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By post & email: pauld.smith@bis.gsi.gov.uk

Dear Paul

Auditor Regulation: Discussion document on the implications of the EU and wider reforms.

We welcome the opportunity to comment on the Department for Business Innovation & Skills (BIS) discussion document: *Auditor Regulation: Discussion document on the implications of the EU and wider reforms.* We are also responding to the Financial Reporting Council (FRC's) consultation paper on *Auditing and ethical standards: implementation of the EU Audit Directive and Audit Regulation* (the FRC CP Paper) and, for ease of reference, have attached a copy of this response.

We also welcome the publication of the *"Auditor Regulation – Supplementary Information: The implications of the EU and wider reforms*" document and the helpful clarity that BIS has provided on the framework for re-tendering and audit rotation.

We recognise that the Government's policy options for implementing the EU Audit Reform Directive are limited and that there are challenges both in providing for the application of the EU Audit Regulation and in bringing together the EU and UK reforms to develop a new auditor regulatory regime.

EY supports reforms that enhance confidence in, and strengthen, the audit regime. We agree that the new regime must "serve the needs of companies, those who work in them and those who do business with them". The new regime must also explicitly serve the needs of, and provide demonstrable benefit to, shareholders; the ultimate users of audit services.

In particular, we believe that audit committees should be empowered, so far as is permissible under EU and UK legislation, to exercise balanced judgment on behalf of shareholders. Placing external restrictions or conditions upon an audit committee, over and above those required by law, would risk diluting their authority and the principles of good governance.

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We set out, in Annex I to this letter, our responses to the specific questions raised in the discussion document.

As a general comment, in developing the best possible regime for the UK we believe that the overarching principles should include:

- Seeking to ensure that the requirements are as clear and simple to understand as possible for all stakeholders (including investors, companies and auditors). This should help to:

    - facilitate efficient adoption and consistent application by audit committees and auditors who carry out their duties on behalf of shareholders; and
    - enable shareholders to understand more easily what is required of companies and their auditors. This will help maintain confidence in the regime and empower shareholders to hold companies and their auditors to account if they do not believe their agents are properly complying with the regime.

    Achieving this is challenging in light of the complexity which already exists in the EU legislation, but it is within the UK Government's power to avoid further increasing complexity as it implements the EU requirements. Consistency of implementation where possible across the EU member states is another way to reduce complexity.

    However, pursuit of such simplicity comes with a note of caution. UK policymakers need to be careful to avoid bringing in a swathe of previously uncovered companies just to keep the audit regulatory framework uniform and simple. Careful consideration is needed to ensure that any extension of more stringent requirements is proportionate to the risks posed by such companies to shareholders and the public interest. The consideration should include ensuring there is broad support for any extension from across the investor community *as a whole,* for it is the owners who ultimately bear the additional costs of increased regulation.

- Consistent with the UK Government's policy on implementing EU legislation, UK-specific additions should be exceptional, proportionate and justified by a cost benefit analysis that considers the public interest and any effects on the competitiveness of UK companies and groups.

- Consistent with the preference for simplicity, we believe that BIS risks overcomplicating the requirements on audit tendering, such that the proposals could have unintended consequences which are not in the best interests of a company and its shareholders (e.g., where a company might be forced to tender its audit at a time when it is going through a major transaction). We believe a public interest entity (PIE) should be able to tender its audit at any time, provided it meets two overriding principles; namely that a PIE cannot:

    - keep the same audit firm for more than 20 years; and
    - go more than 10 years without an audit tender.

- The UK should continue to allow an auditor to provide a non-audit service(s) (NAS) to the company it audits if, as the FRC proposes, an objective, reasonable and informed third party

would not conclude that the auditor's independence is compromised by providing that service and the service is not prohibited by the Regulation.

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

Yours sincerely

Andrew Hobbs
Partner
Regulatory & Public Policy

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Annex I: Response to questions in discussion document

PART A: 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.

We support the Government's proposals to implement the Directive and Regulation using legislative and non-legislative means. The approach and the balance appear logical.

It would also be helpful to understand from BIS how the Government's Guiding Principles for Transposition[1] apply to the UK implementation of the Directive and Regulation particularly where one of the Guiding Principles is "that (save in exceptional circumstances) the UK does not go beyond the minimum requirements of the measure which is being transposed".

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.

We strongly support the Government's minimum implementation principle and believe that any Member State options that go beyond the requirements of the Directive and Regulation should only be implemented in exceptional circumstances and with good reason.

The legislative measures agreed by EU Member States and the EU Parliament are complex and, quite rightly, focus on PIEs - many of whom will be operating on a cross-border basis across the EU. To assist companies, in particular EU groups, and audit networks to comply with the new requirements, it would help to have as consistent an approach as possible across the EU and a level EU playing field. Consistency of approach across the EU will make it simpler for groups to meet their obligations and for stakeholder confidence to be maintained.

