AUDITOR REGULATION – DISCUSSION DOCUMENT ON THE IMPLICATIONS OF THE EU AND WIDER REFORMS

ICAEW welcomes the opportunity to comment on the discussion paper *Discussion document on the implications of the EU and wider reforms* published by Department for Business Innovation & Skills (BIS) in December 2014, a copy of which is available from this link.

ICAEW is the largest Recognised Supervisory Body (RSB) and Recognised Qualifying Body (RQB) for statutory audit in the UK, registering approximately 3,500 firms and 9,300 responsible individuals under the Companies Acts 1989 and 2006.

This response reflects the views of ICAEW as a regulator and also takes account of the experience of its members in public practice and in business. Many of the latter have governance roles in UK companies and other bodies including membership of boards and audit committees.

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ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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OVERVIEW

1. ICAEW welcomes the opportunity to respond to this discussion paper (the Paper). As a Recognised Supervisory Body under the Companies Act we worked closely with the UK Government on the negotiations that took place in Brussels on the Audit Regulation and Directive (the Regulation and the Directive) and were broadly supportive of the package of measures that was eventually finalised in 2014. The challenge now is to see these measures implemented in accordance with current Government principles (considered below).

2. The Paper raises a number of specific questions about the role, remit and oversight of the UK audit market which we address in detail below.

3. In thinking through how the Regulation and Directive should be adopted it is important that policy makers keep front of mind why these pieces of legislation were originally conceived. When the European Commission set out to tackle perceived failings in the audit market in the aftermath of the 2008 financial crisis it stated:

> 'In the wake of the financial crisis, we need to ask the question whether the role of auditors can be enhanced to mitigate any new financial risk in the future…This work on audit is part of our effort to learn the lessons from the crisis and reform the financial sector[1].'

4. In short, the Regulation and the Directive were drafted to address the audit of banks as well as the largest and most complex Public Interest Entities (PIEs) – those that could pose a systemic risk to financial stability and market confidence. The UK Government should bear this purpose in mind when implementing them.

5. The Government's overall principles of regulation also need to be factored in:

> 'The Government will regulate to achieve its policy objectives only:
>
> (i) having demonstrated that satisfactory outcomes cannot be achieved by alternative, self-regulatory, or non-regulatory approaches
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> (ii) where analysis of the costs and benefits demonstrates that the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches
>
> (iii) where the regulation and the enforcement framework can be implemented in a fashion which is demonstrably proportionate; accountable; consistent; transparent and targeted.
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> There will be a general presumption that regulation should not impose costs and obligations on business, social enterprises, individuals and community groups unless a robust and compelling case has been made[2]'.
>
> and 'When transposing EU legislation the aim should be to avoid going beyond the minimum requirements of the measure being transposed...(so as not to) create unnecessary legislative burdens and place UK business at a competitive disadvantage[3].'

6. To those ends we believe there is no case for change in the regulatory model, over and above the minimum necessary. The following issues arise:

- The Financial Reporting Council (FRC) should remain focused on that part of the audit market which poses the greatest systemic risk. At a time when the new tendering regime is generating significant market movement it would be of real concern if the regulator were to divert focus and resource from those firms which audit the largest and most complex PIEs. Such a move would undermine investor confidence without any obvious net gain.

[1] European Commission Press Release, Brussels, 13 October 2010, IP/10/1325
[2] Better Regulation Framework Manual, BIS, July 2013 p.4
[3] How to Implement European Directives Effectively. HM Government April 2013 p.6

- When the current governance arrangements were set up, they were based on the FRC being primarily an oversight body, with limited direct activities beyond standard setting. A number of the proposals envisage the FRC moving away from this role towards taking widespread direct responsibility for executing regulation.

- Concentrating power in the hands of one regulator goes against the good regulatory practice which has emerged since the financial crisis: the 'twin peaks' model of dual regulation ensures appropriate balance, challenge, robustness and specialisation. The UK needs strong, independent professional bodies such as ICAEW as part of the overall regulatory framework.

- If the FRC is to become the single competent authority under the legislation it will be following a quite different purpose from that which it was originally set up to fulfil. If this becomes the case there needs to be an independent review of its current governance structure as well its accountability so that there is robust Government oversight of its new role.

- Changes should not place additional regulatory burden on smaller entities by enforcing standards intended for highly complex (financial) institutions on the lower end of the PIE market which will only constrain the ability of these smaller entities to drive UK economic growth.

7. We do not see that the proposed changes address these issues. ICAEW has a long history of acting as an effective regulator working in the public interest to ensure market and consumer confidence in the role of audit. This was recognised in 2012 by the FRC in its report to the Secretary of State for Business:

> 'The [European] Commission wants to restrict very substantially the role that a professional body can play in audit regulation, placing on the independent oversight body responsibility for monitoring the work of all statutory auditors…we do not consider that the Commission has made a convincing case for such a major change and consider that the existing arrangements, at least in the UK context, are fit for purpose[4].'

8. We agree with the FRC and in order to implement the Regulation and Directive with the minimum substantive change, we would like to see separate legal designation of ICAEW and other RSBs as competent authorities for a designated range of duties with hardwired delegation from BIS rather than through the FRC.

9. We have taken independent legal opinion from Blackstone Chambers where we believe the interpretation of the legislation could be open to ambiguity in respect of the regulatory model and have referred to this advice in our answers to questions where appropriate.

10. ICAEW has played a key role in the audit reform debate both in the UK and Brussels. We have engaged with BIS in a number of ways and are pleased to continue to do so where this is thought to be helpful. We have also backed words with actions in other areas:

- As a result of work we undertook with the Bank of England and the Prudential Regulation Authority (PRA) there is now a framework in place that enables structured dialogue between bank auditors and the main financial services regulators.

- We are currently working with the PRA on a framework for providing assurance on bank capital ratios and measuring risk-weighted assets.

- We have led the debate on how the bank audit model needs to evolve to continue to meet investor expectations producing a new assurance model around benchmarks and indices

[4] POB report to the Secretary of State for Business Innovation and Skills, Year to 31 March 2012 p.39

such as LIBOR as well as a series of 'Audit insights' reports to provide sectoral perspectives on potential risk issues.

11. Our ability to lead on these kinds of initiative – which continue to have a positive impact on investor and market confidence – and to contribute to the success of the accountancy profession more broadly, depends on our being seen as a strong independent voice as well as a distinct component of the UK regulatory architecture. One of the hallmarks of a profession is a clear and significant role in regulation. The reputation of our profession is a key element in its success – in 2012 for example, professional services, of which the accountancy profession is a key component, generated a trade surplus of £9bn for the UK economy[5].

12. We are committed to seeing the effective implementation of the Regulation and Directive but want affirmation of our continued role as an independent regulator within the new framework.

RESPONSES TO SPECIFIC QUESTIONS

MAIN CHANGES

Q1: In relation to the measures discussed in both this and the next chapter, we would welcome comments on the balance between legislative and non-legislative implementation of the requirements of the new Directive and Regulation.

13. Legislation can be inflexible and not allow for changes in circumstances. Accordingly using means other than legislation has advantages in many areas.

14. To the extent that this involves delegation to others such as the FRC, this should not compromise the government's commitment to minimum regulation. The government retains the ultimate responsibility for regulation specified in the Regulation and Directive; and so BIS should set a clear expectation as regards any delegated implementation, that minimum implementation is the default position. Any gold plating must be justified by clear evidence and impact analysis, having regard to the government's wider obligations to enhance competitiveness, as if the relevant regulation were implemented in legislation.

