

**REVIEW OF THE REGULATORY
REGIME OF THE ACCOUNTANCY
PROFESSION: LEGISLATIVE
PROPOSALS**

A CONSULTATION DOCUMENT

March 2003

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CHAPTER 1: INTRODUCTION

1.1 On 24 July 2002, Patricia Hewitt, Secretary of State for Trade and Industry, announced an immediate review of the regulatory arrangements for the accountancy and audit professions.

1.2 The purpose of the Review was to look at the way the accountancy and audit professions were currently regulated and to consider whether any improvements should be made to make the system more effective. The review was to consider, among other things, whether there should be a statutory basis for regulation.

1.3 On 29 January 2003, the Secretary of State announced that she accepted the conclusions of the report of the Review team¹. The Review report followed a wide-ranging public consultation², and its main conclusion was that the Financial Reporting Council should take on the functions of the Accountancy Foundation to create a unified and authoritative structure with three clear areas of responsibility; the setting of accounting and audit standards; their enforcement or monitoring; and the oversight of the major professional accountancy bodies. In her statement to Parliament, the Secretary of State said there was a strong case for statutory underpinning to make the new body work, that she would consider this further, and that she would report her conclusions to the House.

¹ Review of the Regulatory Regime of the Accountancy Profession, Report to the Secretary of State for Trade and Industry, URN 03/589.

² Review of the Regulatory Regime of the Accountancy Profession, a consultation document, URN 02/1340

1.4 This consultation document addresses the specific issue of the DTI's proposals for statutory provisions to support the new regulatory functions of the FRC. Work on the implementation of the new regulatory structure, including on detailed responsibilities and accountabilities, is being taken forward by the implementation Steering Group announced by the Secretary of State on 29 January. In the light of the discussion in the main text, you are asked to respond to the questions set out in the document and summarised in section 5, giving reasons for your views.

1.5 We invite comments by 10 June at the latest. Earlier responses would be very welcome. Responses should be sent – by e-mail if possible to:

Review of Accountancy Regulation: Legislative Proposals
Consultation Document

Company Law & Investigations Directorate

Department of Trade and Industry

Bay 4101

1 Victoria Street

London SW1H 0ET

Fax: 020-7215-0235

E-Mail: rarconsultation@dti.gsi.gov.uk

1.6 All responses will be acknowledged. In accordance with the code of practice on open Government, comments will be made publicly available unless respondents specifically request otherwise.

Devolution

1.7 Company law in Northern Ireland is a transferred matter under the Northern Ireland Act 1998. Any changes to legislation governing the regulation of the profession of auditors would also require separate statutory provisions in respect of Northern Ireland.

Questions

1.8 If you have questions about the issues discussed in this consultation document, please call:

Helen Osman, 020-7215-5783
Rob Cottam, 020-7215-0169

Glossary

1.9 The glossary at Annex A explains the acronyms in the text.

Additional copies

1.10 This document is available electronically at www.dti.gov.uk/cld/post_enron.htm. You may also photocopy it if you wish, or additional hard copies may be obtained by calling 0870 1502 500.

CHAPTER 2: BACKGROUND

2.1 In developing our statutory proposals, we have borne in mind that the Review found no evidence that the existing regulatory system for the accountancy and audit professions was seriously flawed, although it found that there were concerns about the perceived independence of key aspects of the current arrangements, and about the complexity of the current Accountancy Foundation structure. The Review concluded, and Ministers agree, that there is scope to further strengthen the independence of the system of regulation and to achieve a clearer, more authoritative and more transparent regulatory structure.

2.2 The report's main recommendations were that:

- the Financial Reporting Council (FRC) should take on the functions of the Accountancy Foundation to create a unified and authoritative structure with three clear areas of responsibility; the setting of accounting and audit standards; their enforcement or monitoring; and the oversight of the major professional accountancy bodies. The new organisation is illustrated at Annex B.
- the independent regulation and review of audit should be significantly strengthened. Specifically, that responsibility for setting independence standards for auditors and for monitoring the audit of listed companies and other significant entities should be transferred from the professional accountancy bodies to the independent regulator.

2.3 Among other things, the Report also concluded that the long planned Investigation and Discipline Board should be brought into being without further delay to provide, as intended, a demonstrably independent forum for hearing significant public interest disciplinary cases. The reformed structure resulting from these proposals is at Annex B. The full list of recommendations made by the Review team is at Annex C.

