



Paul Smith  
Corporate Frameworks, Accountability and Governance  
Department for Business, Innovation and Skills  
1 Victoria Street  
London  
SW1H 0ET

19 March 2015

Dear Paul,

**BIS Discussion Document: “Auditor regulation - Discussion Document on the implications of the EU and wider reforms”**

PricewaterhouseCoopers LLP (we) welcomes the opportunity to respond to the above Discussion Document on the implications of the EU and wider reforms.

We thank the Department for Business, Innovation and Skills (BIS) for its work throughout the four years of negotiation to achieve an agreed common standard within Europe, and for its continued work since. In particular, we welcome the opportunity to participate in the Audit Contact Group throughout the implementation process.

**UK Government’s negotiating priorities in Europe**

We support the four key negotiating priorities of the UK Government which were maintained throughout the negotiation of the legislation in Europe. These priorities were outlined by Jo Swinson MP in her evidence to the European Standing Committee C on 30 October 2013<sup>1</sup>, as follows:

*“The Government have consistently stated that any proposed audit measures should balance four objectives: avoiding excessive concentration in the audit market, securing independence in auditor judgments, securing high-quality audits more generally, and not imposing additional burdens unless they are objectively justified. In respect of audit quality and independence, we agree with Commissioner Michel Barnier that no change was not an option.”*

They can be summarised as follows:

- avoid excessive concentration in the audit market;
- secure independence in auditor judgements;
- secure high quality audits more generally; and
- only impose additional burdens where they are objectively justified.

<sup>1</sup> <http://www.publications.parliament.uk/pa/cm201314/cmgeneral/euro/131030/131030s01.html>

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*We support the priorities which have guided UK Government throughout the negotiation of this legislation: choice, independence and audit quality without undue regulatory burden. UK Government’s implementation of the legislation should uphold and reinforce these priorities.*



We agree that these priorities are of the utmost importance and that the UK Government's implementation of the EU legislation should uphold and reinforce them. We encourage BIS to maintain the UK's approach of minimum regulatory interference. This approach is essential, particularly during a period of economic recovery, when UK business must be focussed on a return to growth. We also encourage BIS to have the public interest as the focus of their implementation of the reforms in order to preserve the UK's well-functioning and efficient capital markets. Taken together, these priorities and aims should ensure that the EU reforms are implemented in the UK in a manner that maximises their positive impact on the audit market, whilst minimising cost and disruption for UK business.

*It will be important for BIS and the FRC to use their leadership positions in Europe to work proactively for consistent implementation across the EU.*

We urge BIS and the FRC to take a lead within Europe in aiming for consistency of application of the legislation across Europe as far as possible; this is of particular relevance for the many multi-national groups that operate throughout Europe. It is also important in order not to discourage inward investment from outside Europe. We know from discussions with our clients' executive board members and their audit committees that they are concerned about the complexity of having to deal with many different versions of the EU legislation, as implemented by individual EU Member States. Consistency in the implementation of the EU Regulation 537/2014 (the Regulation) and the EU Directive 56/2014 (the Directive) will help to ensure a level playing field, or at least one that is not harmful to the UK's capital markets.

We broadly support the majority of the proposals in the Discussion Document, which we believe to be well-founded and sensible. We have set out our detailed responses to the proposals in the appendix to this letter. We have the following important observations to make on the five areas set out below.

1. Proposal to appoint FRC as single competent authority.
2. FRC's role in implementation.
3. Non-audit services.
4. Engaging with multiple clients simultaneously.
5. Rotation and tendering.

Taking each of these observations in turn.

### **1. Proposal to appoint FRC as single competent authority**

Appointing the FRC as the single competent authority is both logical and practical. This would give the FRC ultimate responsibility for the audit regulatory tasks and for oversight of the implementation of the Directive. However, whilst this would emphasise the role of the independent regulator and give clarity to the regulatory structure, it is important that the FRC retains its focus on matters of public interest, on the audits of public interest entities and on audits which may cause systemic risk.

*We support the appointment of FRC as the single competent authority.*



*Activities which are not concerned with the public interest should be delegated directly to the Recognised Supervisory Bodies.*

To prevent any dilution of this focus, we recommend that BIS delegates responsibility for all regulatory activities in respect of non-public interest entity audits to the Recognised Supervisory Bodies (RSBs) and that this delegation is enshrined in legislation. This would reflect the resource constraints of the FRC, and would be consistent in practical terms with the way that arrangements operate currently, whereby RSBs are authorised by law to carry out regulatory tasks that are delegated to them. It will also ensure that the role of the RSBs is not undermined, and that they continue to play a material role in the UK framework for audit regulation. This is important, because the powerful standing of the audit profession both in the UK and on the world stage is due, at least in part, to the strong heritage of professional oversight in the UK and the work of the RSBs. To diminish the status of the RSBs would risk damaging the reputation of the UK audit profession.

*As the FRC becomes more powerful, its governance and accountability should be reviewed.*

As the single competent authority, the FRC will occupy a powerful position and will certainly have far 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. 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.

## **2. FRC's role in implementation**

*BIS should ensure that the FRC follows the Government's commitments in its Transposition Guidance, and also that the UK Government's negotiating priorities are not compromised.*

As the single competent authority, the FRC will become BIS's "agent" for implementation of much of the EU legislation, and in particular will be responsible for the detailed rules on non-audit services, through development of the FRC's Ethical Standards for auditors. Whilst we acknowledge that this is a sensible approach, and indeed the FRC's Consultation Document ("Consultation: Auditing and Ethical Standards, Implementation of the EU Audit Directive and Audit Regulation"<sup>2</sup> dated December 2014) (FRC's Consultation) assumes that this will be the case, we are concerned that the FRC may not be considering the same primary responsibilities that would apply to BIS in implementing the EU legislation.

As a private body independent of Government, the FRC is not strictly bound by the same obligations as BIS, in particular the Government's "Transposition Guidance: How to implement European Directives effectively" dated April 2013 which requires, amongst other things, that the UK does not go beyond

<sup>2</sup> <https://frc.org.uk/Our-Work/Publications/Audit-and-Assurance-Team/Consultation-Auditing-and-ethical-standards-implem-File.pdf>



the minimum requirement of the measure. In our view, as the FRC will be exercising a statutory obligation on behalf of BIS, BIS should stipulate that the FRC pay close regard to the principles in the Transposition Guidance, including the obligation to avoid “gold plating”.

In the FRC’s Consultation proposals, a number of alternative means of implementing the EU legislation are suggested. We believe that some of these alternatives could compromise the BIS commitments for good regulation, and that the UK Government’s four key negotiating priorities (reducing concentration, preserving auditor independence, promoting high quality in audits and not imposing additional burdens - as outlined above), may also be jeopardised. In particular, some of the FRC’s proposals in respect of non-audit service restrictions (both the proposed restrictions themselves and to whom the regime would apply) go well beyond the minimum requirements of the Regulation. This does not reflect the UK Government’s negotiating priority of not imposing additional burdens on UK business which cannot be objectively justified.

We agree that the FRC has a vital role to play in the implementation of the EU provisions, and that this should be achieved through the revision of the Ethical Standards. However, it is important that BIS is proactive in ensuring that the FRC is mindful of the Government’s four negotiating priorities, and that the FRC discharges its delegated responsibilities appropriately. We suggest that, in delegating powers to the FRC, BIS should set clear guidance and parameters for the FRC to follow in implementing the reforms. In particular, any departure from the minimum requirements of the Regulation should only be considered if it can be objectively justified on clear grounds of public interest, and if it upholds the priorities consistently applied by BIS throughout the negotiation of the legislation.

### **3. Non-audit services**

We recognise and strongly support the critical principle of audit independence that was fundamental to Michel Barnier’s initial proposals and which the UK Government, as well as BIS and the FRC, are seeking to protect. We also recognise that the current restrictions on the provision of non-audit services in the UK need to change to reflect developments (such as increased frequency of audit tendering and audit firm rotation) in the market in which audit firms are operating. However, we are concerned that an overly restrictive regime could have a detrimental impact on choice and competition in the provision of audit and non-audit services, and a negative impact on audit quality. It could undermine the important role played by UK audit committees in making judgements in the best interests of a company and its shareholders, and could prove costly and disruptive for UK business.

*We strongly support the critical principle of audit independence. But an overly restrictive non-audit services regime could have disproportionate and negative consequences.*

A restrictive non-audit services regime can rapidly reduce a company's choice of audit provider. In a world where auditor rotation will become mandatory (and therefore one firm is always unable to compete), the impact on competition and choice could be material. Companies may wish to continue with existing suppliers of non-audit services, who, under a restrictive regime, would therefore be unable to compete in a tender for the audit appointment. This undermines the UK Government's negotiating priority of upholding competition and avoiding concentration in the audit market. The Competition and Markets Authority (CMA, formerly the Competition Commission), in their final report dated October 2013 on their market investigation in to the provision of statutory audit services to large companies, recommended that the FRC amend its articles of association to include an objective of having regard to competition. We believe that the FRC should adopt this recommendation as part of the implementation process.

An overly restrictive regime could also have a negative impact on audit quality, with careers in audit becoming less attractive due to limited opportunities to obtain experience outside the audit practice. Further strains would be placed on the multi-disciplinary firm model; we believe that it is essential that the multi-disciplinary structure of UK audit firms is maintained and, in fact, celebrated. The multiple disciplines which co-exist within audit firms mean that the right expertise can be brought to today's audits, and firms can innovate to develop the audit of tomorrow.

The UK benefits from a culture of strong corporate governance, including the important role of the audit committee. Audit committees are able to make informed judgments, based on clear principles. We support the important role played by audit committees, which BIS has maintained through the EU negotiations, and are in favour of proposals which reinforce this role. An overly restrictive regime could undermine the ability of the audit committee to exercise judgement in the best interests of the company and the shareholders.

Finally, over-regulation in this area will lead to increased costs of compliance for UK businesses and may make the UK less competitive in a number of areas when compared to other EU Member States.

Two examples of our specific areas of concern are set out below.

### **3.1 Extending the scope of the provisions on non-audit services**

The FRC raises the possibility of extending the scope of non-audit service prohibitions to entities that would not be PIEs under the EU definition. This appears to be in direct contravention of BIS's clearly stated intention not to extend the PIE definition, and is contrary to the ideal of European consistency. As a result, groups operating in a number of Member States could be subject to a complex framework of different rules.

*In considering the possible extension of non-audit services restrictions to a wider group of entities, the FRC should focus on where the public interest lies.*

In our opinion the public interest lies with protecting non-professional investors investing in entities in regulated markets; this is also the objective of the Regulation. One alternative raised by the FRC would make the non-audit service requirements of the Regulation applicable to a much broader group of entities. In particular, this would include entities with securities, often debt (for example, high yield bonds) listed on “recognised” but not “regulated” markets, such as markets in the Channel Islands, Ireland and Luxembourg which are generally the preserve of sophisticated professional investors. These entities will regularly be smaller companies, which are vital to UK growth, and which are often cost and resource constrained. Such companies often rely on their auditors to provide additional non-audit services, and find that their auditors are best placed to provide cost effective and high quality advice. To extend the scope of the non-audit service provisions to these companies will impose a cost burden on them, and may restrict their access to advice unnecessarily, with little public interest benefit, but a detrimental impact on UK growth.