15. One area that could benefit from legal certainty is the regulatory structure – discussed in more detail below. We note that the consultation paper issued at the beginning of February by the German Federal Ministry for Economic Affairs and Energy on the necessary changes to professional law and oversight rules for auditors, proposes that the role of the Audit Chamber (WPK) would be enshrined in legislation to ensure legal and organisational certainty for the WPK. This is considered further below.

Q2. In relation to all the Member State options in the Directive and the Regulation, we would welcome comments to inform our thinking on whether and how these should be taken up. Though many are discussed in this document and in specific questions, all the options in the Directive and Regulation are considered in the options tables that are being made available separately.

16. The UK government entered into the negotiations around the European audit reform measures with the aim that the UK system of audit regulation should be preserved as far as possible. A number of other member states will have had similar aims and some of the Member State Options (MSOs) came about as compromises as a result. The guiding principles around MSOs must be to take them up where they maintain something that is fit for purpose, assist practicality and flexibility of implementation, and minimise the administrative and cost burden on business. We make comments on MSOs in a number of specific points in our responses to

[5] CityUK Key Facts 2014, from ONS Balance of Payments Yearbook.

the remaining questions but do not otherwise have comments to make on the MSO tables that accompany the Paper.

17. It is also worth bearing in mind the starting position for many EU member states. Compared with many countries the UK already has a sophisticated level of regulatory oversight in place. It will take a number of years for those states to get to a similar position. While that is happening firms and audit firms within those countries will be at a competitive advantage to those in the UK to the disadvantage of UK industry. A move towards best practice is a worthy end objective. However, we question whether early adoption of additional sophistication is sensible, when other countries are much further behind in their regulatory arrangements.

Q3. In relation to the measures discussed in both this and the next chapter, what issues do you think arise that have not been considered as part of the discussion? If there are any, how do you think these should be addressed?

18. The suitability of existing governance arrangements for the FRC needs to be considered. When set up, they were based on a premise that the FRC was primarily an oversight body, with its direct activities focused on standards and those audits with a potentially systemic impact on the markets. A number of the proposals envisage the FRC moving (sometimes gradually) away from this role towards taking widespread direct responsibility for executing regulation. In such circumstances it would increasingly become prosecutor, judge and jury. In our view the existing governance structure is inappropriate for that role. A greater accountability to the UK authorities would be needed, together with appropriate checks and balances on its ability to require funding. Indeed it may be appropriate to re-consider whether the FRC should become a Non-Departmental Public Body (NDPB). This issue is discussed further in the section on competent authorities.

Q4. In relation to the measures discussed in both this and the next chapter, we would welcome comments on any burdens applied to small and micro sized companies and audit firms in particular by the proposed implementation, which you consider are disproportionate to the wider benefits?

19. Auditors on all audits need to undertake enough work to be able to provide a high quality, independent audit opinion. The additional measures included in the Regulation and Directive will add to cost, which will be likely to be felt disproportionately by small PIEs with fewer resources. In particular, increased non-audit services (NAS) restrictions, tendering and rotation requirements, and enhanced reporting, all of which constrain a company's freedom of choice, take management time to implement and add paperwork. The additional measures have largely been put in place to enhance the auditor's role in mitigating systemic financial risk. We note that US legislation excludes smaller listed companies from some of the Sarbanes-Oxley requirements. We acknowledge the limitation of flexibility in this area given the EU requirements but it highlights the need not to go beyond those requirements for businesses which do not represent a systemic risk. It is also important to explore the provisions on simplification, and ensure that the proportionality provisions for small company audits can be applied. This latter aspect is discussed in more detail in our response to the parallel consultation by the FRC, a copy of which we shall provide to BIS when submitted.

Public interest entities

Q5. Do you agree that the Government should not expand the definition of a PIE beyond the EU minimum requirement – that is listed companies, banks, building societies and insurers? Please provide further information in support of your answer?

20. The introduction to the Regulation (para 5) makes clear that the aim of the reforms is a series of measures to provide a more robust environment for PIEs and their auditors and reduce systemic risk to member states caused by a financial breakdown of those entities.

21. The Regulation accordingly imposes measures on companies and auditors to ensure the audit is addressed effectively. But it goes further than that. The burdens of Article 11 for example require improved governance and financial controls within the entity and the auditor to challenge them. This is a pro-active legislative approach, whereas the elements addressing inspection of the auditors, worthy as they are for public confidence, are re-active and potentially shutting a stable door that may have been left open too long.

22. In this context therefore we would question the appropriateness of the PIE and major audit dual categories being continued in this legislation. The unease expressed by the European Commission in the Transparency Report (12 February 2013) around the UK's approach to the definition of PIE and the wider definition applied by other European member states, and indeed Commonwealth states, suggests that the UK legislation is being manipulated to suit existing structures rather than the outcomes sought by the EU legislative framework.

23. We would also point to the added inspection obligations now required by the Competition Commission and the limited resource that the FRC has at its disposal. The regulatory priorities have changed and we believe that rather than simply extending existing definitions and risk diluting its impact, the FRC should be taking the opportunity to look at the regulatory framework for corporate entities in the UK with a view to considering afresh the risk to the UK economy of the financial failure of any of these, quoted or otherwise, and including them if high risk in the PIE definitions. Then they should concentrate their energies on ensuring that the audit and internal controls are adequate to protect the public and consumer interest. That should be the proportionate and targeted response of the FRC. Any entities that fall outside this definition should have the review of their audits delegated to other bodies, and the FRC role should be confined to ensuring that those bodies carry out their role properly. That is the spirit and aim of the EU legislation and one to which BIS and the FRC should adhere.

24. In view of the underlying aim of focusing on entities which could cause systemic risk, the government could reserve the power to add other entities to the definition: for example significant financial service, utility, IT or transport entities and indeed significant pension funds. However we do not believe such entities need to be 'hard-wired' into legislation at present and we support minimum implementation. Following the same logic, we recommend the discontinuance of the major audit distinction: the major audit definition includes entities that do not present systemic risk.

25. It may also be appropriate for the definition of 'trading on a regulated market' to be considered. At present this appears to include the main stock exchange and the ISDX main market but exclude AIM and the ISDX growth market. We believe that it should be confirmed specifically that it excludes those smaller exchanges. For example, the purpose of AIM, as noted on the AIM website, is to offer: 'smaller growing companies the benefits of a world-class public market within a regulatory environment designed specifically to meet their needs'. As explained above, we do not believe that the European audit reforms were aimed at such entities, unless they are viewed as presenting systemic risk.

Q6. What issues, if any, do you consider arise from the application of the provisions of the Regulation to audits of PIEs as defined in the Directive? How do you consider these should be addressed?

26. It is possible that some small entities falling under the audit exemption threshold may now require audits as a result of being redefined as PIEs. The resulting audit committee obligations will have a significant effect on cost, on top of the cost of an audit where this has been discontinued. In addition, audit firms may be unwilling to take on such work if it is subject to the additional regulation that applies to auditors of PIEs. A shared audit committee arrangement

(similar to that for Local Audit) may help reduce the audit committee cost. Similar innovation on Transparency reporting, for example by considering applicability of the Audit Firm Governance Code, may be appropriate as part of a future FRC consultation.

