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Dear Paul

Auditor Regulation: Consultation on the technical implementation of the EU Audit Directive and Regulation

We welcome the opportunity to comment on the Department for Business Innovation & Skills (BIS) consultation document (condoc): *Auditor Regulation: Consultation on the technical implementation of the EU Audit Directive and Regulation*.

As an overarching comment we strongly support the Government's approach to implementation of the EU Audit Directive and EU Audit Regulation i.e., "*a minimal implementation approach...applying only the mandatory changes required by the EU reforms and other changes that would result in a benefit to the UK business environment*." We are also pleased to note that BIS has addressed, amongst other things, the uncertainties regarding the position of companies that had tendered their audit for accounting years beginning on or after 17 June 2003 and the concerns regarding the flexibility of the tendering and rotation framework.

There are clearly challenges for BIS and the Financial Reporting Council (FRC) in implementing the EU requirements as well as challenges for audit firms and corporates in familiarising themselves with and operationalising the necessary policies and procedures. We would like to take this opportunity to thank BIS for actively engaging with stakeholder representatives. In our view, it is important that all stakeholders continue to engage and discuss practical implementation issues as the requirements 'bed down', to ensure that the regulatory objectives are being met.

We have set out, in Appendix I to this letter, our responses to the questions raised in the condoc. Our other comments are detailed below with more granular drafting comments included in Appendix II. We would, however, note that due to the short consultation period and the additional draft legislative provisions that BIS has published subsequent to the condoc, our comments will not be comprehensive. Should any additional drafting comments come to our attention though, we will provide these to BIS separately.

Scope

- ▶ *Public Interest Entity (PIE) definition:* we welcome the confirmation that BIS has concluded that it should not take up the Member State option define additional PIEs.
- ▶ *Implementing legislation:* we would be happy to comment on the amendments to Part 42 of the Companies Act 2006 that will implement the changes in scope from the 2006 Statutory Audit Directive, the draft regulations that BIS is proposing to publish for informal comment in the coming months, and, in time, the amendments to the LLP legislation, which we believe should be consulted on separately given there is no imperative to implement by 16 June 2016.

Audit tendering and rotation

- ▶ *Length of audit engagements:* we welcome the confirmation that the maximum duration of an audit engagement, for which an auditor should be appointed and reappointed annually, should be ten successive accounting years. We also strongly support BIS' proposal to take up the EU's Member State option to allow audit engagements to be extended by 10 years following a qualifying audit tender, with the maximum duration of a continuous audit engagement being 20 years.
- ▶ *Timing of tenders:* we welcome BIS's proposal that PIEs should have the flexibility to decide when that tender should take effect i.e., the tender process can be for any accounting year up to and including that following the end of the 10 year maximum duration period. This proposal would give PIEs more flexibility and choice when planning their future qualifying tenders. It could provide more scope for audit committees to conduct tenders at a time which better suits the individual commitments or circumstances of the audit committee members and/or company.
- ▶ *Transitional provisions:* we welcome BIS' confirmation that PIEs which have tendered their audit before the EU regulation entered into force should benefit from 'transitional recognition of that tender' where the tender has the same features required under the EU Audit Regulation. We await, with interest, the updated guidance, which will set out further detail.
- ▶ *Auditor Regulation – Supplementary Information: The implications of the EU and wider reforms:* this document provides helpful additional clarity on the framework for re-tendering and audit rotation, should be maintained, at least while the reforms bed down. We recognise that responsibility for the document will pass to the FRC but suggest that it is maintained, as formal FRC guidance, and, if possible, expanded to include other FAQs with contributions from BIS, the Prudential Regulation Authority (PRA) and, where relevant to listing, the Financial Conduct Authority (FCA).
- ▶ *Advance notice to tender:* we support the decision not to require publication of advanced notice to tender increased transparency of tender arrangements. While we believe that, if a company has a tender policy, it is right that the intention to tender is disclosed to stakeholders, we do not believe there is any benefit in a legally binding disclosure that would not enable an audit committee's plans to change if circumstances necessitate.

