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

Comments from ACCA to the Department for Business Innovation & Skills
December 2015

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SUMMARY

ACCA welcomes the opportunity to comment on the proposals issued by the Department for Business Innovation & Skills (BIS). ACCA has established a number of global forums, which are designed to contribute to ACCA's technical and research work on issues facing business and the accountancy profession. The views of members of the global forums are represented in the following, including those forums covering ethics, audit and assurance, accountants for business, corporate reporting, governance, SMEs and the public sector.

We find the setting out of the focus of the implementation process (on pages 4 and 5 of the consultation document) very useful, and welcome the acknowledgement here that the Government is committed to a minimal implementation approach. We acknowledge that there may also be opportunities to further enhance the UK's audit regulatory framework through changes to company law of domestic origin, and trust that such enhancements will be implemented only where the benefits are to be exceeded by the costs (ie with proportionality in mind).

SPECIFIC COMMENTS

In this section of our response, we answer the specific questions set out in the body of the consultation paper.

Question 1. Do you agree with the approach the draft implementing regulations take given the Government's conclusions as set out in these chapters (5, 6, 7, 8 and 12)? Why?

We welcome the Government's July 2015 statement, which sets out, in outline, the future framework for the regulation of statutory auditors – the designation of the Financial Reporting Council (FRC) as the sole competent authority with responsibility for audit inspections and investigation and disciplinary matters related to public interest entities (PIEs), with all other (ie non-PIE) tasks being delegated to the professional bodies to the fullest extent possible permitted by the new Directive and Regulation (subject to FRC oversight). We believe that focussing FRC's monitoring, and investigation and discipline activities on PIEs is proportionate and in the public interest, and guards against dilution of focus on those entities that pose systemic risk to the UK economy.

A crucial aspect of the implementation of the Directive concerns the responsibilities of FRC as the competent authority with ultimate responsibility for the oversight of certain regulatory tasks and the delegation of regulatory

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tasks to the Recognised Supervisory Bodies (RSBs). This topic has been subject to much discussion between BIS, FRC and the RSBs and we do not propose to rehearse those discussions in our response. In summary, our concerns centre on the following areas in particular:

- consistency between the Government's July 2015 statement and the draft regulations
- clarity of the regulations with regard to the roles and responsibilities of FRC and the RSBs
- application of the public interest test regarding retained / reclaimed tasks
- 'appeals processes' with regard to retained and reclaimed task

  and

- funding by the RSBs with regard to tasks not delegated by FRC (clause 26(1)(a)).

We believe clarity is necessary, for both FRC and the RSBs, regarding their respective duties and obligations. To that end, our preference is for these duties and obligations to be fully specified in legislation, including the processes for delegation and reclaiming of tasks from the RSBs. In respect of the latter, there should be a clear public interest test for determining the appropriateness of bringing matters back within FRC's operating scope.

We note the implementation of the Directive will be carried out through a combination of legislative and non-legislative mechanisms, and we understand that the provisions of regulation 3 of the Statutory Auditors and Third Country Auditors Regulations 2016 (the 2016 Regulations) will be supported by a direction by the Secretary of State, which is set out in consultation draft along with the current consultation. Notwithstanding our comment above, we regard the final direction as fundamental to achieving an effective relationship between FRC and the RSBs and a strong regulatory framework for audit in the UK, which is consistent with the Government's position set out in its July 2015 statement.

We broadly support the wording of the draft direction, although there are areas of ambiguity, such as the phrase 'appear to raise important issues affecting public interest'. It is unclear who would determine whether issues are regarded as affecting the public interest, or who would provide a decision if FRC and the relevant RSB could not reach agreement under paragraph 2 iv.

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We suggest a. and b. under paragraph 3 should be joined by 'and' instead of 'or'. This is due to the relatively vague term 'unable to carry out' within a. For example, it might be detrimental to the audit profession for FRC to claim that an RSB was 'unable' (which might be seen as 'unfit') to carry out a particular regulatory task.

We support the decision to not take up the Member State option to define additional PIEs for the purpose of the application of the Directive and Regulation, and that only those entities with securities admitted to trading on a regulated market, banks, building societies, and insurers will be captured. We welcome the clarification that AIM companies are not PIEs. We also note the change in scope concerning entities now required to be audited under EU law, and non-listed entities that can no longer be excluded from the requirements applied to PIEs.