Q7. What issues, if any, do you consider arise from the need to broaden the application of the implementation of the 2006 Directive as amended to include:

• other entities whose securities are admitted to trading on a regulated market;
• electronic money institutions;
• payment institutions;
• MiFiD investment firms;
• Undertakings for Collective Investment in Transferable Securities (UCITS); and,
• Alternative Investment Funds (AIFs).

How do you consider these should be addressed?

27. The EU definitions could be read to include organisations such as, for example, local post offices. The audit exemption threshold provides some comfort, but where an audit is required for bespoke reasons the associated obligations, especially in respect of independence, could be excessive and damage the provision of essential services to local economies outside the urban conurbations. Discouragement of bespoke audit requirements and replacement with a suitable assurance service may be more proportionate.

Q8. What do you think are likely to be the familiarisation costs to auditors of PIEs arising from all the changes affecting them. In particular:

(a) how many person hours likely to be involved in an individual statutory auditor and their team understanding and preparing for the changes?
(b) what are the costs to audit firms of updating internal management systems to reflect the changes?
(c) How this is likely to vary by size of audit firm?

28. We have no data on this, which are most likely to be sourced from audit firms. Other determinants would be the industry of the client and their international reach.

Competent authorities

Q9. Do you agree the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under the 2006 Directive as amended by the new Directive and under the Regulation?

29. The key consideration should be to determine the best model for regulation of the profession, within the permitted framework, that draws on the current model's strengths. The Paper's proposals around competent authority in our view go considerably beyond what was ultimately agreed in the Regulation and Directive and do not result in the best model. This is not only gold plating without a clear benefit, but a significant repositioning of the regulatory structure that poses considerable regulatory risk through placing one regulator in an unhealthily powerful position without appropriate checks and balances. It would weaken the role of the accountancy profession itself in leading and developing the delivery of audit at best quality standards.

30. In our discussions with BIS towards the end of 2013 we were given to understand that the compromise texts were being directed towards a position that was helpful for BIS, the FRC and the profession in that they would allow a focus on areas of systemic risk, and result in the minimum of change for the UK – not least because it was already providing best practice in this area. We believe that the final texts are consistent with that understanding. Accordingly,

little adjustment is required to address the competent authority structure. The proposed role of the FRC would take UK legislation beyond the requirements of EU reforms and would be directly contrary to the Government's red tape programme. As such they need clear justification on a cost-benefit basis.

31. It is worth reflecting on the UK structure, which has been in operation in various forms for the past 25 years. Most recently the differing roles envisaged in the regulatory arrangements included in the Companies Acts 2004 and 2006 recognise the strengths of a twin peaks structure: FRC primarily as an oversight body and standard setter, focusing its direct attention on the minority (by number) of audits of entities that could cause a systemic risk, with the professional bodies (in their roles as RSBs) undertaking the bulk of the regulatory work. The oversight mechanisms and opportunity for challenge in either direction mean that the audit oversight environment in the UK is constantly being reviewed and improved. Although this structure can be made to look complex, it is not so if the purpose is borne in mind.

32. The ability to challenge is a healthy one; the adoption of International Financial Reporting Standards (IFRS) and the appropriateness of prosecution of some public interest cases are areas where ICAEW and other RSBs have questioned the approach of the FRC and adjustments have been made as a consequence. However these sorts of challenges would have no place in a delegated role. We point elsewhere to the inappropriateness of the current governance of the FRC itself should it take on some of these added powers and the resulting lack of accountability. This accountability would be weakened further and BIS would ultimately be more exposed to risk, in its role of ensuring efficient oversight, if the twin peaks balance was dismantled and the regulatory bodies were no longer in such an authoritative position.

33. In our view the current arrangements work well, and there is no evidence that the proposals would be an improvement on them. They do not need to be changed significantly, other than to meet the requirements of the Regulation in respect of PIE audits. It is important for capital markets that the FRC is able to concentrate on issues of systemic risk, without dilution of focus.

34. In terms of the detail, we believe the legislation around competent authority has been misinterpreted. We do not accept the interpretation that could be applied of Article 32 of the Directive requiring a single competent authority and have obtained legal opinion supporting our view. Article 32(4a) makes clear as does Regulation Article 20 that more than one competent authority can be envisaged, one of which should have ultimate responsibility. Our legal opinion also confirms that the independence requirement (Article 32(3)) applies to the competent authority with ultimate responsibility, not to the other competent authorities. 'Ultimate responsibility' is for oversight, not for the performance of the regulatory tasks.

35. It could be argued that the single competent authority proposal is the easiest and neatest solution. We do not agree that either applies. The legislation makes clear that in a number of situations, the body fulfilling that role could be regarded as a competent authority. In the majority of the examples listed in Article 20(1) and Article 20(2) the Financial Conduct Authority (FCA) fulfils the identified roles. It is de facto already a competent authority in this space. Consideration is required in the proposals as to how it would interact with an ultimate competent authority. Indeed, as the FCA oversees the area of highest systemic risk through financial services, there may be a case for it to be considered as the ultimate competent authority. Similar considerations apply to the PRA, which has recently published proposals to enhance direct engagement with, and disciplining of, auditors.

36. As noted above, the requirement for the competent authority to be undertaken wholly by non-practitioners only applies to the ultimate authority (Directive Article 32(3)), not to the other competent authorities which are simply required under Article 32(4a) to be 'organised in such a manner that conflicts of interest are avoided'. We believe ICAEW's enhanced regulatory governance arrangements meet these criteria but there is a role here for BIS and/or the ultimate competent authority to set out what the governance requirements of a competent

authority should be, with due consultation. Reference should be made to the Internal Governance Rules (IGRs) of the Legal Services Board (LSB) which are a regulatory mechanism to achieve the necessary levels of independence for the regulatory oversight of legal services, and these perhaps could serve as a model for how this might work in the audit sphere.

37. ICAEW for its part has recently reviewed its regulatory governance structure, partly in the light of the LSB's IGRs and with an eye to the then draft proposals before the European Parliament in 2013 for competent authority. It has accepted recommendations from a working group chaired by Sir Christopher Kelly to modify its governance structures to deliver the necessary independence in accordance with current best practice and is currently implementing those recommendations. For this reason we believe ICAEW's regulatory governance arrangements will be robust enough to meet the criteria required of a competent authority.

38. Establishing ICAEW as a competent authority gives legal certainty, hard wiring in roles and responsibilities, and maintains the status of the profession, protecting its reputation. This in turn contributes greatly to its being part of a key economic sector within the UK. These points merit further consideration:

- Clear and legal certainty as to what roles and responsibilities the professional bodies undertake is vital for: our ability to plan efficiently; clarity for members; and as noted above, our ability to raise reasonable challenge on issues where we believe there is for example, a public interest concern. Just being a 'body recognised by law' which is capable of being delegated to by the FRC at their discretion severely compromises these aspects.

- A hallmark of a profession is at least a significant role in regulation, which brings with it a perspective that seeks to be in the public interest, rather than that of a lobbying trade body. A successful regulatory system builds on this to create the 'twin peaks' structure discussed above. It takes a long time to build a professional ethos, and it should not be lost.

39. We note that the current governance arrangements of the FRC itself with regard to the nomination process required in Article 32(3) are not compliant. In addition its role in the setting of audit standards may be in conflict with Article 23(1) where the competent authority is not allowed to interfere in the content of audit reports.

