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Paul Smith
Corporate Frameworks, Accountability and Governance Team
Department for Business, Innovation and Skills
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BY E-MAIL

9 December 2015

Dear Paul

BIS consultation paper: Auditor regulation – Consultation on the technical legislative implementation of the EU Audit Directive and Regulation

PricewaterhouseCoopers LLP (we) welcomes the opportunity to respond to the above Consultation Document (the Consultation). We thank the Department for Business, Innovation and Skills (BIS) for its work throughout the four years of negotiations in Europe and for the opportunity to participate in the Audit Contact Group throughout the implementation process.

We agree with the approach that BIS has taken in relation to implementing the provisions of the EU Audit Directive 2014/56[1] (Directive) and EU Audit Regulation 537/2014 [2] (Regulation). In particular we welcome the proposals:

- not to include additional entities in the definition of a public interest entity (PIE);
- to take full advantage of the maximum audit duration period plus the maximum ten year extension;
- to introduce transitional provisions for PIEs that have tendered the audit engagement before the application date of the Regulation, as outlined by Baroness Neville-Rolfe in her statement of 20 July 2015; and
- to clarify that the fee cap for permitted non-audit services will not apply for the first time until the first accounting year beginning on or after 17 June 2019.

These proposals are in line with the Government's objective of making only those regulatory changes which are required or which result in a tangible benefit to UK business. They also acknowledge the important role of the audit committee in the UK corporate governance regime and will allow UK audit committees to continue to make judgements in the best interests of their companies and their shareholders.

This letter is divided as follows:
Appendix I – our responses to the questions raised in the Consultation
Appendix II - additional comments on proposals made in the Consultation

[1] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:32014L0056
[2] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32014R0537

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Appendix III - our responses to some of the additional questions on the impact assessment, as set out in the letter to the Audit Contact Group of 15 October 2015.

We have some over-arching observations which we have set out in the paragraphs which follow.

The role of the FRC

We agree that the FRC should be the single competent authority with ultimate responsibility for audit regulatory tasks, as well as for oversight of the audit profession under the EU Audit Directive 2006/43 [3], as amended by the Directive and the Regulation. In order for the FRC to retain its focus on audits where there are public interest considerations and issues of systemic risk, we welcome the delegation of non-public interest activities to the recognised supervisory bodies, as outlined in Baroness Neville-Rolfe's statement of 20 July 2015.

As we set out in our response of 19 March 2015 to the BIS Discussion Document, the FRC, in its role as the single competent authority, will occupy a powerful position and will have greater responsibilities than those contemplated at its inception. We believe, therefore, that it will be important to review the existing FRC governance structure to ensure not only that the FRC is properly accountable (and in a way that is visible) to the public, but also that there is active oversight of the FRC, as well as adequate resource within the FRC. We recommend that a separate consultation be considered in order to build consensus as to the appropriate future governance and oversight model for the FRC. As part of this, we would encourage BIS to consider arrangements for how Parliament, and BIS itself, might exercise more active oversight of the FRC.

Guidance

We understand that the FRC does not intend to issue guidance on the precise meaning of the various clauses that have been transposed directly into the revised Ethical Standard from the Regulation, in particular those clauses dealing with restrictions on the non-audit services which may be provided by the auditors of PIEs. We note, however, that some provisions in the Regulation are ambiguous, and the appropriate application of the provisions will not be clear in all cases. We suggest, therefore, in order to achieve the FRC's objective of enhancing confidence in audit quality, that non-binding guidance be developed by BIS, the FRC and the wider profession to assist audit firms and audit committees in interpreting the provisions. Ultimately, such guidance would also assist shareholders and the FRC (which will have responsibility for monitoring compliance). In the absence of guidance of any sort, there is a real risk that inconsistent practices will emerge. The provision of guidance would not undermine the FRC's clear focus on principles and ethical outcomes.

