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11 March 2015

For the attention of Paul Smith
Corporate Frameworks, Accountability and Governance
Department of Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

Dear Sirs

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

We are pleased to respond to your request for comments on the above discussion document. We have responded to the questions posed in the discussion document in the Appendix to this letter; however we also have some overall observations.

We are pleased that the period allowed for comment has been extended to 19th March as the previous consultation period was simply too short for the entities, and audit firms, affected by the changes – particularly smaller PIEs and smaller auditors of PIEs – to submit proper, considered responses. Nonetheless, we believe that BIS and/or the FRC should still undertake specific outreach to smaller PIEs and to firms which audit a small number of PIEs to ensure that their views can be properly heard and considered, as such businesses and firms simply do not have the same level of resources as larger businesses and firms to consider a consultation which runs to a total of 54 questions and 88 pages.

We believe that it is vital that the changes required by the revisions to the EU Audit Directive, and the other changes proposed, are implemented in a proportionate fashion and do not place a disproportionate burden on smaller listed companies, which we are concerned will be the end result. We also believe that the effect of the changes will need to be carefully monitored on an ongoing basis.

We are pleased that BIS is not proposing to extend the definition of PIEs, for instance to AIM companies, as we believe this would be entirely disproportionate. In general we are opposed to any 'gold-plating' of EU requirements, with a few specific exceptions, such as the audit exemption limit, on which we have commented further in the Appendix where relevant.

We are particularly concerned that – contrary to the assertion on page 5 of the Document that one of its foci is to 'avoid excessive concentration in the audit market' – mandatory rotation of auditors will not reduce concentration, or improve competition, in any meaningful way. Indeed, in our opinion, over time it will actually increase concentration because listed entities currently audited by non Big Four firms may well switch to a Big Four firm, rather than another mid tier firm, when required to rotate. We would observe that although there has been a noticeable increase in changes of auditor appointments of larger listed companies recently as a result of increased

tendering, this has simply involved switching of audits between Big Four firms. We do not see any reason why this will not continue or even increase following adoption of the revised Audit Directive. Similarly, the regulation of auditors needs to be proportionate and whilst we realise that BIS may consider it has no real option other than to require the monitoring of auditors of PIEs to be conducted by the single competent authority (which we realise is highly likely to be the FRC – though we do not believe this should be a fait accompli) we remain concerned that this will lead to a disproportionate regulatory burden on smaller audit firms with relatively small numbers of PIE audit clients. It is possible to foresee an unwelcome scenario where smaller firms may elect to withdraw from PIE audits altogether in order to avoid the need for such monitoring, further increasing market concentration.

In addition, we believe that any increased powers of the FRC (if it becomes the single competent authority) should be restricted to the minimum required under the Directive and Regulation, rather than granting the FRC further increased powers at the expense of the RSBs. We remain concerned about the composition of the FRC and in particular the AQR and believe it is vital that the representation of non Big Four firms on both bodies is addressed to ensure that there can be no question of 'Big Four bias'. This will be particularly important given the significant increase in the number of mid tier and smaller firms that the FRC will be monitoring as a result of these changes.

If you have any questions on the contents of this letter, then please contact either Sir Michael Snyder or Tessa Park.

Yours faithfully

Kingston Smith LLP

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APPENDIX 1 – RESPONSES TO CONSULTATION QUESTIONS

1. **Do you have any comments on the balance between legislative and non-legislative implementation of the requirements of the new Directive and Regulation.**

In general we believe that where possible the implementation should be non-legislative (e.g. in professional standards) rather than legislative, in order to allow as much discretion and flexibility as possible and also to make it easier in future should amendment be required.

2. **Do you have any comments in relation to the Member State options in the Directive and Regulation and whether and how these should be taken up.**

We have commented on these below where relevant.

3. **In relation to the measures discussed, what issues do you think will arise that have not been considered as part of the discussion? If there are any, how do you think these should be addressed?**

We have explored a number of possible issues in our detailed responses.