40. The existing governance structure for the FRC is based on its original role as primarily a standard setter and oversight body. The further the FRC moves away from this role towards direct responsibility for executing regulation, the more it effectively becomes prosecutor, judge and jury all in one. The existing governance structure is not appropriate for such a role and more accountability to the UK authorities is needed. Indeed it may be appropriate to re-consider whether the FRC should become a NDPB, a structure for which the Cabinet Office has established a formal oversight mechanism.

41. It may be worth considering the governance and accountability structures of other regulators. An example offering a salutary lesson is the Legal Ombudsman Service, which has recently found itself compromised through remuneration packages that the Ministry of Justice consider to be irregular and yet appear to have been processed through the internal governance arrangements[6]. This in part appears to be down to uncertainty in the governance structure, the oversight role of the Ministry of Justice, and the treatment of the service as not being an NDPB. Such mix-ups and lack of accountability have been highly damaging to the reputation of the ombudsman when fundamentally it appears to be carrying out a good job. It would be destabilising to market confidence were the FRC to find itself in a similar position.

[6] Office for Legal Complaints Annual Report and Accounts 2014, HMSO 2015

Q10. What issues, if any, do you consider arise from the need to implement a new statutory framework for the setting of auditing standards and for audit inspections, investigations and discipline by the single competent authority to replace the current framework that requires the bodies' rules to provide for this? If there are any, how should they be addressed?

42. The investigation and disciplinary processes currently in place do not need to be amended to accommodate the new regime. There is a need to modify the definitions in schedule 10 of the Companies Act 2006, which had allowed auditors of fewer than 10 PIEs to be inspected by the RSBs. Other than that the existing processes flow from the definitional change. We do not see the need for the FRC to select and delegate on non-public interest inspection arrangements on an individual basis. This would dilute the necessary focus around public interest, which the supervisory body should be focusing on.

43. As noted above we question the continued use of the major audit distinction given the focus the EU legislation is seeking to place on oversight bodies to deal with systemic risk issues associated with the provision of audit. Currently 'major audit' is a filtering mechanism where both supervisory body and RSBs determine the parameters for the sharing of the work, but given the additional requirement for inspection of listed entities placed upon the FRC by the Competition and Markets Authority (CMA), supporting the EU approach, we consider that energies are best focused on this role. The RSBs should deal with the secondary role subject to the rigorous oversight that the FRC already applies.

44. There is nothing in the EU legislation which would require the existing licensing arrangements to change; in particular the Regulation makes no reference to licensing.

Q11. What issues, if any, do you think might arise for the current investigation and disciplinary arrangements between the professional supervisory bodies and the FRC, that apply to accountants generally as opposed to only auditors, given the changes in relation to audit? If there are any, how should they be addressed?

45. Accountants undertake a wide variety of activities and the professional bodies are accordingly engaged with a number of other regulators, for example the Legal Services Board. The EU Audit Reform legislation did not address the work of accountants generally. The current arrangements made by letters of exchange between the RSBs and the FRC are not affected by the EU Audit Reform legislation. There are no issues that need to be addressed here.

Q12. In relation to each of the tasks provided for in the Directive and Regulation, do you consider that responsibility should be allocated to the single competent authority, for it to delegate to the professional supervisory bodies as appropriate and to the extent permitted in the Directive and Regulation? Please provide further information in support of your answer.

46. No. As noted above, we do not believe there is a requirement or a need for a single competent authority in respect of non-PIE audits. The role of the ultimate competent authority should be to supervise and delegation responsibilities would alter that role significantly. Changing the structure of execution and accountability unnecessarily would damage the ethical and professional platform of the UK accountancy bodies, with consequences for our international work and our relationships with other areas of professional services. It is also damaging for audit quality and competition.

Q13. For any tasks where responsibility is allocated to the single competent authority for it to delegate, what limitations, if any, do you consider would needed to ensure that authority only retained responsibilities or reclaimed delegated responsibilities in appropriate circumstances? What do you consider these circumstances should be?

47. The prime role of the FRC is and should be to limit the risk of systemic risk to financial markets. Accordingly it should focus on material entities associated with the public interest, namely the PIEs and where appropriate the major audits, though the latter should be revisited from time to time to ensure the category includes only those entities which would pose systemic risk. Over involvement at a lower level creates unnecessary cost and dilutes effort and focus.

48. The current arrangements are a statutory recognition of an appropriate allocation of rights and responsibilities. Recognising ICAEW and the other RSBs as competent authorities for relevant regulatory purposes would enshrine necessary safeguards for ensuring responsibilities are not unnecessarily transferred to the ultimate competent authority.

Q14. In relation to each of the tasks provided for in the Directive and Regulation, are there any tasks, or any aspects of those tasks, that you consider it is important should continue to be covered by provisions in legislation on the content of the rules of the supervisory bodies? Please provide further information in support of your answer.

49. Our initial reading of the legislation is that it adds to rather than takes away any of the existing obligations as applied in the audit rules. There are no issues we can identify at this juncture, other than to refer to the benefits of legislative certainty, addressed in our responses to Q1 and Q9 above.

Q15. Do you consider that both the registration of statutory auditors and their removal from the register should be covered by regulations under the Companies Act? If so, which body or bodies do you think should have statutory powers for the removal of statutory auditors from the register?

50. Provision is already made for this in the existing legislation. The RSBs have the responsibility for these aspects and set out the requirements as they see fit in their audit regulations. The FRC has nevertheless input into the process: the decision to require a licence to be suspended or terminated for the auditors of PIEs can come from the FRC under their existing powers in section 1225 of the Companies Act 2006 as amended. They can also exercise this for public interest cases. If the FRC is intended to be a body focused on systemic risk, we question why the FRC would have any involvement other than in the context of a public interest case.

Q16. Do you consider that, for consistency with a framework of ultimate responsibility, single competent authority approval should be required for the rules of the supervisory bodies?

51. The FRC already has an oversight role enshrined in existing legislation. The proposal that this question addresses is not included in the EU legislation and is unnecessary.

Q17. What do you consider are the costs and benefits in monetary terms and in terms of the effectiveness of audit regulation of the proposals in this chapter and of your preferred approach to implementation of these provisions?

52. Costs will increase substantially for medium-sized firms currently performing less than 10 PIE audits to cover the additional inspection arrangements. If the framework otherwise followed the current arrangements we would expect the costs to be marginal. However, further changes to the framework and centralising all power in one competent authority would: add further cost of change for the sake of it; add ongoing cost through removing or complicating regulation of smaller entities from the RSBs, who have extensive experience in this area; dilute focus and destroy the balance of the twin peaks model of regulation, adding to systemic risk; and weaken accountability without wholesale change in the FRC's governance arrangements.

Audit fees and non-audit services

Q18. Do you agree that the provisions of Article 4 of the Regulation on the cap on non-audit services should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

53. We agree. It is sensible to keep independence provisions in one place. However, this should not be a reason to change the underlying regulatory stance that BIS would itself have looked to adopt. We believe it appropriate that BIS should indicate an expectation to the FRC that minimum implementation is the default position. Any additional measures need to be thoroughly justified, with a comprehensive impact analysis, including the effects on competition, and of extraterritoriality through deviating from the European norm.

Q19. What issues, if any, do you consider arise from the application of the provisions on the cap on non-audit services? If there are any, how do you consider these should be addressed?

