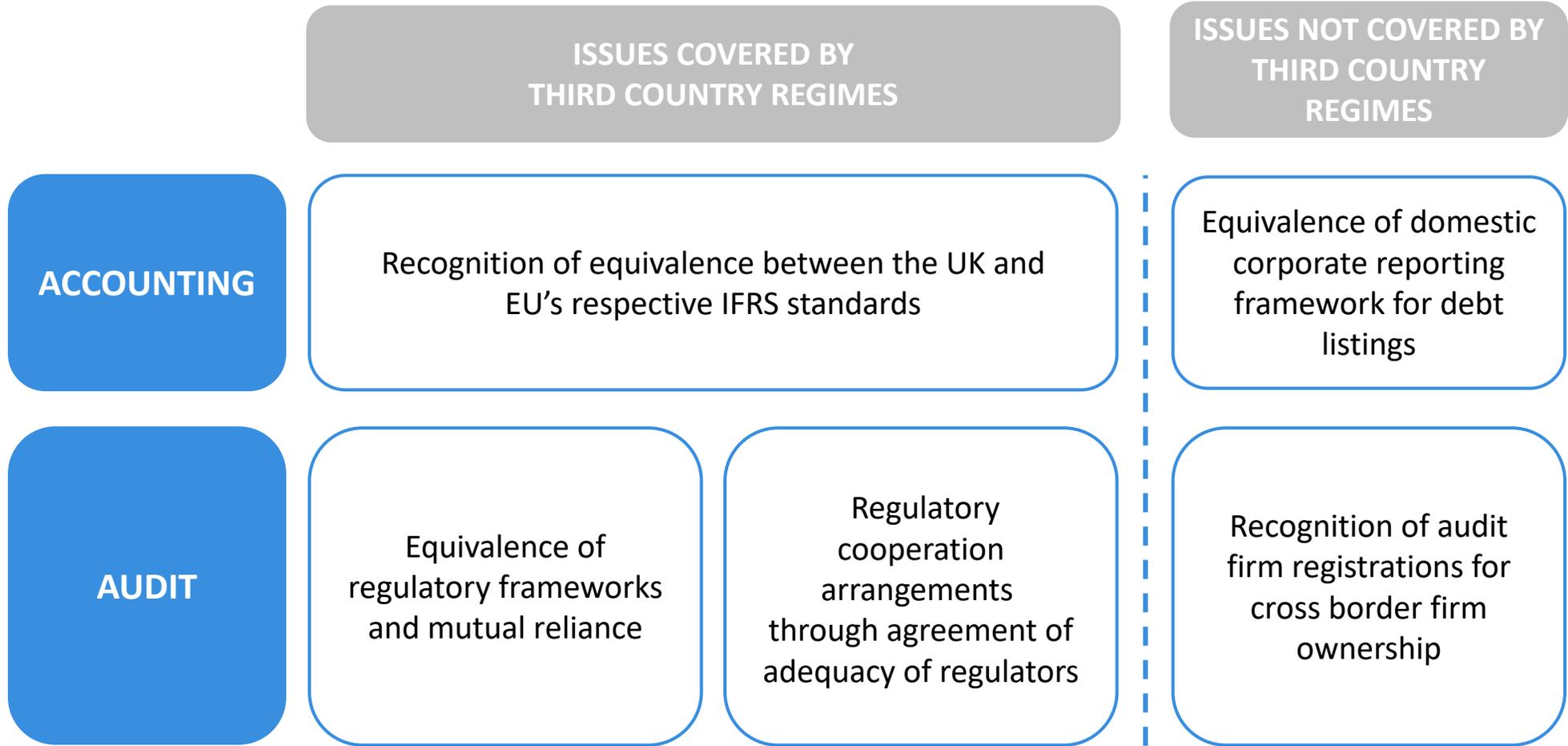
PART II CONTEXT

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Existing EU third country regimes are not sufficient

Existing EU third country regimes partially cover accounting and audit. They do not provide sufficient continuity of equivalence, stability for companies and enforcers, nor cover all issues.



Existing third country regimes are not sufficient: continuity

EU and UK companies face considerable disruption if there is no certainty that they can rely on continued equivalence of accounting and audit arrangements.

CONTINUITY AT THE END OF THE IMPLEMENTATION PERIOD

EQUIVALENCE OF THIRD
COUNTRY CORPORATE
REPORTING
FRAMEWORK

EU equivalence decisions in the past have taken between 18 - 24 months.