4. **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.**

We believe that the increased regulation will be disproportionately burdensome both to smaller PIEs and to smaller auditors of PIEs.

For smaller PIEs, the 'blacklist' of non-audit services will make it more difficult for companies to benefit from the synergies arising from using the same firm for a variety of professional services. This will lead to increased costs, as well as the additional management time which will need to be spent sourcing additional providers. In our view, the restrictions in the Ethical Standards for Auditors were already quite sufficient (and indeed in some areas overly restrictive) although we realise that BIS has no scope for derogations from the restrictions imposed by the Directive. There is, however, scope to reduce the burden for entities not caught by the PIE definition that are currently caught by the more onerous requirements of the Ethical Standards (e.g. AIM companies), and there is a real opportunity for change in this area which we have commented on in more detail elsewhere in our response.

We believe that the increased regulation for auditors of PIEs will be disproportionately burdensome to smaller audit firms which audit a small number of PIEs. There may well be a number of firms which only audit one PIE as defined in the revised Directive. Firms which audit fewer than ten 'major audits' as currently defined by the FRC have in recent years been able to benefit from the delegation of the reviews of those audits to the relevant supervisory authority, e.g. the ICAEW. In our opinion, this was a proportionate and reasonable approach.

Under the new requirements, the review of PIEs has to be undertaken by the single competent authority (as proposed in this consultation, the FRC). However, the new requirements also require the review of *auditors* of PIEs to be performed by the single competent authority, not simply that of relevant *audits*. This will mean that the review of 'whole firm procedures' will also be undertaken by the FRC, rather than by (e.g.) the ICAEW's Quality Assurance Department.

Our understanding of the scope of AQR 'whole firm' procedures reviews is that they are considerably more time consuming and onerous than when such reviews are undertaken by the QAD. We are therefore concerned that the additional burden on firms not currently subject to AQR monitoring will be significant.

As an example, a firm which audits two listed PIEs is currently monitored by the ICAEW and the review of the PIE audits is delegated by the FRC to the QAD which is carried out alongside their review of both 'whole firm' procedures and other, non PIE, audits conducted by the firm.

Under the new regime, the review of both the PIE audits and 'whole firm' procedures will be undertaken by the FRC. The review of non-PIE audits will presumably be delegated by the FRC to the QAD (as discussed on page 17 of the Document). There will therefore not only be two layers of monitoring of the firm but there will also be the risk of a lack of 'joined up thinking' by the two bodies when assessing the quality of the firm in question. This is a practical issue which the FRC will need to consider in consultation with the ICAEW and similar bodies to ensure that the arrangements ultimately made are workable.

Either way, the level of regulation, and time and costs involved in dealing with it, is likely to increase significantly, and fall most heavily on smaller firms who simply do not have the same level of resource available for dealing with the AQR as do the larger firms.

As we have noted in our introductory remarks, it is easy to see a scenario where a firm that audits only a very small number of PIEs may decide that the costs of dealing with this increased regulation outweigh the benefits of remaining as auditors of the PIEs. This will most likely result in Big Four firms undertaking these audits, further increasing market concentration.

5. 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?

We entirely agree that the Government should not seek to expand the definition of PIEs beyond the EU minimum requirement.

We would however note that the question is loosely drafted and 'listed companies' should mean 'companies listed on a regulated market in the EU'. We are in complete agreement that companies listed on other exchanges, for instance AIM and ISDX, should not be scoped in to the definition of PIEs. Many such companies are relatively small, and simply do not have the same level of public risk and accountability as do larger listed companies or systemic financial institutions.

6. **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?**

We have addressed the majority of the issues either in our responses above or our introductory observations. In particular we believe that mandatory auditor rotation will lead to further concentration of the audit market for the reasons described in our introductory observations.