54. We have argued in the European debates on these measures, that the whole basis for a cap is unjustified. We considered it unnecessary and arbitrary given existing overall fee dependence and transparency safeguards. We note that the final wording of the Regulation applies several significant limits to the scope of the requirements, eg, limits on which audit firm it applies to, when it applies, and the inclusion of a MSO to grant exceptions. This suggests that in the final analysis this was regarded as a political measure rather than a restriction that would significantly enhance independence.

55. Given the important safeguard that non-audit service fees are subject to transparency to allow the market to make its own assessment, and that the proportion of non-audit fees to audit fees has been falling for some years[7] we do not believe that more than minimum implementation is necessary.

Q20. Do you agree that the Member State options in Article 4, to set more stringent requirements on the cap and on the auditor's independence where their total fee income from a PIE exceeds 15% of their total fee income overall, should be capable of being applied by the FRC in its ethical standards for auditors? Please provide information to support your answer.

56. We agree, with caveats. Independence provisions have historically been set in standards rather than legislation in the UK and the FRC ethical standards remain the most logical place to include these measures. As a standard setter, FRC needs to have the ability to amend its standards should evidence dictate that more stringent requirements are needed. Accordingly the MSOs should be taken up. However, we do not currently see any evidence of a need to go beyond EU and existing Ethical Standards requirements. Our points in answer to Q18 above regarding expectations and conditions for going beyond the requirements, apply here too.

Q21. Do you agree that the FRC should have the ability to exempt an audit firm from the 70% cap for up to two financial years on an exceptional basis and on application by the firm?

57. We agree. Any fixed percentage cap is very arbitrary, and there could be circumstances where a good reason arises to go above this for short periods. An example would be the provision of audit related services on a takeover or listing, where the UK has a much admired reporting accountant role which is generally carried out by the auditors. The ability to grant an exception recognises this and guidance to the capital markets as to how it will work would be useful. We expect such an exception to be disclosed as part of the transparency around the provision of

[7] For example, FRC Key Facts and Trends in the Accountancy Profession 2012, FRC, June 2012

non-audit services. However, it is important that the application process itself is not overly restrictive. Events such as takeovers cannot necessarily be anticipated, and it could be very prejudicial to the interests of a PIE if an application was excessively onerous or unpredictable in outcome.

Q22. Do you agree that the subject matter of Article 5 of the Regulation on the blacklist of non-audit services, including the possibility of setting more stringent requirements, should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.

58. Our answer to Q20 above also applies here.

Q23. What issues, if any, do you consider arise from the application of the provisions on the blacklist of non-audit services? If there are any, how do you consider these should be addressed?

59. As the blacklist is somewhat ill-defined, issues of interpretation inevitably arise (for example, the meaning of 'services that involve playing any part in the management or decision-making'). To the extent that the European Commission has not itself pronounced on such matters, interpretations should have regard to the underlying purpose of the list and existing guidance from the International Ethics Standards Board for Accountants, the Fédération des Experts Comptables Européens, and the existing FRC Ethical Standards.

Q24. Do you agree that implementation of the revised requirements on ensuring and documenting auditor independence in the 2006 Directive should be implemented primarily via the ethical standards, with amendments to the existing legislation as necessary only to:

(a) underpin the standards? And,
(b) introduce simplifications for audits of small non-PIEs?

Please provide further information to support your answer.

60. We agree, though the points raised in our answer to Q18 regarding minimum implementation and gold plating also apply here.

61. We encourage the introduction of simplifications for small non-PIE audits. The 'PASE' ethical standard is useful, and indeed can be applied to a number of other types of entity such as smaller charities. However, simplification can go further in wider areas than those addressed in this question. In particular we note that there are MSOs allowing simplification in the areas of preparation, consideration of threats and safeguards, organisation, and breaches reporting. Documentation, for example, is a disproportionately significant cost in a small audit and we are pleased to see the BIS encouragement in this area, referred to in the Paper.

62. Addressing such matters positively helps to underpin the principle that while all audit reports have to reflect the same conclusion, the appropriate means of arriving at such conclusions will vary with size and circumstance. This in turn helps to counter the potential trickle-down effect that PIE provisions can have on audits of non-PIE entities, including charities, which the EU's regulatory intention did not seem to focus on. Proportionality and simplification are discussed further in our response to the parallel consultation from the FRC.

Q25. Do you agree that the existing framework on disclosure by PIEs in notes to their accounts of the audit and non-audit fees they paid their auditor should be adapted, to ensure public disclosure of the information the auditor is required to provide to the competent authority under Article 14 of the Regulation? Please provide information to support your answer.

63. Disclosure of audit and NAS fees paid by a company to its auditors, in the accounts of the company, is an important mechanism for ensuring that the market can make its own assessment of the relationship between company and auditors.

64. We assume that it is intended to continue to require only information about the fees paid by the organisation itself to be included in its accounts, rather than that for all PIEs who pay fees to the relevant auditor: the latter interpretation would be something of a departure for company accounts and in any event would be in the auditor's own transparency report.

65. On that basis, the proposal is in essence to analyse between NAS required by national legislation and other NAS. While it may be useful information to assist the market in assessing NAS fees, there may be other more appropriate analyses under the particular circumstances. It is important that the disclosure framework should not be too rigid.

Q26. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the blacklist?
(b) the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor?
(c) the extent to which these additional costs vary by the size of PIEs?
(d) the person hours likely to be involved in a non-audit team at an audit firm understanding and preparing for the changes given that they will not be able to provide certain non-audit services to the firm's audit clients?

66. We do not have data on the points raised, which are more likely to be sourced from the audit firms. However, we have summarised in our response to the parallel FRC consultation, an analysis of the provision of services by our smaller registered audit practices, based on recent annual returns. While the information we have does not distinguish between services to audited entities and to others, it highlights that even quite small practices provide a wide range of non-audit services. The impact of any change will not diminish for smaller PIEs and their auditors.

67. The impact on the audit market of reduction in choice is also relevant. Given that NAS prohibitions apply for a period before and after audit appointment and resignation, and that they realistically need to be considered during a period of audit tendering, the impact on choice of expanding the list of NAS prohibitions widely, would be significant.

Tendering and duration of audit engagements

Q27. Audit Committees must submit a recommendation to the board for the appointment of an auditor. However, under Article 16(1) sub-paragraph (2) of the Regulation, this does not apply where the Member State has provided an alternative system for the appointment of the auditor. The current alternative systems set out in the Companies Act 2006 are where:

• the directors appoint the auditor before the company's first accounts meeting;
• the directors appoint the auditor to fill a casual vacancy in the office of auditor; and where,
• the Secretary of State appoints the auditor because a public company failed to do so.

Do you consider that all of these alternative systems for the appointment of an auditor should continue to operate in the UK as they do at present? Are there any other systems that should also be provided for on the grounds that a competitive tender process is not appropriate? Please provide further information to support your answer.

68. Yes we agree. We see no reason why the current system should not continue: the first two circumstances referred to in the question are useful pragmatic arrangements and the third is a

valuable general failsafe, which could be used in a variety of circumstances. Given that, there is no need for additional circumstances to be included.

Q28. Where the PIE is exempted from having an audit committee (eg because it is an unlisted bank), there is no provision as to which body should fulfil the audit committee's role. Do you agree that in this situation the directors should determine the recommendations that should be put to shareholders of the audited entity? Please provide information in support of your answer.