The proposals

2.4 We consider there is a case for relatively light touch statutory provisions to support the recommendations of the Review and to ensure that they are delivered as Ministers intend. In our view, it is unnecessary to put the FRC on a fully statutory basis in order to deliver independent regulation and oversight which is authoritative, accountable and transparent. A legislative framework is already in place for the regulation of the statutory auditor; this devolves to the Recognised Supervisory Bodies the day to day responsibility for ensuring appropriate training and authorisation of registered auditors and the appropriate supervision of audit firms. This framework is described in more detail in chapter 3. We propose to build on that framework in a way which preserves the principles of the current arrangements, which have in general operated successfully, in particular by placing new requirements on the recognised supervisory bodies and by delegating the Secretary of State's recognition power to the FRC as part of its core role in monitoring the arrangements of the recognised supervisory bodies for the supervision of auditors. In summary, we propose that:

- (i) It should be a condition of recognition that the recognised supervisory bodies participate in a disciplinary process for serious public interest case which is demonstrably independent of them.
- (ii) It should be a condition of recognition that the recognised supervisory bodies participate in an audit inspection process for listed companies and other public interest entities which is demonstrably independent of them
- (iii) The Secretary of State's recognition function should be capable of being delegated to a private body expected to a statutory body. In practice, we envisage that this would be the Professional Oversight Board of the FRC, which would carry out the recognition of supervisory bodies and qualifying bodies which is currently carried out by the DTI.
- (iv) The Secretary of State's grant in aid power should be extended to permit her to make grants in relation to the audit functions and towards the implementation costs of the new structure.

.5 Under existing requirements, it is already a condition of recognition that a supervisory body "has rules and practices as to the technical standards to be applied to company audit work...". In practice this requirement is met by a requirement imposed by the supervisory bodies on registered auditors to follow standards set by the Auditing Practices Board. We have considered whether it would be preferable either (i) to make it a condition of recognition that a supervisory body requires registered auditors to follow auditing standards and auditor independence

requirements set by a body designated by the Secretary of State (making it clear that the Secretary of State has it in mind to designate initially the Auditing Practices Board) or (ii) impose a direct statutory requirement on registered auditors to follow auditing standards, and auditor independence standards, set by a body designated by the Secretary of State. However, the European Commission is currently considering proposals for the adoption of International Standards of Auditing across the European Union, and this is expected to form part of a forthcoming Communication to Member States on the statutory audit. We believe it is sensible therefore to await the Commission's proposals, and the overall reaction to them, and then put forward a specific proposal for further comment. We would, however, welcome comments in the interim on the desirability or otherwise of providing clearer statutory backing for auditing standards.

2.6 Our proposals confer no statutory powers on the FRC although should the SoS's recognition functions be delegated to the Professional Oversight Board, as the DTI intends, functions under Part II CA 1989 would be transferred to that body. This is consistent with the existing statutory framework under which the FRC has no statutory role but its subsidiaries, the Accounting Standards Board and the Financial Reporting and Review Panel, are statutorily prescribed or authorised for specified purposes.

CHAPTER 3: THE STATUTORY FRAMEWORK FOR AUDITORS

3.1 The DTI has overall responsibility for company law in Great Britain, which includes company reporting requirements, corporate governance, and the regulation of auditors. In Northern Ireland this is the responsibility of the devolved Administration.

3.2 A statutory framework governs the supervision and qualifications of company auditors, although the day to day responsibility for ensuring appropriate supervision of audit firms is a matter for the recognised professional accountancy bodies.

The statutory auditor

3.3 The statutory provisions on the regulation of auditors contained in the Companies Act 1989 give effect to the requirements of the Eighth Directive (84/253 EEC).

3.4 The Companies Act 1985 (CA85) states that every company shall appoint an auditor or auditors³. The Companies Act 1989 (CA89) provides that a person will qualify to be appointed as a statutory auditor if he or she (or a qualifying entity) is a member of a recognised supervisory body *and* holds a recognised professional qualification. Sections 27 and 28 of the Act make specific provision for the independence of company auditors; for example, he or she may not be an officer or employee of the company being audited.

³ except for certain categories of small companies or dormant companies.

