



Department  
for Business  
Innovation & Skills

## AUDIT REGULATION

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

DECEMBER 2014

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

## Discussion document response form

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

The closing date for responses is 19 March 2015

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

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The Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries and we welcome the opportunity to comment on the FRC's consultation on implementation of the EU audit directive and audit regulation. Company secretaries have a key role in advising companies on their governance arrangements and for governance reporting. Our members are therefore well placed to understand the issues around the proposals for implementation of the EU audit directive and regulation. However we think there are a number of questions that would be better addressed by the accounting firms that provide audit services as they largely relate to audit regulation and the costs of providing the audit and are outside our experience. We have therefore not attempted to answer those questions.

#### Chapter 4

Q1. In relation to the measures discussed in both this and the next chapter, we would welcome comments on the balance between legislative and non-legislative implementation of the requirements of the new Directive and Regulation.

It is our view that new measures to be introduced should cover the requirements of the new Directive and Regulation, and no more. We do not support new measures that introduce additional requirements ('gold plating') unless the benefits can be shown to outweigh the costs. However, where the UK already has more stringent requirements in place that have been shown to be effective, we think these additional requirements should remain.

Q2. In relation to all the Member State options in the Directive and the Regulation, we would welcome comments to inform our thinking on whether and how these should be taken up. Though many are discussed in the discussion document and in specific questions, all the options in the Directive and Regulation are considered in the options tables that are being made available separately.

It is our view that de-regulatory options set out in the Directive and Regulation should be taken up by the UK.

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 do not have any other issues to raise.

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?

X Yes                       No                       Not sure                       Not applicable

We think that the definition of a PIE should be as defined in the Audit Directive.

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?

We think the definition of listed entities, as set out in the Directives, should not be extended to automatically include smaller companies quoted of markets such as AIM.

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?

As in question 6 above, we think the definition of listed entities, as set out in the Directives, should not be extended to automatically include smaller companies quoted of markets such as AIM.

Q9. Do you agree the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under the 2006 Directive as amended by the new Directive and under the Regulation?<sup>1</sup>

X Yes                       No                       Not sure                       Not applicable

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

We think the FRC is the only appropriate body to do this.

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 think the audit firms are best placed to answer this question.

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 think the FRC and professional supervisory bodies are best placed to answer this question.

Q12. In relation to each of the tasks provided for in the Directive and Regulation, do you consider that responsibility should be allocated to the single competent authority, for it to delegate to the professional supervisory bodies as appropriate and to the extent permitted in the Directive and Regulation?

Yes       No       Not sure       Not applicable

We think the single competent authority should be the FRC and it should delegate to the FCA or PRA as appropriate and to the extent permitted.

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

We are not aware of any need for limitations on the single competent authority but the audit firms are probably best placed to answer this question.

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 think the competent authority is best placed to answer this question.

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

Yes             No             Not sure             Not applicable

We agree that the cap on non-audit services should be included in the FRC's ethical standards for auditors.

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?

We think a 70% cap on the provision of permitted non-audit services is sufficient and are strongly of the view that it should not be any lower. We also think it is important that the FRC (as competent authority) should be able to grant exemptions from the cap on an exceptional basis for a period of up to two years.

Q20. Do you agree that the Member State options in Article 4, to set more stringent requirements on the cap and on the auditor's independence where their total fee income from a PIE exceeds 15% of their total fee income overall, should be capable of being applied by the FRC in its ethical standards for auditors?

Yes             No             Not sure             Not applicable

We see no need for this option for a more stringent requirement.

Q21. Do you agree that the FRC should have the ability to exempt an audit firm from the 70% cap for up to two financial years on an exceptional basis and on application by the firm?

Yes             No             Not sure             Not applicable

We think the FRC should be empowered to grant exemptions as it considers appropriate. This would be particularly relevant to times of corporate actions or transaction where services such as the consultation document are provided by the auditor. These services include an opinion on information in circulars and prospectuses, and to support confirmations provided by the sponsor to the FCA and, because of their understanding of the company, the auditor is best placed to provide these services.

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

Yes             No             Not sure             Not applicable

We think it is appropriate that there be flexibility for a blacklist to be updated and supplemented if the need arises but do not see the need for the setting of more stringent requirements for the purposes of 'gold plating'.

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?

We do not envisage any issues arising from the application of a blacklist of non-audit services. We support the option for a blacklist of prohibited services as this approach corresponds with current practice; is easily understood; and can be updated and supplemented as the need arises. It is more flexible and provides for the discretion of audit committees and/or auditors to exclude other services as they consider necessary. We do not believe that the alternative of a 'whitelist' is helpful, and could tend to be confusing.

Q24. Do you agree that implementation of the revised requirements on ensuring and documenting auditor independence in the 2006 Directive should be implemented primarily via the ethical standards, with amendments to the existing legislation as necessary only to:

- underpin the standards? And,
- introduce simplifications for audits of small non-PIEs?

Please provide further information to support your answer.

Yes, we agree that implementation should primarily be via the ethical standards, with amendments to legislation only as necessary.