7. **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 entities such as other entities whose securities are admitted to trading on a regulated market, e-money institutions, and MIFID Investment firms? How do you think these should be addressed?**

The main implication is that entities which would not have previously been subject to restrictions over non-audit services to the same degree as listed companies now will be, and will also be subject to the need to rotate auditors therefore leading to increased costs and management time. Given that there is no real scope for derogation of the new requirements there is probably little that BIS can do to address this other than, as noted in our introductory observations, monitoring the impact with a view to further discussions with the Commission at some stage in the future.

8. **What do you think are likely to be the familiarisation costs to auditors of PIEs arising from all the changes affecting them, including to person hours and costs? How is this likely to vary by size of audit firm?**

It is impossible to quantify this particularly given that the full impact of the changes cannot as yet be known. However, it may well be significant, particularly for smaller firms who do not have the same level of internal regulatory resource as do the largest firms. For an audit firm who audits one PIE, the impact will be proportionately much greater than for a large firm that audits many PIEs and is already subject to inspection by the AQR.

9. **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?**

Whilst we have reservations as to how the requirements of the Directive/ Regulation may be applied in practice (largely because of their disproportionate impact on smaller entities and audit firms) if the Government is truly required to appoint a single competent authority, and is minded to appoint an existing body to this role, we can see that the FRC may be the only realistic choice.

However, we do not believe that Government should dismiss the idea of setting up another body, or indeed taking on some of the responsibilities of the SCA itself, out of hand, but should instead consider all possible options. Appointing the FRC to carry out all the functions of the SCA is not the only option, and should not be regarded as a fait accompli.

10. What issues, if any, do you consider arise from the need to implement a new statutory audit 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?

The main issues that we anticipate are that this is likely to involve a significant increase in the workload of the FRC (assuming it becomes the SCA) together with major practical issues in determining how the new framework will fit together. The FRC will need – as noted above – to work with the professional bodies to achieve a result which is balanced, fair and reasonable, and proportionate (at least as far as is possible in the context of the new requirements).

With the FRC having expanded responsibilities and direct oversight over a broader range of firms than is currently the case, it will be vital that not only FRC/ AQR staff, but also those governing the FRC, are drawn from a wide range of backgrounds with experience of audit that is not restricted to the Big Four. This will help ensure that its monitoring of smaller and medium sized firms is drawn from a basis of relevant experience.

We believe that the FRC should continue to delegate the inspection of non-PIE 'major audits' to the RSBs and indeed believe that the Government should require it to do so. At present this is permitted where an audit firm conducts ten or fewer 'major audits'. A 'major audit' is defined very differently from a PIE and it is possible – although perhaps not likely – that an audit firm could conduct more than ten 'major audits' (for instance of large charities or pension schemes) but not conduct any audits of PIEs.

We note that the Document states on page 17 that BIS would want to continue to provide the FRC with inspection powers in respect of non-PIE major audits. However, we would suggest that the FRC could be required or permitted to delegate the inspection of auditors that conducted more than ten 'major audits' to the relevant RSB if none of those 'major audits' were also PIEs. If it wished to conduct a review of an individual major audit itself, rather than delegate that review to the RSB, then it would of course be able to do so.

We do have concerns that the end result of the new requirements is that the FRC becomes 'judge, jury and executioner' not only for those audit firms of which it has direct oversight under the new requirements, but of the profession as a whole. As noted in our introductory remarks, we believe that the FRC's expanded responsibilities (assuming it does become the SCA) should be restricted to those required by the Directive and Regulation, and not increased beyond this at the expense of the RSBs, or for that matter at the expense of the FRC's primary function as an oversight body (which has already been eroded as the FRC has tended to take on some direct operations and activities itself, rather than supervising them). It is also vital that the way in which the new framework operates is reviewed by BIS on an ongoing basis to ensure it is operating in a fair, reasonable and proportionate manner. Finally, we would stress that appropriate checks and balances need to be put in place to ensure fairness of approach, which needs to include an effective recourse to external appeal.

