

## **STATUTORY AUDIT SERVICES FOR LARGE COMPANIES MARKET INVESTIGATION**

### **The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014**

#### **Background**

1. On 21 October 2011, the Office of Fair Trading, in exercise of its powers under sections 131 and 133 of the Enterprise Act 2002 (the Act), referred the supply of statutory audit services to large companies in the UK to the Competition Commission (CC) for investigation and report.
2. The CC investigated the matters referred to it pursuant to sections 131 and 133 of the Act and, in accordance with section 134(1) of the Act, concluded that there are features of the market or markets which, either alone or in combination, prevent, restrict or distort competition in connection with the supply of statutory audit services to large companies in the UK and, in accordance with section 134(2) of the Act, that there were adverse effects on competition (AECs). The CC published its findings in a report under section 136 of the Act entitled *Statutory audit services for large companies market investigation: a report on the provision of statutory audit services to large companies in the UK* and notified on 15 October 2013 (the Report).
3. The CC considered, in accordance with section 134(4) of the Act, whether (a) action should be taken by it for the purpose of remedying, mitigating or preventing the AECs or any detrimental effect on customers; and whether (b) it should recommend the taking of action by others for the purpose of remedying, mitigating or preventing the AECs or any detrimental effect on customers; and (c) in either case, if action should be taken, what action should be taken and what is to be remedied, mitigated or prevented.
4. In the Report, the CC decided on a package of remedies to address the AECs that it found. The remedies included:
  - (a) that companies listed on the FTSE 100 and FTSE 250 indices must put their statutory audit services engagement out to tender not less frequently than every ten years. The CC was of the view that many companies would benefit from going out to tender every five years, but if they choose not to, then the Audit Committee should set out in the Audit Committee

Report the financial year in which it next plans to go out to tender and why going out to tender in this year is in the best interests of its members; and

- (b) measures to strengthen the accountability of the auditor to the Audit Committee, including a stipulation that only the Audit Committee is permitted to negotiate and agree audit fees and the scope of audit work, influence the appointment of an audit engagement partner, initiate and supervise competitive tender processes, make recommendations for appointment of auditors and authorise the auditors to carry out non-audit services.
5. On 1 April 2014 the functions of the CC transferred to the Competition and Markets Authority (CMA) pursuant to Part 3 of the Enterprise and Regulatory Reform Act 2013 and the Enterprise and Regulatory Reform Act 2013 (Commencement No 6, Transitional Provisions and Savings) Order 2014.
  6. By virtue of section 138(3) of the Act, the remedies implemented by the CMA must be consistent with the findings in the Report unless there has been a 'material change of circumstances' or other 'special reason' for deciding differently since preparation of the Report.
  7. Since publication of the Report, the European Parliament and the Council have adopted measures reforming the statutory audit market, namely Directive 2014/56/EU (the Directive) and Regulation (EU) No 537/2014 (the Regulation). The CMA considers that this constitutes such a material change of circumstance or special reason to justify taking these measures into account in implementing the remedies decided upon in the Report.
  8. The Directive amends Directive 2006/43/EC<sup>1</sup> on statutory audits of annual and consolidated accounts. The Regulation provides specific requirements regarding statutory audit of public interest entities (PIEs), which includes listed companies, credit institutions and insurance undertakings.
  9. In particular, PIEs are required to change their statutory auditor every ten years. Member states can, however, by way of derogation, permit shorter rotation periods. By way of further derogation, member states may allow PIEs to extend the audit engagement to up to 20 years, provided that retendering takes place at least every ten years (we understand the UK Government is minded, subject to consultation, to take advantage of this derogation and that

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<sup>1</sup> Directive 2006/43/EC lays down conditions for the approval and registration of statutory auditors and the rules on independence, objectivity and professional ethics.

this is consistent with the Government's negotiating position during the negotiation of the EU audit reforms).

10. The transitional provisions in the Regulation provide that where a statutory auditor has been in office for 20 or more consecutive years, the PIE must change its statutory auditor by June 2020. Where a statutory auditor has been in office for 11 or more but less than 20 consecutive years, the PIE must change its statutory auditor by June 2023.
11. The CMA has given thought as to how its remedies can work effectively with the Regulation so as to provide certainty as to the timing of tenders, whilst giving effect to findings in the Report and incentivising FTSE 350 Companies to tender the audit engagement at periods of less than ten years. The explanatory notes to the Order considers how the Order is expected to operate within the framework of the Regulation.