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?

Branches of third country companies need clarity on their position under the Directive and Regulation. Clarity is of particular concern to the banking and insurance sectors, where a branch structure is often used for substantial business operations.

[1] HM Government – Transposition Guidance: How to implement European Directives effectively

As we understand it:

- an EU-based branch of a non-EU entity will not fall within the scope of the PIE definition and the NAS prohibitions/cap would not apply.
- if an EU PIE has a branch inside/outside the EU, the NAS prohibitions/cap would apply equally to the branch, regardless of its location.

We would ask BIS to confirm the position of branches in its subsequent consultation and, if necessary, clarify in the implementing legislation.

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?

The small and micro-sized company aspects of this question are best answered by other stakeholders. As an overarching comment, though, we support the Government's approach to small and micro-sized companies in the Better Regulation Framework Manual i.e. "Regulatory measures should only extend to small and micro-businesses where any disproportionate burden is fully mitigated".

AUDITS OF PUBLIC INTEREST ENTITIES AND APPLICATION OF THE REGULATION AND DIRECTIVE (4.1)

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?

Yes, we agree with the Government's approach to implementing the PIE definition. In our view there are no exceptional circumstances to justify departure from the Government's minimum implementation guiding principle for transposing EU legislation (see our response to Q1 above).

As we also discuss in response to Q2 above, to facilitate efficient adoption and consistent adherence, it would help to have as consistent an approach across the EU as possible and a level EU playing field.

Any significant expansion of the PIE definition by individual Member States (for example, to include companies quoted on markets other than regulated markets) would be the source of significantly increased costs and complexity for companies, particularly EU groups.

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?

Unlisted banks, building societies and insurance companies were exempted from the PIE definition under the 2006 Audit Directive. Hence, in addition to understanding the new EU requirements on tenders, duration of audit firm tenures, and NAS etc., unlisted insurers and unlisted banks and building societies that do not fall under the exemption will need to change their governance models to include an audit committee (if it does not have one in place already).

These companies may require additional guidance from the FRC and the Prudential Regulation Authority (PRA) to understand the changes needed and possibly practical assistance from relevant trade bodies.

In addition, we would note that, at least initially, there could be a shortage of appropriately qualified/skilled non-executive directors (NEDs) - in particular, NEDs with financial services risk expertise - to fill new audit committee positions. This problem could be exacerbated by the interpretation of the requirement for the audit committee "as a whole" to have competence in the sector in which the audited entity operates (see our response to Q48 for more detail on this point).

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?

We are not currently aware of specific issues for the companies that now fall within scope of the Audit Directive but not within the scope of the PIE definition.

However, as a general comment, there will, of course, be cost and resource implications for any companies that are currently exempt from the requirement for a statutory audit but will require an audit from June 2016 as a result of the broader application of the amended Audit Directive. Given that additional costs will be borne, ultimately, by the investors (which for the UCITs are often pension funds), it is important that any changes to the UK regime are clear and 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?

Familiarisation costs vary depending on the nature, scale and complexity of each PIE audited and the NAS that the PIE procures from its auditor. The costs will also depend on the size of the audit firm concerned.

However, the costs - for both PIEs and auditors - would be minimised if the requirements could be kept as simple and clear as possible, with guidance on areas of uncertainty.

If you would find it helpful to discuss the aspects of this question in more detail please do not hesitate to contact us.

COMPETENT AUTHORITIES – DESIGNATION AND DELEGATION OF TASKS (4.2)

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?

We believe that the Recognised Supervisory Bodies (RSBs) are best placed to provide a detailed response to this question.

However, as a general observation, it would seem to us that a more cohesive and less complicated regulatory structure would make regulation more effective.

If the FRC is given “ultimate responsibility” for oversight, we agree that it should delegate tasks to the RSBs. Indeed, we would encourage the maximum possible delegation of responsibilities - particularly all responsibilities that do not relate to PIEs - to ensure that the FRC’s public interest focus is not diluted. We would also encourage the FRC to take a “risk-based” approach to the way in which it decides to delegate.

In agreeing and formalising the roles of the RSBs, factors to take into consideration include the need for:

- strong, credible RSBs if the industry is to remain a profession; and
- the FRC to be able to continue to focus its activities on companies and audit firms with the most public interest.

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?

We support the adoption of International Standards on Auditing (ISAs) across the EU.

Consistency in the application of ISAs by auditors across the EU is very important for overall audit quality. Audit quality is enhanced by independent audit oversight. That said, as ISAs are adopted across the EU it is equally important for there to be common individual inspection reporting protocols to enhance consistency of ISA application among Member States.