11. 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 these be addressed?

The main issue is that the overall regulation of those accountancy practices that are not registered auditors will also now fall ultimately to the FRC. We believe that monitoring of such practices should continue to be delegated to the RSBs and again would suggest that the FRC be required by Government to delegate this.

12. 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?

Yes, although we note that Government may require the single competent authority to delegate tasks, or even designate other bodies than the FRC as competent authorities for specific purposes.

In this context, as noted above, we would propose that Government should require (rather than merely allow) the delegation of the review of audit firms that do not audit PIEs, and the audits of non-PIEs, to the relevant RSB. We would agree that any reclamation of this delegation should only be in exceptional circumstances.

We would propose that a similar arrangement is put in place for investigations and discipline in respect of non-PIE audits and non-PIE auditors.

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

We would expect that this would only apply in exceptional circumstances for instance where there was a genuine systemic risk arising from the conduct of a particular audit or particular audit firm.

14. 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.

We believe that it is important that the rules of the RSBs are sufficient to ensure that only individuals competent to perform properly as accountants and auditors are admitted to membership. We do not particularly see any need to amend the law as currently drafted in this area, save as is required by the Directive and Regulation to incorporate the existence and responsibility of the single competent authority. In general, we believe that as far as possible it should still be left to the RSBs to determine their rules.

15. 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?

We are concerned about some of the options raised in respect of the approval of statutory auditors. In our view it should continue to be the responsibilities of the RSBs to determine whether a member firm should, or should not, be eligible for appointment as a statutory auditor licensed by that RSB.

We are concerned that the proposals as drafted would permit the FRC to reclaim the task of approval of auditors, at least in some circumstances. Whilst we appreciate that the Directive and Regulation may require this possibility, it should not be down to an external oversight body to determine who may or may not belong to an entirely different body. To grant the FRC the right to license audit firms would also seriously compromise its role as an oversight body.

We are also concerned that granting rights to remove auditors from the register to the FRC would not only compromise its oversight role still further but also risks being applied disproportionately. It is all too easy to foresee a scenario where a smaller firm might be removed from the register for a transgression which would not attract the same punishment were the perpetrator one of the largest firms – simply because removal of the smaller firm would not have the same impact on audit competition or on the profession as a whole. It is also possible to see that such a transgression at a large firm would be viewed as an isolated error but for a smaller firm would be viewed as evidence of systemic issues. In our opinion, removal from the register should only be granted by the express permission of Government, after careful consideration and with a right of appeal.

We are also concerned by the statement on page 19 'At present there are no additional approval requirements for auditors conducting certain audits such as major audits'. Some years ago, the then Audit Inspection Unit suggested, following the publication of a report on the inspection of 'smaller firms' that firms should be licensed to conduct listed audit work. The tone of the report was critical and potentially highly damaging to smaller firms, with the implication both of the report and subsequent FRC comment being that the FRC believed 'bigger is better' and did not appear to believe that 'smaller firms' should be conducting listed company audits.

This proposal was subsequently dropped, but it is all too easy to envisage a scenario under the new requirements where the FRC might resurrect this proposal, for instance requiring the licensing of firms to undertake the audits of PIEs. We strongly believe that it should be down to the individual audit firm to determine whether or not they are capable of conducting PIE audits in accordance with relevant professional standards, subject of course to appropriate monitoring. Any licensing procedure would make it effectively impossible for any firm that audited few, or no, PIEs to gain PIE clients, or for that matter to retain existing PIE clients or clients that might become PIEs in the future (e.g. AIM companies that might at some stage wish to graduate to the main exchange).

Whilst we can accept that there may be extreme circumstances in which a firm may need to be prohibited from conducting PIE audits, we believe this should be a 'last resort' as a result of ongoing unacceptable quality of work following a programme of *constructive* feedback and repeat reviews. We do not believe it would be appropriate to require firms to 'prove themselves' in advance of undertaking PIE audits, or to require smaller firms who have conducted a small number of PIE audits for some time to 'prove themselves' simply because they do not audit the same number of PIEs as a larger firm, or have not previously been subject to AQR monitoring.