Ability to consult with BIS/ the FRC (as appropriate)

For the same reasons, we anticipate questions and issues on the application of the new legislation and regulations will arise in the future. Audit committees and auditors will need to consult with BIS and/or the FRC in applying the new regime in a way which meets regulatory expectations. We encourage BIS to work with the FRC in developing an effective process which can be used by audit committees, companies and audit firms to raise questions with

[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CONSLEG:2006L0043:20080321:EN:PDF

BIS and/or the FRC which enables them to be resolved quickly and efficiently.

Non-audit services required by law
We welcome the confirmation in the FRC's consultation "Enhancing confidence in audit" (published on 29 September) that non-audit services which are required by law, or by a rule issued by a regulator in accordance with a statutory power, will be exempt from the cap on fees for non-audit services which may be billed by the statutory auditor of a PIE. This is an important clarification, but in the interests of certainty, we would encourage BIS to publish an illustrative list of non-audit services which would be exempt from the cap.

Guidance on tendering and rotation
We welcome the supplementary information on tendering and rotation which was published by BIS in March 2015 and produced in collaboration with the CMA and the FRC and we look forward to updated guidance in this area. We encourage BIS to continue to work with the CMA and the FRC in implementing changes on tendering and rotation as consistently as possible.

Conclusion

We welcome the progress that BIS has made to ensure that the EU audit legislation is implemented in UK legislation in such a way as to further the Government's key objectives. Recognising that there is further work to be done, we would be happy to assist and support BIS throughout the implementation process, through our involvement in the Audit Contact Group and more widely.

Yours sincerely,

Margaret Cole

Margaret Cole
General Counsel

Cc: Baroness Neville-Rolfe, BIS
Richard Carter, BIS
Sir Winfried Bischoff, FRC
Stephen Haddrill, FRC

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BIS – AUDITOR REGULATION: Consultation on the technical legislative implementation of the EU Audit Directive and Regulation

APPENDIX I

General question on the draft clauses prepared to complement the discussion in Chapters 5, 6, 7, 8 and 12

Q1. Do you agree with the approach the draft implementing regulations take given the Government's conclusions as set out in these chapters? Why?

We agree with the approach the draft implementing regulations take, subject to the following drafting points.

- **Part 2 para 4(1)** - this refers to a person "A", defined in Schedule 1 para 1 as "*a person appointed as a statutory auditor*". It would appear that the FRC will be able to impose sanctions on individuals or firms (para 4(4) refers to the measures of financial strength where A is either a firm or an individual). In line with the FRC's Accountancy Scheme[4], we assume that the FRC will be able to impose sanctions on both the audit firm and the individual (i.e. the audit partner), but would welcome clarification of this.

- **Part 2 para 4(1)** - this sub-paragraph does not reflect the list of sanctions set out in the revision to Companies Act 2006 (CA06) Sch 10, para 12(3). The draft implementing regulations omit the following sanction "*the withdrawal of eligibility for appointment as a statutory auditor*" (Sch 10 para 12(3)(i)). In addition, the sanction "*a temporary prohibition of up to three years preventing a person responsible for any breach from carrying out statutory audits or signing audit reports*" (Sch 10 para 12(3)(iv)) is only partly replicated in the draft implementing regulations as para 4(1)(c) refers only to an order being made to prohibit the individual from carrying out statutory audits or signing audit reports, with no reference to a temporary prohibition. We suggest that the sanctions in the implementing regulations and the revisions to CA06 Sch 10 para 12 should mirror each other.

- **Part 2 para 6(2)(b)** - this deals with the publication of sanctions and refers to P as the person being sanctioned – for consistency with both para 4 and Sch 1, the reference should be to "A".

