



ICAS RESPONSE TO THE BIS CONSULTATION ON THE
TECHNICAL LEGISLATIVE IMPLEMENTATION OF THE EU AUDIT
DIRECTIVE AND REGULATION

Submission Date: 9 December 2015

ICAS welcomes the opportunity to comment on the proposed technical legislative implementation of the EU Audit Directive and Regulation.

Background to ICAS

ICAS received its Royal Charter in 1854 and is the oldest professional body of accountants in the world. We were the first body to adopt the designation 'Chartered Accountant' and the designatory letters 'CA' are the exclusive privilege of Members of ICAS in the UK.

ICAS is a professional body for over 20,000 Members who work in the UK and in more than 100 countries around the world. Our CA qualification is internationally recognised and respected. We are a highly respected regulator.

We are a Recognised Supervisory Body (RSB) for statutory company audit in the UK (supervised by the Financial Reporting Council (FRC)), and received similar status in relation to Local Audit on 1 November 2015. We are also a Designated Professional Body for incidental investment business (supervised by the Financial Conduct Authority (FCA)) and a Recognised Professional Body for insolvency licensing and regulation (supervised by the Insolvency Service).

As an RSB, we welcome the opportunity to comment on the various proposals which will affect firms authorised by ICAS to conduct statutory audits of PIE and non-PIE entities. We further welcome the opportunity to comment on the proposal to designate the FRC as the competent authority for the UK and the impact of the Directive for ICAS as an RSB.

The ICAS Royal Charter requires that we act in the public interest. Our proactive projects and responses to consultation documents are therefore intended to place the general public interest first. We consider the public interest in this instance to be the effective implementation of the EU Audit Directive and Directive in a way which remains faithful to the legislation and increases the confidence of users of audited accounts; particularly of PIE entities.

While we appreciate that ICAS has a vested self interest in the present proposals, we have tried to offer impartial comments where possible so that BIS can better understand the practical implications – or unintended consequences – of the current proposals.

We have focused our response on Question 1 of the consultation document, as we believe that this is where ICAS can make the most valuable contribution to the legislative and policy processes. Audit firms will be better placed to comment on the financial impact and unintended practical consequences of the reforms.

Consultation response

1. Do you agree with the approach the draft implementing regulations take given the Government's conclusions set out in Chapters 5 – 8 and Chapter 12 of the Consultation?

ICAS commends BIS for avoiding the gold-plating of the EU requirements. We will work with BIS and the FRC to ensure that the draft legislation meets the requirements of Government, the audit profession and audit entities.

We would like to offer some comments on the current draft implementing regulations. We do so in an attempt to be constructive, to enable BIS to revisit and amend the draft legislation based on the outcomes of the consultation.

We would also like to comment on the following key issues and we would be happy to share detailed drafting comments with BIS separately, if requested:-

Competent authority

ICAS accepts the decision to appoint the FRC as the competent authority for the UK, which is, on reflection, the most sensible outcome. However, we encourage all parties to view the Audit Directive and Regulation not as an opportunity to increase the FRC's scope, but rather a chance to redefine its future remit, with a clear focus on PIE audit regulation. As the FRC helps safeguard public trust in the capital markets in the UK, its designation as the competent authority offers the FRC a rare opportunity to review its scope and future priorities.

On a separate note, we believe that the draft implementing regulations need to adequately set out the powers of the FRC as the competent authority under the Directive, and should fully detail the tasks set out in the Directive; whether or not they are ultimately delegated or retained. We would encourage BIS to reconsider the draft legislation, as certain fundamental powers may have been omitted, with potential unintended consequences.

Delegation to Recognised Supervisory Bodies

Under the changes, the Government may allow or require the designated competent authority to delegate tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks. The Government has publicly stated that *"the legislation would require the FRC to delegate regulatory tasks so far as possible to the existing Recognised Supervisory Bodies, where they meet criteria set out in the legislation"*. This statement inferred that the delegation would be included within a legislative framework. We are therefore surprised that this approach has not been adopted in the draft implementing legislation.

The RSBs have discussed the draft legislation on several occasions during the consultation period. The delegation of powers by the FRC to the RSBs should be clear and unambiguous. We would prefer to have clarity over the powers which will be delegated to ICAS in the near future. As currently proposed, the framework is still very uncertain, with the competent authority being able to delegate, and revoke, powers at will, albeit within procedures that have yet to be established. We are concerned that a non-legislative arrangement could be amended at very short notice. We believe an element of certainty is preferable and understand that the other RSBs are of a similar view.

From ongoing discussions, we appreciate that the competent authority may already have decided the powers which are likely to be delegated to the RSBs, such as the licensing of audit firms and key engagement partners. However, the Government has an opportunity to create a framework which is based on clear principles from the outset. We would encourage Government to build a strong framework which clearly sets out in legislation the delegation to the RSBs, so that the monitoring and investigation of PIE audits vest in the competent authority, and the monitoring and investigation of non-PIE audit vest in the RSBs.

We would encourage BIS to revisit the draft legislation to ensure that the current Government statement is implemented faithfully, by providing a formal presumption in favour of delegation of regulatory tasks to the RSBs, so far as possible.

Reclamation of tasks

While we accept that the FRC requires a mechanism by which delegated tasks can be reclaimed, we would welcome further clarity in relation to the process by which this would take place under the regulations.

For example, if tasks are capable of being reclaimed on the basis of the public interest, the use of this particular test may prove troublesome. 'Public interest' would need to be defined. We are also concerned that the only right of recourse available to an RSB would be to refer the matter to the High Court, which is a very expensive and public remedy. We had hoped for a formal right of appeal to the Secretary of State, rather than the ability to seek direction, which appears to be the only safeguard.