16. **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?**

As we have noted above we believe that the rules of the RSBs should be a matter for the RSBs. If approval of the rules of the RSBs by the single competent authority is indeed required by the Directive and Regulation, then we believe that it should be enshrined in law that such approval shall not be unreasonably withheld save in exceptional circumstances and with the agreement of Government. We do not believe it is at all appropriate for the SCA to be the ultimate arbiter of the suitability and adequacy of an RSB's rules.

17. **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?**

We believe – as should be clear from the responses to the above questions – that the costs of implementation will be significant (including for the FRC as a result of its significantly increased workload). We are also entirely unconvinced as to the benefits of the new requirements as in our opinion the current system is, and has been, operating effectively and on the whole in a proportionate manner.

However, we recognise that BIS effectively has no choice but to apply the new requirements and the challenge will therefore be in ensuring that they are applied in a balanced and proportionate manner – which we believe will be very difficult to achieve.

18. **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?**

Yes, in our opinion this is a sensible approach given that Ethical Standard 5 already incorporates various restrictions on the provision of non-audit services to audit clients.

19. **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?**

We have referred in our introductory remarks to the main issues we expect to arise, namely additional costs as a result of using firms other than the auditor for certain non-audit services and therefore reduced ability to benefit from the auditor's knowledge of the business.

20. 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?

We are not generally in favour of 'gold-plating' the requirements and in our opinion it is time to consider revising the Ethical Standards in this, and other, areas.

At present, the requirements of the Ethical Standards are more stringent than those of Article 4 and 5 of the Regulation and also apply to entities which are not PIEs, as the definition of 'listed company' in the Ethical Standards includes entities listed on other exchanges such as AIM and ISDX. We believe now is the time to consider amending the requirements of the Ethical Standards so that the more stringent provisions (as modified where necessary to avoid 'gold-plating') are applied to PIEs (whether listed or otherwise) but not to companies listed on other exchanges, many of which are very small and where the systemic risk is much less than for PIEs.

21. 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, we believe that this should be permitted.

22. 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?

As with the 'cap' on the provision of non-audit services, we believe it would be sensible to include the 'Blacklist' in the Ethical Standards.

However, as noted above we do believe it is time for the application of the more stringent requirements of the Ethical Standards to be reconsidered. In our view the stringent prohibitions required by Article 5 of the Regulation should be restricted to the audits of PIEs and should not be extended to other companies currently included in the 'listed' definition such as AIM and ISDX. Many such companies are very small and simply do not have the same level of in house financial reporting expertise as do larger companies listed on the main London Stock Exchange, which can lead to issues with preparation of the financial statements given the complexity of IFRS and the prohibition of the auditor providing this service.

In our view, a proportionate solution would be to revise the Ethical Standards so that the prohibitions currently in place for 'listed' companies (i.e. including AIM and ISDX) apply only to PIEs (whether listed or otherwise) and are modified as necessary to avoid 'gold-plating' of EU requirements, with all other entities being subject to the basic requirements of the Standards. This would be particularly helpful in assisting AIM and ISDX companies in preparing quality financial statements, and therefore helping to address an ongoing concern of the FRC.

We do not believe that the FRC should seek to add any additional non-audit services to the 'Blacklist' - which is already very restrictive – or to take a 'white list' approach (i.e. produce a list of permitted non-audit services with anything else being prohibited).

23. 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?

We have discussed these earlier in our response in relation to the increased time and costs that PIEs, and particularly smaller PIEs, are likely to incur.

24. 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

Yes, we agree that this would be a sensible approach.

25. 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 4 of the Regulation?