In this regard, we are supportive of the efforts of the International Forum of Independent Audit Regulators (IFIAR) and the European Audit Inspection Group (EAIG) to promote greater consistency in the way inspections are conducted and the results are reported.

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?

For the purposes of the implementation of the EU Directive and Regulation, we do not believe that any structural changes should be made to the current investigation and disciplinary arrangements.

The FRC should continue to take public interest cases and in the future all cases involving PIEs and it should delegate to the RSBs the responsibility for all other cases (subject to the FRC's oversight of the RSBs themselves).

In relation to the PIE/public interest cases, we believe that all accountants and auditors should be subject to the same set of independent disciplinary arrangements, applied with the same rigour and safeguards.

Any other changes would need to be considered carefully and the wider population of accountants consulted. Therefore, if BIS and/or the FRC are minded to change the current investigation and disciplinary arrangements that apply to accountants generally, we would suggest postponing consideration of possible changes until after the EU Directive and Regulation have been implemented.

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.

As discussed in response to Q9 above, to make the regulatory process more efficient and effective, we agree that responsibilities should be allocated to the single independent competent authority.

However, and for the considerations also discussed in our response to Q9 (in particular the risk of dilution of the FRC's important public interest focus), we strongly support the delegation of non-PIE related responsibilities to the RSBs, including supervision of audit firms who conduct ten or fewer major audits and the other regulatory tasks proposed by BIS.

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?

Apart from the comments we make in response to Q9 above, other stakeholders are better placed to answer this question.

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.

Other stakeholders are better placed to answer this question. As a general comment though, legislation tends to be less flexible in adapting to future unforeseen scenarios than rules and/or similar measures adopted by the FRC.

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 Act21? If so, which body or bodies do you think should have statutory powers for the removal of statutory auditors from the register?

Registration and removal of statutory auditors from the register should continue to be the role of the RSBs.

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?

Changes to the rules of the RSBs should be subject to oversight by the competent authority as to the overriding principles of the RSBs rule setting powers (rather than the individual rules themselves).

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?

Companies and investors are better placed to answer this question.

AUDIT FEES AND NAS (4.3)

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

Yes, we support implementation through the FRC's Ethical Standards for auditors. This is a tried and tested approach which is familiar to users.

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

The application of the cap on permissible NAS, as set out in the Regulation, will have a differentially negative effect on the ability of certain companies and certain sectors to use their auditors to perform permissible services i.e. services that are not prohibited and would be regarded as acceptable and beneficial for auditors to provide by an objective, reasonable and informed third party.

Specific examples of differentially negative impact, which should be taken into account when designing criteria for the exemption on an exceptional basis (as discussed in Q21 below), include:

- Companies with smaller audit fees are more likely to hit the cap if they have a large one-off transaction. This is likely to impact sectors with lower audit fees (such as the retail sector). Whilst the impact of the cap will depend on the size of the audit fee, the transactions that could cause particular issues are complex class 1 acquisitions – especially where they result in a reverse takeover.

- If there are several entity transactions and some are aborted but then re-emerge, the NAS fee may become significant (in our experience, there have been examples when it has almost reached parity with the audit fee).

- Highly regulated sectors with significant levels of NAS - such as financial services - are also likely be more negatively impacted by the provisions. There is a higher likelihood of multinational groups in these sectors, which have legal and regulatory requirements across all the jurisdictions in which they operate, reaching the cap more quickly.

Under Article 4(2) of the Regulation, NAS "other than those referred to in Article 5(1), required by Union or national legislation shall be excluded" from the cap. We welcome the FRC's statement that this exemption "applies even if the law does not specifically require the entity's auditor to be the provider of the service that is required by law" (para 5.3 of the FRC CP). It would be helpful if BIS and the FRC could confirm that this exemption extends to services required by regulators in delegated legislation (such as PRA and Financial Conduct Authority (FCA) rules). For example, if PRA or FCA require a bank to appoint a reporting accountant or undertake remediation and it is more efficient and expedient for the auditor to perform the service.

For the reasons discussed above, it would be helpful for multinational groups if the exemption were to extend to NAS required by third country "national law" and third country regulators e.g., additional work required to be performed by the auditor of banks by FINMA or the SEC. Again, we would welcome confirmation on this point.

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.

As discussed in response to Q1 and Q2, we support the principle of minimum implementation and do not believe that the UK Government should take up this Member State option.

The legislative measures, agreed by EU Member States and the EU Parliament, are complex and, quite rightly, focus on PIEs, many of whom will be operating on a cross-border basis across the EU. As noted in response to Q19 above, multinational groups, for example in the financial services sector, could have requirements across all the jurisdictions in which they operate, which may result in a naturally high NAS. A patchwork of different cap limits across the EU will be harder for groups and their auditors to police than a single approach across the EU.