69. We agree: this is in line with the unitary board concept that prevails in UK law and there is no practical alternative that would fit with the varying circumstances of such entities.

Q29. The Government does not intend to take up the option to provide for an extension of the maximum duration of the engagement beyond 10 years where a joint auditor is engaged. Do you agree that the replacement of a single auditor with two joint auditors, one of whom was the original auditor, should be made on the basis of a retender? Please provide further information in support of your answer.

70. To not take up the MSO in this area could be considered to be gold plating. There are arguments for and against joint audits and we are not opposed to them as a concept. However, as the current appetite for joint audits in the UK market is negligible, we accept that it is appropriate not to overcomplicate matters for minimal likely benefit.

71. BIS may wish to consider reserving the power to take up the MSO at a future point, should this position change.

Q30. We are considering whether provision should be made so that, where a PIE has stated in its annual report it will appoint an auditor based on a tender process before the expiry of the maximum duration of 10 years, it should still be able to take advantage of an extension of the maximum duration beyond ten years, following that tender. Do you agree?

72. We agree. As the Paper notes, this would be in line with Competition and Markets Authority thinking. Indeed, as a purpose of the Regulation in this area is to encourage tendering and audit firm movement, applying a notion that advantage can only be taken of the extension if tendering takes place at exactly 10 year intervals, is likely to have been unfortunate drafting of the Regulation rather than the underlying intent.

73. We think that the proposal to make the year proposed binding, when it is the next but one accounting year, may have the opposite effect however. Companies will be nervous of specifying earlier dates than those mandated, as this would reduce the flexibility available should there be, for example, a takeover bid or other event that might make a change of auditor unhelpful at a particular date.

Q31. We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the annual report setting out key matters for the audit committee on the appointment of auditors. Do you agree that the report should include:

a) when the current auditor took up the audit engagement at that company? (Yes / No)
b) when the audit engagement was last retendered? (Yes / No)
c) the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender? (Yes / No)
d) the directors' reasons for considering that the proposed year is in the best interests of the company's members? (Yes / No)

Do you consider that any other information should be included in addition the above? Please provide further information to support your answer.

74. We agree up to a point. We generally favour transparency to allow stakeholders to make their own decisions as to whether they have concerns. However, the proposals go beyond what is required in the Regulation. It therefore needs to be clear that they would result in useful information for shareholders at minimal cost. We believe items (a) to (c) achieve that though it would be useful to engage with shareholders and audit committee representatives after a suitable period to assess this. It may be that some of the information would be better included in alternative locations such as the company's website.

75. Regarding item (d) we think it likely that annual reports will end up including a standard meaningless boilerplate phrase. We would encourage explanation to be added where it is thought to be useful, but not to be required at all times.

76. An example of useful disclosure would be use of the power to grant an extension on an exceptional basis, in article 17(6) of the Regulation. If firms are unable to apply for such an extension, they are likely to tender at least a year before the backstop date, just in case there is a major issue needing continuity in the following year. We assume therefore, that the relevant competent authority will give such requests proper consideration, but if an extension is granted, it would be reasonable to require an explanation in the annual report.

Q32. We are considering whether, where the statement under point (c) above is included in the company's annual report, and the incumbent auditor is reappointed on the basis of the planned tender process before the expiry of the 10 year maximum duration (eg at 7 years), the next tender process should be expected to take effect:

(a) after the same period has expired again (ie year 14 in this example);
(b) after a further 10 years has expired (ie year 17 in this example); or,
(c) after the same period has expired again, though with the potential to extend it by the full 10 years via further notice from the audit committee in the annual report (ie in this example at year 14 though this could be extended to year 17)?

Which option would you prefer? Please provide further information in support of your answer.

77. The analysis seems overcomplicated. The requirements can and should be kept simple. While businesses may as a policy choose to tender at less than 10 years that should not limit their room for manoeuvre in law. The basic premise of the Regulation is that there should be tendering at least every 10 years and (assuming the MSO is exercised), rotation at least every 20 years. That should be what is required.

78. The period count should be based on the date of change, not the date on which the tender process is commenced. Complex organisations can take some time to go through a tender process and are likely to want to undertake it before the financial period commences.

79. There is also a need to be clear about the date at which the tender and rotation requirements apply to PIEs, depending on when they last tendered and/or rotated. The transitional provisions in the Regulation are not entirely logical (at least based on the Commission's interpretation) and questions arise about how events prior to 17 June 2016 could be taken into account. We know that BIS is aware of the issues and the guidance issued recently after consultation with the CMA is welcome. A table analysing impact dates in terms of last tender or change of auditors would be welcome.

Q33. What issues, if any do you consider arise from the UK's obligation to apply effective, proportionate and dissuasive sanctions for failure to comply with the UK's implementation of the framework on mandatory rotation and retendering? If there are any such issues, how should they be addressed?

80. We consider that responsibility for compliance should rest jointly with the PIE and the auditor. This would reflect reality: the auditor has a professional responsibility, and the business has a responsibility to appoint independent auditors. It would need to keep track of time periods in order to comply with the disclosure requirements anyway. Therefore we think it unlikely that there would be many instances of non-compliance. As regards sanctions, proportionality is key: invalidating an audit already carried out in error would cause excessive cost and disruption to stakeholders who are not at fault, for example.

81. With joint responsibility' it is important to be clear who should undertake what function. It is clearly the company's responsibility to appoint the auditors, but we would expect the auditor to advise on unsuitability for reappointment, and, in the absence of that, the auditor would face professional discipline.

Q34. For our impact assessment on the changes we would welcome any estimates that could be provided on:

(a) resources that are likely to be deployed by PIEs to tender audit appointments?
(b) resources that are deployed by auditors to tender for audit work?
(c) additional familiarisation costs that arise for both auditors and the audit client when a new auditor takes up an audit engagement?
(d) the extent to which this varies by the size of the PIE?

82. We do not have data on the points raised, which are more likely to be sourced from the audit firms. That said, a number of members with corporate governance experience have estimated that the internal costs approximate to at least the external audit fee.

83. As a general point resource usage is likely to be higher based on the complexity of the PIE rather than size. For example, distributors are large but relatively centralised and straightforward to audit, whereas decentralised small PIEs can be complicated to audit and present from the PIE perspective. There would be significant costs to some small PIEs.

Audit reporting, and reporting to the audit committee

Q35. What issues, if any, do you consider arise from the inclusion in legislation on audit reporting of a requirement for the auditor to include a statement in the audit report where there is a material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern? How do you consider these should be addressed?

84. While the provisions of the Directive must be implemented through UK legislation, to the extent that the going concern statement is already covered by auditing standards, we believe that BIS should seek to make the minimum necessary changes to the Companies Act 2006, in accordance with the Government's own transposition guidance.

Q36. Do you agree that the provisions of Article 10 of the Regulation on the audit report should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

85. We agree that the provisions of Article 10 of the Regulation covering the risks, response and key observations by auditors in audit reports should be included through amendments to the FRC's ISAs (UK and Ireland). We see no efficient or realistic alternative to this.

Q37. What issues, if any, do you consider arise from the application of the provisions of the Regulation on the audit report? If there are any, how do you consider they should be addressed?