### 3.2 “White list” of permitted non-audit services

In the FRC’s Consultation the FRC sets out an option for a “white list” of permitted services as an alternative to the “black list” in Article 5 of the Regulation. We believe that the “black list” is the UK Government’s preferred approach, as this was confirmed by Jo Swinson MP in her evidence to the European Standing Committee C on 30 October 2013, when she referred to the agreed “black list” as a list which “*mirrors existing ethical standards*” and “*will impose no further burden*”.

Following the “black list” approach in the Regulation, and taking the Member State derogations on prohibited non-audit services, will ensure that the UK remains a competitive market with flexibility for UK business. This approach will protect audit independence, whilst providing the right platform for audit quality to be secured and reinforced in the future. It will also mitigate any anti-competitive impacts which an overly restrictive non-audit services regime could cause. A “white list”, which goes substantially beyond the minimum EU requirements, would trigger many of the problems of an overly restrictive regime which we discuss above. In addition, a “white list” is inherently inflexible, which has the potential to stifle innovation in the field of assurance.

### 4. Engaging with multiple clients simultaneously

Situations where an audit firm engages with multiple parties simultaneously are not considered in the BIS Discussion Document. However, this is an important issue that should be considered carefully by both BIS and the FRC, because of its potential to have highly disruptive impacts. The EU Directive and Regulation, the FRC Consultation Document and the BIS Discussion Document consider only simple situations, where an auditor provides services

*We believe that a “black list” is UK Government’s preferred approach.*

*A “white list” could stifle innovation in the field of assurance, and would have a highly detrimental impact on choice. Ultimately, audit quality could be impacted.*

*Difficult issues could arise for engagements where it’s necessary to engage with multiple clients. A practical solution will be needed here.*

to a single audit client, or an entity within that audit client's group. In practice, situations arise where multiple parties need to procure services jointly from an accounting/audit firm. An example of such a situation would be a syndicate of banks wishing to appoint an accountant to perform a business review of a borrower that is in financial difficulty. It is unlikely to be in the public interest for companies to be faced with a very limited choice of audit firms to provide the services, particularly in material restructuring and turnaround situations where only a small number of firms would have the capability to provide the services required. Clarity is required so that the multiple companies and audit committees, who might consider it their responsibility to assess the situation, have a clear framework to follow, which will avoid different (and conflicting) approaches being taken.

## **5. Rotation and tendering**

*UK businesses, and their audit committees, need clarity on how the different rotation and tendering regimes will work together.*

There have been a number of changes recently in the UK audit market, for example the FRC's tendering regime (as set out in the UK Corporate Governance Code) as well as the CMA's tendering regime. These changes will, in our view, create a dynamic and even more competitive audit market. As we have noted already, there are clear benefits arising from audit firms being incentivised to set out and better explain their approach to audit quality.

We did not initially support mandatory audit firm rotation as, in our view, it explicitly restricts an entity's choice of audit provider. However, we recognise the need for a compromise to be reached within Europe, and we agree with BIS that the requirement to rotate auditors at 20 years is a reasonable compromise.

Implementation of the EU's rotation and tendering regime in the UK is particularly complicated as we have two existing tendering regimes (the FRC's UK Corporate Governance Code and the CMA's Order) to take into account. Whilst at a high level, there is some congruence in the regimes, complex problems arise on detailed implementation. We have discussed some of these specific issues with you already and the publication "Auditor Regulation – Supplementary Information" dated March 2015, produced by BIS is helpful in dealing with some of them.

In our experience, UK businesses and their audit committees would welcome clarity as to how these regimes will work together. The uncertainties that UK businesses are currently facing are significant and, for some, time critical as they need to plan competitive tender processes, or audit firm rotation in the near future. It is imperative that BIS, the FRC and the CMA continue to meet to discuss and address these complexities and ambiguities in order to provide the clarity that UK businesses need. We have attached a list of common problems that UK businesses are facing (attached at the end of the appendix to this letter), and we would be happy to assist further to resolve these.



One specific issue that we have considered in more detail in our answer to question 31 in the appendix is the reference in the Discussion Document (at page 34) to the potential that a stated intention by a PIE to tender the audit appointment in the future (perhaps before the “mandatory” ten year point) could be binding on the PIE. In our opinion, companies should not be legally bound by any previously stated intentions to retender for the audit. If a statement of intention to hold an early tender were to be binding on a company, this would be a clear disincentive to companies to tender more frequently. Such a disincentive is contrary to the intentions of the CMA as set out in their Order (The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014), where the CMA expressly states that it wishes to incentivise FTSE 350 companies to tender at periods of less than ten years.

We also question whether it is possible from a legal point of view for a statement of this nature to be binding on the directors of the company.

### **Conclusion**

In conclusion we welcome the progress that BIS has made to ensure that the EU regime 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,

A handwritten signature in black ink that reads 'Ian Powell'.

Ian Powell  
Chairman and Senior Partner

cc: Jo Swinson MP  
Richard Carter, BIS  
Sir Winfried Bischoff, FRC  
Stephen Haddrill, FRC

*We welcome the implementation progress made so far and look forward to continuing to support BIS in its work.*

## **Appendix - BIS discussion document**

### **PwC's responses to questions**

**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.

*Legislation is inflexible and can be difficult to amend to meet changing circumstances. It is important that any framework can keep pace with the changing market in which audit firms operate, and on this basis our view is that implementation should be via non-legislative means as far as possible because this will be more responsive to market changes. This is also in line with the UK Government's "Transposition guidance: how to implement European Directives effectively" (dated April 2013) in which the Government states that when transposing EU law it will "wherever possible seek to implement EU policy and legal obligations through the use of alternatives to legislation".*

**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 this 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.

*We welcome the confirmation that the UK Government is not proposing to take up the Member State option to define additional PIEs. However, in its Consultation Document ("Auditing and ethical standards – Implementation of the EU Audit Directive and Audit Regulation" dated December 2014) the Financial Reporting Council (FRC) is taking a different approach as it is seeking views on whether there are some entities that are not PIEs under the EU definition, but which are of sufficient public interest for some of the more stringent requirements of the Regulation to be applied to them. We do not agree with the approach taken by the FRC on this issue (as we have explained in our response to the FRC Consultation Document at question 4) and we urge BIS to ensure that the FRC adheres to the UK Government's stated position on this point i.e. that it does not propose to define additional PIEs for the purposes of the application of the Regulation and the Directive to PIE audits.*

*In addition, the FRC's Consultation sets out an option for a "white list" of permitted services as an alternative to the "black list" in Article 5 of the Regulation. We believe that the "black list" is the UK Government's preferred approach, as this was confirmed by Jo Swinson, MP in her evidence to the European Standing Committee C on 30 October 2013, when she referred to the agreed "black list", as a list which "mirrors existing ethical standards" and "will impose no further burden". In our opinion (and as we have explained in our response to the FRC Consultation at question 7), the "white list" would have a highly detrimental impact on choice in both audit and non-audit services.*

*As to how the Member State derogations should be taken up, we support the four key*

*negotiation priorities of the UK Government which were maintained throughout the negotiation of the legislation in Europe. These priorities were outlined by Jo Swinson MP in her evidence to the European Standing Committee C on 30 October 2013<sup>3</sup>, as follows:*

- *avoid excessive concentration in the audit market;*
- *secure independence in auditor judgements;*
- *secure high quality audits more generally; and*
- *only impose additional burdens where they are objectively justified.*

*We agree that these priorities are of the utmost importance and that the UK Government's implementation of the EU legislation should uphold and reinforce them. We encourage BIS to maintain the UK's approach of minimum regulatory interference and to have the public interest as the focus of their implementation of the reforms in order to preserve the UK's well-functioning and efficient capital markets. Taken together, these priorities and aims should ensure that the EU reforms are implemented in the UK in a manner that maximises their positive impact on the audit market, whilst minimising cost and disruption for UK business.*

**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?

*We believe that it will be important to review the existing governance structure of the FRC to ensure that the FRC is properly accountable (and in a way that is visible) to the public and to ensure that there is active oversight of the FRC. As the single competent authority, the FRC will occupy a powerful position and will have far greater responsibilities than those contemplated when the FRC was first established. 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.*

**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?

*We acknowledge that the tendering and rotation regime is decided. However, in the interests of completeness, we note that the requirements for tendering and rotation will result in substantial disruption and transition costs (due to more frequent tenders) to both companies and audit firms. Companies will have to deal with disruption to their business caused by more frequent tendering and rotation and with senior personnel being distracted from other commercial activities in order to focus on tendering and rotation. Audit firms*

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<sup>3</sup> <http://www.publications.parliament.uk/pa/cm201314/cmgeneral/euro/131030/131030s01.htm>

*will have senior partners and staff diverted from audit work in order to prepare for competitive tenders and the impact of rotation. It is important that these downsides are recognised particularly when considering potential extensions of the rules to smaller companies and when considering the additional impacts imposed by other aspects of the Directive and Regulation.*

**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? Please provide further information in support of your answer?

*We agree that the definition of a PIE should not be expanded beyond the EU minimum requirement. This definition was agreed following negotiations in Europe and reflects the underlying aim of the Regulation and the Directive which is to focus on entities where there is a public interest and which could give rise to systemic risk. Not expanding the definition of a PIE is in accordance with the Government's policy of not "gold plating" the implementation of EU legislation in the UK. It also reflects the UK Government's negotiating priorities in Europe at the time the EU legislation was debated which included the objective of not imposing additional burdens unless they can be objectively justified.*

*As noted in our response to question 2 above, the FRC are consulting on extending the requirements of the Regulation to a wider group of entities than are currently included in the FRC's definition of "listed entities". The FRC's definition of "listed entities" is wider than the definition of "public interest entity" in the Regulation and the FRC are consulting on extending the requirements of the Regulation to entities which are considered to be of sufficient public interest to warrant some of the more stringent requirements of the Regulation. Consequently, exchanges such as AIM and regulated but unrecognised exchanges such as the Channel Islands Securities Exchange could be included as "listed entities". In our view, BIS should ensure that the FRC adhere to the UK Government's stated position in not expanding the definition of a PIE or, as a minimum, that the FRC extend the requirements of the Regulation to entities where there is a clear and material public interest.*

*We have the following additional points.*

- 1. *Simplicity and consistency across Europe*** - adopting the EU minimum requirement is in the interests of simplicity and consistency across Europe. Groups operating in, or looking to invest in, Europe will welcome a unified and consistent regulatory regime. Inconsistent definitions would impose a significant administrative burden on groups operating in a number of Member States, with different PIE definitions and different versions of the Regulation to comply with. Consistency, where possible, is also important in order to encourage inward investment from outside Europe.
- 2. *Disproportionate cost and administrative burden*** - expanding the definition of a PIE would impose an additional cost burden on all entities classified as a PIE. In