Yes, we agree that this is a workable way of providing the required information and will be less onerous than, for instance, requiring the auditor to report separately to the FRC in respect of audit and non-audit fees charged to each PIE audit client.

26. 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?**

As we have responded to previous similar questions, it is very difficult to quantify the additional time and costs that will result, but we do believe that they will be significant, and fall disproportionately on smaller PIEs and smaller auditors of PIEs.

27. Do you consider that all the 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?

Yes, we agree that the current system should continue.

28. Where a PIE does not have an audit committee (e.g. because it is an unlisted bank) do you agree that in this situation the directors should determine the recommendations in respect of auditor appointment that should be put to the shareholders?

Yes, this appears to be a sensible solution.

29. **The Government does not intend to take up the option to provide for an extension of the maximum duration of the audit 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?**

We would query why the Government does not intend to take up the option to provide for an extension of the maximum duration of the audit appointment. Whilst joint audit is not common in the UK (unlike some other member states) we believe this option should nonetheless be available. We therefore do not agree that a tender should automatically result from the decision to appoint a joint auditor.

We still believe that shared audit – where a firm other than the parent company auditor conducts the audit of certain subsidiaries but the parent company auditor is still responsible for the opinion on the group financial statements – would be the only meaningful way of broadening the number, and size, of firms involved in the audit of PIEs and their subsidiaries because it would allow such firms to gain relevant experience. We do not believe that the measures resulting from the CMA enquiry or those resulting from implementation of the Directive and Regulation will have any meaningful impact on increasing competition for larger listed audits and if Government genuinely wishes to increase competition we would urge that this issue is reconsidered.

30. **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 agree with this.

31. **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;**
    b. **When the audit engagement was last retendered;**
    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;**
    d. **The directors' reasons for considering that the proposed year is in the best interests of the company's members.**

Do you consider that any other information should be included in addition to the above?

We do not have any objections to the above proposals but believe Government could also consider including a requirement to disclose which firms it will consider for its next tender when that tender is to take place in the subsequent financial year. If only Big Four firms are to be considered then the reasons why should also be disclosed.

32. **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 (e.g. at 7 years) the next tender process should be expected to take effect:**
    a. **After the same period has expired again (i.e. year 14 in this example)**
    b. **After a further 10 years has expired (i.e. 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 (i.e. in this example at year 14 though this could be extended to year 17)?**

We believe that there should not be any requirement or expectation for the next tender process to take place earlier than ten years after the previous tender, regardless of whether that tender was conducted earlier than ten years after the auditor was appointed. In the example given, the next tender process should therefore be expected to take effect at year 17. There would of course be no barrier to the next tender taking place at an earlier stage if the company decided to do so, but this option provides the maximum flexibility.

33. **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 tendering? If there are any such issues, how should they be addressed?**

As we have noted in our introductory remarks we are concerned that mandatory rotation of auditors will only serve to increase market concentration and indeed its imposition automatically reduces choice because an incumbent auditor, which may well still be the best auditor for the business, will no longer be able to be appointed once a maximum of 20 years has elapsed.
The issues which are most likely to arise are for businesses that operate in specialist industries, for instance systemic financial institutions. Such businesses may be very limited in choice of auditor, particularly given that the 'blacklist' on non-audit services may well rule out potential auditors due to their provision of non-audit services on the 'blacklist'.

In rare circumstances a business may have no effective choice of which auditor to appoint because only one firm, other than the incumbent, will have the relevant experience and also be permitted to act. Indeed unless the business is very careful who it appoints to provide non-audit services it is entirely possible that no auditors with suitable experience would be permitted to act. Whilst this is an extreme example, it is certainly possible in specialised industries.

34. **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; and**
    d. **The extent to which this varies by the size of the PIE?**

Again, it is impossible to quantify the time and costs although we would expect the burden to fall disproportionately on smaller PIEs. There will inevitably be costs to PIE auditors of familiarising themselves with new clients, however this is already the case when taking on any new audit engagement. The auditor of course has the option of reviewing the previous auditor's most recent audit file and for the audit of PIEs we would normally expect this option to be taken up.