- **Part 2 para 6(3)** - this covers circumstances in which P's (more correctly A's) identity must not be published. We would encourage the FRC to exercise great care in any decision about publication in order to avoid any adverse or unintended consequences from premature publication. The FRC's Accountancy and Actuarial Discipline Board has

[4] The Accountancy Scheme dated 1 July 2013: https://frc.org.uk/Our-Work/Publications/Professional-Discipline/The-Accountancy-Scheme-(Effective-1-July-2013).aspx

a publication policy[5] which includes the factors that will be taken into account as regards non-publication, where this is in the public interest. In our opinion, the draft implementing regulation should reflect this, by the inclusion of a new sub paragraph 6(3)(e) "*where publication would not be in the public interest*".

- **Part 2 paras 8(2),(3)** - this deals with contractual terms restricting an audited person's choice of auditor, and para 8(2) provides that such a term shall have no effect. Para 8(3) then states that 8(2) does not apply when the audited person is a PIE, but refers to Art 16(6) of the Regulation. We suggest that in the interests of clarity the text of Art 16(6) of the Regulation is replicated in para 8(3).

- **Sch 1 para 3(2)** – this sub-paragraph, in the context of persons with a relevant connection to A (a person appointed as a statutory auditor) refers to "*... or other individual whose services are placed at A's disposal*" or who are "*under A's control*" or are "*linked to A by control*". We understand these references to include contractors. The requirement on the statutory auditor is to "*take reasonable steps*" to ensure that independence is not affected by, inter alia, business or other relationships with the statutory auditor or a person with a relevant connection to the auditor. Our concern is that it will be impractical for the statutory auditor to ensure this in relation to a contractor, and guidance on this point would be welcome.

- **Sch 1 para 12** – we suggest the following wording at (d): "*documents any request for advice from an external expert where the advice is requested for a statutory audit, together with the advice received*". Also, the numbering in this paragraph is missing a subsection (1).

- **Sch 1 para 15(1)(b)** – we suggest this sub-para is deleted. It reflects point 22 of the Directive, which in turn amends Art 27 EU Audit Directive 2006/43. Art 27(1)(a) (as amended) places full responsibility on the group auditor for ensuring the requirements of Arts 10 and 11 of the Regulation are met in relation to the audit of any of the PIE undertakings in the consolidated accounts. In contrast, under the Regulation, responsibility for compliance with Arts 10 and 11 in relation to the statutory audit of that PIE undertaking rests with the appointed statutory auditor of that PIE undertaking. Therefore, unless the group auditor is also the appointed statutory auditor of all PIE undertakings in the consolidated accounts, it is difficult to see how the group auditor could be expected to bear full responsibility for the statutory auditor's compliance with the Regulation. The group auditor is required under ISAs (UK& Ireland) ("UK&I")) to be involved with the work of a component auditor to the extent necessary to obtain sufficient appropriate audit evidence on which to form the audit opinion on the consolidated entity's accounts; the group auditor bears no responsibility with respect to the component auditor's fulfilment of their statutory audit responsibilities. The Regulation places responsibility and accountability with individual statutory auditors and we believe that is appropriate. For these reasons, we suggest that para 15 (1)(b) is deleted.

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[5] Accountancy and Actuarial Discipline Board Publication policy: https://www.frc.org.uk/Our-Work/Publications/AADB/AADB-Publication-Policy.pdf

- **Sch 1 para 15(1)(c)(ii)** - the words "where applicable" from Article 27 (1)(b) EU Audit Directive 2006/43 (as amended by point 22 of the Directive) have been deleted. We recommend they are reinserted to ensure the provision is aligned with the Directive and ISA (UK&I) 600: *"(ii) documents the nature, timing and extent of the work so carried out, including, where applicable, the group auditor's review of the relevant parts of the audit documentation."*[6]

- **Sch 1 para 15(2)(c)** – include "or" at the end of (i), as (i) and (ii) are alternative actions in Art 27(3) EU Audit Directive 2006/43 (as amended by point 22 of the Directive). This sub-para should include an option to take "other appropriate action" (per Article 27 (3) of the EU Audit Directive 2006/43). The reference to sub-paragraph 2(c) should refer to sub-paragraph 2(b).