*particular, it would impose a disproportionate burden on smaller entities which are so classified. More importantly, there is little or no public interest in many of the entities which might fall to be included in an expanded PIE definition. Many smaller entities would require additional governance, for example audit committees, which may not currently be in place. In addition, these companies would have to become familiar with the new rules, may have to put non-audit services out to tender and may be burdened by an increase in audit fees due to the new governance structures. These additional costs may have a detrimental impact on companies (in particular, smaller companies) operating in a recovering economy, many of which will incur costs with no corresponding public interest benefit.*

- 3. **Recognised but unregulated exchanges** – the FRC’s Consultation considers extending the scope of non-audit service prohibitions to entities that would not be PIEs under the EU definition. Our view is that this could have a significant and disproportionate impact on entities listed on recognised, but unregulated exchanges, with no corresponding public interest benefit. Exchanges of this type, for example, the Channel Islands Securities Exchange (CISE), a stock exchange recognised by HMRC but not a regulated market, are typically used by institutional investors. We believe there is little “public interest” in entities with instruments quoted on such exchanges, and that such entities pose limited systemic risk, and to extend the definition to entities that have debt listed on such an exchange would go beyond the policy aims of the Regulation and Directive.*

*Another example is companies listed on exchanges such as AIM, Sharemark and Asset Match. The typical type of entity listed on these exchanges will not have the same level of internal resources as larger listed entities. For an entity of this type to be subject to the mandatory audit firm rotation requirements that apply to PIEs will be costly and time consuming. Additionally, entities of this type are more likely to seek advice and support from external advisors. For these smaller entities, the level of audit fee is likely to be relatively low, and the impact of the EU fee cap at 70% may effectively preclude the audit firm from undertaking permitted non-audit services and therefore preclude the company from leveraging the audit firm’s knowledge of the business. Consequently the company may have to seek advice from different advisers, and it may be more difficult and expensive to engage appropriate assistance when it is most needed. This could be detrimental both to the ability of the company to grow, and also to investors. This does not create a level playing field when compared to a large main market listed entity, where significant audit fees would allow the provision of a considerable volume of permissible non-audit services within the level of the cap.*

*The exclusion of exchanges such as AIM, Sharemark and Asset Match from the PIE definition is also consistent with the financial reporting requirements set out by the London Stock Exchange. These financial reporting requirements do not apply to*

*AIM, Sharemark or Asset Match listed entities. In addition, not applying the same restrictions to entities listed on these exchanges is consistent with the concept of having two markets in the London Stock Exchange. To apply the same rules to the main market and the junior market would be, in our view, to undermine the purpose of having two distinct markets.*

**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?

*The issues which arise from the application of the Regulation to PIE audits are, in our view, as follows.*

- 1. *Rotation of audit firms may have anti-competitive effects*** - the promotion of competition in the statutory audit market is of utmost importance. The provisions of mandatory audit firm rotation will be a feature of the new regime, but rotation may prove to be anticompetitive, as there will always be at least one potential provider of statutory audit services who will not be eligible to tender. Whilst we recognise that mandatory audit firm rotation is now a feature of the audit market, we are concerned that the combination of a mandatory audit firm rotation regime with an overly restrictive non-audit services regime could have a detrimental impact on choice and competition in the provision of audit and non-audit services with, as a consequence, a reduction in the number of audit firms which are available and willing to participate in an audit tender. For this reason we recommend that BIS ensure that some flexibility in the provision of non-audit services is retained.
- 2. *Increased complexity*** - the application of the provisions in the Regulation is likely to bring increased complexity for PIEs including the imposition of new and additional governance procedures. There are likely to be familiarisation costs for auditors and also for PIEs which may not previously have been subject to the same governance and regulatory requirements. For example, there may be entities included in the PIE definition which will not have an audit committee or which have one audit committee within a group where that audit committee does not have oversight of the PIE. Specific examples include entities which have only listed debt securities, where those securities are owned within the group and not by external investors, or alternatively are held by providers of financing to the business in place of a regular loan structure. These entities are unlikely to have an audit committee at the individual entity level (the entities are often specialist financing vehicles set up for the purpose of ring fencing the listed debt) and often there is no audit committee within the group of which they are a part. These issues may be mitigated by: (1) for PIEs which have no audit committee, the board being permitted to act in place of the audit committee; and (2) the application of the requirements in the Regulation being

kept to the minimum required.

3. **Clear wording in the implementation of the Regulation and supporting guidance** - it will also be important for there to be clear and unambiguous wording in the implementation of the Regulation and for supporting guidance to be published. The prohibitions in Article 5 of the Regulation, for example, are widely drawn and open to a range of interpretations e.g. it is unclear what is intended by the prohibitions on “the provision of general legal counsel” (Article 5(1)(g)) and “services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity” (Article 5(1)(i)). The extent of the prohibition in Article 5(1)(d), “services that involve playing any part in the management or decision-making process of the audited entity” is also very unclear, especially as regards when an activity becomes “part” of the management or decision-making process.
4. **Potential for detriment to audit quality** - maintaining auditor independence is of paramount importance, however, the prohibition on the provision of non-audit services by the audit firm may be detrimental to the quality of the audit. A career in audit may become less attractive if there are limited opportunities to obtain experience outside the audit practice. Further strains would be placed on the multi-disciplinary model which, if it leads to audit only firms, could have a detrimental impact on the quality of the audit as audit quality depends on input from experts in other areas, such as tax. We believe that it is essential that the multi-disciplinary structure of UK audit firms is maintained and celebrated. Whilst we recognise that the current restrictions on the provision of non-audit services in the UK need to change to reflect development (such as increased frequency of audit tendering and audit firm rotation) in the market in which audit firms are operating, BIS should ensure that such change does not lead to unintended and adverse consequences with respect to choice, competition and audit quality.

**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?

*For the UK, a number of these entities will have previously been subject to audit as a result of their constitution (an LLP structure, a company or as a qualifying partnership), financial services legislation or on a voluntary basis. In our view there will only be a small additional burden for this population of entities taken as a whole.*

- 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?
  - (b) what are the costs to audit firms of updating internal management systems to reflect the changes?
  - (c) How this is likely to vary by size of audit firm?

*For (a) and (b) - it is too soon to be able estimate the costs in quantitative terms. However, in qualitative terms, costs will include the costs of familiarisation for new clients which have not previously required an audit, as well as training costs for firms in training their assurance partners and staff involved in audits.*

*We can draw a useful parallel with the costs of ISA implementation, by reference to the study carried out by the University of Duisberg-Essen published in June 2009<sup>4</sup> on the cost of clarity ISA implementation. The study identified costs as follows:*

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

*In addition, 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, were also identified.*

*(c) It is too soon to be able to estimate variation in familiarisation costs by size of audit firm but clearly the costs in (a) will be greater for the larger firms, with a greater number of staff to train and more clients for whom to adapt the audit. The costs in relation to (b) are likely to be proportionately more burdensome on the larger audit firms than the smaller firms with fewer PIE clients.*

**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?

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<sup>4</sup> [http://ec.europa.eu/internal\\_market/auditing/docs/ias/study2009/report\\_en.pdf](http://ec.europa.eu/internal_market/auditing/docs/ias/study2009/report_en.pdf)

*It is logical and sensible for the FRC to be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under both the 2006 Directive (as amended by the new Directive) and the Regulation. This would give clarity to the regulatory structure, and would emphasise the role of the independent regulator in overseeing the audit profession. However, it is important for the FRC to retain its focus on audits where there are public interest considerations and issues of systemic risk, without dilution of focus. Consequently, we suggest that in the interests of successful management of responsibility for auditor oversight, BIS should consider delegating all non-public interest activity to other bodies, and in particular to the Recognised Supervisory Bodies (RSB). We also suggest that this delegation is enshrined in legislation. We anticipate that the outcome of such delegation will be broadly consistent in practical terms with current arrangements.*

*The governance and accountability of the FRC, as the single competent authority, would need to be reviewed under any new structure. As the single competent authority, the FRC will occupy a powerful position and will certainly have far greater responsibilities than those contemplated at its inception. In our view 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. The mechanism for the FRC's accountability already exists as it is set out in the Memorandum of Understanding between BIS and the FRC which states (at para 8) that the FRC is "directly publicly accountable for all its responsibilities" and must "report on the exercise of its regulatory functions in its annual company report and otherwise as it considers appropriate". 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.*

**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?

*We have already considered the issue of a review of the governance and accountability of the FRC (see our response to question 9). There may be a risk that the concentration of all powers with the FRC (as the single competent authority) could result in little or no ability to challenge the view taken by the FRC or to appeal their decisions. Such a provision is, in our opinion, important to consider in designing the new structure. We recommend that a separate consultation be undertaken to build consensus as to what is an appropriate future governance and oversight model for the FRC's new role. We have the following additional points.*

**1. Governance of single competent authority by non-practitioners** - There is a requirement (2014 Directive Art 32(3)) that the governance of the single competent authority should be undertaken by non-practitioners, as follows:

*"The competent authority shall be governed by non-practitioners who are knowledgeable in*

*the areas relevant to statutory audit...The competent authority may engage practitioners to carry out specific tasks and may also be assisted by experts when this is essential for the proper fulfilment of its tasks. In such instances, both the practitioners and the experts shall not be involved in any decision-making of the competent authority.”*

*We recognise this requirement under the Directive but we encourage the FRC to consider ways in which practitioners can contribute positively to policy development of the competent authority.*

**2. Recognised Supervisory Bodies (RSBs) to be responsible for managing complaints** - *It is important for the stability of the capital markets that the FRC concentrates on systemic risk to those markets. This is in line with Sir Winfried Bischoff's statement in the FRC's Annual Report 2014<sup>5</sup> at page 9:*

*“...the FRC has focused its authority and resources on the contribution that high quality corporate governance and reporting can make to effective functioning of the capital markets and to economic stability and growth”.*

*Any expansion of the FRC's role risks the FRC's focus becoming distracted from this. Equally, there needs to be a proper mechanism for individuals' complaints about accountants, auditors or audits to be heard and responded to. Mechanisms for dealing with these complaints are crucial and in the best interests not only of consumers but also the vast majority of high quality professionals and professional firms which abide by the Ethical Standards. Responsibility for managing them is, in our view, best delegated to the RSBs to deal with (as is the current arrangement).*

**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?

*We do not believe that there are any issues which might arise for current investigation and disciplinary arrangements between the professional supervisory bodies and the FRC that apply to accountants generally as opposed to auditors only, given the changes in relation to audit. The FRC already has disciplinary powers over accountants (and auditors) in cases where there is deemed to have been an impact on the public interest but otherwise disciplinary responsibilities would remain with the RSBs.*

**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? Please provide further information in support of your answer.

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<sup>5</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/335054/financial-reporting-council-annual-report-and-accounts-2013-14.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/335054/financial-reporting-council-annual-report-and-accounts-2013-14.pdf)

