



Department  
for Business  
Innovation & Skills

## AUDIT REGULATION

Discussion document on the  
implications of the EU and wider  
reforms – Response Form

DECEMBER 2014

# Regulation on the Specific Requirements Regarding Statutory Audit of Public Interest Entities and Directive amending Requirements on Statutory Audits of Annual Accounts and Consolidated Accounts

## Discussion document response form

The Department may, in accordance with the Code of Practice on Access to Government Information, make available, on public request, individual responses.

The closing date for responses is 19 March 2015

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The form can be submitted by email or by letter to:

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Please tick a box from the list below that best describes you as a respondent.

	Business representative organisation/trade body
	Non-government standard setting/regulatory body
	Charity or social enterprise
	Individual
✓	Large business (over 250 staff)
	Legal representative
	Local Government
	Medium business (50 to 250 staff)
	Micro business (up to 9 staff)
	Small business (10 to 49 staff)
	Trade union or staff association
	Other (please describe)

## Chapter 4

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.

Legislative implementation should be kept to a minimum, be clear and concise and as simple to implement as possible and practical. It should try and limit itself to one interpretation. If there is room for multiple interpretations, legislative implementation should be avoided until clarification of the consensus interpretation required.

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 the discussion 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.

No comment (no comment will be the response as shorthand for a question being not applicable to us as users of annual reports as a fund manager institutional investor acting as agent of and therefore representative for our investing clients).

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?

No comment.

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?

There should be scope to apply proportionality to any requirements as the privilege of limited liability should require audit requirements to apply to all sizes of entity.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

It is difficult to envisage how any entity should be captured as a public interest entity unless its activities impact the majority (ie over 50%) of the population of the UK or the EU. It is also difficult to envisage who should decide what is or is not a PIE. If a Government decides what a PIE is, they should have a specific mandate from the majority of a population to do so. Otherwise they should leave the definition as the minimum requirement.

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?

No comment.

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?

See reply to Q5 – in any event UCITS and AIFS, which have sufficient other applicable EU regulations and oversight, should not be included.

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?

No comment. However, it should be noted that most risk or equity capital providers to PIEs as applicable will accept reasonable audit costs arising from any new requirements agreed with.

(b) what are the costs to audit firms of updating internal management systems to reflect the changes?

No comment.

(c) How this is likely to vary by size of audit firm?

No comment.

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?<sup>1</sup>

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

The FRC already regulates audits in the UK and there appears to be no reason to change this. Also, audits of other sectors to banks, which were seen as the main causes of the financial crisis, are not perceived to have any material audit issues.

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?

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<sup>1</sup> In answering this question, it may help in particular to consider the tasks of audit inspection, investigations and discipline, auditor approval and continuing professional development and the setting of technical and ethical standards for statutory audits and auditors.

No comment.

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?

No comment.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

See Q9.

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 be needed to ensure that authority only retained responsibilities or reclaimed delegated responsibilities in appropriate circumstances? What do you consider these circumstances should be?

No comment.

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.

No comment.

Q15. Do you consider that both the registration of statutory auditors and their removal from the register should be covered by regulations under the Companies Act<sup>2</sup>?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

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

Please provide information in support of your answer:

FRC.

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?

☐ Yes

☐ No

☒ Not sure

☐ Not applicable

Please provide information in support of your answer:

No comment.

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?

No comment.

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

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

It should be included to avoid confusion between legislation and non legislation implementation requirements.

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<sup>2</sup> The [Statutory Auditors \(Registration\) Instrument 2008](#) currently applies for this purpose, having been made by the FRC using powers in section 1239 of the Companies Act, which are delegated to it.

The cap of 70% should also refer to the prior year's audit fee and not an average over the three preceding financial years to try and avoid gaming the requirements and to keep the requirements clear and simple.

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

Please provide information in support of your answer:

No comment.

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?

☐ Yes      ☒ No      ☐ Not sure      ☐ Not applicable

Please provide information in support of your answer:

There should be no need to set more stringent requirements to the cap in the UK as the existing requirements in the FRC's Ethical Standard 4 are if the total fees for both audit and non-audit services receivable from a listed entity regularly exceed 10% of the annual fee income of the audit firm then the firm is not allowed to stand as auditor and has to resign or not stand for reappointment, as appropriate.