- **Sch 1 para 15(2), Sch 10 part 2, s.10A amendments to CA06, Sch 10 part 2 s.16AA amendments to CA06** – it is not clear how the requirements of the second and third paragraphs of Art 27(3) EU Audit Directive 2006/43 (as amended by the Directive) are reflected in sections 10A and 16AA CA06, whereby the competent authority can request from relevant competent authorities additional documentation of the work performed by statutory auditor(s) or audit firm(s) in the context of the group audit for the purposes of a quality assurance review. Sch 1 para 15(2)(b) of the draft Regulation acknowledges that the competent authority may seek to obtain documentation from the relevant competent authority of a third country auditor. This is an important provision as the group auditor may not have the ability to obtain the necessary access for the competent authority.

- **Sch 1** – there are a number of requirements relating to standards in respect of various aspects of the audit process. We would welcome guidance as to what the FRC considers to be a minor independence breach, and what course of action the statutory auditor should take in the event of such a breach.

General question on the proposed legislative approach in Chapters 10 and 11
Q2. Do you agree with the Government's proposals on amendments to the Companies Act to reflect Articles 15 and 18 of the Regulation and the amendments to Articles 23, 45 and 47 of the Directive? Do you agree that these are all that is needed to reflect the provisions of the new Directive and Regulation on cooperation, transferring information and confidentiality? Why?

[6] Consistent with ISA (UK&I) 600, Article 27 EU Audit Directive 2006/43 is based on the documentation in the group audit file focussing on what is needed to demonstrate the group auditor's basis for forming the opinion on the group financial statements. ISA (UK&I) 600 does not require all of the detailed working papers of component auditors to be included in the group auditor's files. Detailed review of the component auditors' other documentation/working papers is one of a number of ways in which the group auditor can be sufficiently involved in the work of component auditors. Article 27 recognises this, making a distinction between review and evaluation of the "audit work" and access to or transfer of "audit documentation".

We agree with the Government's proposals on amendments to CA06, subject to the following drafting points.

- **Part 16 S485A(2)(b)** – insert the words "and include" as follows "*the directors must propose an auditor or auditors for appointment, and include the following information in the proposal...*".

- **Part 16 S494A** – insert "or" in the definition of "public interest entity" after (b) as follows "*... and investment firms, or ...*".

- **Part 16 S495(2)(a)** – amend as follows: "*(a) ~~an introduction~~ identifying ~~ing~~ the annual accounts...*". This reflects the revisions proposed by the FRC to ISA 700 (UK&I) whereby the structure of the auditor's report has changed so that the first section of the auditor's report is the opinion. This section will include the identification of the financial statements but it is no longer "the introduction".

- **Part 16 S495(3)** - we suggest including the last sentence of Article 28(c) EU Audit Directive 2006/43 (as amended by point 23 of the Directive) which reads: "*If the statutory auditor(s) or audit firm(s) are unable to express an opinion, the report shall contain a disclaimer of opinion.*" This is for completeness and better alignment with the ISAs (UK&I).

- **Part 16 S495(4)** - For the same reasons as for S495(3) above, we suggest that (a) includes the possibility that the audit opinion could be an adverse opinion i.e. "*... must be unqualified, qualified or adverse*".

- **Part 16 S495** - although the existing structure of this section has not caused difficulties in practice, there would be merit in aligning it more directly with both the ISAs (UK&I) and the Directive by having all of the requirements relating to the audit opinion combined, so that sub-para (4)(a) is incorporated into the introduction to sub-para (3), as follows:
  "*(3) The report must include an audit~~or's~~ opinion, which must be either unqualified, qualified or an adverse opinion~~,~~ and must state clearly whether, in the auditor's opinion, the annual accounts -*
  (a) ....."