*We do not consider that responsibility for the tasks set out in the Directive and Regulation should be allocated to the single competent authority for it to delegate in turn to the RSBs. If the single competent authority were to take on delegation responsibilities, its effectiveness in its supervisory role could be diminished. In our view, the FRC's primary role is, and should continue to be, to focus on issues of public interest, to ensure the stability of the capital markets and reduce any systemic risk to those markets. This is in line with Sir Winfried Bischoff's statement in the FRC's Annual Report 2014 at page 9<sup>6</sup>: "...the FRC has focused its authority and resources on the contribution that high quality corporate governance and reporting can make to effective functioning of the capital markets and to economic stability and growth".*

**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?

*The FRC's current key activities (as set out on their website<sup>7</sup>) in relation to audit and assurance are as follows:*

*"The FRC sets high quality audit standards and guidance for listed and other entities for the aim of supporting investor, market and public confidence in financial and governance stewardship.*

*The FRC, through its audit and assurance team, develops and maintains auditing & assurance standards and guidance for engagements that are performed in the UK and Republic of Ireland; influences international standards & guidance and policy developments that may affect audit and assurance services in the UK and Ireland; and undertakes and commissions research on matters relevant to audit and other assurance engagements that are performed in the public interest."*

*Our view is that the primary role of the FRC is, and should continue to be, to ensure the stability of the capital markets and reduce any systemic risk to those markets. This is in line with Sir Winfried Bischoff's statement in the FRC's Annual Report 2014 as set out in our response to question 12 above. This, as well as a focus on issues of public interest, could be emphasised in the FRC's objectives as follows:*

*"The FRC, through appropriate allocation of rights and responsibilities to the RSBs, maintains a primary responsibility for entities associated with the public interest and a focus on the reduction of systemic risk to the capital markets".*

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<sup>6</sup>[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/335054/financial-reporting-council-annual-report-and-accounts-2013-14.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/335054/financial-reporting-council-annual-report-and-accounts-2013-14.pdf)

<sup>7</sup><https://www.frc.org.uk/Our-Work/our-key-activities/audit-and-assurance.aspx>

**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.

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

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

*Article 32(4b) of the 2014 Directive provides for delegation of tasks to other authorities as follows:*

*“Member States may delegate or allow the competent authority to delegate any of its tasks to other authorities or bodies designated or otherwise authorised by law to carry out such tasks.*

*The delegation shall specify the delegated tasks and the conditions under which they are to be carried out. The authorities or bodies shall be organised in such a manner that conflicts of interest are avoided.”*

*The Recognised Supervisory Bodies (RSBs), for example the ICAEW, currently have responsibility for the registration and removal of statutory auditors. In our view, practising accountants are best placed to determine what is achievable and reasonable in practice. Consequently, responsibility for the registration and removal of statutory auditors should be delegated to the relevant RSB, to be dealt with by a panel where practitioners have the majority view, as long as conflicts of interests are avoided.*

*Delegation to the RSBs would also help to ensure that the focus of the FRC is not diverted from areas of systemic risk in public interest audits whilst the RSBs can focus on the smaller end of the market, where issues of material public interest are much less likely to arise.*

**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?

*This is an issue for the RSBs to comment on, but in our view, the RSBs should be able to set their own rules, with input from practitioners, as appropriate. The FRC has an oversight role, and there is no provision in the EU Regulation or Directive that requires the single competent authority to approve the rules of the supervisory bodies. Consequently we do not consider that single competent authority approval should be required for the rules of the RSB's.*

**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?

*The key aspects for BIS to consider are not just financial cost/benefit in terms of audit regulation, but also the wider impact on the accountancy profession as a whole. In particular, it is important that a career in audit remains an attractive option for future entrants and that it continues to attract new applicants, as it is they who will be responsible for maintaining and promoting audit quality, both now and in the future. In order to achieve this, there is a need to ensure that audit does not become a profession which is over-regulated and that the RSBs, as the professional bodies, retain a role which, in turn, helps to maintain the status of the auditing profession.*

**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? Please provide information to support your answer.

*We agree with this proposal as it would be helpful if all requirements relating to non-audit service restrictions were included in a single set of standards. This would:*

- (1) ensure consistency of application and ease of understanding;*
- (2) make it easier for firms to implement, monitor and comply with the provisions; and*
- (3) enable the FRC to deal with any issues of non-compliance using their existing disciplinary processes (as opposed to the Courts having to determine such issues which would involve additional cost and uncertainty of outcome for all parties).*

*However, any amendments should represent the minimum requirements under the Regulation. This is in accordance with the UK Government's negotiating priorities in Europe at the time the EU legislation was being debated, one of which was that additional burdens should not be imposed other than where they are objectively justified. In addition, there should be no "gold plating" by the FRC when implementing the EU requirements unless accompanied by a comprehensive cost/benefit analysis which includes analysis of the effects of introducing complexity through multiple different EU Member State regimes.*

*There is currently confusion over the methodology which should be used to calculate the cap. If the FRC do incorporate the provisions of Article 4 of the Regulation into their revised Ethical Standards, the basis for calculation of the cap must be made absolutely clear.*

**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?

*The issues which we consider arise from the application of the cap on non-audit services are as follows.*

1. *A key issue is clarity around the calculation of the cap. In particular whether fees billed by the network firms of the PIE auditor need to be included, both in the audit fees and the fees for non-audit services. Clarity is also required as to when the calculation should be undertaken and what level of monitoring is required.*
2. *Pre-dispensation from the cap - there are some situations where, for practical purposes, a pre dispensation (under the exclusion from the cap in Art 4) would be appropriate or, failing this, for a "guaranteed" exemption to be granted following a formal application.*

*In particular, this would be appropriate when considering private reporting aspects of reporting accountants' work, if these are not considered to fall outside the scope of the cap calculation. Private reporting services are unlikely to pose a threat to independence and, in many cases, the statutory auditor is likely to be the only choice of independent advisor with sufficient knowledge and expertise especially where there is a time critical deal timetable. Having to wait for an exemption from the cap to be granted may result in a failure to comply with timetables and requirements imposed by other regulatory regimes and thus lead to disruption in the market. Additionally, there may be a need for confidentiality, for example to protect price sensitive information about a potential deal. These factors all mean that it may be difficult or impractical to appoint anyone other than the auditor.*

3. *A fast, efficient and pragmatic process is needed to deal with inadvertent and immaterial breaches of the cap, to ensure that companies being audited are not suddenly disadvantaged by being unable to obtain an audit opinion.*

**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? Please provide information to support your answer.

*In relation to the cap, our view is that the 70% cap on fees for non-audit services is sufficient, and we do not believe that a lower cap should be implemented, particularly as the level of cap was based on a thorough and lengthy European negotiation process. The Government's support for the 70% cap was highlighted by Jo Swinson MP in her evidence to the European Standing Committee C on 30 October 2013, as follows:*

*"On the cap of permitted non-audit services—an issue raised by the European Scrutiny Committee—the Council proposal is less favourable. None the less, we can accept it in the context of the overall negotiation that took place on that particular directive. .... For exceptional cases, the regulator might lift the cap for up to two years. Overall, the combination of that flexibility and the 70% cap, which in itself is better than some had wanted, is sufficient to make the proposals acceptable to the UK."*

*The FRC's Ethical Standards are well established in the UK and are in our view, the logical place to deal with these requirements. ES 4 paras 31 and 32 currently deal with the limits on total fee income and, for listed entities, are more stringent than the Regulation, as an overall cap of 10% applies. In our response to the FRC Consultation (at question 20) we have suggested that the Member State option is taken to apply the more stringent 10% overall fee cap to all PIEs.*

**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?

*In our view, it is very important that the FRC have the power to exempt an audit from the cap, and also that this power should be exercised in a responsive manner. There are a number of situations, as outlined in our answer to question 19 (above), where the ability to exempt an audit firm from the cap will give vital flexibility to the efficient operation of the UK capital markets, particularly in time-critical deals transactions. Situations may also arise where the cap has been used up on permitted non-audit services during the year, but towards the end of the year there is a time-critical deal, or time-critical regulatory inspection. The impact of the cap would make it impossible for the incumbent audit firm to provide the services, notwithstanding that it is best placed to undertake the work. An efficient means of approving a breach of the cap is needed to deal with circumstances such as these.*

*Furthermore, the ability to exempt the audit firm from the cap was supported by the UK Government during the negotiation phase as articulated by Jo Swinson MP in her evidence to the European Standing Committee C on financial audit on 30 October 2013:*

*"On the cap of permitted non-audit services...There are some helpful potential exemptions. For exceptional cases, the regulator might lift the cap for up to two years. Overall, the combination of that flexibility and the 70% cap, which in itself is better than some had wanted, is sufficient to make the proposals acceptable to the UK."*

**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? Please provide information to support your answer.

*We agree with this proposal as it would be helpful if all requirements relating to non-audit services restrictions were included in a single set of rules. This would ensure consistency of application and ease of understanding, and the restrictions would be easier for firms to implement, monitor and comply with. However, the exact nature of the amendments should represent the minimum requirement under the Regulation, and there should be no "gold plating" by the FRC when implementing the requirements of the Regulation. The UK Government has already made clear its preference for a "black list" of services and its view is that no additional burden should be imposed on firms which are already complying with the FRC's Ethical Standards. As Jo Swinson, MP stated in her evidence to the European Standing Committee C on financial audit on 30 October 2013:*

*“On non-audit services to the largest companies, a blacklist of services that auditors would not be able to provide has been agreed. The hon. Gentleman expressed concerns about this issue, but we are reassured by the proposal on the table, because the list now mirrors existing ethical standards. If firms are already complying with the standards that we would expect of them as responsible auditors, the proposed blacklist will impose no further burden. That should reassure the Committee.”*

*This should also help to achieve some degree of consistency with other Member States, which will in turn help to reduce the cost and administrative burden for multi-national groups.*

*The requirements of the Regulation have been the subject of consultation, debate and negotiation within the EU, and for the FRC to set more stringent prohibitions in relation to non-audit services, goes further than the EU considered necessary, suggesting that the work of the EU in this respect is inadequate or insufficient. It also goes beyond the UK Government’s negotiating priorities at the time of the debates in Europe which included the objective of not imposing additional burdens other than when they can be objectively justified.*

*To the extent that the EU audit legislation gives the option for certain derogations, the risk to independence in doing so is deemed acceptable at an EU level. We suggest that the UK Government should exercise these options and allow UK businesses, through their audit committees, to decide whether non-audit services should be provided by the statutory auditor as audit committees are bound – and can continue to be bound – by principles which allow them to exercise judgment in the best interests of the company and its shareholders. This further serves to emphasise the importance of the audit committee in the UK governance model.*

**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?

*For some time auditor independence in the UK under the Ethical Standards, and outside the UK under IESBA, has operated under the key principle of considering the threats to independence and applying safeguards to reduce such threats to an acceptable level. This principle is well known and has served UK (and global) business well over many years. Therefore, in our view those principles should remain at the core of standards to be applied in the UK.*

*We consider that the following issues arise from the application of the provisions on the “black list” of non-audit services.*

- 1. Overly restrictive non-audit services regime can undermine audit quality** – *an overly restrictive regime may result in a career in audit becoming a less attractive option if there are limited opportunities to obtain wider experience outside the audit practice. Further strains would be placed on the multi-disciplinary*

*firm model; we believe that it is essential that the multi-disciplinary structure of UK audit firms is maintained and celebrated. As a result of this potential impact on the multidisciplinary firm model, the inevitable outcome could be the emergence of audit only firms, which would not, in our view, be a positive development for audit quality or for the profession as a whole.*

2. ***Detrimental impact on choice and competition in audit and non-audit services*** – an overly restrictive regime for the provision of non-audit services can rapidly reduce a company's choice of audit provider. For instance, a company may wish to continue with its existing supplier of non-audit services; under an overly restrictive regime, the existing supplier would be unable to compete in a tender for the audit appointment. In a world where auditor rotation will become mandatory (and therefore one firm is never able to compete), the impact on competition and choice is material. This is important because it undermines the UK Government's negotiating priority of upholding competition and avoiding concentration in the audit market. The Competition and Markets Authority (formerly the Competition Commission), in their final report dated October 2013 on their market investigation in to the provision of statutory audit services to large companies recommended that the FRC amend its articles of association to include an objective of having regard to competition. We believe that the FRC should adopt this recommendation as part of the implementation process and in doing so, should reconsider some of the proposals in their Consultation.
  