# The Order

## Reference and power

The Competition and Markets Authority (CMA) makes this Order in performance of its duty under section 138 and in exercise of the powers conferred by section 86(1) to (5) and section 87 (each applicable by virtue of section 164), section 161(1), (3) and (4) and paragraphs 2(1), 10, 21(1), 21(2), 21(4) and 22 of Schedule 8 to the Enterprise Act 2002, for the purpose of remedying, mitigating or preventing the adverse effect on competition and any detrimental effects on customers so far as they have resulted, or may be expected to result, from the adverse effect on competition as identified in the report of the Competition Commission entitled *Statutory audit services for large companies market investigation: a report on the provision of statutory audit services to large companies in the UK* and notified on 15 October 2013, and by virtue of the Enterprise and Regulatory Reform Act 2013 (Commencement No 6, Transitional Provisions and Savings) Order 2014.

## Part 1

### 1. General – title, commencement and scope

- 1.1 This Order may be cited as The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014. This Order shall come into force on 1 January 2015 and applies to Financial Years beginning on or after 1 January 2015.
- 1.2 This Order applies to the provision of Statutory Audit Services in the United Kingdom.
- 1.3 The provisions of this Order apply to a Company from the date on which it enters the FTSE 100 or FTSE 250 index until the date on which it ceases to be a FTSE 350 Company.
- 1.4 The Order shall continue in force until such time as it is varied or revoked under the Act. The variation or revocation of the Order shall not affect the validity or enforceability of any rights or obligations that arose prior to such variation or revocation.

## Part 2

### 2. Interpretation

- 2.1 In this Order:

<b>Act</b>	means the Enterprise Act 2002;
<b>Audit Committee</b>	has the meaning given by paragraph 10B of Schedule 10 to the Companies Act;
<b>Audit Committee Report</b>	means the separate section of a FTSE 350 Company's annual report detailing the work of the Audit Committee in discharging its responsibilities and prepared in accordance with the UK Corporate Governance Code as amended from time to time;
<b>Audit Engagement Partner</b>	means the individual identified by an Auditor or Incumbent Auditor as being primarily responsible for the conduct of the Statutory Audit;
<b>Auditor</b>	means a person eligible for appointment as a statutory auditor under Part 42 of the Companies Act;
<b>Auditor Appointment</b>	means the appointment of an Auditor of the accounts of a Company under Part 16 of the Companies Act;
<b>Bidder</b>	means any Auditor participating in a Competitive Tender Process;
<b>CMA</b>	means the Competition and Markets Authority;
<b>Companies Act</b>	means the Companies Act 2006;
<b>Company</b>	means a company formed under the Companies Act;
<b>Competitive Tender Process</b>	means (a) a process by which a Company invites and evaluates bids for the provision of Statutory Audit Services from two or more Auditors; and (b) includes a Competitive Tender Process completed in a period where the Company was not a FTSE 350 Company. Completion of a Competitive Tender Process shall be construed as having occurred on the day before the first day of the Financial Year in relation to which the Auditor Appointment is made pursuant to that process;
<b>FCA</b>	means the Financial Conduct Authority;
<b>Financial Year</b>	means the financial year of a Company as determined in accordance with section 390 of the Companies Act;

<b>Firm</b>	means an entity, whether or not a legal person, which is not an individual and includes a body corporate, a corporation sole and a partnership or other unincorporated association;
<b>FRC</b>	means the Financial Reporting Council;
<b>FTSE 100 index</b>	means the share index maintained by the FTSE Group in connection with the 100 companies listed on the London Stock Exchange with the highest market capitalisation from time to time;
<b>FTSE 250 index</b>	means the share index maintained by the FTSE Group in connection with the 250 companies listed on the London Stock Exchange consisting of the 101 <sup>st</sup> to 350 <sup>th</sup> companies with the highest market capitalisation from time to time;
<b>FTSE 350 Company</b>	means a Company whose equity shares are admitted to trading on the London Stock Exchange and which is included on the FTSE 100 index or FTSE 250 index;
<b>FTSE Group</b>	means the business of FTSE International Limited operating under the FTSE Group name;
<b>Group</b>	means a Parent Undertaking and its Subsidiary Undertakings;
<b>Incumbent Auditor</b>	means the person serving as Auditor to the FTSE 350 Company at the time at which relevant obligations arise pursuant to this Order;
<b>Listing Rules</b>	means the set of requirements for companies listed on a United Kingdom stock exchange and which are the responsibility of the FCA operating as the United Kingdom Listing Authority;
<b>London Stock Exchange</b>	means the main market of the stock exchange provided by the London Stock Exchange PLC;
<b>Non-Audit Services</b>	means any professional service provided by an Auditor to the FTSE 350 Company other than Statutory Audit Services;