- **Part 16 Ss 510A, 519** – these sections refer to "public interest company" which is defined in S519A. The definition is the same as the definition of "public interest entity" in S494A, and we suggest that, in the interests of consistency, the same term ("public interest entity") should be used in both sections or, alternatively, that a cross reference is included. We note that "public interest company" is the defined term used in the Deregulation Act 2015.

- **Part 16, Ss514(1), 515(1), 515(1A), 515(2)** – to improve the clarity of the draft text, we suggest that the bracketed definition "(the "*outgoing auditor*")" is moved to the end of the sentence in each case.

- **Part 16, Ss495(5)(b), 496 (2), 497A(2)** – in the case of joint auditors (when more than one person is appointed as auditor), these provisions require an explicit statement as to whether all persons agree on the matters contained in the report/statements and indications. In the Directive, on the other hand, the joint auditors are expected to submit a joint report and opinion, and separate opinions from each auditor are to be provided only in the case of a disagreement, together with the reason for the disagreement. Although we are not opposed to an explicit statement, the same effect is given by the report being signed by both auditors and, therefore, this provision is not necessary. We also note that the repetition of such a requirement across each separate element of reporting required by auditors, as applicable to the engagement circumstances, would seem unnecessarily duplicative.

- **Schedule 10, para 12(3)(a)(ii)** –: deletion of "or" as follows "*The arrangements for enforcement must include provision for (a) sanctions which include...(ii) a notice requiring the person responsible for any breach to cease the conduct amounting to a breach [or] and to abstain from repeating such conduct.*"

- **Schedule 10, para 13(10)** – retain "In this paragraph -".

Impact assessment
Q3. Given the analysis of costs and benefits in the Impact Assessment in general, do you have any comments on how our estimates or underlying assumptions might be improved? Please explain your answer.

We have no comments to make in relation to this question.

Familiarisation costs
Q4. Responses to our Discussion Document suggested that familiarisation and implementation costs to:
• newly designated PIEs; and,
• audit firms that become auditors of PIEs for the first time...
... would be disproportionately higher. We propose that in the final IA we should uplift the estimated costs for such businesses by a percentage to reflect the additional resource costs to such firms arising from their lack of experience of the requirements of the Regulation and of those provisions of the Directive applying to audits of PIEs. For each category listed above, what do you consider to be a reasonable percentage?

It is too soon to be able to estimate the costs in quantitative terms to new PIEs and audit firms becoming PIE auditors for the first time, or indeed for the PIE and PIE audit firm population as a whole. For this reason, we are unable to suggest a percentage uplift to reflect the additional resource cost to new PIEs and new auditors of PIEs. However, we have considered below the costs that may be incurred in relation to familiarisation, the tender process and restrictions on the provision on non-audit services by the statutory auditor. Taking each of these in turn.

(a) **Familiarisation costs** - in quantitative terms for audit firms auditing PIEs for the first time, costs will be incurred in relation to training, developing or updating internal guidance and quality control procedures and policies, and system changes. To the extent that new systems or guidance have to be introduced, the costs will be proportionately higher.

(b) **Tender costs** - there will also be tender costs relating to resources deployed by both new PIEs and audit firms auditing PIEs for the first time. Whilst we do not have specific data in relation to this, useful comparisons in relation to the costs to both PIEs and audit firms may be drawn from the Competition Commission's final report dated 15 October 2013[7].

In the section on 'Company costs in tender processes' (paras 9.301-9.306), the Competition Commission explains that significant resources are likely to be deployed by FTSE 350 companies (the relevant market in that investigation) in running a tender. Whilst the Competition Commission did not have quantitative data on company tender costs, from the evidence submitted to it, the estimates of time spent on various stages in the tender process ranged from 3-4 days to 3-4 weeks and over periods of between 6 weeks to several months. Senior management time is required to run a tender, with the cost relating to the size, complexity and geographic spread of the company. The views of the Commission on the tender process are set out at paras 9.273-9.287 (final report) and at appendix 9.2 ('The tender process') and set out the different stages of the process for FTSE 350 companies and audit firms. Whilst the FTSE 350 population is different from the population of new PIEs, some comparisons may be made.