To assist companies, groups and audit networks to comply with the new requirements, it would help to have as consistent an approach across the EU as possible and a level EU playing field.

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?

Yes, an exemption would enable companies to deal with exceptional circumstances. A company may have an unexpected need for an assurance service often within a short timescale. Although the service could exceed the 70% cap, the company may have demonstrable reasons why it needs to be provided by the audit firm.

We also believe that this exemption is in the public interest, particularly where the beneficiaries of the services are the shareholders (i.e. the same beneficiaries as for audit services). For example, where a company needs to issue urgently, under the Takeover Code, a profit forecast in defence

of a bid, the work may be subject to very tight timescales that might preclude the engagement of another firm.

See our response to Q22 for examples of services that we believe: (i) would not cause an objective, reasonable and informed third party to conclude that the auditor's independence is compromised; and, (ii) would be in the interests of companies and the capital markets – both in terms of efficiency and expediency – for a company to be able to procure from its auditor.

Many exemption requests are likely to arise from unpredictable capital market events (e.g., takeovers) and, hence, could be subject to tight deadlines. The competent authority will, therefore, need a suitably proportionate and expedient application process that provides companies with certainty as quickly as possible.

Depending on the interpretation of Article 4(2) of the Regulation (see our response to Q19 above), the FRC could, for example, have a fast-track process for NAS which are required by regulation (e.g. the Takeover Code). We would be happy to explore the practical issues with BIS and the FRC in more detail.

Q22. Do you agree that the subject matter of Article 5 of the Regulation on the blacklist of NAS, 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.

We support the implementation of the prohibited list through the FRC's Ethical Standards for auditors.

It should be within the FRC's power to exercise the Article 5 option to set more stringent requirements if appropriate in the future, however the option does not need to be exercised at this time. The EU list of prohibited NAS is already stricter than the equivalent requirements at an international level, as well as those of our major trading partners outside of the EU. Additional restrictions will further reduce flexibility and choice for companies.

The prohibitions are also complex and hard to understand. Therefore as much consistency as possible is needed across the EU to enable EU groups and their auditors to observe the requirements with confidence. Also, if an NAS is not considered to impair independence by the EU, we would question why it would need to be prohibited in an individual Member State.

In addition to the prohibited list (and the possibility of an FRC permitted list), there are a number of other safeguards which we believe strike an appropriate balance between ensuring auditor independence and allowing companies to exercise choice:

- the audit committee will continue to provide independent oversight on behalf of shareholders over the procurement of permissible NAS;
- the existing checks and balances in the system (pre-approval, disclosure, financial limits and professional independence standards) provide strong ex-ante safeguards; and

- independent inspections of statutory audits by the competent authorities also include ex-post assurance on auditor independence and the appropriateness of NAS provided.

In our view, it would not be in the interest of companies, their shareholders or the capital markets - both in terms of efficiency and expediency - if a company could not use its auditor to perform certain services that do not impair independence. Moreover, shareholders may also take comfort from an auditor's involvement in the provision of some services. These include capital markets transactions particularly where:

- *A working capital report is issued* - there may be substantial overlap with the consideration of going concern in the context of the audit of the financial statements and third parties such as investors may take comfort if the service is provided by the audit firm;

- *Auditor comfort letters* – whilst not required by regulations, they are typically requested on just about every capital market transaction. There are also certain comfort letters that cannot be issued without having an "audit base". Theoretically another firm could obtain an audit base just to issue a comfort letter, but it is unlikely that many firms would wish to take on this work because of the risk issues. Even if they did, the cost to the company – and ultimately the shareholders – would be significantly increased and on some transactions there would not be the time for another firm to obtain knowledge of the company equivalent to an audit base;

- *Reporting on pro forma financial information in a circular/prospectus* - it is much more difficult for a non-auditor to do this work (assuming another firm is prepared to do so if they are not the auditor). As the auditors already understand what is in the accounts and what the accounting policies are, there would be efficiencies to the company - and ultimately the shareholders - if the audit firm was to provide this service;

- *Reporting on profit forecasts* – it is possible for a firm, other than the auditor, to provide this service but it would need to take on much more risk than the auditor because they are unlikely to possess the same knowledge of the company as the auditor. To manage this risk, the provider would need to acquire knowledge of the company quickly, or face significant risk issues and price higher accordingly. From a company perspective, it would take longer to engage another firm (and there might not be time for the firm to do this in a takeover situation) and therefore cost more. Users may also take more comfort if the report is provided by the auditor. Also, in Takeover Code transactions the accelerated timetable may mean it is wholly impractical to use someone other than the auditor;

- *Investment circulars, for example Class 1 disposals* - all information in the shareholder circular is likely to be derived from the accounting records of the company and the services will involve working capital and pro-forma reporting and a comfort letter (see above). Again, it is theoretically possible for firms other than the auditor to provide the services, but as the work requires an understanding of what is in the financial; statements, the accounting policies and the business in general, it would be very inefficient for the company and ultimately the shareholders.