This provides no guarantee to EU or UK companies that their accounts and audit reports will be deemed acceptable.

Companies in both jurisdictions need certainty on this decision early.

EQUIVALENCE OF THIRD
COUNTRY AUDIT
REGULATION

ADEQUACY OF AUDIT
REGULATORS

Similar timescales mean regulators would not be able to continue seamless cooperation creating a gap in regulatory oversight.

Why this matters: continued equivalence of audit regulation/adequacy of regulators

Where equivalent (or transitional) status not available by the end of the implementation period, audit inspection programmes will quickly need to be put in place for issuers across UK and EU borders.

CASE STUDY: NO EQUIVALENCE – AUDIT REGULATION

FRC

Audits of a company that issue securities in EU and UK have to be dual inspected

Without an adequacy agreement the incoming audit authority will not be recognised for regulatory cooperation and so the inspection will not be able to happen

RESULT: The auditor – whether UK or EU based will be **in breach of legal obligations** and **future filings across borders will be void.**

We need to ensure that issuers in both jurisdictions have clear processes from day one. We can ensure this happens through agreeing EU/ UK equivalence and adequacy

IMPACTS

Unnecessary level of complexity in audit regulation.

↓
Added cost for regulators and business

↓
Could impede raising capital in the two jurisdictions

↓
Negative growth impacts for EU and UK companies



Existing third country regimes are not sufficient: stability for companies and enforcers

To be able to conduct business across borders, UK and EU companies and enforcers need to be able to rely on equivalence provisions not being withdrawn at short notice.

SECURITY OF STATUS

EQUIVALENCE OF
THIRD COUNTRY
CORPORATE
REPORTING
FRAMEWORK

EQUIVALENCE
OF THIRD COUNTRY
AUDIT REGULATION

ADEQUACY OF AUDIT
REGULATORS

Third country equivalence regimes allow equivalence to be revoked without notice.

They don't provide sufficient confidence that equivalence will remain in place.

Investors and companies across the EU & UK need confidence in these arrangements.

Similar provisions mean that UK and EU audit authorities would not have confidence to rely on these arrangements.



Case study: stability for companies and enforcers

Without regulatory cooperation within a framework of equivalence there is a risk of potential divergence between UK and EU IFRS which could impact on companies.

CASE STUDY: NO REGULATORY COOPERATION ON UK/EU IFRS



UK and EU adopt IFRS accounting standards



Without regulatory cooperation on UK and EU IFRS there's a risk that the standards could diverge and equivalence would break down

RESULT: Companies might then need to produce two sets of financial statements. This is expensive and complex for companies and reduces clarity for investors.

IFRS as adopted and endorsed by the EU is mandatory for the group accounts of companies listed in the EU. Under a standard equivalence regime there is not the necessary regulatory cooperation in place to ensure that EU adopted IFRS standards remain equivalent to UK adopted IFRS.

IMPACTS

Break down of accounting equivalence

Companies having to produce two sets of accounts

Could impede raising capital in the two jurisdictions

Negative growth impacts for EU and UK companies

Existing third country regimes are not sufficient: scope

There are areas where EU Directives do not provide for coverage by third country regimes. We would be interested in exploring the mutual benefit of agreeing further provisions.

WHAT IS NOT COVERED?

CORPORATE REPORTING AND ACCOUNTING REQUIREMENTS

A company issuing debt on a market across the UK-EU border would find that its domestic standards are no longer accepted. It would then have to reconcile its accounts to the market's accepted standards.