3. ***A need for clarity of interpretation*** - one of the key issues arising from the "black list" of non-audit services is interpretation, for example, what might be included as part of "services that involve playing any part in the management or decision making of the entity" (Article 5(1)(b) Regulation) or "services linked to the financing, capital structure and allocation, and investment strategy of the audited entity" (Article 5(1)(i) Regulation)? Clarity of interpretation is important given the wording in the EU legislation is not precise and there is a need to ensure consistency and clarity as to what services are not permitted, both across Europe and within the UK. Different Member States may take different approaches which will lead to complexity for PIE groups operating throughout Europe. To minimise this complexity as far as possible, guidance should be drawn from, for example, the existing IESBA code. We would welcome clear and principles based guidance from the FRC on the interpretation of the non-audit services prohibitions through the update of their Ethical Standards. This will greatly assist UK businesses, their audit committees and audit firms to comply with the requirements.

4. **Costly and disruptive to business** - an overly restrictive non-audit services regime can cause undue cost and difficulty to UK business if alternative suppliers have to be appointed to provide a service which could be provided more efficiently, cheaply and to a higher quality by the incumbent auditor
5. **“Black list” to reflect requirements of Regulation** - it is important to restrict the “black list” to the requirements of the Regulation, taking the Member State options to allow certain tax and valuation services. This will help: (1) to ensure that the provisions on the “black list” are implemented in such a way as to not impose additional burdens on UK businesses (in line with the UK Government’s negotiating priorities in Europe at the time of the debate on the legislation); and (2) to ensure that UK businesses will not be unfairly restricted, or subjected to unnecessary costs or complexities, in line with the Government’s protocol on no “gold plating” of EU legislation.

*It is also in line with the UK Government’s view on a “black list” for services and its view that no additional burden should be imposed on firms which are already complying with the FRC’s Ethical Standards. This point was made by Jo Swinson MP in her evidence to the European Standing Committee C on financial audits (evidence dated 30 October 2013) in which she said:*

*“On non-audit services to the largest companies, a blacklist of services that auditors would not be able to provide has been agreed. The hon. Gentleman expressed concerns about this issue, but we are reassured by the proposal on the table, because the list now mirrors existing ethical standards. If firms are already complying with the standards that we would expect of them as responsible auditors, the proposed blacklist will impose no further burden. That should reassure the Committee.”*

*In addition, the role of the audit committee, to exercise judgement over the provision of non-audit services, in the best interests of the shareholders, would not be undermined and they would be in a position to apply the existing principles of threats to independence and application of safeguards to reduce such threats to an acceptable level.*

- 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:
- (a) underpin the standards? And,
  - (b) introduce simplifications for audits of small non-PIEs?
- Please provide further information to support your answer.



*We agree that combining the requirements on ensuring and documenting auditor independence through the Ethical Standards is a sensible and pragmatic approach. The ability to refer to a single consistent text will be a helpful approach for UK companies, audit committees and audit firms that are required to comply with the requirements.*

*We support the simplifications for small non-PIEs. The extant Ethical Standard "Provisions available for small entities" provides welcome simplification to facilitate the cost effective audit of small entities. Simplifications should extend, where possible, to documentation requirements, either through the provisions within Ethical Standards or through other guidance. By way of example, the APB issued a Practice Note (PN26) to explain how the documentation requirements in Auditing Standards could be applied in a simple way to small audits and similar guidance in relation to Ethical Standards might be useful.*

*Nevertheless, it is important that the essential nature of an audit is unchanged, regardless of the size of the entity, as well as the essential nature of auditor objectivity and independence in order to preserve the value of the audit report to users of financial statements for businesses of all sizes.*

**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? Please provide information to support your answer.

*As the data on audit and non-audit fees needs to be compiled to comply with the Regulation and it would enhance transparency for public interest entities, we agree with this proposal. There is, however, a need for clarity over whether non-audit services that are provided under a regulatory requirement are to be treated as "required by Union or national legislation" or not.*

*The perception concerning the influence of non-audit services over the audit would be, in our opinion, addressed by a more detailed disclosure than the current accounting requirement. Consistent categories between the requirements of the law and the requirements in the Regulation would be desirable, which may mean changing the current disclosure requirements to align with the categories set out in the Regulation.*

*From a practical perspective, the requirements of Article 14 may place a significant administrative burden on statutory auditors and audit firms, whose systems may not be able to provide the required analysis.*

**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?

(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?

*We do not have data available to enable us to provide the estimates requested. This is due to the current uncertainties about what services are to be restricted by the "black list" (see our response to Q23 above). We anticipate that the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the "black list" will be high. We also anticipate that the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor will 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. This is especially the case where multinational groups have different audit firms/joint audit arrangements across the EU.*

*As regards the internal costs which are likely to be incurred by audit firms in preparing partners and staff for the changes that will arise as a result of the EU audit legislation, we anticipate that these will include costs of training partners and staff on the implications of the new legislation, costs of ensuring compliance with the legislation, and costs of setting up and maintaining internal monitoring systems for the provision of non-audit services. These costs will be incurred not just in the audit business, but across the whole firm, as each part of the business will need to understand the impact of the changes on their clients. We anticipate that all of these costs will be significant for firms.*

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

Please provide further information to support your answer.

*We agree that the existing alternative systems for the appointment of an auditor should continue to operate. There will always be a need to ensure that non-standard situations are covered, for example the appointment of a new auditor following the resignation or removal of an incumbent auditor. As a result, these alternatives should be retained, possibly by allowing emergency appointments for a period of one year followed by a tender process.*

**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? Please provide information in support of your answer.

*Where the PIE is exempted from having an audit committee, this approach, which is in line with the unitary board concept in UK law, would be both practical and appropriate, and will be equivalent to a recommendation of the full board, rather than a subcommittee (i.e. the audit committee) of the board.*

**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? Please provide further information in support of your answer.

*We agree with the proposal not to take up the option to provide an extension of the maximum duration of the audit engagement beyond ten years where a joint auditor is engaged. We also 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 and we support a mechanism that does not seek to complicate the process. The popularity for joint audits in the current UK market is low, a view also reached by the Competition Commission in their 2013 investigation (Statutory audit services for large companies market investigation).*

**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?

*We agree that where a PIE has stated that it will appoint an auditor, consequent to a tender, before the maximum expiry of ten years, it should be able to take advantage of an extension of the maximum duration beyond ten years. That said, the proposals by BIS are in our view: (1) problematic (as we explain in our response to question 32 below); and (2) unnecessary because (we anticipate) it is unlikely that PIEs will wish to make a binding public statement about their intentions to carry out a tender process before the maximum duration of ten years. This is because PIEs will not want to be bound by a statement about a future tender process (in case their plans happened to change).*

**Likelihood of early tenders by PIEs** - in any event, the requirement to tender at the ten year point is unlikely to dissuade large numbers of PIEs from tendering earlier if they choose to do so. This is because those PIEs which choose to tender at the five year point (to coincide with the rotation of the audit engagement partner) will not be disincentivised from tendering at the ten year point (because it is in line with the five year audit partner rotation cycle). Those PIEs which choose to tender mid-way through the second audit engagement partner period (at years 6-9) are likely to be dissatisfied by their existing audit firm and so are likely to switch (in which case they would not be affected by the requirement to tender

at the ten year point in any case).

**Flexibility in the rules is desirable** - our view on the likelihood of early tenders aside, we appreciate that it is important to ensure that there is no disincentive for a PIE to hold an early tender process. This would be anticompetitive and contrary to the intentions of the Competition and Markets Authority (CMA) as expressed in their Order (The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014) where they expressly state that they wish to incentivise FTSE 350 companies to tender at periods of less than ten years. It is important that an early tender by a PIE, (perhaps prompted by the application of the CMA's Order) which results in the reappointment of the incumbent auditor, is recognised for the purposes of the Regulation. Otherwise the PIE would be forced to tender again (within a short timescale) in order to satisfy the requirements of the Regulation. Flexibility in this area is desirable, and the rules should not be so onerous as to require tendering at specific dates.

**Statement of intention to hold an early tender** - in our opinion, PIEs should not be bound by any previously stated intentions to retender for the audit. If a statement of intention to hold an early tender was to be binding on a PIE, this would be a clear disincentive to PIEs to tender more frequently.

**Simplified approach** - we suggest a simplified approach whereby the PIE is permitted to decide on the duration of the period between tenders, subject to a maximum period of ten years. Our proposed solution is as follows: where a PIE tenders early (say, at year 7), it is permitted an extension of ten years (i.e. to year 17) before it is required to carry out a competitive tender. At that point, if the PIE wishes to reappoint the incumbent it would be obliged to tender the audit (at year 17) before it would be permitted to reappoint the incumbent for a further three years (prior to the mandatory firm rotation obligation applying). In this way, the PIE would have the benefit of the maximum duration of the audit engagement to 20 years (which reflects the UK Government's intention in taking up the Member State derogation extension option). PIEs would not be at a disadvantage if they chose to tender early and this solution would be consistent with the mandatory tendering requirements of the CMA's Order (tendering at ten year frequency) for companies in the FTSE 250 and FTSE 100 indices. We note the BIS document "Auditor Regulation – Supplementary Information" (dated March 2015) in which BIS set out (at question 12) that consideration is being given to the minimum requirements for an early tender to be effective to allow an extension to the maximum duration and that notification in the directors' report would be needed two years in advance of the financial year for which the auditor appointment is made. We are concerned that this could restrict or distort a company's choice of auditor during the two year period running up to the tender process, if the company did not wish to reappoint its incumbent at any point during that period.