We hope that our comments are helpful. We would, of course, be happy to provide further particulars on any of the points raised or discuss our responses in more detail, so please do not hesitate to contact me.

Yours sincerely,



Andrew Hobbs
Partner, Regulatory & Public Policy
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APPENDIX I: responses to consultation questions

Q1. Do you agree with the approach the draft implementing regulations take given the Government's conclusions as set out in these chapters? Why?

Yes, we agree with the approach taken.

Q2. Do you agree with the Government's proposals on amendments to the Companies Act to reflect Articles 15 and 18 of the Regulation and the amendments to Articles 23, 45 and 47 of the Directive? Do you agree that these are all that is needed to reflect the provisions of the new Directive and Regulation on cooperation, transferring information and confidentiality? Why?

Yes, we agree in principle, but will advise BIS should we identify any drafting issues.

Q3. Given the analysis of costs and benefits in the Impact Assessment in general, do you have any comments on how our estimates or underlying assumptions might be improved? Please explain your answer.

We are not convinced that the wage costs in Annex C – from the median Annual Survey of Hours and Earnings data - are representative of the costs for the audit firms that likely to audit PIEs. We suggest that BIS contacts the ICAEW and ICAS, as the professional bodies may be able to provide more specific data on industry wage costs.

Q4. Responses to our Discussion Document suggested that familiarisation and implementation costs to:

- newly designated PIEs; and,
- audit firms that become auditors of PIEs for the first time...

... would be disproportionately higher. We propose that in the final IA we should uplift the estimated costs for such businesses by a percentage to reflect the additional resource costs to such firms arising from their lack of experience of the requirements of the Regulation and of those provisions of the Directive applying to audits of PIEs. For each category listed above, what do you consider to be a reasonable percentage?

We do not have the data to answer this question and would suggest that BIS contacts the trade associations most likely to represent the newly designated PIEs (for example, the British Bankers Association, the Association of British Insurers and the Managing General Agents Association) and also the Society of Lloyds itself.

- Q5. In the consultation IA we have estimated the direct costs to PIEs of having to tender the audit engagement every 10 years. In our final analysis, we also plan to include an estimate of the additional costs that would be incurred by a new auditor that has to familiarise itself with the business of a new PIE client. We propose that the additional familiarisation cost to auditors engaged in a new audit could be estimated is an additional 10-30% of the cost of the audit in the first two years. Is this reasonable?**

We have nothing to add to BIS' familiarisation costs.

- Q6. Our preliminary analysis suggested that the costs and benefits of the measures in the new Directive affecting audits of non-PIEs would be negligible. This has been assumed in the consultation IA. Is this reasonable? If not, what do you estimate will be the main changes giving rise to costs and benefits for non-PIEs and their auditors? Can you provide quantitative estimates?**

The conclusions drawn from BIS's preliminary analysis, that the costs and benefits for non-PIEs would be negligible, are difficult to comment on without access to research data. However, we would note that, in implementing the EU requirements, the FRC is also consulting on proposed changes to its Ethical Standard that apply to all companies, not just PIEs and question whether the costs of these changes should be included in the overall costs to non-PIEs.

- Q7. It is particularly important to assess the costs and benefits arising from the new Directive for non-PIE LLPs and their auditors as the implementation of the new Directive is not required by EU law for these audits. Would your answers to question 6 differ for non-PIE LLPs? How and why?**

We believe that the proposal to extend the non-PIE provisions in the EU Audit Directive to LLPs – following the precedent set by the UK implementation of the previous Audit Directive – should be the subject of a separate consultation and Impact Assessment.

- Q8. Do you think that the Government should:**

- **implement the changes required by the new Directive for audits of non-PIE LLPs alongside those same changes for entities (such as companies) that are required to be audited by EU law; or,**
- **implement some or all of the changes required by the new Directive for audits of non-PIE LLPs at a later stage?**

... please give reasons for your answer.

