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Dear Mr Smith

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

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the consultation by the Department for Business Innovation and Skills (BIS) on "the technical legislative implementation of the EU Audit Directive and Regulation".

We acknowledge that the current consultation is of a technical nature and that the more substantive issues were dealt with in the earlier discussion paper and the responses thereto. Accordingly, our response has been drafted in this context and we only comment below where we have specific points to raise on the technical implementation.

Transition

We do, however, have one overriding comment. As noted in para 15.4 of this consultation, and as has been mentioned in earlier FRC papers, we are assuming that the effective date for the new regulations is the start of the first accounting period beginning on or after 17 June 2016. However, this is not crystal clear from the wording of the detailed draft legislation. We think it very important that there is absolute clarity on this point. Moreover, if everything had to be in place so as to comply with the new legislation and standards as of 17 June this would place a very onerous and unrealistic burden on both companies and auditors. For example, if an audit committee had commissioned a service from its auditor prior to that date, which would then be prohibited under the new regulations, to have to cease the provision of that service as of 17 June could be very costly and inefficient for the company. The issues caused by any lack of clarity on this point would be exacerbated if the final regulations are not published until well into 2016.

Our specific comments on the consultation are set out below.

Chapter 5: Differences between entities covered by the 2006 Directive and the new Directive

As noted in our response to the earlier discussion paper we do not anticipate the need to broaden the application of the 2006 Directive to the additional entities listed in the

consultation to be a significant issue as these types of entity generally already require an audit. However, as part of the implementation BIS will need to consider how the new framework applies to any sole traders and general partnerships that undertake any of the activities listed, e.g. MiFiD investment firms.

Chapter 6: Investigations, sanctions and powers

The draft regulation provides for a disciplinary regime under which the SCA would have jurisdiction to sanction auditors for a "contravention of a relevant requirement". We are unclear how this regime will align with or replace the FRC's existing Accountancy Scheme. Importantly, we note that the test under the existing scheme is "misconduct" and conduct that falls "significantly short" of the standards expected. This would seem to be a higher hurdle than a just a breach of a relevant requirement.

Furthermore, it is not at clear that the procedural safeguards under the existing scheme, such as a hearing before an independent Tribunal to determine whether to impose sanctions, would also apply to the process envisaged by the draft regulation. Such safeguards are particularly important when dealing with cases that frequently give rise to difficult issues and judgement calls. We acknowledge that the EU legislation has to be implemented in the UK but we do not think it necessarily means that additional guidance and procedures cannot be put in place as long as they remain consistent with the legislation. If the draft legislation is intended to bring about a significant change to the existing disciplinary process then we think further debate is required before its implementation.

Chapter 7: Length of audit engagements

We welcome the additional clarification provided by BIS, both in this consultation and in the March 2015 supplementary guidance. We also note that BIS says that updated guidance will be provided. We think this is vitally important because in narrative form it is difficult to grasp exactly what the provisions mean and the more examples that can be provided the better.

In this respect, for example, we struggle to understand the wording in paragraph 7.17. We believe the first bullet refers to a situation where the maximum duration of the audit can in exceptional circumstances be 22 years where there is actually a tender at the end of year 10 but the re-appointment does not take effect until year 12. The second bullet seems to envisage a situation, again in exceptional circumstances, where there is a tender at the end of year 12 and the SCA permits an extension of 2 years when the 20 year period is reached. If our understanding is correct we question why there is not a third exemption covering the situation where the initial appointment is for 10 years followed by a tender at that point but, for what may be very good reasons at the end of a second period, the company would like to defer re-tender until the end of year 12 thus making 22 years in total.

The illustration in figure 7.1 is helpful. However, we question whether such a situation is likely to arise in practice. It envisages a first tender in year 7 and then at the end of year 17 a further tender for a 3 period. Would a company, or indeed an audit firm, really be prepared to go through a costly tender process for the benefit of such a short period?

The regulations require the Audit Committee to recommend at least two firms for appointment following a tender process. We can see circumstances where, given the independence requirements, it may well be possible that only one firm may wish, or indeed be able, to tender in the event that the incumbent is time-barred. This might apply particularly in

the case of specialised businesses. At the moment under the regulations this is not permitted and we think that due consideration should be given to this possibility.