**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)
- b) when the audit engagement was last retendered? (Yes / No)
- 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)
- d) the directors' reasons for considering that the proposed year is in the best interests of the company's members? (Yes / No)

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

*We are in favour of increased transparency which will help stakeholders to make informed decisions, in areas where they may have concerns.*

*The information in (a) to (c) is largely factual information that can be presented efficiently, and may be useful for stakeholders. Where judgements have been taken in establishing the dates required (for instance, in the case of company restructurings, acquisitions and mergers), we suggest that directors also be required to disclose the details of such judgements. However, we are concerned that the information in (d) may be included as standard boilerplate text, which will reduce its value.*

*For category (d) in particular, we suggest that it would be useful for the directors to highlight any judgements made to support their reasons. This may be helpful, especially as it could form the basis for shareholder challenge and discussion. There may, of course, be situations where this disclosure might have commercial sensitivities, for example if the change of auditor is set to time harmoniously with a planned, but not yet disclosed, acquisition or disposal. Consequently, we recommend that this should not be required in circumstances where there is a risk of significant prejudice to the company and/or its members.*

*However, we note that the BIS Discussion Document refers (at page 34) to the binding nature of the PIE's intention that the auditor's appointment in the next year but one will be based on a retender. We question whether it is possible from a legal point of view for a statement of this nature to be binding on the directors of the company, especially as it is contrary to the "comply or explain" ethos of UK corporate governance. We also expect that it could be difficult to require the audit committee to set legally binding periods in relation to auditor appointments because we anticipate that audit committees would be uncomfortable with such responsibility.*

**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? Please provide further information in support of your answer.

*We have considered each of the options proposed at (a)-(c) and comment on them in turn.*

*(a) We do not support an option in which the next tender process should be expected to take effect after the same period has expired again (year 14 in BIS's example) for the following reasons:*

- it is not compatible with EU Regulation Article 17 (4);*
- it does not reflect the UK Government's stated intention of taking up the Member State option to extend the maximum duration of the audit engagement to 20 years (as set out on page 31 of the BIS Discussion Document);*
- it places at a disadvantage those PIEs which have tendered their audit appointment early and reappointed their incumbent auditor;*
- it would act as a disincentive to companies to tender more frequently than once every 10 years;*
- it is contrary to the intentions of the Competition and Markets Authority (CMA) as set out in their Order (The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014) where they expressly state that they wish to incentivise FTSE 350 companies to tender at periods of less than ten years; and*
- it is contrary to BIS's aim of trying to ensure consistency between the EU Regulation and the CMA's Order. This is of particular concern because at the BIS/ICAEW stakeholder event on 24 February 2015, BIS expressly stated that their implementation of the rules on retendering and rotation is to be consistent as possible with the CMA's Order (Marie-Anne Mackenzie, Head of Corporate Frameworks, Accountability and Governance, BIS at the BIS/ICAEW stakeholder meeting on 24 February 2015). This is in line with the BIS document "Auditor Regulation – Supplementary Information" (dated March 2015) which states: "BIS, the CMA and the FRC are agreed that, in so far as possible, the CMA Order and the requirements of the Regulation should be applied consistently with one another."*

*(b) We support an option in which the tender process is expected to take effect after a further ten years has expired (year 17 in BIS's example). In our view, a simplified approach whereby the PIE is permitted to decide on the duration of the period between tenders, subject to a maximum period of ten years, is most suitable. Our proposed solution is as follows: where a PIE tenders early (say, at year 7), it is permitted an extension of 10 years (ie to year 17) before it is required to carry out a competitive tender. At that point, if the PIE wishes to reappoint the incumbent it would be obliged to tender the audit (at year 17) before it would be permitted to reappoint the incumbent for a further three years (prior to the mandatory firm rotation obligation applying). In this way, the PIE would have the benefit of the maximum duration of the audit engagement to 20 years (which reflects the UK Government's intention in taking up the Member State derogation extension option) but would also have held an audit tender at least every ten years. PIEs would not be at a disadvantage if they chose to tender early and this solution would be consistent with the mandatory tendering requirements of the CMA's Order (tendering at ten year frequency) for companies in the FTSE 250 and FTSE 100 indices. We also consider that this solution is*

appropriate for PIEs which tendered and reappointed their incumbent auditor prior to 17 June 2016. These PIEs would also have the benefit of the maximum duration of the audit engagement to 20 years starting from the date of their incumbent's first appointment.

(c) We do not support an option in which the next tender process is expected to take effect after the same period has expired again (but with potential to extend to the full ten years with consent from the audit committee) (year 14 in BIS's example, although it could be extended to year 17). This option has the same flaws as we have identified in relation to option (a) (see our response above). We also consider that seeking to delegate to the audit committee the ability to set the maximum duration of the tender process would be fraught with difficulty and we believe that audit committees will be uncomfortable with being given responsibility to set legally binding maximum durations for audit appointments.

**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?

As regards sanctions for failure to comply with the UK's implementation of the framework for mandatory rotation and tendering, our view is that responsibility for compliance should be joint (on the part of the auditor and the PIE). There is a professional requirement for the auditor to comply with the framework, and a board has a fiduciary responsibility to ensure that there is an audit. Consequently, our view is that the right approach is joint responsibility on the part of the auditor and the PIE.

The sanctions for failure to comply need to be comparable and proportionate and there needs to be clear guidance as to how the sanctions will be imposed. Sanctions for different parties should be comparable, for example, if an auditor is stripped of their Responsible Individual status, then the equivalent sanction for a company director would be a ban on holding a similar role. Instances of deliberate non-compliance are likely to be rare.

However, given the large number of uncertainties and questions of interpretation that we have seen in the Regulation and Directive, particularly in the application of the transitional provisions set out in Article 41 of the Regulation (in respect of which we attach a list of tendering and rotation uncertainties which we have identified from our own work with clients), there may well be instances of unintended non-compliance. As a result, we recommend that the sanctions regime reflects the fact that where directors and auditors have acted in good faith and have made full disclosure to shareholders, there should not be punitive consequences, nor should the company be left without an audit as a result of an action, or lack of an action, that is deemed to be non-compliant in retrospect. This reflects the view expressed by BIS on sanctions which may be applicable for breaches of the framework as set out in their document entitled "Auditor Regulation – Supplementary Information" (dated March 2015) as follows:

"We do not consider it would generally be appropriate for an audit report to be invalidated by such a breach, once the report had been accepted at an annual general meeting."

**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?

*(a) For evidence about resources likely to be deployed by PIEs to tender audit appointments, it is useful to refer to the Competition Commission's final report dated 15 October 2013 ('Statutory audit services for large companies market investigation') as it includes a section on 'Company costs in tender processes' (paras 9.301-9.306). The Competition Commission explain in that section that significant resources are likely to be deployed by FTSE 350 companies (the relevant market in that investigation) in running a tender. The Competition Commission did not have quantitative data on company tender costs but from the evidence submitted to them 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. They found that senior management time is required to run a tender and the cost appears to relate 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 FTSE350 companies and audit firms.*

*(b) For evidence about resources likely to be deployed by auditors to tender for audit appointments, it is useful to refer to the Competition Commission's final report dated 15 October 2013 ('Statutory audit services for large companies market investigation') as it includes a section on 'Firms' costs in tendering' (paras 9.296-9.300). The Competition Commission found 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. They found that for the purposes of the tender process audit firms submit teams comprising senior representatives and that these teams were generally more senior than the engagement team which was required to provide the audit service. In the evidence submitted by PwC to the Competition Commission's investigation, we stated that our experience was that the average cost per tender to a firm was £360,000 (appendix 16.2 'Estimating the costs to audit firms of mandatory tender processes at ten years', A16(2)-2). This figure is based on data from PwC's own experience of tender proposals for 2011-2013. The Competition Commission's final report (appendix 7.1 'Analysis of tender processes' data') also 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).*

- (c) *The Competition Commission concluded in their final report dated 15 October 2013 ('Statutory audit services for large companies market investigation') that there are costs to companies associated with switching auditor which comprise: loss of relationship; costs which a company incurs in educating the new auditor; and uncertainty in the performance of a new auditor (paras (9.210-9.212). More detail is set out in the appendix on switching costs (appendix 7.4 'Switching costs').*
- (d) *We have no data which would enable us to provide an estimate of the extent to which additional familiarisation costs varies by size of PIE.*

**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?

*In keeping with the UK Government's "Transposition guidance: how to implement European Directives effectively" (dated April 2013), BIS should "seek to implement EU policy and legal obligations through the use of alternatives to legislation", with legislation only being used where there are no preferable alternatives. The going concern statement is already covered by Auditing Standard ISA (UK&I) 570 (and IAASB's ISA 570) which requires the auditor to disclose in the audit report the existence of a material uncertainty in relation to going concern through the inclusion of an "emphasis of matter" paragraph (or through a modified audit opinion if the company's disclosure of the material uncertainty is inadequate). Consequently in accordance with the obligation to avoid "double-banking" as set out in the "Transposition Guidance: How to implement European Directives effectively" (dated April 2013), there is no need for the Companies Act 2006 to be amended in respect of this.*

**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.

*We agree that the FRC will need to align the reporting obligations under ISA (UK & Ireland) 700, the proposed revised auditor's report requirements issued by IAASB and Article 10 of the Regulation. The only practical way to achieve this is to amend the FRC's ISAs (UK & Ireland), which will ensure that all reporting requirements are consolidated in one place.*

**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?

*The issues which we consider arise from the application of the provisions of the Regulation on the audit report are as follows.*

- 1. Amendments will be required to ISA (UK&I) 700 to reflect the Regulation, including the need to disclose, "where relevant" key observations. In making any revisions to ISA (UK&I) 700, the FRC should take into account the recently issued IAASB standards, i.e. revised ISA 700 and new ISA 701.*
- 2. A statement is required in the audit report (per Article 10(2)(f)) confirming that prohibited non-audit services were not provided and that the statutory auditor remained independent of the audited entity. We are concerned that in relation to this, there is no allowance for, or mechanism to deal with, inadvertent breaches by the auditor of the prohibitions on non-audit services. Although instances of such breaches are expected to be rare, internal controls and procedures are not infallible and it is therefore possible that a "prohibited" non-audit service might inadvertently be provided by the auditor (for example, a minor service to an immaterial subsidiary in the group). If this was the case, there is a risk that, without a proportionate application of this requirement of the Regulation, the auditor would not be able to sign the required auditor's report if the report had not yet been issued.*

*If the breach became known after the release of the auditor's report, as might typically be the case, the original auditor's report may need to be withdrawn, with significant implications for the auditor/audit firm and also economic consequences for companies and investors. The consequences seem to us to be disproportionate, particularly in the case of an immaterial inadvertent breach. It is clear that a minor immaterial breach of a "rule" does not automatically render the firm or the audit engagement team "not independent" or unable to provide an objective opinion and we need a proportionate way of dealing with these situations.*

**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)? Please provide information to support your answer.

*In our view, the FRC will need to align the reporting obligations under existing ISA (UK&I) 260, the proposed revised requirements issued by the IAASB and Article 11 of the Regulation. The resulting amendments should be made to the FRCs ISAs (UK and Ireland). This will ensure that all reporting requirements are consolidated in one place.*

**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?

*The issues which we consider arise from the application of Article 11 of the Regulation on the additional report to the audit committee are as follows.*

- 1. Level of detail required in the additional report – auditors will need to consider the level of detail to include in the additional report (there will be areas on which they are likely to need to communicate more information, in particular the requirement to describe the methodology used which will include the categories of the balance sheet which have been directly verified as opposed to verified based on system and compliance testing). If the requirements of Article 11 are included in Auditing Standards it will be useful for those standards to include guidance as to what is expected in the additional report as well as enabling some flexibility on the part of the auditor.*
- 2. Open and effective communication between the auditor and the audit committee will need to be encouraged and maintained - the requirement for a formal report to the audit committee should not constrain the effective interaction between auditors and audit committees nor their ability to discuss matters in an effective manner.*

**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?*
- (b) the additional annual cost of the audit committee considering the additional report?*
- (c) how these costs vary by size of PIE?*

*We do not have specific data available to give a quantitative response to this question. From a qualitative perspective, taking each of the sub-questions in turn:*

- (a) Article 11 of the Regulation imposes new requirements. Consequently these new requirements, together with likely differences in interpretation over whether additional audit work is required, are likely to give rise to both additional work and additional costs on the part of the auditor;*
- (b) There is likely to be an additional burden on the audit committee, as they will have to spend time considering the new information required to be provided in the additional report; and*
- (c) We do not anticipate that there will be significant variation in cost by size of PIE but where a PIE is more complex there will inevitably be more work involved in explaining audit methodology and other relevant issues in the report to the audit committee.*

**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)?
- Please provide further information in support of your answer.