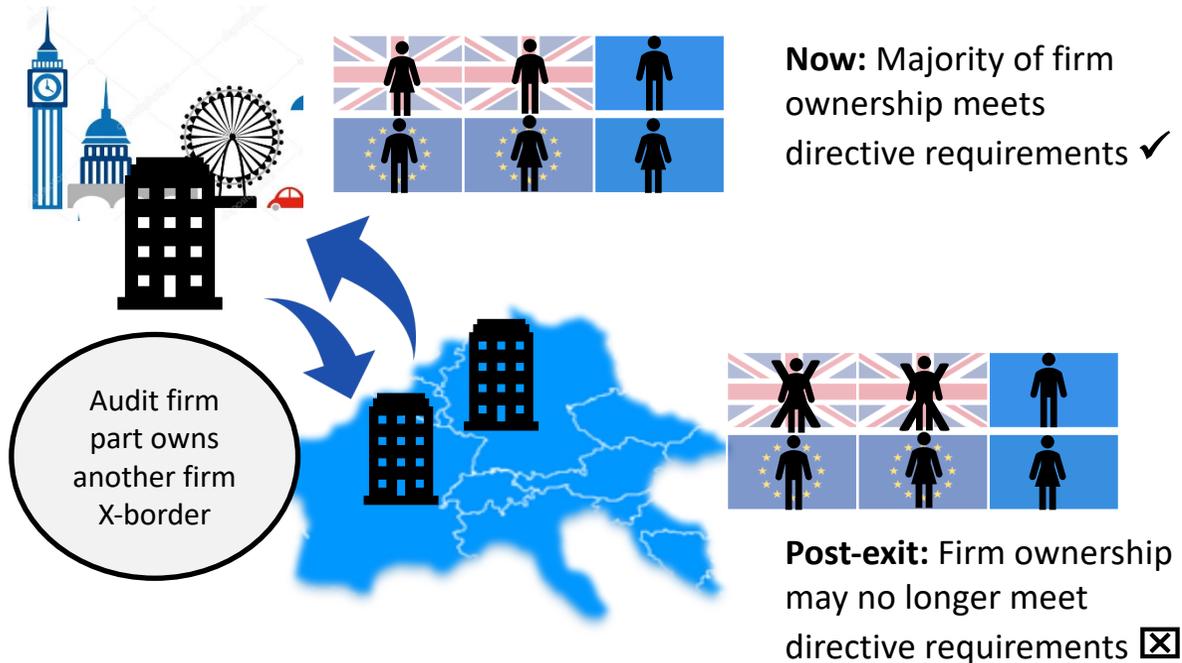
AUDIT FIRM REGISTRATIONS

After exit a UK firm will no longer be counted in the required majority of qualified owners of an EU firm. If there is no remaining majority, the EU firm's registration in the Member State would have to end. This risks causing expensive and disruptive restructuring of UK and EU firms.

Case study: scope

After the UK leaves the EU the recognition of individuals and firms across the EU will not extend to UK qualified auditors and UK approved firms, affecting both EU and UK registered audit firms.

CASE STUDY – AUDIT FIRM REGISTRATION



- Audit firms across Europe will be impacted by the loss of approved audit firms in their ownership majorities
- This could affect confidence in the audits of multinational companies with a potential wider market impact
- Unpredictable change in the structure of the audit market creating high costs and bureaucracy for audit firms and potentially reducing audit capacity across the EU

The benefits of providing continuity, stability and extended scope

We believe there could be mutual benefit from going further than what would be provided by negotiation of a usual EU third country regime.

CONTINUITY

- ✓ UK and EU companies could benefit from certainty that their accounts will be deemed acceptable in the reporting year when the implementation period ends

STABILITY

- ✓ Regulatory oversight provides assurance to investors and capital markets
- ✓ Increased confidence of investors in company accounts, particularly multinational groups
- ✓ Increased willingness to invest or raise capital across borders
- ✓ Increased market and economic stability
- ✓ Increased investment, employment and growth

EXTENDED SCOPE

- ✓ UK and EU companies could benefit from certainty on equivalence of their corporate reporting and the timeframe and review process for formal long term equivalence assessments.
- ✓ UK and EU audit authorities could benefit from certainty that each other's firm registrations will be recognised as equivalent in order to qualify for the majority threshold of owners

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The role of company law in the economic partnership

UK and EU markets are deeply interconnected. Accounting and audit frameworks facilitate cross border listing of securities. And companies across borders rely extensively on accounting and audit services provided in other countries. This underpins strong markets and contributes to our joint economic prosperity.

Third country regimes for accounting and audit equivalence and adequacy exist in some areas.

Existing third country regimes do not guarantee sufficient stability of coverage by the end of the Implementation Period. UK and EU companies and enforcers need early assurance that our accounting and audit standards will be equivalent, especially given our unique starting point and complete convergence on day one of exit.

They also do not provide sufficient stability that equivalence will continue to be provided. Companies and enforcers would benefit from greater confidence that equivalence will not be withdrawn without undue notice.

Existing third country regimes do not cover all accounting and audit issues, notably corporate reporting and audit requirements, and audit firm registrations. We would be interested in exploring the mutual benefits of agreeing provisions on these issues.