Chapter 8: Standards and standard setting

In paragraph 8.2 the consultation refers to revised article 28 in the Directive. It states that this provision acknowledges that reporting on whether a company may continue to adopt the Going Concern method of accounting is now a" separate requirement" under the International Auditing Standards. We are not sure that the specific requirement in paragraph 28(f) of the Directive can be read in this way. It states where there is a material uncertainty regarding going concern the audit report must make a statement to that effect. We do not think it suggests that "going concern" should be dealt with in a separate standalone section in the audit report, whether there is a "going concern" issue or not.

The FRC's parallel consultation on changes to Auditing Standards also deals with this subject and in our response to that consultation we raise concerns over proposals for a such a separate standalone section, which seems to us to be unnecessary gold plating. If there is an issue regarding going concern, or there is a material uncertainty, this will be covered by existing audit reporting requirements. Furthermore, drawing attention unnecessarily to going concern, where it is not a key issue for the business, might have the opposite effect, and incorrectly imply that business in the UK has a greater issue with regards to going concern than its European counterparts.

Chapter 9: Removal of auditors

We note the new provisions regarding the removal of auditors by certain parties. We are unsure how the current regime which requires auditors to provide a statement of reasons or a statement of circumstances upon resignation aligns with these new provisions. It would be helpful for such guidance to be provided.

Chapter 11: Other audit measures

As regards reporting to supervisors of PIEs then there has already been in place for some time a regime for entities regulated by the PRA. For other entities we believe instances of any such reporting have been rare and therefore that it would be helpful if further guidance were provided on both the scope and timing of such reports.

The regulation refers, inter alia, to a "material breach of laws, regulations or administrative provisions". This is potentially very wide ranging and we note that a material breach of an administrative nature, for example regarding the articles of association, might not have a material effect on the stability of the company or the audit. Is it intended that all such breaches would be within the scope of this reporting requirement?

We are also unsure how these reporting requirements are aligned with, or consistent with, the existing requirements regarding whistleblowing and "tipping-off" under the money-laundering and bribery legislation. Clarification on this matter would be helpful.

As regards the timing of such a report, in particular of a material threat or doubt concerning the continuous function of the PIE, this could be market sensitive information if the market was not already aware of the issue. Such an issue could arise much earlier in the audit process than the signing of the audit opinion, which indeed might be deferred to see if the issue can

be resolved. The regulation is unclear as to the timing of such a report and further guidance would be helpful.

More detailed comments on the draft regulations

Section 5(3) of the Statutory Auditors and Third Country Auditors Regulations 2016, in dealing with the right to appeal against sanctions imposed by the competent authority, states that the competent authority must provide for a panel to determine the appeal. There seems to be no provision setting out the how the composition or attributes of such a panel are to be determined (eg independent of the SCA).

Schedule 1 para 2(4) of the Statutory Auditors and Third Country Auditors Regulations 2016 defines the relevant period (for independence purposes) as the period covered by the financial statements to be audited and the period during which the statutory audit is carried out. There is a logical gap here in that if the audit is started for example sometime after the end of the financial period then that gap period will not be covered by the these provisions. We think the provision could be simplified by stating that the relevant period means the beginning of the period covered by the financial statements to be audited until the end of the period during which the statutory audit is carried out.

Schedule 1 para 5(4) of the Statutory Auditors and Third Country Auditors Regulations 2016, in dealing with the requirements for professional ethics and independence, states that a person (defined elsewhere) cannot participate in the audit if that person "owns financial instruments of the audited entity". The term financial instruments is indeed wide ranging and could cover things such as trade payables, trade receivables, vanilla loans etc. We understand it is not the intention to capture such items but some more immediate reference as to what is meant by financial instruments would be helpful.

If you have any questions on our response, or wish us to amplify our comments, please contact me or Andrew Vials (tel: 020 7728 3199, email: andrew.vials@uk.gt.com).

Yours sincerely

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