*We have not expressed a view either in favour of retaining alignment between the audit exemption and small companies accounting thresholds, or of leaving the thresholds for audit exemption unchanged, in so far as they are lower than under the accounting regime. Rather, we set out below some considerations both for and against raising the audit thresholds, together with observations based on our experience with companies in our client base.*

*As we noted in our recent response to BIS on the UK implementation of the EU Accounting Directive, there are differing relevant and legitimate policy objectives that should be considered. There is a powerful argument in favour of relieving regulatory burdens, and as a firm, we support the Government's initiatives to alleviate regulatory burdens on business and to remove 'red tape'. Allowing the current thresholds for audit exemption to increase in line with the thresholds used for accounting purposes, will provide an opportunity to lift the regulatory burden for small business. Having common thresholds for accounting and audit purposes also helps to reduce complexity, and the burden on business of understanding the regulations.*

*On the other hand, de-regulation involves risk, for example a range of stakeholders may be disadvantaged, or potentially disadvantaged, by the removal of the audit requirement. The external audit is a means of enhancing confidence in the financial information used by stakeholders. Removal of the audit requirement for some companies is also likely to have an impact on the accounting profession, and in addition some of the expertise and capacity in the sector to audit SMEs may be lost.*

*Based on our experience of dealing with companies, regardless of the limits set by statute, many would continue to wish to be audited, on a voluntary basis, for example, because they are currently privately owned but fast growing and may wish to raise finance in the markets in the future, or because they are connected with venture capital funds that might require an audit. Hence allowing the audit exemption thresholds to increase by a relatively modest amount, while justifiable from the perspectives of simplicity and de-regulation, may in practice have a limited impact.*

**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?

*The issues which we consider arise from the measures considered in this chapter are as follows:*

1. *Section 5.3 Statutory audits of consolidated accounts - there is a requirement for the group auditor to make audit working papers available to the competent authority in relation to an inspection or an investigation of the audit of the consolidated financial statements. This could cause issues where local law in a particular country does not permit access to audit working papers outside that country (as the group auditor could be prevented from making audit working papers available to the competent authority in the country where the inspection or investigation was taking place). Recent discussions between the SEC, US audit firms and the Chinese regulatory authorities have served to illustrate this issue (although we understand that agreement has been reached between the Chinese regulator and the SEC).*
2. *Section 5.8 Recognition of statutory auditors from another Member State – we have responded to the specific questions on this area in our responses to questions 53 and 54. The current process for recognition of statutory auditors from other Member States is time-consuming and problematic. We support measures to streamline and speed up this process so that a statutory auditor who has already proved his competence in another Member State is able to act quickly as a statutory auditor in the UK.*

*We are aware that BIS is considering steps which could be taken to complete the EU single market for services. To that end, we believe that the aptitude test/adaption period is an area that could be modified, or removed, which would allow for the easier movement of statutory auditors across the EU. In pursuit of this objective and in line with the UK Government's negotiating priorities at the time of the EU debates, we strongly urge that the requirements go no further than the minimum set by the Regulation and/or Directive.*

3. *Section 5.10 Competent authorities – investigations, sanctions and powers. We have two points to make: (1) we would support formal confirmation of the FRC's publication policies in relation to decisions under the FRC's Accountancy Scheme and AADB's Actuarial Scheme such that publication of names of individuals and the names of relevant firms are made only once charges in the disciplinary process are formally laid; and (2) we would not support any attempt to include in legislation any power for the FRC to impose penalties on a punitive basis under the Auditor Regulatory Sanctions Procedure because sanctions under this procedure are expressly not intended to be punitive.*
4. *Section 5.13 Monitoring market quality and competition – the Regulation imposes an obligation on the competent authorities in each Member State and the European Competition Network to monitor the developments in the market for statutory audit*

*services to PIEs and to assess various factors (including market concentration levels). In our view BIS should emphasise to the FRC (as single competent authority) these obligations to monitor competition developments particularly in view of the recommendation in October 2013 by the Competition Commission that the FRC should have a secondary objective to have due regard to competition.*

**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?

In addition we remind you that the general questions asked at the start of chapter 4 also apply to the measures discussed in this chapter.

*We have no data which would enable us to provide an estimate in relation to this question.*

**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)?

*In our opinion the most appropriate mechanism for implementing the EU requirements on technical standards is through changes to the FRC's ISAs (UK & Ireland).*

**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?

*We are not in a position to provide an estimate because we do not anticipate that we will be affected by the requirement for a quality control review to be undertaken by an individual auditor from outside the firm. The size of PwC means that we will be able to find sufficient suitably qualified engagement quality control reviewers within the firm.*

**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?

*Full texts of each ISA applicable to the audit of a complete set of historical financial statements as promulgated by the IAASB should be adopted. We would not support EU only changes to the ISAs to be adopted, unless these are needed to address a specific conflict with EU legislation. We strongly recommend that UK representatives raise with the European Commission the need to finalise all arrangements for ISA adoption in the interests of ensuring audit quality in Europe.*

*We do not expect many UK specific issues in adopting ISAs (subject to our response to question 47 below regarding the need to avoid "gold plating"). However, the status of other pronouncements issued by the FRC (such as Practice Notes or Bulletins) needs to be*

*established so that they can continue to be issued to provide supporting guidance for the effective implementation of ISAs. Such guidance is important in maintaining excellence in UK auditing and reporting.*

**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) 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 / No)
- Please provide further information in support of your answer.

*We support this suggestion, in respect of (a) where is a clear need or omission.*

*As regards (b), while we understand that there are certain national specific requirements that need to be reflected, given existing UK legislation and regulation (in which we would include existing UK additions for auditors of entities that apply the UK Corporate Governance Code), the FRC should: (1) have regard to the UK Government's negotiating priorities at the time of the European debates in relation to the EU legislation which included the priority to secure high quality audits (as stated by Jo Swinson MP in her evidence to the European Standing Committee C on financial audits on 30 October 2013); and (2) seek to avoid unilateral "gold plating" provisions. As far as possible, standardised global and pan-European solutions should be the goal, providing a platform for consistency.*

*Furthermore, any proposals to introduce additional requirements and auditing standards beyond those in the ISAs adopted by the EU should not be automatic but subject to consultation (consistent with existing FRC practice) and a qualitative and quantitative impact assessment of any proposals.*

*The UK should, as far as possible, not take unilateral action in relation to audit quality. Changes should be initiated at a global or European level (with input from the UK), in order to ensure consistency in quality, standards and mechanisms for promoting audit quality across Europe.*

**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)?

*For UK premium listed FTSE 350 companies currently complying with the UK Corporate Governance Code, there are likely (in our view) to be relatively few issues arising from the implementation of the new requirements on audit committees via amendments to the existing DTR 7.1 in the FRC Handbook because their membership and activities are likely to meet most of the new requirements already.*

*There may be a change for premium listed companies outside the FTSE 350 as there is no current requirement for all directors to be put up for election each year, so taking the Member State option to have the chairman of the audit committee elected annually may represent a change.*

*DTR 7.1 also applies to UK companies with a standard listing. For these companies the Directive would extend the requirements for the composition of the audit committee beyond the current requirement in DTR 7.1 that "at least one member of that body must be independent and at least one member must have competence in accounting and/or auditing". These companies can already have audit committees that include members other than non-executive directors.*

*Standard listed companies would also be affected by the requirement for the committee as a whole to have competence in the sector. Board composition in terms of the range of skills and experience is effectively covered by the Code for premium listed companies.*

**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?

*Most banks and building societies will already have audit committees. For any which do not, they will face the same issues as any other organisation trying to establish an audit committee for the first time, in this case in the financial services sector, but without the profile of a public company board. Given the public interest in well-functioning banks, building societies and insurers our view is that the new requirements on audit committees are reasonable.*

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

*We are unable to comment as we have no relevant data. In relation to (d) above, we do not charge separately for attending audit committee meetings: any such costs are included as an integral part of the provision of the audit.*

**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?

*We do not consider that there is a need for this additional reporting. There is an existing protocol between the PRA and the FCA which enables these regulators to share information and to refer to the FRC if there is a question about audit quality. In our view the single competent authority with responsibility for regulation of audit should not be designated to receive the information required to be provided to supervisors of PIEs, whether the supervisor is the PRA or the FCA. The FRC, as the single competent authority, should focus on the public interest aspects of the audit, and not issues of financial supervision, which are more properly the concern of other regulators.*

*The information provided by the auditor to supervisors is to help ensure the financial stability of, and appropriate conduct of those within, the PIEs concerned. The provision of such information to the FRC as single competent authority would not necessarily be relevant for the competent authority with responsibility for audit regulation. In addition, in many cases it may not be appropriate to share such information (which may be sensitive for the PIEs concerned) with the single competent authority. At a practical level, the single competent authority will have limited resources and, if it were to receive large amounts of information, may quickly become overwhelmed.*

**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?
- (b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?
- (c) the frequency with which the FCA is provided with this information for other PIEs in practice already?