86. The FRC will need to consider the extent to which the current requirements of ISAs (UK and Ireland) effectively implement the provision of Article 10, and whether specific changes to requirements will be necessary in order to deal with the requirement for auditors to disclose key observations. We note that paragraph 13 of newly revised ISA 701 issued by the International Auditing and Assurance Standards Board (IAASB) refers to how matters were dealt with during the audit, and that the related application material (paragraph A46) states this may include key observations. ISA (UK and Ireland) 700 does not have parallel provisions and while paragraph 19A (c) requires auditors to provide an overview of the scope of the audit, including an explanation of how the assessed risks disclosed were addressed, there is no specific reference to key observations either in paragraph 19 B which describes how paragraph 19 A is to be applied, nor any of the related application material.

87. Should the FRC decide that amendments need to be made in this respect to ISAs (UK and Ireland), and we believe that they should, we encourage the FRC to consider carefully the example laid out in the IAASB's newly revised ISA 701.

Q38. Do you agree that the provisions in Article 11 of the Regulation on the additional report to the audit committee should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.

88. The FRC should consider whether the fourteen detailed headings covering the content of the additional report to the audit committee should be included in ISAs (UK and Ireland), or whether it might be better housed within guidance on corporate governance matters, to which ISAs (UK and Ireland) might be cross-referenced, or at least in an appendix. This would preserve the clarity of the ISAs which are currently applied by auditors of all entities, and not just those required to or voluntarily implementing the UK Corporate Governance Code.

Q39. What issues, if any, do you consider arise from the application of the provisions of Article 11 of the Regulation on the additional report to the audit committee? If there are any how should they be addressed?

89. Many of the reporting requirements are similar to existing practice in the UK. Nevertheless, overall there will be more material to read. If it aids the Committee's understanding of how the audit is undertaken, it would be worthwhile. However, in view of the cost both to the auditor and the company of producing and processing this information, it is important that the requirements can be interpreted sufficiently flexibly to allow value to be added from the company's perspective.

90. In particular, some of our members with experience on audit committees have suggested that discussions on methodology are either likely to be unduly complex or end up as boiler plate statements, and question if they would add value. In their experience, informed discussion between the audit committee and the auditor is always more useful.

Q40. For our impact assessment on the changes, we should particularly welcome data on:

(a) additional resources are likely to be needed by the auditor to produce the additional report for the audit committee?
(b) the additional annual cost of the audit committee considering the additional report?
(c) how these costs vary by size of PIE?

91. The Paper notes that many of the specific requirements in Article 11 are new but that none should require additional audit work and none individually is expected to have a significant

impact on the audit. The fact that many of the requirements are new, means that there will be scope for different interpretations regarding whether additional audit work is required and prudent auditors will, for the avoidance of doubt, perform more work rather than less in such cases. It is almost inevitable that additional work will be deemed necessary at least in some cases and collectively, the impact is unlikely to be negligible, given the importance of the report to the audit committee and the level of partner time likely to be involved. We do not have data to quantify the additional resources that are likely to be required.

92. It is almost inevitable that additional work will be deemed necessary on the part of the audit committee in considering the new information provided. We comment on the net effect of the extra time involved in our answer to Q39 above. Again, we have no data to quantify the additional resources that are likely to be required.

93. We are concerned that the real costs of these and similar regulatory changes are dismissed, or assessed as negligible, partly because they are difficult to quantify and partly – as is often asserted – because many auditors already do much of what is being proposed. Doing something voluntarily and having to do it are two different things and there is always a certain amount of additional process that becomes necessary in voluntary-to-mandatory transitions. These costs and other incremental costs of applying this legislation will ultimately be borne by investors. As noted above, it is therefore important that the requirements can be interpreted sufficiently flexibly to allow value to be added from the company's perspective. As the scope for adding value may well be less for smaller, simpler entities, investors in smaller PIEs may suffer disproportionately.

Audit exemption thresholds

Q41. Do you consider that the small companies audit exemption thresholds should:

(a) remain aligned with those for the small companies accounting regime, so that the number of audit exempt small companies will increase in line with the increase in the small companies accounting thresholds;
(b) remain unchanged so that the turnover and balance sheet thresholds are considerably lower than the thresholds for access to the small companies accounting regime; or,
(c) be amended in some other way (please set this out)?

Please provide further information in support of your answer.

94. Business confidence is vital for growth and effective financial management is crucial for this in any business. Strong financial controls and appropriate management oversight are important components for any organisation seeking to grow and build their business, no matter what their size. Audit is critical in this. It plays a vital role in the oversight and governance of companies. This is as true for many smaller businesses as it is for larger multi-nationals. It provides investors, shareholders and management with trusted independent verification of an organisation's financial statements and gives insight into how well it is being run.

95. We believe that the extent of reporting and the degree of assurance are likely to have different impacts on different stakeholders. Increasing the audit exemption thresholds to be consistent with the proposed higher small company accounting thresholds would be consistent with the current approach whereby the thresholds are aligned and would be easy to understand. There are a number of countervailing issues. For example:

- the size and nature of companies classified as small already varies greatly; a feature that would become even more apparent were small company accounting thresholds to be increased;

- there are potential competition consequences on companies not exempt from audit, with accountancy firms increasingly incentivised to exit the audit market;

- assurance or lack of it would be likely to have a greater potential impact on funding costs than whether the small company accounting regime is adopted; and

- critically, there is also a public interest agenda: cost of fraud to society, public protection against companies having limited liability, and a general impact on raising the 'ethical' bar in the market.

96. While we understand the notion that a voluntary audit sends a clearer signal to stakeholders than a compulsory one, this perhaps ignores aspects of human nature: a voluntary 'assurance' product can be no substitute for a public interest mandate afforded to auditors as we cannot expect those giving rise to the greater risk to the public interest to volunteer to be audited.

97. The Paper indicates that the number of companies affected is approximately 7,400. While this would have a relatively small effect in terms of fees for the profession, the small companies thresholds are about to increase to a size which will include entities which may be of some significance to local economies. If one assumes an average turnover half way between the current and new limits, these companies have combined sales of over £60bn. This is by any measure a substantial and visible economic effect and the failure of a handful of such companies would be noticeable to the public.

98. The value of audit needs to be considered carefully against the possible cost benefits of deregulation. The need for a proper consultation is illustrated by the differing views of stakeholders. Our response to the BIS consultation on the Accounting Directive implementation[8] referred to a Financial Reporting Faculty event for around 120 ICAEW members with BIS and the FRC on 15 September 2014. While there was substantial support for maximising the accounting thresholds for small companies, views were more divided regarding the audit exemption threshold. The issue was further discussed in our *Small Business Matters* report[9] published shortly afterwards. This indicated, for example, that quite a number of small business representatives thought that the threshold should be maintained at the current level.

99. We continue to believe that it is in the public interest for there to be a detailed separate consultation to give stakeholders the opportunity to consider the issues above and the potential review alternatives to audit thoroughly – regardless of whether thresholds are increased or not. This would allow proper consideration of whether there are different factors that should be considered. Accordingly we support the decoupling of the audit and accounting thresholds.

OTHER CHANGES

The following general questions apply in relation to all the measures discussed in this chapter.

Q42. What issues, if any, do you consider arise from the measures considered in this chapter? If there are any, how do you consider these should be addressed?

100. All significant issues are addressed in our answers to the detailed questions, or the general observations at the beginning of this response.