The Competition Commission's final report also provides evidence about resources likely to be deployed by auditors to tender for audit appointments (section on 'Firms' costs in tendering', paras 9.296-9.300). The report states that all firms agreed that the more complex the tender, the more time firms spent in the preparation for the tender and the higher its cost. Audit firms submit teams comprising senior representatives for the purposes of the tender, and these teams are generally more senior than the engagement team required to provide the audit service. The Competition Commission's final report (appendix 7.1 'Analysis of tender processes' data') includes a summary of information provided by audit firms on the number of staff involved in preparing for tender submissions (the average being 15, although this varied considerably across tender processes), grades of staff involved (in all firms, partners, directors and senior managers accounted for the largest proportion of time spent preparing tender submissions) and hours spent preparing a tender submission (the average number being 947 hours). The population of audit firms considered in the report is different from those audit firms auditing PIEs for the first time, but again some comparisons may be made.

(c) **Restrictions on non-audit services** - additional costs may also be incurred as a result of the non-audit service restrictions, although we do not have data available to enable us to provide an estimate. However, we anticipate that the additional costs

[7] https://assets.digital.cabinet-office.gov.uk/media/5329db35ed915d0e5d00001f/131016_final_report.pdf

associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor may be significant, in particular, because many of these non-audit service contracts will require a formal tender process. The reallocation of some of the non-audit services to different firms may also give rise to reduced choice for companies in the market for both audit and non-audit services.

Q5. In the consultation IA we have estimated the direct costs to PIEs of having to tender the audit engagement every 10 years. In our final analysis, we also plan to include an estimate of the additional costs that would be incurred by a new auditor that has to familiarise itself with the business of a new PIE client. We propose that the additional familiarisation cost to auditors engaged in a new audit could be estimated is an additional 10-30% of the cost of the audit in the first two years. Is this reasonable?

Our more recent experience suggests that the additional costs incurred by the auditor in the first two years of a new engagement are closer to 30%-40%, and could be higher. This includes the cost for the following types of activities:

- ensuring that the audit firm is independent;
- other formal activities upon appointment;
- familiarisation with the client's business;
- accounting systems and controls; and
- working paper reviews with the outgoing auditors.

Costs to non-PIEs and their auditors

Q6. Our preliminary analysis suggested that the costs and benefits of the measures in the new Directive affecting audits of non-PIEs would be negligible. This has been assumed in the consultation IA. Is this reasonable? If not, what do you estimate will be the main changes giving rise to costs and benefits for non-PIEs and their auditors? Can you provide quantitative estimates?

The following answer applies to questions 6 – 9.

In our view it is reasonable to assume that the costs of the measures in the Directive which affect audits of non-PIEs are likely to be negligible. Many of the requirements of the Directive, in so far as they relate to the auditor's report or responsibilities of group auditors, are already addressed by the ISAs (UK&I). We do not expect those requirements which are not already addressed by the ISAs (UK&I) to require any significant incremental costs.

We have the same view for the costs to non-PIE LLPs as regards the implementation of the Directive to the audits of those entities. BIS has explained that the main changes for non-PIE LLPs and their auditors are limited to the introduction of an adaptation period for individual EEA auditors and mutual recognition of EEA audit firms. We agree that these changes are likely to have a negligible impact on costs to these entities.

In the interests of maximising consistency in the audit of companies and of LLPs, we suggest that the Government should implement the changes required by the Directive for audits of

non-PIE LLPs at the same time as the implementation of the changes for entities required to be audited by EU law. We anticipate that there are likely to be cost savings from implementation of these changes at the same time, as it will be possible for audit firms to combine effort on training, updating of guidance and communication of changes.