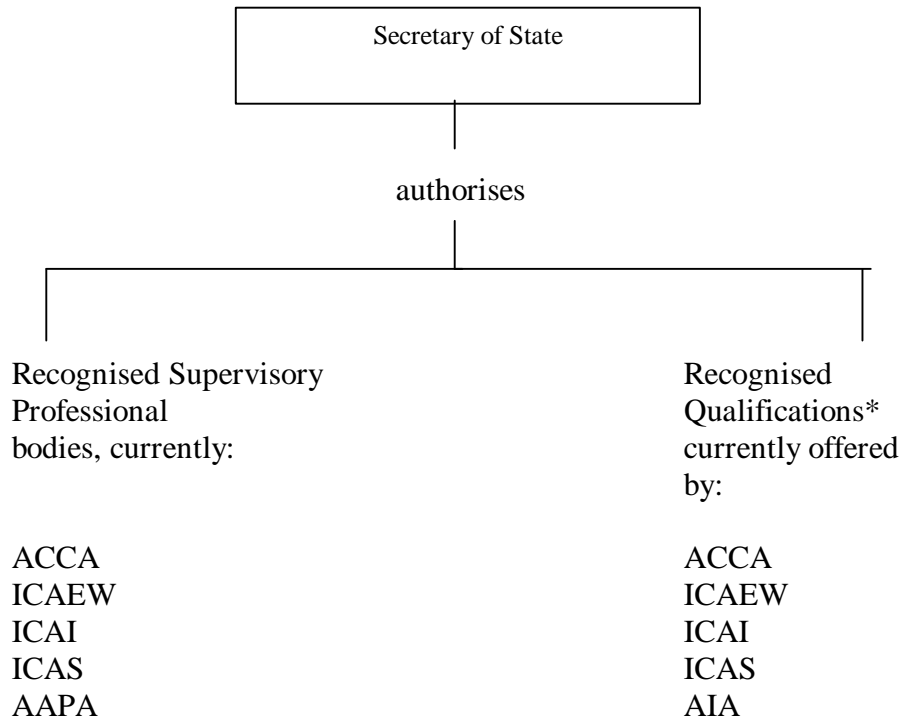
3.5 Schedule 11 to the CA89 provides that a recognised supervisory body must have rules and practices on issues such as the technical standards to be applied in company audit work and on maintaining an appropriate level of competence among statutory auditors. The body must also have adequate arrangements and resources for the effective monitoring of and compliance with its rules, and must be able and willing to promote and maintain high standards of integrity in the conduct of company audit work.

3.6 Schedule 12 to the CA89 sets out the requirements for recognition of a professional qualification; for example, the period of professional experience and of theoretical instruction and training. The body offering the qualification must have rules and arrangements to ensure continuing compliance with these requirements.

3.7 A professional body may apply to the Secretary of State for an order declaring it to be a recognised supervisory body and/or declaring that a qualification offered by it is a recognised professional qualification, in both cases for the purposes of the Act. Figure 1 lists the professional bodies and qualifications currently recognised by the Secretary of State. The Secretary of State may also recognise appropriate overseas professional qualifications.

STATUTORY AUDITORS

Fig 1



*Section 33 CA 89 allows the Secretary of State to recognise appropriate overseas qualifications.

3.8 Recognition is granted only on the basis of a full and detailed investigation of the body concerned, focusing on the quality and depth of the training and examination system, standards of marking and the pass rate of students, the ethical standards expected of qualified members and supervisory and disciplinary procedures. The Secretary of State last authorised recognition of a professional body in 1994. The DTI is currently considering an application for recognition from CIPFA. Recognition may be withdrawn if at any time it appears to the Secretary of State that any requirement for recognition is not satisfied by the body in question.

3.9 The DTI monitors the activities of the recognised supervisory bodies through the mechanism of six monthly and annual reports from the bodies concerned (in practice from ACCA and from the Joint Monitoring Unit of the ICAEW, ICAS and ICAI). The DTI meets the bodies to discuss their reports and the key monitoring issues which have arisen in the course of the year. Changes to recognised qualifications must be cleared with the DTI.

The Secretary of State may delegate her recognition role

3.10 Section 46 of the CA89 empowers the Secretary of State to establish an independent body to exercise her recognition functions in relation to the supervision of statutory auditors. The Secretary of State would retain a duty to oversee the body concerned.

3.11 The following chapter discusses our proposals for new statutory provisions which will build on the existing recognition framework.

CHAPTER 4: PROPOSALS FOR NEW STATUTORY PROVISIONS

Discipline

4.1 Under the statutory recognition arrangements described in chapter 3, the profession is responsible for arrangements for investigating and disciplining statutory auditors. The arrangements are essentially self-regulatory and confer no statutory powers on the recognised supervisory bodies.

Current role and position of the IDB

4.2 It was agreed between the Government and the CCAB bodies⁴ in 1998 that the Investigation and Discipline Board should be set up as part of the Accountancy Foundation structure to take on investigation and prosecution of major cases involving auditors and accountants in the UK. The IDB arrangements were not intended to cover the Institute of Chartered Accountants in Ireland (ICAI) which would remain responsible for investigating and disciplining their members, although the new, statutory Irish Auditing and Accounting Supervisory Authority would have an oversight role. Paragraph 4.16 below discusses the position of the ICAI under the legislative proposal made in this section.