*(a) The costs of providing information to supervisors of PIEs (e.g. where we become aware of a material breach of law or regulation, of a material threat to the PIE, where we intend to qualify our audit opinion or make any other type of disclosure to them) is low and is built in to the costs of our provision of the audit.*

*(b) Under existing requirements we report to supervisors on an "as necessary" basis where we become aware of material breaches of law or regulation, of a material threat to the PIE and on occasions when we plan to issue a qualified audit opinion. To ensure an effective dialogue with the PRA, we meet at least annually with them (frequency depends on size of institution under discussion). Separately, the PRA also receives an annual return from insurance entities which includes an audit opinion on the return.*

*(c) We have no comment to make on the frequency with which the FCA is provided with this information for other PIEs. The only specific reports we provide to the FCA is on The Clients Assets Sourcebook in the FRC Handbook (CASS reporting).*

**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? Please provide further information in support of your answer.

*We do not agree that the single competent authority should be enabled to exercise the choices of aptitude and/or adaptation period for the approval in the UK of statutory auditors from other Member States. In our view, the registering professional bodies should continue to have responsibility for administration of the tests required to approve individual statutory auditors from other Member States.*

*We support the use of aptitude tests over adaptation periods. Whilst such tests are just one part of a wider framework for audit quality, in our view an exam approach ensures consistency of technical knowledge and is one way of maintaining and protecting audit quality in line with the Government's negotiating priorities at the time of the debates on the legislation in Europe. The Government should ensure that the tests reflect the requirements of the Regulation without additional "gold plating" of the EU legislation. Regulators in each Member State will need to ensure that aptitude tests are consistent across the EU in order to preserve audit quality and prevent anti-competitive behaviour.*

*The proposed period of no more than three years (for adaptation periods) is too long to be useful to audit firms such as PwC where we host individuals on secondment from other PwC network firms in order that they may gain experience of audit services in a different market. We need a form of testing that is rigorous and effective but also less time-consuming. Currently our experience is that the requirements to approve in the UK individual statutory auditors from other Member States are cumbersome and problematic - we support testing which is efficient and quickly enables a statutory auditor who has already proved his competence in another Member State to act as a statutory auditor here in the UK.*

*We are aware that BIS is considering steps which could be taken to complete the EU single market for services. To that end, we believe that the aptitude test/adaptation period is an area that could be modified, or removed, which would allow for the easier movement of statutory auditors across the EU. In pursuit of this objective and in line with the UK Government's negotiating priorities at the time of the EU debates, we strongly urge that the requirements go no further than the minimum set by the Directive.*

**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; and

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

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?



*If the FRC, as the single competent authority, were to have this role, our view is that they should delegate responsibility for the operational provision of aptitude tests to the professional supervisory bodies because they already have experience in this area. We do not support the use of adaptation periods because in our view an aptitude test is a more rigorous form of testing, ensures consistency of technical knowledge and assists in maintaining and preserving audit quality. The proposed period of no more than three years (for adaptation tests) is too long to be useful to audit firms such as PwC where we host individuals on secondment from other PwC network firms in order that they may gain experience of audit services in a different market. We need a form of testing that is rigorous and effective but also less time-consuming.*



**Examples of uncertainties in EU Regulation/CMA Order with respect to rotation and tendering timing (as referred to in our response to question 33 above)**

*We have identified a number of areas where we and our clients are uncertain as to the correct application of the EU Regulation and/or the CMA Order in respect of tendering and rotation. We have set out these uncertainties below.*

*There are several areas where the CMA's Order does not align well with the EU Regulation (the uncertainty listed at 2 below is a good example) which is leading to confusion. This is of particular concern because at the BIS/ICAEW stakeholder event on 24 February 2015, Marie-Anne Mackenzie, Head of Corporate Frameworks, Accountability and Governance at BIS explained that BIS is keen for implementation of the EU Regulation to be as consistent as possible with the provisions of the CMA Order. This is also reflected in the BIS document "Auditor Regulation – Supplementary Information" (dated March 2015) which states "BIS, the CMA and the FRC are agreed that, in so far as possible, the CMA Order and the requirements of the Regulation should be applied consistently with one another".*

*We appreciate the guidance issued recently by BIS in its "Auditor Regulation – Supplementary Information" document as this deals with some of the uncertainties which we have identified. Further guidance which gives companies and their auditors clarity in the areas we have identified below would be welcome and is urgently required since many companies are already making decisions on tendering and rotation timing.*

**1.) Application of the EU transitional provisions to audit appointments made post-2003 and before mid-2006**

*EU Regulation: Article 41(3) and Jonathan Faull 2 September 2014 letter*

Companies who appointed their auditor between 2003 and 2006 face a particular complexity when applying the EU transition rules. As at 16 June 2014, these companies have had their auditor in place for under 11 years, and therefore they fall to be dealt with under Article 41(3) of the Regulation. This article tells us that, as of 16 June 2016, the auditor can remain in place "until the expiry of the maximum period". However, for these companies, the maximum period (10 years) will already have expired as at 16 June 2016.

Jonathan Faull dealt with this in his open letter of 2 September 2014 and noted that companies in this situation would be required to rotate the auditor in advance of 16 June 2016 (we understand that it was later clarified that Mr. Faull's letter was not intended to address situations where Member States had chosen to take the option to extend in the event of a tender, and also that there may be subsequent, more informal, guidance from the EC expanding on Mr. Faull's views).

A legal interpretation of the Regulation could suggest that the option to extend the auditor appointment by ten years only begins to exist on application of the Regulation. So, if a UK company in this situation holds a tender in 2015, for example, this tender would not unlock any extension of tenure, since that option would not yet exist.

This could leave UK companies with auditor appointments made between 2003 and mid-June 2006 in immediate breach of the Regulation at its application date, unless they had rotated their auditor in advance of the application date. BIS has included this issue in its “Auditor Regulation – Supplementary Information” document (at question 13) and we welcome a solution which gives PIEs in this situation the benefit of the maximum duration of the audit appointment to 20 years.

**2.) Date of first action for companies falling in the under 11 year transition category, where the auditor was appointed after mid 2003 but before mid 2006.**

*EU Regulation: Article 41(3) and Jonathan Faull letter*  
*CMA Order: Article 3.1(a), Article 6.1*

The EU Regulation transitional arrangements for entities with auditor incumbency under 11 years who appointed their auditor between 2003 and 2006 seem to suggest that action (a tender in the UK followed by a reappointment or a new appointment) might be required before 17 June 2016. Otherwise the entity could be deemed in breach of the Regulation (this accords with the advice given in the Jonathan Faull letter of 2 September 2014). BIS have considered this question in their “Auditor Regulation – Supplementary Information” of March 2015 (at question 11).

The CMA Order’s transitional arrangements (which aspire to be consistent with those of the EU) provide that Article 3.1(a) (the core tendering provision) should be applied to the next “Auditor Appointment” following 17 June 2016. This differs to the model proposed in question 11 of BIS’s “Supplementary Information” where the focus is on the financial year beginning after 16 June 2016. This means that the CMA’s Order would allow companies in this category to act later than could be suggested by the Regulation and by BIS’s proposal in its “Supplementary Information”.

**3.) Application of the EU Regulation rotation rules, and the CMA Order tendering rules, to a UK PIE/FTSE 350 company which has been created through demerger from a predecessor UK PIE/FTSE 350 company.**

*EU Regulation: Article 41, Article 17 (8)*  
*CMA Order: Article 3.1(a), Article 6.1*  
*CMA Order, explanatory notes: Part 1 pa 14-15, Part 2 pa 17 (e)*

Where a newly created UK PIE/FTSE 350 company has been created by demerger from a predecessor UK PIE/FTSE 350, and the same auditor has been retained by the new company, should the period of auditor incumbency of the new company take into account auditor incumbency in the predecessor group?

Here, following a legal analysis, the legal form of the demerger may be relevant, at least under the CMA's Order. If the newly created UK PIE/FTSE 350 company uses a pre-existing topco (ie an existing subsidiary of the predecessor parent) as its new listed topco, then the Order, which requires periods of auditor incumbency prior to FTSE 350 status to be taken into account, would therefore mean that pre-demerger incumbency is relevant. However, if the demerger is effected with a new topco being inserted on top of the newly demerged group, this strictly legal analysis would give a different answer. BIS's document "Auditor Regulation – Supplementary Information" (March 2015) gives helpful guidance as to how the competent authority might view such situations (at question 18 – the competent authority can put emphasis on the "substantive effect resulting from the change in the ownership structure of the group in question") but confirmation for demerger situations would be useful.

**4.) Application of the EU Regulation rotation rules, and the CMA Order tendering rules, to a UK PIE/FTSE 350 company which has been created through merger of two existing UK PIEs/FTSE 350 companies.**

*EU Regulation: Article 41, Article 17 (8)*

*CMA Order: Article 3.1(a), Article 6.1*

*CMA Order, explanatory notes: Part 1 pa 14-15, Part 2 pa 17 (e)*

The uncertainty here is again similar to that described under 3 above. Where a newly created UK PIE/FTSE 350 company has been created by merger of two pre-existing UK PIEs/FTSE 350 companies, who both had the same auditor, and the same auditor has been retained by the new group, should the period of auditor incumbency of the new group take into account auditor incumbency in the predecessor groups? Or, should the period of auditor incumbency be deemed to have restarted as a new UK PIE/FTSE 350 company has been created? As in situation 3, the legal form of the merger may be relevant if a legal analysis is followed.

We should also consider the more likely situation where the two pre-existing UK PIEs/FTSE 350 companies had different auditors, and the new group selects one of those auditors to continue as the auditor of the new group. Should the period of auditor incumbency of the new group's auditor take into account that auditor's incumbency in one of the predecessor groups?

BIS's document "Auditor Regulation – Supplementary Information" (March 2015) gives helpful guidance as to how the competent authority might view group reconstruction situations but confirmation for merger situations would be useful.

**5.) The legal status of the PIE definition and implications for tenure calculations**

The EU Directive introduces a new definition for "public interest entity" (PIE) which means that entities which hitherto have not been designated as a PIE will now be caught within this definition. These entities will be subject to the requirements of the Regulation, including, inter alia, the rotation requirements.

The Directive has an application date of 2016, and therefore prior to that date, the new definition of PIE does not have any formal legal status. On application of the Directive, in 2016, some entities will immediately become PIEs for the first time, and therefore the Regulation will apply.

Should the period of auditor tenure for such companies include the period in which the new definition of PIE did not exist (and therefore, technically, they did not have PIE status)? Or should the period of auditor tenure for such companies begin from the application date of the Directive, being the date on which they become a PIE?

#### **6.) Availability of the two year extension for reappointment of the incumbent auditor at year 10**

*EU Regulation: Article 17(6) and reference to Article 17(4)*

Article 17(6) allows that after the expiry of the maximum duration of auditor appointment, a PIE can request, on an exceptional basis, that the competent authority grants an extension to reappoint the incumbent for up to 2 years. We anticipate that such a request could be made in the event of unexpected transaction activity, or where financial stability is threatened.

The reference in Article 17(6) to paragraph 4 of Article 17 suggests that such an extension may only be requested (and therefore granted) at the end of the 20 year maximum term. This is also the suggestion made by BIS in the Discussion Document (at page 29): *“The competent authorities may grant an extension to re-appoint the statutory auditor for up to two years beyond the twenty years maximum, but only on an exceptional basis and following a further tender.”* It is not clear whether the extension could also be requested at the end of the first ten year term. This could be required in exceptional circumstances where unexpected events mean that an entity has no capacity to hold an audit tender. Were such an extension to be granted, what implication would this have for the “ordinary” ten year extension under Article 17(4)(a)? Would the “ordinary” ten year extension under Article 17(4)(a) be reduced by two years so that the maximum period of the auditor appointment remained at the 20 year maximum term?