Public Interest Entities

ICAS welcomes the Government's proposal to adopt the definition of Public Interest Entity (PIE) set out in the Audit Regulation. We consider that there could be significant cost implications for the profession and wider business if the PIE definition was expanded further under exercise of the Member State option. Nevertheless, we remain concerned that the FRC may indirectly expand the definition of a PIE to include larger companies listed on the AIM market, which is not a regulated market under the EU Audit Regulation.

In our response to the Audit Regulation Discussion Document (March 2015), ICAS opposed the inclusion of large AIM within the definition of a PIE and encouraged the FRC and BIS to ensure that the competent authority's future focus remained true to the spirit and the wording of the Regulation. We find it odd that whilst Government elected not to define additional PIEs for the purpose of the application of the Regulation, the competent authority is planning to make alternative arrangements which will ultimately amount to the same outcome.

Paragraph 6.8 of the consultation document provides that "*the FRC must delegate the conduct of inspections and investigations and the application of sanctions for non-PIEs*". If large AIM (> £100m) audit inspection work is to be retained by the FRC, it must be with the agreement of the RSBs. The non-delegation of such inspection work to the RSBs in the first instance would not be justified in the public interest, as all current RSBs are capable of undertaking this work.

The RSBs have not had an opportunity to engage fully with the FRC on these proposals. To date we have focused on a common desire to help formulate the implementing regulations and provide a good regulatory foundation for the future. However, in the context of the current consultation, we consider it appropriate to highlight that the competent authority has raised the potential monitoring and investigation of large AIM.

Investigations

The FRC presently operates a scheme for the investigation and discipline of public interest cases. To date, most, but not all, of these cases have related to the audit of companies which would fall within the definition of a PIE. ICAS would like to see non-PIE audit cases remitted to the RSBs and all non-audit cases remitted to the relevant chartered body.

Powers

While ICAS fully acknowledges that the FRC will continue to retain this power going forward by virtue of the Audit Regulation, to enable the FRC to function effectively, we consider that the draft implementing legislation should set out more clearly the powers which are being conveyed to the FRC for non-PIEs (and thereafter delegated to the RSBs).

As for potential powers, ICAS has consistently argued that the FRC should have a wider jurisdiction over the directors of PIEs in relation to audit related complaints, and not just the qualified accountants. We can see no rationale for a significant regulatory burden to be attached to professionally qualified accountants who are members of the six chartered bodies.

Sanctions

In relation to the ability for the FRC or an RSB to sanction an audit firm based on its financial position, we note that references to total turnover and annual income are not defined; either with reference to services offered, or geography. The FRC previously consulted on a similar framework. ICAS would be opposed to a sanctioning framework based on total turnover or annual income where the metrics are not defined by reference to UK audit services.

These financial metrics will, in the main, be internally generated figures within audit firms which are not audited and could result in inconsistencies in accounting between firms.

Whilst sanctioning on the basis of financial metrics may act as a deterrent, this does not reflect the nature or extent of the 'offence'. The competent authority should be a proportionate regulator.

We note that no provision has been made for the fine proceeds. It is unclear if the intention is that such fine income would boost the competent authority's reserves; or be offset against the cost to the profession and PIE base.

Audit register

While ICAS understands that the Government would prefer not to directly delegate functions to the RSBs, this appears to be the approach being adopted in relation to the audit register. ICAS currently maintains the joint audit register and whilst we would be prepared to continue to do so, we would encourage BIS to reflect further on this policy and perhaps explore whether or not the FRC should be designated as the keeper of the audit register. Members of the public will expect to be able to refer to the competent authority for details of firms licensed to undertake audit.

Length of engagement

We are supportive of the approach that BIS is proposing to take, namely that a PIE should be permitted to extend the maximum duration of an audit engagement by 10 years on the basis of a tender process for the auditor appointment for any accounting year up to and including that following the conclusion of the 10 year maximum duration.

We support the proposals at paragraph 7.13 of the consultation document in relation to the exemptions which the Government intends to provide from mandatory tendering of auditor appointments. We also welcome the decision to drop the proposed linking of the maximum duration of the audit engagement to a disclosed plan on retendering in a PIE's annual report. We do, however, note the FRC's proposal to have advance notice of tendering and an explanation of changes on the timing of the proposed tender as good practice. We are also supportive of the competent authority having the power to be able to grant an extension of the maximum duration of up to two years where a public tendering process is conducted.

We believe it is unhelpful to have separate provisions in relation to retendering of the audit appointment in both legislation and in the Competition and Markets Authority (CMA) Order. We would therefore request that the CMA be invited to consider whether there is a need for its Order to remain in force.

Our preference is to avoid reference to the EU legislation as we do not believe this is a user friendly approach. For example, regulation 8(3) of Part 3 of the draft regulations refers the reader to Article 16(6) of the Audit Regulation.

Standards and standard setting

We are supportive of the underpinning legislation to allow the FRC to introduce changes in ethical and technical standards for auditors as part of the implementation of the new Directive and Regulation. We will be submitting a separate response to the FRC's consultation paper.

Funding

While the funding arrangements for the competent authority will be a fundamental consideration, there are no published proposals for the future funding model. The funding framework, as set out in the proposed amendments to Schedule 10 of the Companies Act 2006, appears to place the funding requirements directly on the RSBs; irrespective of whether or not the task has been delegated, reclaimed or re-assigned. This appears to place a disproportionate administrative and financial burden on the RSBs for costs which are wholly outwith their control. We note that in relation to the recent consultation from the Irish Auditing and Accounting Supervisory Authority (IAASA), the proposal is to administer and levy firms directly. We consider this approach to be more appropriate.