Length of audit engagements

We agree with the Government's approach and the draft regulations in this respect, and we believe that the proposals have been developed with due regard for proportionality since the publication of the discussion document in 2014.

Standards and standard setting

We have responded separately to FRC's consultation *Enhancing Confidence in Audit*, and we comment here only on those requirements of the Directive and Regulation that are to be implemented by amendments in legislation.

There are drafting errors in sections 496 and 497A (on audit reporting), as each of these sections includes a subsection (2), but neither appears to have a subsection (1).

We welcome the Government's conclusions that the current requirements for the disclosure of audit and non-audit fees by small and medium sized companies should be revoked.

Restrictive clauses in contracts with third parties

Proposed paragraph 8(1) of the 2016 Regulations states that the regulation applies to 'any term in a contract which**, in relation to the conduct of a statutory audit of an audited person**' (emphasis added), has the effect of restricting the choice of auditor. We are unclear what the emboldened words add to this explanation, and would suggest that they restrict the usefulness of these provisions.

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Question 2. 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?

We have responded separately to FRC's consultation *Enhancing Confidence in Audit*, in respect of the retention of documents and other matters.

We agree that amendments to the Companies Act that cross-refer to the requirements of the Regulation are useful as a proportionate means of providing greater clarity.

We have no further comments concerning confidentiality or cooperation between competent authorities.

Question 3. 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 welcome the Government's preferred option for implementation - in particular, one of the drivers for additional requirements beyond the 'minimum implementation approach' being the reduction in the burdens on auditors and their clients. These additional requirements are the only proposals that warrant an impact assessment (as there is little scope for flexibility around minimum implementation), and the table on page 35 of the consultation document provides a useful summary.

With regard to the implementation of changes to the competent authority's framework for oversight of the RSBs, we trust that the limited additional measures that may be included (not required by the Directive) will further the objective of reducing the regulatory burden on auditors and their clients. Given the announcement made in Baroness Neville Rolfe's written statement in the House of Lords, we are pleased to note that '[t]here are currently no additional measures in the legislative implementation that go beyond those required by the Directive'.

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Familiarisation costs

Question 4. 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 have insufficient data to be able to determine a reasonable percentage. However, the number of newly designated PIEs will be relatively small and the number of audit firms that become PIE auditors for the first time will be smaller still. Of these audit firms, some may choose to resign the audit rather than familiarise themselves with the requirements of the Regulation and Directive. As a result, we think it unlikely that the estimated familiarisation and implementation costs will be sensitive to the precise percentage used in each category.

Question 5. 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?

These amounts do not appear unreasonable.

In respect of PIEs, we note that non-audit restrictions and the non-audit fee cap may make PIEs reluctant to engage their auditors for non-audit engagements. In addition, some PIEs may impose even more stringent restrictions on the accountancy firms they engage in order that they maintain a pool of credible accountancy firms to participate in the next audit tendering process. The impact on cost of this self-imposed restriction of competition is unknown, but should be estimated.

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Costs to non-PIEs and their auditors

Question 6. 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?

In our opinion, this assumption appears reasonable.

Question 7. 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 have insufficient data to be able to answer this question.

Further questions on application to non-PIE Limited Liability Partnerships

Question 8. 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.

It is essential that the changes affecting non-PIE LLPs are implemented effectively and after due consideration. With this in mind, and in the light of the parallel consultations on LLPs specifically, and in particular the Micro-entity regime for LLPs and Qualifying Partnerships proposals, a single implementation date for all changes to the regime for all sizes of non-PIE LLP would be preferable. Accordingly, we believe that the Government should not implement the non-mandatory requirements of the Directive alongside the mandatory company changes, so that consistency throughout the LLP population (and their auditors) may be maintained.

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Question 9. 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?

While we are not in a position to provide detailed costings, we believe that the potential savings from implementing LLP changes at the same time as company changes are unlikely to be significant. The firms undertaking audits will be driven by the company timetable - by far the larger audit market - and the skills and training required will be transferable to the LLP sector whenever those changes are made. Given the importance of maintaining a coherent regime for all LLPs, that aspect should be given priority.

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