Q7. It is particularly important to assess the costs and benefits arising from the new Directive for non-PIE LLPs and their auditors as the implementation of the new Directive is not required by EU law for these audits. Would your answers to question 6 differ for non-PIE LLPs? How and why?

Please see our response to question 6 (above).

Further questions on application to non-PIE limited liability partnerships

Q8. Do you think that the Government should:
• implement the changes required by the new Directive for audits of non-PIE LLPs alongside those same changes for entities (such as companies) that are required to be audited by EU law; or,
• implement some or all of the changes required by the new Directive for audits of non-PIE LLPs at a later stage?
... please give reasons for your answer.

Please see our response to question 6 (above).

Q9. Do you think there would be cost savings from implementing the changes required by the new Directive for non-PIE LLPs at the same time as for entities (such as companies) whose audits are subject to EU law? Please give reasons for your answer. Can you provide any estimate of the extent of these savings?

Please see our response to question 6 (above).

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APPENDIX II – ADDITIONAL COMMENTS

1. Exemptions to the cap on non-audit services

In the interests of clarity we would welcome an illustrative list of non-audit services which would be exempt from the cap. The FRC consultation "Enhancing confidence in audit", dated 29 September 2015, sets out parameters to enable determination of which non-audit services are excluded from the cap (i.e. required by national or EU law, as well as rules *"issued by a regulator in accordance with powers granted by legislation"*). There are, however, some areas of uncertainty that remain, such as what is meant by national law? For example, we assume that US legislation such as Sarbanes-Oxley Act 2002 is included as national legislation so that services required under it would be exempt from the cap, but clarification would be useful.

2. Disclosure of non-audit services provided by the statutory auditor

Under Article 10 of the Regulation, auditor's reports for statutory audits of EU PIEs will be required to indicate any services, in addition to the statutory audit, provided by the statutory auditor or the audit firm to the audited entity and its controlled undertaking(s) which have not been disclosed in the management report or financial statements. This provision will come into effect for audits of financial statements commencing on or after 17 June 2016. In our view, it would be useful to have early publication of clear guidance on the nature and extent of disclosures expected, as it would be preferable for this requirement to be met through sufficiently detailed disclosures by companies.

3. Two year extension to maximum duration of audit appointment

Sections 487(1C) and 491(1C) CA06 refer to the two year extension of the 10 +10 year maximum audit period in "exceptional circumstances". We would welcome some guidance as to what "exceptional circumstances" would be needed for this two year extension to be granted. It will also be necessary for the FRC, as the competent authority, to develop an effective protocol for dealing with requests to extend the maximum duration of the audit appointment.

4. Consistency between the Regulation and CMA Order

BIS state that in implementing changes on length of audit engagements, their starting point *"was to look at the CMA Order, with a view to implementing changes in as consistent a way as possible with the Order"* (para 7.5, page 18 consultation document). However, there is a difference in the starting date for calculation of the requirements for mandatory firm rotation under the Regulation and the calculation of mandatory tender timing under the CMA Order. Under Art 17(1) of the Regulation, the starting date for calculation of the requirements on mandatory firm rotation is the first year in which the auditor is appointed to the EU PIE. In contrast, under the CMA Order, the starting date for calculation of tender timing is the first year in which the auditor is appointed to the company (regardless of its date of entry in to the FTSE 350), pursuant to a competitive tender process. This can lead to confusion and

misalignment in the calculation of the requirements for PIEs to which both the Regulation and the CMA Order apply and therefore we suggest that the difference is highlighted explicitly in a revised version of the Supplementary Information published by BIS (in collaboration with the FRC and CMA) in March 2015.

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APPENDIX III - QUESTIONS ON THE IMPACT ASSESSMENT (FROM 15 OCTOBER 2015 LETTER TO AUDIT CONTACT GROUP)

We set out below our responses to some of these questions.