Also, where public reports are required in performing such work (which is normally the case), the work is already subject to independence standards (Ethical Standards for Reporting Accountants). In addition, an auditor of a financial services firm will have a direct relationship with, and duty to report to, the PRA or FCA.

Although, as we say above, it is important to minimise divergence across the EU and avoid moving the list of prohibited NAS even further away from the IESBA Code of Ethics, if in future new service offerings are developed and these are seen as creating threats to independence, then the option could then be applied.

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

In the absence of greater clarity about what the prohibited list means in practice, it is difficult to identify all the public interest issues[2].

However, it is clear that without greater clarity companies will not be able to understand how to interpret and apply the requirements with confidence, in particular how to identify precisely which services are prohibited. We recognise that Member States cannot give formal guidance on the interpretation of EU legislation, but we would ask that BIS and the FRC provide as much information to the market as possible on the scope of the prohibitions and criteria for an audit committee driven approach.

Examples of interpretational challenges in respect of the Article 5 prohibited list include:

- Services that involve playing the part of management or decision making (point b);
- Legal services with respect to the provision of general counsel (point g (i));
- Services linked to the financing, capital structure and allocation, and investment strategy of the audited entity (point i); and
- Human resource services (e.g. human capital tax compliance and cost control on HR-related services) (point k).

Other issues are likely to include:

- As discussed in response to Q19 above, if companies cannot use their audit firms for permissible NAS, where the use of an auditor is efficient, expedient and an objective, reasonable and informed third party would not conclude that the auditor's independence would be compromised by providing that service, the cost to companies - and the market as a whole - of certain services may rise because of the inefficiencies created.

- The need for 'grandfathering' where work relating to existing NAS engagement is coming to an end during auditor transition. In these cases, it is in the shareholders' interests for the audit

[2] But see also our response to Q7 et seq. in the attached response to the FRC

firm to complete the work (e.g. to avoid duplicative costs). For example, an audit firm might be carrying out tax services, such preparing tax returns and dealing with HMRC in respect of past returns. We believe that a company would appreciate being able to have the service completed before being required to engage another firm. It would appear to us that where the services fall under the derogation in Article 5(3) of the Regulation, this could be used to allow the work to be completed (subject to the stated conditions).

Finally, if the UK Government is minded to implement the Member State option, we believe that audit committees will welcome clarity on what is meant by services that "have no direct or have immaterial effect…on the audited financial statements" in the Article 5(3) derogation."

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:

- **underpin the standards? And,**
- **introduce simplifications for audits of small non-PIEs?**

Please provide further information to support your answer

Yes, we support implementation through the FRC's Ethical Standards for auditors as this is a tried a tested approach that is understood by users.

We also strongly support simplification for small non-PIE audits.

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.

Yes. This represents an opportunity to revisit and improve the classifications in the Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) Regulations 2008 so that they give stakeholders a clear description of the permissible NAS that the auditor is providing to the company.

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

(a) the percentage of NAS 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 NAS 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 NAS to the firm's audit clients?

This data could be commercially sensitive but we would be happy to discuss the question with BIS directly in more detail.

TENDERING AND DURATION OF AUDIT ENGAGEMENT (4.4)

We welcome the additional clarity provided in the BIS "*Auditor Regulation – Supplementary Information: The implications of the EU and wider reforms*" document issued on 6 March 2014 ("the Guidance").

We have the following comments at this time:

- The 2003-2006 audit tender ("sub 11 years") category i.e. the third transitional provision, will apply to many companies in the FTSE 350. We welcome BIS' confirmation that these companies will need to tender their audit for the first financial year beginning on or after 17 June 2016. There are significant numbers of UK PIEs affected (we estimate around 50 in FTSE 350 alone). Based on our conversations with such companies, we believe they will welcome the extra time this provides. It is important to note that for smaller PIEs, some tenders for financial years beginning on or after 17 June 2016 could take place after the start of that financial year. As we read it, there is nothing in the Guidance that prevents this.

- As regards a company that tendered its audit in the recent past (period unclear), BIS has asked whether such a tender may be sufficient to extend the appointment up to a maximum of 20 years without a further tender. We note that BIS is interested to hear more about this from companies affected.

  Based on our conversations with companies so affected, they are understandably reluctant to face the prospect of another audit tender so soon after the last one. We encourage BIS to include in the implementing legislation provisions that seek to capture tenders that happened before the Regulation took effect, but which would have otherwise satisfied the criteria for tenders set out in the Regulation. In that sense, the reference in the Guidance to the definition of "competitive tender" in Question 14 of the Guidance is unnecessary, overcomplicated and confusing, given the Competition and Markets Authority (CMA) Order only applies to UK-incorporated FTSE 350 companies, not all UK PIEs. Moreover the CMA took a very deliberate step to delay implementation of their Order until after the Regulation takes effect.