[8] ICAEW rep 140/14 available at http://www.icaew.com/en/about-icaew/what-we-do/consultations-and-representations/representations/2014-representations

[9] Available at http://www.icaew.com/en/technical/finance-and-management-faculty/smes/sme-news/small-business-matters

Q43. For the purpose of our impact assessment, we would welcome any information you can provide on the expected costs and benefits of the measures considered in this chapter, particularly any estimates of costs or benefits that you consider it would be possible to quantify?

101. We have no data on this, which are more likely to be sourced from the audit firms.

Technical standards and audits of consolidated accounts

Q44. Do you agree that the implementation of EU requirements on technical standards should be primarily through changes to the FRC's ISAs (UK and Ireland)?

102. We see no reason why the implementation of EU requirements on such matters should not be primarily through changes to ISAs (UK and Ireland).

Q45. For the purpose of our impact assessment on the changes we would welcome any estimate you could provide of the percentage of PIE audits for which the quality control review will now have to be undertaken by an individual auditor from outside the appointed audit firm (where there is a lack of detachment from the audit or knowledge of the client sector) where this was not previously required?

103. The percentage of PIE audits for which the quality control review will have to be undertaken by an auditor from outside the audit firm (where there is a lack of detachment from the audit or knowledge of the client sector) where this was not previously required depends entirely on the extent to which the UK/FRC decides to take advantage of the MSO to include entities other than listed companies, and unlisted banks, building societies and insurers in the definition of PIEs. If the definition is kept to that specified by the Directive, we think that the percentage is likely to be negligible.

Q46. What issues do you consider arise from the implementation of EU adopted ISAs in the UK that UK representatives should raise with the European Commission?

104. A number of detailed issues were picked up in the European Commission's consultation on possible ISA adoption several years ago. One of these related to the status of additional standards, statements or other guidance issued by standard setters. For example, the FRC would presumably wish to be able to continue to issue Practice Notes and Bulletins in addition to the standards, and the professional bodies would wish to be able to issue helpful guidance to members.

Q47. Do you agree that following any adoption of ISAs by the European Commission, the FRC should have the discretion to:

(a) apply standards where the Commission has not adopted an ISA covering the same subject-matter; (Yes / No) and,
(b) impose procedures or requirements in addition to adopted ISAs if these national procedures or requirements are necessary to give effect to national legal requirements or to add to the quality of financial statements? (Yes / No)

Please provide further information in support of your answer.

105. We believe such discretion should be available in both cases. However, as with other add-ons, there should be robust provisions requiring the FRC to provide a high level of justification for any such additional standards, including a requirement to perform a high quality qualitative and quantitative impact assessment, performed prior to a broad stakeholder consultation, the outcome of which should be included in the consultation. The impact assessment should

consist of more than a belief that the additional national procedures, requirements or standards will improve or maintain audit quality.

Audit committees

Q48. What issues, if any, do you consider arise from the implementation of the new requirements on audit committees via amendments to the existing DTR 7.1 in the FCA Handbook (for companies with securities admitted to trading on a regulated market)?

106. As regards general listed companies, implementation via amendments to DTR 7.1 seems most appropriate as it follows the present route. The enhanced requirements for the composition and reporting will need to communicated and advised upon. In particular the phrase 'the committee members as a whole will need to have competence in the sector...' can be interpreted in a number of ways. Does competence mean qualification or experience? Does experience mean 'executive' experience? Does 'as a whole' mean a majority of the individuals or collectively? The guidance from the FRC that accompanies the UK Corporate Governance Code is the most logical place to provide guidance. We look forward to consultation on any amendments to such guidance in due course.

107. It is important to set requirements within the context of the current UK framework: for example shareholders can appoint directors annually.

108. The composition requirements may create demand for particular types of individuals which could take time to be met.

Q49. What issues, if any, would you consider arise from the implementation via provisions in PRA rules of the new requirements on audit committees for those banks, building societies and insurers that are not required to have an audit committee under DTR 7.1?

109. The use of PRA rules seems logical, as these form a common base of reference for the unlisted PIEs that are newly subject to audit committee requirements. The FRC guidance relating to audit committees may be of use, or at least aspects of it.

110. Our point in answer to Q48 above about the need to allow time to achieve the required composition applies even more here, as many entities will have to enlist those with appropriate expertise to fulfil the new responsibilities, from scratch.

Q50. For our impact assessment on the changes, we would welcome data on:

(a) the numbers of non-listed PIEs that currently do not have an audit committee?
(b) the cost of recruiting members to be part of an audit committee?
(c) the annual cost of attendance of a member?
(d) the auditor's fees for attending audit committee meetings?
(e) how these costs vary by size of PIE?

111. We have no data on this.

Reporting to supervisors

Q51. Do you consider that the single competent authority with responsibility for regulation of audit should be designated to receive the information required to be provided to supervisors of PIEs when it is provided to:

(a) the PRA for banks, building societies and insurers?
(b) the FCA for other PIEs? or

(c) both?

112. Assuming the FRC is designated as the competent authority to regulate PIE audits, we agree that it is reasonable for it to receive reports, as regards the audits of PIEs, from the PRA and FCA as relevant. However we do not see the need for duplicate reporting. The information required is of such a nature that there are unlikely to be significant numbers of such reports and it should not be difficult for the PRA and FCA to co-ordinate with the FRC to pass on copies of reports. There may be circumstances relating to, for example, proceeds of crime, where the initial reportee may wish to withhold the information for a time and liaison between regulators rather than dual reporting, would allow for this.

Q52. For the purpose of our impact assessment on these changes we should be grateful for any estimates you can provide of:

(a) the costs of the auditor providing this information to supervisors of PIEs?
(b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?
(c) the frequency with which the FCA is provided with this information for other PIEs in practice already?

113. We have no data on this, which are more likely to be sourced from the PRA and FCA directly, and audit firms.

Recognition of auditors from other member states

Q53. Do you agree that we should enable the single competent authority to exercise the choices of aptitude test and/or adaptation period for the approval in the UK of individual statutory auditors from other Member States?

Please provide further information in support of your answer.

114. We believe that the registering professional bodies should retain the right to insist on applicants passing an aptitude test. An exam approach is robust and protects audit quality. If an applicant is competent, they will pass the test.

Q54. Were the single competent authority to have this role, what do you consider would be the implications for the operational provision (currently by the professional supervisory bodies) of:

(a) aptitude tests; and
(b) adaptation periods (if these were to be provided for)?

How would this be affected by the CEAOB progressing discussions 'with a view to achieving a convergence of the requirements of the adaptation period and the aptitude test' across the EU?

115. We do not believe it would be appropriate for the competent authority to have this direct operational role as it would establish an inconsistency where the large majority of audit qualification cases would be run by the professional bodies but the handling of the small number of cases of auditors from other states would become a matter for operational control by the competent authority. We think it would be better to maintain the present position of a division of responsibility in this area where there is supervision of the operational and policy practices of the professional bodies by the competent authority.

116. We would not see this view changed by the fact of the CEAOB progressing discussions to converge requirements of the adaptation period and aptitude test. Our strong preference would remain for the retention of an appropriate exam test, administered by the professional bodies.

117. Were the competent authority to have this role, we believe it should delegate the right for the professional bodies, which have experience in this area, to continue to run aptitude tests which are robust, proportionate (covering UK tax and law) and cost-effective for all parties. We do not have the same confidence in adaptation periods to deliver these results. As noted above, a competent applicant should be able to pass an exam.