<b>Parent Undertaking</b>	has the meaning given by section 1162 of the Companies Act;
<b>Person</b>	includes any individual, Firm, partnership, body corporate or association;
<b>Report</b>	means the report of the CC entitled <i>Statutory audit services for large companies market investigation: a report on the provision of statutory audit services to large companies in the UK</i> and notified on 15 October 2013;
<b>Statutory Audit</b>	means an audit carried out in accordance with Part 16 of the Companies Act;
<b>Statutory Audit Services</b>	means the professional services provided by an Auditor in performing a Statutory Audit;
<b>Statutory Audit Services Agreement</b>	means an agreement between an Auditor and a FTSE 350 Company for the provision of Statutory Audit Services in connection with an Auditor Appointment and includes the renewal of such an agreement in connection with a subsequent Auditor Appointment;
<b>Subsidiary Undertaking</b>	has the meaning given by section 1162 of the Companies Act;
<b>UK Corporate Governance Code</b>	means the FRC's UK Corporate Governance Code which applies to companies with a premium listing of equity shares under the Listing Rules.

2.2 In this Order any reference to:

- (a) '**working day**' means any day except for Saturday, Sunday, Christmas Day, Good Friday or a bank holiday under the Banking and Financial Dealings Act 1971; and
- (b) a government department or non-departmental public body or organisation or person includes a reference to its successor in title.

2.3 The headings used in the Order are for convenience and have no legal effect.

2.4 References to any statute or statutory provisions shall be construed as references to that statute or statutory provision as amended, re-enacted or modified, whether by statute or otherwise.

- 2.5 The Interpretation Act 1978 applies to this Order except where words and expressions are expressly defined.
- 2.6 The provisions of this Order are without prejudice to the duties and liabilities attaching to directors by law.

### **Part 3**

#### **3. The prohibition**

- 3.1 An Auditor and a FTSE 350 Company must not enter into or give effect to a Statutory Audit Services Agreement unless:
- (a) subject to Article 6, the FTSE 350 Company has made an Auditor Appointment pursuant to a Competitive Tender Process in relation to one or more of the preceding nine consecutive Financial Years or has conducted a Competitive Tender Process for an Auditor Appointment in relation to the Financial Year immediately following these preceding nine consecutive Financial Years; and
  - (b) the terms of the Statutory Audit Services Agreement, including, to the extent permissible by law and regulations, the Statutory Audit fee and the scope of the Statutory Audit, have been negotiated and agreed only between:
    - (i) the Audit Committee, either acting collectively or through its chairman, for and on behalf of the board of directors; and
    - (ii) the Auditor; and
  - (c) the provisions of Article 4 have been complied with.

### **Part 4**

#### **4. Mandatory use of Competitive Tender Processes – further provisions**

- 4.1 Where a FTSE 350 Company has not completed a Competitive Tender Process for Auditor Appointments in relation to five consecutive Financial Years, the Audit Committee must set out in the Audit Committee Report relating to the fifth Financial Year in relation to which there has been no Competitive Tender Process :
- (a) the Financial Year in which the FTSE 350 Company proposes that it will next complete a Competitive Tender Process; and



- (b) the reasons as to why completing a Competitive Tender Process in the Financial Year proposed is in the best interests of the FTSE 350 Company's members.
- 4.2 The information specified in Article 4.1(a) and (b) must also be supplied by the Audit Committee in each subsequent Audit Committee Report (following the Audit Committee Report referred to in Article 4.1) until such time as the FTSE 350 Company completes a Competitive Tender Process.
- 4.3 Where the Audit Committee considers that the proposed Financial Year is no longer appropriate for the completion of a Competitive Tender Process, it must provide reasons for the decision in the Audit Committee Report published immediately subsequent to the making of the decision.
- 4.4 In circumstances where a FTSE 350 Company does not issue an Audit Committee Report, the information specified in Articles 4.1, 4.2 and 4.3 must be set out by the Audit Committee elsewhere in the relevant annual report.
- 4.5 Subject to Article 6, the FTSE 350 Company, in preparing its tender documents, must have regard to the need to ensure that tender documents allow Bidders to understand its business and the type of Statutory Audit to be carried out.

## **Part 5**

### **5. Audit Committee responsibilities – further provisions**

- 5.1 Only the Audit Committee, acting collectively or through its chairman, and for and on behalf of the board of directors, is permitted:
- (a) to the extent permissible by law and regulations, to negotiate and agree the Statutory Audit fee and the scope of the Statutory Audit;
  - (b) to initiate and supervise a Competitive Tender Process;
  - (c) to make recommendations to the board of directors as to the Auditor Appointment pursuant to the Competitive Tender Process;
  - (d) to influence the appointment of the Audit Engagement Partner; and
  - (e) subject to Article 5.2 and to the extent permitted by law and regulations, to authorise an Incumbent Auditor or an Auditor appointed to replace an Incumbent Auditor to provide any Non-Audit Services to the FTSE 350 Company or the Group of which that FTSE 350 Company is a part, prior to the commencement of those Non-Audit Services.