  If BIS is minded to include provisions that deal with this point, there is then the question of how far back it would be reasonable to cast the net. In our view, the "look back" should be identified by reference to periods when UK companies altered their positions in reliance on a shift in UK governance practice (i.e. changes to the UK Corporate Governance Code) which required audit

tendering every 10 years for FTSE 350 companies. Some of those tenders happened in advance of the changes to the Code taking effect. In our view, it would be reasonable to include tenders which meet the criteria set out in Regulation and which took/take place between 1 January 2012 and 16 June 2016.

In relation to Questions 17 and 18 of the Guidance, we have sympathy with the sentiment and substantive approach. However we believe the Regulation is clear on the points. It applies (1) only to the length of the auditor's relationship with the specific legal entity in question (rather than predecessor entities) and (2) only from the time that legal entity becomes a PIE. In that sense, the Regulation is clear and simple for companies in calculating tenure periods; something that will be very helpful for compliance and orderly markets, as the Regulation beds down in UK law and practice.

If the view BIS is expressing in Questions 17 and 18 of the Guidance is prompted by concerns that a group might in the future seek to get around the spirit of the Regulation through reconstructions, we believe this risk is very small - groups do not reconstruct lightly. In any event, in our view, the Regulation already contains protections to mitigate such risks, in that it provides where a new PIE is created, it must run an audit tender which meets the criteria set out in the Regulation.

A simpler construction as set out above has the following benefits. It increases certainty and simplicity for companies. It reduces the number of enquiries the competent authority might receive and, above all, boards - through their audit committees - are still free to tender the audit or rotate the auditor at a time of their choosing. We have seen many examples of this in the UK audit market already.

We also note that BIS will publish more in due course on the sanctions companies will face if they fail to comply. We welcome the proportionate suggestion that, where there are inadvertent breaches, companies might simply be required to correct the position.

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.

Yes, we support the continuance of these alternative systems of appointment of an auditor.

However, we are unclear about situations where, for example, it may not be possible for the tender to be genuinely competitive (regardless of who makes the appointment) because there is an insufficient number of firms capable, and independent, at that particular moment in time, to conduct the audit.

We are also unclear as to how the current systems would manage situations where:

- the directors of a non-EU parent of an EU PIE subsidiary appoint an auditor for its EU subsidiary; or
- only one audit firm tenders for the audit, rather than the two required in the Regulation.

Q28. Where the PIE is exempted from having an audit committee (e.g. 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.

Yes we agree, although we are uncertain what would happen if the company without an audit committee has a controlling shareholder. Could that shareholder fulfil the role of the audit committee solely for the purposes of recommending a particular audit firm?

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.

We agree that this option should not be taken.

Whilst the positions of other EU Member States may differ, on the basis that it was UK Government policy in the EU negotiations not to support incentives for companies to have joint audits, it would be odd for the UK to take this option, which would amount to a public policy decision to provide an added incentive to use joint audits.

Companies may have joint audits in the UK under the current proposals, but subject to the same requirements as for a single auditor. In that sense the policy will be joint/single auditor neutral.

Finally, subject to the above, we agree it makes sense 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.

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?

Yes, we support the proposal to provide flexibility.

There may be circumstances, as discussed in our response to Q31 below, in which the board believes it is in the best interests of shareholders to accelerate or delay a tender.

Firms who are not the incumbent auditor and who might wish to tender for a PIE's audit need to be independent of the PIE to take up an appointment. This can take time as existing relationships between the PIE and a bidding firm and its partners/people can be extensive. To maximise the number of potential bidders, it is often helpful for companies to start their tender well in advance of the first financial year that auditor will audit (e.g. a year in advance or for complex financial services companies several years in advance). This additional time allows for an orderly transition - for example, to enable the audit firm to unravel employees' pension or banking arrangements and the company to wrap up projects involving NAS which might be prohibited without the disruption of having to change service provider.

As discussed above, we also encourage BIS to include in the implementing legislation provisions that seek to capture tenders that happened before the Regulation took effect, but which would have otherwise satisfied the criteria for a qualifying tender set out in the Regulation, such that a company that tendered early will still be able to take advantage of an extension of the maximum duration beyond ten years, following that tender.

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

We support increased transparency of tender arrangements. If a company has a tender policy we believe it is right that the intention to tender is disclosed to stakeholders.