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      ☒ No      ☐ Not sure      ☐ Not applicable

Please provide information in support of your answer:

It is difficult to envisage why exceptions would be needed.

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

☐ Yes      ☒ No      ☐ Not sure      ☐ Not applicable



Please provide information in support of your answer:

To keep requirements simple and consistent for all entities.

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

No comment.

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.

No comment.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

Also to provide relevant information to investors.

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

- (a) the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the blacklist?

No comment.

(b) the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor?

No comment.

(c) the extent to which these additional costs vary by the size of PIEs?

No comment.

(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?

No comment.

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?

☒ Yes      ☐ No      ☐ Not sure      ☐ Not applicable

Please provide further information in support of your answer

There is nothing wrong with the current requirements.

Are there any other systems that should also be provided for on the grounds that a competitive tender process is not appropriate?

No.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

Audit Committees are committees of the whole Board and therefore it is logical that if there are no Audit Committees, all the directors determine the recommendations to be put to shareholders.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

As this is consistent with tendering every 10 years and mandatory rotation every 20 years.

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

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

See Q29. There will always be risks to auditor objectivity and/or scepticism and these should be

managed by the companies, in particular audit committees, and their major shareholders. We wait to see if this management of the risks becomes more effective over time under the new audit committee reporting and audit reporting regimes. These new regimes should be given time (at least three years) to work before any legislative requirements are needed.

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      ☐ Not sure      ☐ Not applicable

b) when the audit engagement was last retendered?

☒ Yes      ☐ No      ☐ Not sure      ☐ Not applicable

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      ☐ Not sure      ☐ Not applicable

d) the directors' reasons for considering that the proposed year is in the best interests of the company's members?

☒ Yes      ☐ No      ☐ Not sure      ☐ Not applicable

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

☒ Yes      ☐ No      ☐ Not sure      ☐ Not applicable

Please provide information in support of your answer:

The key factors that will be used to consider the appropriateness of an existing or a new auditor.

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?

☐ (a)                      ✓ (b)                      ☐ (c)                      ☐ No preference                      ☐ Not applicable

The ten year requirement should be consistent for all situations.

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?

No comment.

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?

No comment.

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?

None.

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      ☐ No      ☐ Not sure      ☐ Not applicable

Please provide information in support of your answer:

No further comments.

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?

☐ Yes      ☒ No      ☐ Not sure      ☐ Not applicable

No further comments.

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)?

☐ Yes      ☐ No      ☒ Not sure      ☐ Not applicable

Please provide information in support of your answer:

No comment.

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?

No comment.

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?

No comment.

(b) the additional annual cost of the audit committee considering the additional report?

No comment.

(c) how these costs vary by size of PIE?

No comment.

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)?

☐ (a)                      ☐ (b)                      ☐ (c)                      ☒ No preference                      ☐ Not applicable

Please provide information in support of your answer:

No comment.

## Chapter 5

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?

No comment.

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

No comment.

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)?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

No comment.

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?

Please provide information in support of your answer:

No comment.

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?

Please provide information in support of your answer:

No comment.

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

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

Based on sufficient consultation of interested parties.

(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

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

Based on sufficient consultation of interested parties.

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)?

No comment.

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?

No comment.

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?

No comment.

(b) the cost of recruiting members to be part of an audit committee?

No comment.

(c) the annual cost of attendance of a member?

No comment.

(d) the auditor's fees for attending audit committee meetings?

No comment.

(e) how these costs vary by size of PIE?

No comment.

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?

☐ (a)                      ☐ (b)                      ☐ (c)                      ☒ No preference                      ☐ Not applicable

Please provide information in support of your answer:  
  
No comment.

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?

No comment.

(b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?

No comment.

(c) the frequency with which the FCA is provided with this information for other PIEs in practice already?

No comment.

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?

☒ Yes

☐ No

☐ Not sure

☐ Not applicable

Please provide information in support of your answer:

No further comment.

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;

No comment.

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

No comment.

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?

No comment.

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