35. 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?

This essentially codifies in legislation a requirement which is already embedded in auditing standards – i.e. that where there is a material uncertainty which casts significant doubt on the appropriateness of the going concern basis, the auditor should include an emphasis of matter paragraph in the audit report. We would prefer if this remained a matter for auditing standards but appreciate that this is not possible because of the requirements of Article 28 of the Directive.

However we would note that whether or not to include an emphasis of matter paragraph will remain a matter of judgement, based on consideration of the facts and circumstances available to the auditor at the time the audit opinion is formed. One possible issue arising from including this requirement in legislation might be an increased risk of litigation by shareholders against the auditor if a company collapses and no emphasis of matter paragraph had been included in the audit report. However there may be many reasons why a company fails which may not have been in existence at the time the audit report was signed and therefore the collapse of a company subsequent to the issuing of a clean audit report does not automatically mean that audit report was incorrect (though this may well be a misperception held by certain commentators).

36. 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 on Auditing (UK and Ireland)?

Yes, we agree that this approach is sensible although we would stress that the requirements of Article 10 should not be extended to non-PIEs.

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

We note that the requirement to include additional information in the audit report, including a description of the most significant risks of material misstatement and the auditor's response to them, extends the scope of such additional disclosure to all PIEs whereas at present the need for similar disclosure extends only to those companies required to comply fully with Corporate Governance requirements or that choose to do so voluntarily.

38. 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 on Auditing (UK and Ireland)?

Yes, again this appears a sensible approach.

39. 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 do not agree with the assertion on page 40 of the Document that the requirement to report on certain matters to the audit committee in a separate report will not require additional audit work or have a significant impact on the audit. Whilst the audit work itself may not be affected clearly additional time will be required on the audit in order to prepare the report, the requirements of which are more extensive than the current requirements for communication with those charged with governance.

We are concerned by some of the language used in the Regulation particularly the requirement to describe the methodology used 'including which categories of the balance sheet have been directly verified'. 'Verify' is not a term used in auditing standards and we are concerned that its use in the Regulation could lead to a misleading impression of what an audit is designed to do. The objective of an audit is to determine whether the accounts show a true and fair view and are therefore not *materially* misstated. We are concerned that the use of the word 'verify' could lead to a false impression that the accounts have been checked in their entirety.

We presume that what the Regulation intends to say is that the auditor should, when describing the methodology used, specify which balance sheet areas have been subject to substantive testing and which areas subject to compliance testing. This needs to be clarified in the relevant amendments to Auditing Standards.

40. We should particularly welcome data on:

- **a. Additional resources 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 annual report; and**
- **c. How these costs vary by size of PIE?**

As for our response to previous similar questions this is impossible to quantify.

41. Do you consider that the small companies audit exemption thresholds should:
- **a. Remain aligned with the small companies accounting regime?**
- **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?**

We commented in our response to the previous consultation on the implementation of the revised Accounting Directive that we believe the small companies audit exemption limits should remain aligned with the small companies accounting regime. However, we only agree with this if the small company thresholds were to be set at the minimum, rather than the maximum, level permitted by the Accounting Directive, i.e. £7m turnover, £3.5m total assets and 50 employees. If the small company accounting thresholds are to be set at the maximum limits – which appears to be the course of action the Government intends to take – then the audit exemption threshold should be decoupled.

To raise the audit exemption limit to the maximum permitted 'small company' thresholds will mean that companies which in reality are not 'small' – and which would actually have been at the top end of the 'medium' category not so many years ago – will no longer be required to have the seal of approval conferred by an audit report.