Q25. Do you agree that the existing framework on disclosure by PIEs in notes to their accounts of the audit and non-audit fees they paid their auditor should be adapted, to ensure public disclosure of the information the auditor is required to provide to the competent authority under Article 14 of the Regulation?

Yes       No       Not sure       Not applicable

We think adapting the existing framework would be appropriate.

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?

X Yes       No       Not sure       Not applicable

We think it is important that all the alternatives currently set out in the Companies Act 2006 are retained.

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

No, we do not think any other systems are necessary.

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?

X Yes       No       Not sure       Not applicable

We agree that for smaller companies without an audit committee the role should be fulfilled by the whole board and the directors should determine the recommendations to be put to shareholders.

Q29. The Government does not intend to take up the option to provide for an extension of the maximum duration of the engagement beyond 10 years where a joint auditor is engaged. Do you agree that the replacement of a single auditor with two joint auditors, one of whom was the original auditor, should be made on the basis of a retender?

X Yes       No       Not sure       Not applicable

We think it is unlikely that companies will choose to have a joint auditor but, in the event they do, we agree that the replacement of a single one of the two joint auditors should be made on the basis of a retender.

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?

X Yes       No       Not sure       Not applicable

We agree.

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?

X Yes       No       Not sure       Not applicable

b) when the audit engagement was last retendered?

X Yes       No       Not sure       Not applicable

c) the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender?

Yes      X No       Not sure       Not applicable

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

Yes      X No       Not sure       Not applicable

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

Yes      X No       Not sure       Not applicable

We agree the report should include a) and b). We think it is unhelpful for the information in c) and d) to be required as the directors should be able to retender whenever they consider it appropriate. The time should not be fixed in advance. We do not think any other information is necessary.

Q32. We are considering whether, where the statement under point (c) above is included in the company's annual report, and the incumbent auditor is reappointed on the basis of the planned tender process before the expiry of the 10 year maximum duration (eg at 7 years), the next tender process should be expected to take effect:

- (a) after the same period has expired again (ie year 14 in this example);
- (b) after a further 10 years has expired (ie year 17 in this example); or,
- (c) after the same period has expired again, though with the potential to extend it by the full 10 years via further notice from the audit committee in the annual report (ie in this example at year 14 though this could be extended to year 17)?

Which option would you prefer?

(a)                      X (b)                       (c)                       No preference                       Not applicable

We think it is important that companies should not fix the tender cycle. It is important that companies, through the audit committee, carry out a tender as and when they think it is appropriate.

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 they be addressed?

In relation to Q33 we have also noted the comments under Q 20 of the supplementary information published in March 2015.

It is our view that the appropriate body to consider the need for additional sanctions, if any, is the Financial Reporting Council.

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?

We do not have concerns about the inclusion in legislation of a requirement for the auditor to include a statement in the audit report where there is a material uncertainty in relation to going concern, although we are not convinced there is a need for such a statement.

Any issues involving a 'material uncertainty' would result in a requirement for a company to make an announcement under the requirements of the Disclosure and Transparency Rules (DTRs) and, as such would already be in the public domain. Companies would also need to report such issues in the annual report.

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)?

X Yes                       No                       Not sure                       Not applicable

We think this would be appropriate.

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?

We think the audit firms are best placed to answer this question, however we do not believe there would be a significant increase in resource needed.

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

We do not believe there would be a significant increase in cost.

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

We think the audit firms are best placed to answer this question.

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)?

X (a)                       (b)                       (c)                       No preference                       Not applicable

We have no additional comments.

## Chapter 5

Q42. What issues, if any, do you consider arise from the measures considered in this chapter? If there are any, how do you consider these should be addressed?

There are no issues we wish to raise.

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?

We think the audit firms are best placed to answer the question on expected costs and benefits.

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)?

X Yes             No             Not sure             Not applicable

Changes to technical standards are currently implemented through the FRC's ISAs and we agree that this should be the way future changes are implemented.

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;

X Yes             No             Not sure             Not applicable

We have no issues with the FRC having this discretion.

(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?

X Yes             No             Not sure             Not applicable

We think it appropriate that the FRC has this discretion provided the need for additional requirements can be demonstrated and a cost/benefit analysis has been carried out.

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)?

We do not have any issues in relation to the new requirements on audit committee implemented via DTR 7.1.

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?

We do not have any issues with the implementation via the PRA rules of the new requirements on audit committees for banks, building societies and insurers that are not required to have an audit committee under DTR 7.1.

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?

We do not have any data on the numbers of non-listed PIEs without audit committees.

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

We do not have any information on the cost of recruiting members to be part of an audit committee but the costs will vary hugely depending on the nature and size of the company.

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

We do not have information on the cost of attendance of an audit committee member. Much will depend on the size and nature of the company and the frequency of meetings.

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

We do not have any information on fees charged by audit firms for attendance at audit committee meetings.

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

Audit costs overall will vary hugely depending on the size of the PIE but we have no specific information on this.

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?

X (a)

X (b)

(c)

No preference

Not applicable

We think information on audit should be shared with the relevant supervisory body in (a) or (b) as applicable, but not both.

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