However, we do not believe there is any benefit in a legally binding disclosure that would not enable an audit committee's plans to change if circumstances necessitate (e.g. if the company is going through a major transaction such as a merger or if the CFO or audit committee chair is new or absent). Such changes of plan should be a matter for disclosure to enable shareholders to scrutinise and ask questions.

Except for the fact that it should be non-binding, we agree that the report should include all of the disclosure requirements suggested in the question (i.e., (a) to (d)). Many companies do this already.

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.

We support allowing a company to tender early and not forfeit the ability to retender on reaching year 20. The more flexibility that can be offered to companies the better for all stakeholders. We believe that there is a simpler "option (d)" that could be expressed as follows. A PIE should be able to tender its audit at any time provided it meets two overriding principles; namely that the PIE cannot:

- keep the same audit firm for more than 20 years; and
- go more than 10 years without an audit tender.

This option would leave it up to the company to decide when to tender, even if that meant two tenders to comply (e.g. in year 7 and year 17). In our view, this best meets the spirit of the Regulation.

In addition, it is important that audit committees acting on behalf of shareholders should not be restricted unnecessarily from making decisions about the best time to tender. Decisions on timing may be based on, amongst other things:

- as discussed in response to Q30 above, the need for a sufficient period between the tender and the effective date to allow all bidding audit firms to become independent, and allow a company to wrap up projects without the disruption caused by having to change of service provider (this could also enhance competition and choice as more audit firms would be able to bid);
- a wish to test the market for audit services because they want a better service from their incumbent auditor or want to see what other options are available;
- as discussed in response to Q31 above, knowledge of future developments (e.g. a major transaction at year 10 or a new CFO).

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 do should they be addressed?

Other stakeholders are better placed to answer this question.

However, we would like to highlight the need to ensure that sanctions do not give rise to unintended consequences for shareholders when the breach may be minor and/or unintentional. For example, could an audit firm lose its licence from a breach or would an audit opinion be invalid if the appointment was invalid?

As discussed above, we welcome BIS' suggestion[3] that where there are inadvertent breaches companies might simply be required to correct the position.

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?

Point (a) is best answered by companies.

[3] Auditor Regulation – Supplementary Information: The implications of the EU and wider reforms

Given the recent changes in audit tender activity, we have no track record that would enable us to provide normalised tender-related resources and costs for points (b) and (c). As a general comment, resources and costs will vary over sectors, sizes of company and different tender requirements such as timings (with tenders at short notice tenders requiring higher resources and costs). If it would be helpful we would be happy to discuss with BIS in more detail.

In relation to point (c), generally speaking the cost of tenders is proportional to the complexity of the company as well as to its size. For example, a company that has decentralised systems and processes and a complex legal structure will require more resources and higher familiarisation costs than one which is uniform in all locations in which it operates.

Costs to PIEs and audit firms arising from the new EU requirements would, however, be minimised if the requirements could be kept as simple and clear as possible with guidance on areas of uncertainty.

AUDIT REPORTING AND ADDITIONAL REPORTING TO THE AUDIT COMMITTEE (4.5)

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?

There have been a number of changes in this area, including the requirement in the Corporate Governance Code for companies to produce viability statements. It is important that the EU requirements are implemented consistently.

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.

Yes, we support the implementation of Article 10 of the Regulation though amendments to the FRC's International Standards for Auditing (UK and Ireland).

We understand why the Government would want to legislate to give the FRC the power to implement the option in Article 10(2) to add to the content of the audit report. However, as there is no specific time limit by when these options must be implemented, the UK could always revisit this question if there is a clear need to expand the content of the Auditors Report in the future.

As the content of the Audit Report is already quite detailed and has been considerably expanded following adoption of this Regulation, it is preferable for all Member States to allow the market to adapt to this requirement before seeking to expand it further.

It is also important that the EU acknowledges the important work being carried out at International level by the IAASB. We should be encouraging closer alignment between EU and International standards. That process is not facilitated by Member States adding further requirements at national level, above and beyond what is agreed at EU level.

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?

See our response to Q36 above.

In addition, given both the lack of clarity regarding the interpretation of the prohibited list of NAS in Article 5(1) of the Regulation and the lack of any de-minimis provision, if an auditor were to provide inadvertently just £1 of prohibited NAS, they would not be able to provide the declarations required by Article 10(2)(f) of the Regulation. Even where an audit firm takes all reasonable steps to comply with the NAS restrictions, a breach may still occur as no system is infallible. As discussed in response to Q33 above, it is important to consider carefully what consequences (for both companies and audit firms) could and should flow from inadvertent breaches in this area so as to avoid unintended consequences.

We would, therefore, ask both BIS and the FRC to provide as much clarity as possible for audit committees, users of accounts and auditors.

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.

Yes, we support the implementation of Article 11 of the Regulation though amendments to the FRC's ISAs.

