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Paul Smith Esq  
Corporate Frameworks, Accountability and  
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Department of Business, Innovation and Skills  
1 Victoria Street  
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19 March 2015

Dear Mr Smith

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

On behalf of Baker Tilly, I hereby submit this response to the above discussion paper. Baker Tilly is the UK's seventh largest full-service multi-disciplinary accountancy and audit firm, with 321 partners and 3,136 staff operating from 33 offices throughout the UK.

The firm subscribes to the joint response of the Group A firms and Association of Practising Accountant firms dated 16 March 2015, which response is annexed hereto. We now wish, having given detailed consideration to BIS' discussion paper, to offer the following principal comments.

- the need for proportionate regulation going forward:  
the EU Regulation and the Directive were drafted with the backdrop of a financial crisis precipitated by the near-collapse of clearing banks and other financial institutions, and the spectre of systemic risk to the stability of the capital markets. Implementation of the options open to the Government should be informed by the need to be proportionate, having regard to the full spectrum of companies which are covered by the statutory audit regime and tempering the consequences accordingly.

Proportionate regulation has regard to the principles to which the Government already subscribes: regulate only where satisfactory outcomes cannot be achieved by alternative, self-regulatory, or non-regulatory approaches, where analysis of the costs and benefits demonstrates that the regulatory approach is superior by a clear margin to alternative, self-regulatory or non-regulatory approaches; and where the regulation and enforcement frameworks can be implemented in a way that is demonstrably proportionate.

The presumption of UK government policy is that the whole professional and business services sector and the commercial entities they advise and support



should not be burdened by the imposition of new costs and obligations unless there is absolutely no other option, lest competitive disadvantage be the result.

We strongly suggest that a joint audit & accountancy working group, comprising the profession and regulators should be set up, with the objective of converting commitment to the principle of Proportionality to a specific agenda, intended primarily to serve the end-user recipients of the professional services we provide.

- regulatory architecture and the ‘Single Competent Authority’:  
BIS is faced with not merely important but critical choices in implementing the new European norms. The FRC is (i) an oversight body, that (ii) should have as its main (arguably, its only) focus on the stratum of the audit market that presents the greatest systemic risk. At a time when the audit firm market is experimenting with means of generating genuine competition, causing audit engagements to move from firm to firm (even if only between the four largest), regulation needs to maintain its focus on those firms which audit the largest and most complex PIEs: it should go without saying that investor confidence in that stratum needs to be maintained and that doing so is the regulator’s first duty.

We respectfully remind government too that when the current governance arrangements were set up, they were based on the FRC being an oversight body, focused on standard setting, not operational activity. Unfettered oversight is terribly important and BIS should ensure that as little as possible responsibility for executing regulation is adopted by the FRC. The present dual-regulator system is fit-for-purpose and the FRC appears to agree<sup>1</sup>.

- the need for effective checks and balances:  
Concentrating power in the hands of one regulator would be a retrograde step. The present dual regulation ensures appropriate balance, challenge, robustness and specialisation. Regulation in the UK has benefited from the work that the independent professional bodies have done as complementary element of the overall regulatory framework.

If the FRC is to become the SCA, it must be realised that the result will be a new and untested construct quite different from its original one. There would have, prior to any such decision being made, to be an independent review of its current and future governance structure.

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<sup>1</sup> In its 2012 report to BIS, the FRC conceded as much: “The European Commission wants to restrict very substantially the role that a professional body can play in audit regulation, placing on the independent oversight body responsibility for monitoring the work of all statutory auditors...we do not consider that the Commission has made a convincing case for such a major change and consider that the existing arrangements, at least in the UK context, are fit for purpose.”



In the event that the FRC is designated as SCA, then we think that the potential option of vesting it with powers to delegate operational functions to the professional bodies should be avoided: those powers should be written into legislation and conferred directly by government on those bodies.

- the definition of PIE and consequential regulation:  
Any changes in FRC activity should not place additional regulatory burden on smaller entities (by which we mean AIM-listed and some CISX-listed entities, or those entities not deemed under current Audit Quality Review criteria as 'major audits'). These entities are, by common acknowledgement, the engine-room of growth. Similarly, we have urged in the joint response to you and to the FRC consultation paper that there are sound public policy reasons for taking the sorts of entity we have just mentioned out of the definition of PIE, and aligning the effects of the Ethical Standards for Auditors accordingly.
- The raising of the audit threshold:  
Raising the audit threshold would potentially increase the risk of fraud and material misstatements in financial statements and reduce the confidence of many business and other organisations when dealing with each other. The proposed raising of the audit exemption threshold would cause some £50bn of turnover to be taken out of audit examination, and the risk of damage to local economies and employers is substantial.<sup>2</sup>

Any further rise in the audit exemption threshold will cause contraction in the numbers of Responsible Individuals the profession can train. The professional environment for young auditors is in any event already daunting – the regulatory risks to career and reputation are causing good young professional people to turn away from the auditing specialism.

It must be appreciated that the critical skills that statutory audit practice instils in young auditors – professional scepticism, the appreciation of risk and relationship to going concern issues, attendance at stocktakes, dealing with management and interrogating it on material issues, understanding whole-business concepts, and adding value to the statutory process, are invaluable lessons that are learned not only through participation in PIE and major company auditing – arguably, they are better learned in firms where the audit chain-of-command is shorter. The raising of the audit threshold will inevitably bring about a loss of opportunity to train auditors, because it will take (according to figures supplied by BIS itself, we understand) some 7,000 companies out of the statutory audit obligation.

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<sup>2</sup> In research undertaken by the firm prior to making this submission, some 60% of those who responded to our research request agreed with the proposition that there will be a decline in the quality of financial reporting in the UK if the audit thresholds are raised and auditors no longer check the accounts of entities with a £10m turnover.

contd.

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We hope that the foregoing response is helpful to BIS in forming its views on implementation of the Regulation and Directive going forward and we stand ready to contribute further to the debate, in its option.

Yours sincerely

A handwritten signature in blue ink that reads "T M McMorrow".

**T M McMorrow LLB LLM PhD**  
**Director of Policy, Regulation and Ethics**