- 5.2 The Audit Committee may specify a policy for the pre-approval of permitted Non-Audit Services including setting materiality thresholds based on the value of the proposed Non-Audit Service engagements.
- 5.3 The Audit Committee may consult such persons as it deems appropriate in the performance of the obligations in Articles 3.1(b), 4.1, 5.1 and 5.2.

## **Part 6**

### **6. Transitional provisions – mandatory use of Competitive Tender Processes**

- 6.1 Subject to Article 6.2:
- (a) where an Incumbent Auditor has been the subject of Auditor Appointments with a FTSE 350 Company in relation to 20 or more consecutive Financial Years as at 16 June 2014, Articles 3.1(a) and 4.5 shall apply in respect of Auditor Appointments made on or after 17 June 2020; or
  - (b) where an Incumbent Auditor has been the subject of Auditor Appointments with a FTSE 350 Company in relation to 11 or more but less than 20 consecutive Financial Years as at 16 June 2014, Articles 3.1(a) and 4.5 shall apply in respect of Auditor Appointments made on or after 17 June 2023; or
  - (c) where an Incumbent Auditor has been the subject of Auditor Appointments with a FTSE 350 Company in relation to less than 11 consecutive Financial Years as at 16 June 2014, Articles 3.1(a) and 4.5 shall apply in respect of Auditor Appointments made on or after 17 June 2016.
- 6.2 Where an Auditor other than the Incumbent Auditor as at 16 June 2014 is the subject of an Auditor Appointment with a FTSE 350 Company on or after 17 June 2016, Articles 3.1(a) and 4.5 shall apply in respect of that and all subsequent Auditor Appointments.

## **Part 7**

### **7. Monitoring and compliance**

- 7.1 A FTSE 350 Company must include a statement of compliance with the provisions of this Order in the Audit Committee Report (or elsewhere in the

annual report in circumstances where an Audit Committee Report is not issued) for each Financial Year.

- 7.2 The Incumbent Auditor must, where requested by the CMA, provide, within 15 working days of the request, a schedule of the following information to the CMA in relation to each FTSE 350 Company for which it is the Incumbent Auditor on the relevant date:
- (a) the last Financial Year in which the FTSE 350 Company completed a Competitive Tender Process; and
  - (b) in relation to the annual report published immediately prior to the relevant date:
    - (i) whether the FTSE 350 Company has included a statement of compliance with the provisions of this Order;
    - (ii) whether the Audit Committee has made a statement in accordance with the provisions in Articles 4.1 or 4.2; and
    - (iii) if the Audit Committee has made such a statement, the next Financial Year in which the FTSE 350 Company intends to complete a Competitive Tender Process.
- 7.3 For the purposes of Article 7.2, 'relevant date' means 1 January, beginning with 1 January 2016 and annually thereafter.

## **Part 8**

### **8. Directions by the CMA as to compliance**

- 8.1 The CMA may give directions falling within Article 8.2 to:
- (a) a person specified in the directions; or
  - (b) a holder for the time being of an office so specified in any body of persons whether incorporated or unincorporate.
- 8.2 Directions fall within this paragraph if they are directions:
- (a) to take such actions as may be specified or described in the directions for the purpose of carrying out, or ensuring compliance with, this Order; or
  - (b) to do, or refrain from doing, anything so specified or described which the person might be required by this Order to do or refrain from doing.

- 8.3 In Article 8.2 above, 'actions' includes steps to introduce and maintain arrangements to ensure that any director, employee or agent of an Auditor, Incumbent Auditor or FTSE 350 Company carries out, or secures compliance with, this Order.
- 8.4 The CMA may vary or revoke any directions so given.

## **Part 9**

### **9. Supply of information to the CMA**

- 9.1 Any person to whom this Order applies is required to provide to the CMA any information and documents required for the purposes of enabling the CMA to monitor the carrying out of this Order or any provisions of this Order and/or to review the effectiveness of the operation of this Order, or any provision of this Order.
- 9.2 Any person to whom this Order applies may be required by the CMA to keep and produce those records specified in writing by the CMA that relate to the operation of any provisions of this Order.
- 9.3 Any person to whom this Order applies and whom the CMA believes to have information which may be relevant to the monitoring or the review of the operation of any provisions of this Order may be required by the CMA to attend and provide such information in person.
- 9.4 Subject always to Part 9 of the Act, the CMA may publish any information or documents that it has received in connection with the monitoring or the review of this Order or any provisions of this Order for the purpose of assisting the CMA in the discharge of its functions under or in connection with this Order.