As a company grows, it is more likely to have complex financial transactions, external finance and external investors. Moreover, stakeholders are more likely to want the protection of knowing that the financial statements have been subject to at least some form of independent scrutiny, which will often not be the case. The concept that audit is a regulatory burden may be believed by the Secretary of State and those that do not realise the considerable value of an audit to a business, but it is simply not true. In particular even a business with a £7m turnover will be a very significant size in relation to a local community or small town and could have wide ranging implications for the local economy should it fail due to inaccurate and unaudited accounts. If this analogy is applied to all companies which would drop out of audit as a result – the combined turnover of which would be in the billions - then the loss of public confidence would be significant.

Furthermore, to reduce so significantly the number of companies subject to audit will have a direct impact on the number of accountancy practices providing audit services and therefore able to train the auditors and Responsible Individuals of the future. The skills that an auditor requires, including, but not limited to professional scepticism, analysis of audit risk and critical appraisal and challenge of management, are not limited to the Big Four but are *currently* available to those taking up an audit career at all sizes of audit firms. The inevitable result of reducing the number of *audits* will be further concentration of audit amongst the largest firms due to the reduction in the number of firms providing audit services. The whole profession, and its clients, will be much the poorer as a result.

42. What issues, if any, do you consider arise from the measures considered in respect of chapter 5 'Other changes'? If there are any how do you consider they should be addressed?

We have commented in our responses to various questions about our concerns regarding changes to the way audit firms will be monitored.

43. We would welcome any information you can provide on the expected costs and benefits of the measures considered in chapter 5.

As with previous questions of this nature we believe it is not possible to quantify the costs of the measures in any meaningful way.

44. 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)?

Yes, we agree that this would be a sensible approach.

45. 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 are unable to comment on this question and believe specific outreach should be undertaken to small audit firms conducting PIE audits on this issue.

46. 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?

The main issue we would stress is that it is vital Member States continue to have the option to supplement ISAs to reflect specific national legal requirements or to enhance the credibility of financial statements, as is currently done in the United Kingdom.

47. 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; 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, we agree.

48. 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)?

We have no comments to make on this question.

49. What issues, if any, would you consider arise from the implementation via provisions in the 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?

We have no comments to make on this question.

50. 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; and**
- **e. How these costs vary by size of PIE?**

We have no comments to make on this question.

51. 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?**

We are not convinced that the single competent authority is required to itself receive the information required to be provided to supervisors of PIEs under Article 12 of the Regulation. If it is not, then we see no particular need to 'gold-plate' the requirements. However, we can see that this could be considered desirable for reasons of the public interest.

However, a close eye would need to be kept on the potential for unintended consequences. In particular, we see no reason why the FRC should be required to be informed in the event of a qualified audit report being issued on a PIE. Whilst in some cases qualified audit reports arise because of a disagreement over accounting treatment this is not the only reason for qualification. Limitations in scope, for instance, could arise because of difficulties in obtaining information about a foreign operation or about the fair value of a significant balance sheet item without there being any suggestion of 'fault'. We are concerned that a requirement to inform the FRC of qualified audit reports would automatically trigger a Corporate Reporting Review into the particular entity and whilst this may well have happened in any event, we do not believe it should automatically result from the imposition of a qualification.

52. We should be grateful for any estimates you can provide of:

- **a. The costs of the auditor providing 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; and**
- **c. The frequency with which the FCA is provided with this information for other PIEs in practice already?**

As with previous similar questions we do not believe it is possible to provide meaningful estimates.

53. 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?

No. Rather we believe that statutory auditors from other Member States should be required to be approved by a relevant RSB, by means of either an aptitude test or an adaptation period, both to be determined by the RSB in question.

We are not convinced that convergence of aptitude tests or adaptation periods across the EU is either necessary or desirable given the different legal and regulatory regimes operating in different Member States.

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

a. Aptitude tests; and

b. Adaptation periods (if these were to be provided for)?

Please see our response to the above question. On a more general point, we believe it is vital that it remains up to the RSBs to determine what aptitude tests, including professional examinations, they require in order to admit an individual to membership.