We understand why the Government would want to legislate to give the FRC the power to implement the option in Article 11.2 of the Regulation to add to the content of the Additional Report to the Audit Committee (ARAC). However, we do not believe that the option in Article 11.2 should be implemented at this stage. As there is no specific time limit by when these options must be implemented, the UK could always revisit this question if there is a clear need to expand the content of the ARAC in the future.

As the content of the ARAC is already quite detailed and as this is a new requirement across the EU, it is preferable for all Member States to allow the market to adapt to this requirement before seeking to expand it.

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?

We would not expect any issue to arise as most of the requirements are already implemented.

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?

Whilst there will be extra costs arising from the ARAC, we do not believe that, for the market as a whole, they will be significant.

THE SMALL COMPANIES AUDIT EXEMPTION THRESHOLDS (4.6)

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.

This question is best answered by other stakeholders.

PART B: OTHER CHANGES

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?

We have no further comments at this time.

Q43. For our impact assessment, we would welcome any information you can provide on the expected costs and benefits of the measures considered in this chapter?

We have no comments at this time

TECHNICAL STANDARDS FOR STATUTORY AUDITS (5.1)

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)? Please provide further information in support of your answer.

Yes, we agree. Technical requirements should continue to be applied by technical standards issued by the FRC and subject to ongoing review and due process.

That said, it is important to avoid unnecessary add-ons to ISAs, to ensure both a level-playing field and consistency.

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?

We would be happy to clarify and discuss this question with BIS.

TECHNICAL STANDARDS FOR INTERNATIONAL AUDITS (5.2)

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?

Timing or synchronicity might be an issue if a disparity arises between different reporting standards (e.g., IASB IFRS and EU IFRS) which require a change in some aspect(s) of the audit and related auditing standard.

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.

We are supportive of EU-wide adoption of international standards to promote consistency within the EU and consistency internationally and reduce the risk of a patchwork of rules.

AUDIT COMMITTEES (5.4)

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)?

The method of implementation appears logical and is consistent with the approach taken to the audit committee requirements in the 2006 Audit Directive.

Depending on the interpretation in the FCA rules, the requirement for the audit committee "as a whole" to have competence in the sector in which the audited entity operates could restrict the membership of, and limit the pool of available NEDs for the audit committees of smaller listed companies or companies operating in more specialist sectors (e.g., financial services).

We would encourage "as a whole" to be interpreted as, when taking all of the audit committee members together, the committee could be said to have sector competence and not that every audit committee member should have competence in the sector. It is important that audit committees have diversity of thought and an ability to challenge sector norms. This may be inhibited if all members must have sector competence.

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?

Implementation via provisions in the PRA rules seems sensible.

It would be helpful if the PRA could communicate directly with the effected financial services firms regarding the changes and what they will need to do to comply.

See also our response to Q6 above re the availability of NEDS with appropriate financial services risk experience and expertise.

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?

This data could be commercially sensitive, but, if it would be helpful to BIS, we should be happy to discuss the question in more detail.

REGULATORY REPORTING AND INFORMATION – REPORT TO SUPERVISORS OF PIEs (5.5)

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?

It is clearly important that the regulators have adequate gateways and arrangements for sharing relevant information. However, we believe that introducing dual reporting requirements, such that an auditor would be required to report to the FRC in addition to reporting to the PRA/FCA, could introduce confusion. For example, would the FRC be involved in all bilateral meetings between auditors and supervisors of PIEs on the basis that relevant information could be provided orally?

Instead we would support a system in which information on PIEs provided by an audit firm to the PRA or FCA under the EU Regulation is then shared with the FRC by the PRA/FCA as appropriate.

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?

The answers to this question will vary depending on the PIE.

However, if BIS would find it helpful to discuss any aspects of this question in more detail please do not hesitate to contact us.

RECOGNITION OF STATUTORY AUDITORS FROM ANOTHER MEMBER STATE (5.8)

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.

Yes, the competent authority should be given the power to determine what type/level of aptitude test and/or period for approval is/are appropriate.

That said, we believe that the responsibility for such tests should be delegated to the RSBs.

However, we would note that at an EU level, there should be equivalence between EU Member States aptitude tests etc. When using ISA for auditing and IFRS accounting standards, there should be reciprocity for a UK auditor to work in another EU Member State and vice versa.

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?

As noted above, we believe that the competent authority should delegate the task to the RSBs.

As a general comment, Article 9 of the Regulation requires an European Quality Control Reviewer (EQCR) for every PIE on an annual basis. The article provides that this person must be a "statutory auditor" but does not say "a statutory auditor who is a member of the local profession". With a single set of auditing standards and IFRS, we believe that any EU statutory auditor could be an EQCR as they apply to work to the same standards. It would be helpful if BIS could confirm its interpretation.