***Question**: In the consultation IA we have estimated familiarisation costs for both PIEs and audit firms that audit PIEs (in which we included the costs of updating firms' internal systems and processes to ensure compliance with the new requirements). These are graduated for the size of the entity or firm. For:*

- *a large audit firm (having more than 100 audit principals);*
- *a medium sized audit firm (having more than 30 audit principals);*
- *a small audit firm (up to 30 audit principals);*
- *large PIE (for accounting purposes);*
- *medium sized PIE (for accounting purposes);*
- *small PIE (for accounting purposes);*

...in each case do you consider these estimates and the underlying assumptions to be reasonable? Where you do not consider them to be so, please indicate what you consider would be a more reasonable estimate assumption or estimate of the cost.

We have reviewed the estimates of familiarisation costs for both PIEs and audit firms that audit PIEs in the impact assessment. We are not able to provide any additional data in relation to the assumptions, but those in respect of a large audit firm appear to us to be reasonable. However, until the new requirements are finalised, it is too soon in our view to be able to estimate the costs for either PIEs or audit firms in quantitative terms. For audit firms, the costs of familiarisation will be greater for the larger firms, with a greater number of staff to train and more clients for whom to adapt the audit.

There is data available that relates to ISA implementation, in a study carried out by the University of Duisberg-Essen published in June 2009[8] on the cost of clarity ISA implementation. The study identified total costs of €65.4m, as follows:

- methodology, guidance amendment costs of €20m for larger firms;
- training costs of €35m;
- costs of system changes (as most audits are performed using electronic tools) of €8.4m; and
- costs to change quality control policies and procedures of €2m.

In addition, the report identified one-off costs at a client engagement level, as well as ongoing costs at engagement level to introduce and then continue with new policies, processes and procedures. In our opinion, the estimate of £72.7m (total familiarisation and implementation costs for all PIEs and audit firms) as set out in the impact assessment would seem to be

[8] http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/report_eu.pdf

reasonable.

***Question**: Audit firms that will become auditors of PIEs for the first time as a result of the changes would need to prepare a transparency report. Our current estimate for the cost of preparing these reports is £59,000, which we took as an upper bound given that it had been calculated for auditors of large numbers of PIEs. Could you provide an estimate of the cost of preparing a transparency report for auditors that become auditors of PIEs for the first time? Alternatively, could you provide an estimate of how much auditor time in hours it would take to prepare such a transparency report?*

We do not have the necessary data to be able to provide an estimate of the cost of preparing a transparency report for the first time, nor details of the number of hours that would be required. Based on our own experience, a transparency report can take approximately 1,400 hours to prepare, review, audit and publish. Using the BIS cost estimate of £59,000, this gives an hourly cost of around £40. If we assume the time taken to produce our report is a suitable proxy for firms producing a report for the first time, this suggests that the cost could significantly exceed the BIS estimate. However, it is important to note the following factors, all of which will impact the cost of preparing a transparency report and increase the difficulty in making such a direct comparison.

- Firms that will be required to prepare a transparency report for the first time will, we assume, be significantly smaller than PwC, and this will have an impact on the extent of data to be collated and reported, potentially reducing the cost.
- However, much of the data required for PwC's transparency report is readily available from our comprehensive and well developed systems and processes. Firms which have less comprehensive systems and less well-established processes may find extracting and collating the data time consuming, which will have implications on the time and costs to produce the transparency report.
- Additionally we have been producing transparency reports for a number of years, and so are familiar with requirements. Further, some of the data is relatively static from year to year, and requires less time to update. Conversely, there will be familiarisation costs for firms preparing a report for the first time, as well as systems that may have to be updated to provide the required information.

***Question**: Appointment and scope of audit committee: There are 556 insurers, some won't have audit committees – we assumed 60-80% did. Do we have a better assessment?*

We do not have precise data but our view is that the vast majority of unlisted insurers are likely to have an audit committee of some description. Our experience is that there are many variations of audit committee, including some which combine that role with a risk committee.