See our response to Q7 above. Given the shortage of time available between now and the date by which the EU Audit Directive must be implemented in UK legislation, we believe that BIS should focus on implementing the changes required by EU audit reform. Amendments to LLP legislation to reflect the non-PIE elements of the EU Audit Directive should follow, as a separate consultation that can be targeted at LLPs, as there is no time imperative to make these changes.

Q9. Do you think there would be cost savings from implementing the changes required by the new Directive for non-PIE LLPs at the same time as for entities (such as companies) whose audits are subject to EU law? Please give reasons for your answer. Can you provide any estimate of the extent of these savings?

See response above. We are not aware of any cost-savings from earlier implementation.

APPENDIX II: drafting issues

Draft Regulations: Schedule 1 (Requirements for professional ethics, independence, objectivity, confidentiality and professional secrecy)

- ▶ Schedule 1 (3)(1)(b) would benefit from clarification. It currently reads : “Standards must ensure that A takes all reasonable steps to ensure that, in carrying out statutory audit work, A’s independence is not affected by [...] (b) any business or other direct or indirect relationship with A or a person having a relevant connection with A”. On one reading, it is the relationship “with A” that A must ensure does not affect A’s independence.
- ▶ The reference at Schedule 1(15)(3)(c) to “sub-paragraph (2)(c)” should be “sub-paragraph (2)(b)”.

Mark-up of proposed amendments to the Companies Act 2006

Appointment of Auditors

- ▶ In s485A(2)(b) (Appointment of auditors of private company: additional requirements for public interest entities), the word “including” has been omitted before “the following information” (c.f. s.489A)
- ▶ s491 (Term of office of auditors of public company) – it seems to us that, in a casual vacancy, the effect of the 491(1)(a), which provides that an auditor does not “take office until the previous auditors have ceased to hold office”, and the new s491(1B)(a), which provides that “the period of ten years beginning with the date on which the auditor or auditors take office for the first time”, could enable an auditor filling a casual vacancy to audit eleven accounting years. We believe that s491(1B) should reflect section 3 of the Supplementary Guidance and the Article 17(8) of the EU Audit Directive requirement that “the audit engagement should be calculated as from the first financial year covered in the audit engagement letter”, with a provision that provides that, in cases where the date in s491(1) is later, the ten year maximum engagement starts from the earlier date.
- ▶ In s494A (Meaning if “public interest entity”...) and s519A (also see below), we note that credit institution has been defined by reference to Article 4(1)(1) of the Capital Requirements Regulation rather than Article 3(1) of the Capital Requirements Directive IV, as per the definition of PIE in the EU Audit Directive. Whilst this is logical as the definition in CRDIV refers to the full definition in the CRR, we wonder whether the apparent difference might create confusion.
- ▶ s519A (Meaning of “public interest company”...) – we note that although the term “public interest company” cannot be amended throughout the Companies Act at this stage, the definition has been aligned with the definition of a PIE. We agree that this is a logical interim approach but suggest that “public interest company” is replaced by PIE when the Companies Act is next amended.

Auditors report

- ▶ It seems to us that the EU Audit Directive only requires that joint auditors give their own opinions if they disagree, otherwise they would give a joint report and opinion (Article 28). However, the draft legislation (c.f. the amendments in red font to s495(4), s496(2), s497A(2), s498(6)) appears to be asking for a positive statement that they agree – rather than this being taken as read by them both, say, signing the opinion. If s498 (duties) is being updated to reflect this, why not also update s498A on duties?
- ▶ s503 (Signature of auditor's report) – we believe that the amendment is confusing as to who signs the audit report, if there are joint auditors. Presumably, the signatories should be the senior statutory auditor of any firms that are joint auditors - or the individual(s) if the statutory auditor is an individual(s). We believe that this should be more clearly expressed (c.f. Article 28.4 of the EU Audit Directive).
- ▶ s505 (Names to be stated in published copies of auditor's report) – we believe that the amended section could be read as just requiring the names of the firms for a joint audit – but would we not want the names of the firms and the senior statutory auditor?