4.3 The IDB was incorporated in October 2001 but is not yet in operation. Its draft scheme envisages that it will investigate cases which “raise or appear to raise serious issues affecting the public interest in the UK, and the matter needs to be investigated to determine whether there

⁴ ICAEW, ICAS, ACCA, ICAI, CIMA, CIPFA

may have been an act of misconduct”. In assessing public interest, the draft scheme would allow the IDB to take into account whether the matter “appears to give rise to serious public concern or to damage public confidence in the accountancy profession in the UK”. Investigations might also be launched where, among other things, a firm has failed to comply with a request to provide information or appear at a tribunal.

4.4 The draft scheme envisages that the IDB should have the power to “call in” cases which it regards as meeting the criteria, as well as having cases referred by the professional bodies. The bodies would retain direct responsibility for cases which do not have such a public interest angle.

4.5 The current draft scheme would operate as an arrangement between the IDB and the participating CCAB bodies.

DTI’s policy objectives for IDB

4.6 Ministers consider that that the long planned Investigation and Discipline Board should be brought into being without further delay to provide, as intended, a demonstrably independent forum for hearing significant public interest disciplinary cases; that it should become a subsidiary of the FRC and should be able to impose appropriate sanctions including removal of eligibility to audit.

4.7 One option for establishing a body like IDB would be to set up a fully-fledged statutory body which would investigate and discipline auditors. Among other things, statutory provisions would be required in order to separate the investigation and tribunal functions, to empower the tribunal to apply appropriate sanctions, including the removal from firms

and individuals of eligibility to audit, to provide for the tribunal to make procedural rules and to provide for appeals. It would also be possible to make provision for a fully statutory tribunal to hear cases involving *accountants* on the model proposed in the draft legislation recently published by the Irish Government for the establishment of the Irish Auditing and Accounting Supervisory Authority (IAASA). The Irish Government proposes that legislation should prescribe the professional accountancy bodies which would be subject to the arrangements and should empower the IAASA to require participating bodies to change their rules and to intervene in the relevant bodies' amended disciplinary process or to investigate their members and to impose any sanction on them which would be available under the (amended) rules. Legislation would provide for the participating bodies to pay for the arrangements, and would confer compulsory investigation powers on the disciplinary committees/tribunals of the prescribed bodies.

4.8 We do not think that such extensive legislation is necessary in the UK in order to achieve the Government's policy objective of a fully functioning and independent disciplinary arrangement with the full range of appropriate sanctions at its disposal. Extensive legislation should generally be used only where this is necessary to achieve compliance with regulatory arrangements that are appropriate in the public interest. The thrust of the existing statutory framework for the regulation of auditors is that it is for the recognised bodies to deliver appropriate arrangements for auditors, and Ministers would prefer to build on that framework unless it is clear that this is unlikely to deliver the independent disciplinary arrangements that the response to the Review suggested were necessary in the public interest.

4.9 We understand that the IDB propose shortly to circulate to the CCAB bodies a final draft of a scheme for an independent disciplinary arrangement for auditors and accountants. Ministers look forward to this receiving the support of the bodies.

4.10 However, consistent with the nature of the existing statutory framework, we think that there is a strong case for obliging the recognised supervisory bodies to participate in a fully functioning independent disciplinary scheme in relation to auditors. The prospect of a statutory condition of recognition would give impetus to the goal of a disciplinary scheme which was independent of the professional bodies, and would ensure that appropriate, independent arrangements would remain in place in the longer term. This could be achieved by an amendment to the recognition criteria in the Companies Act 1989 (CA89) which would require that, in order to continue to be recognised, an RSB must establish or participate in appropriate independent investigation and disciplinary arrangements for the firms and individuals it supervises, in respect of serious public interest cases, which we envisage would be defined along the lines of the draft IDB scheme.

4.11 The amendment to the recognition criteria would also specify that:

- **appointments and staffing** of the independent disciplinary entity should be handled by a body independent of the RSBs. Although the condition would not specify this, the efficient solution would be for the RSBs to establish the independent disciplinary entity within the Financial Reporting Council, as the new unified independent regulator with responsibility for accounting standards and auditors,

and bearing in mind the existing proposal for an IDB, the draft arrangements for which are at an advanced stage.

- Audit firms and individual auditors must submit to **disciplinary powers** of the independent disciplinary body, including the removal of eligibility to audit. We envisage that the RSB rules would provide that if the independent disciplinary body decided that eligibility to audit should be removed that would have automatic effect;
- the cost of investigating and prosecuting serious public interest cases referred to, or called in by the independent disciplinary body, should be covered by the professional body or bodies of the individuals or firms concerned in the case.

4.12 Failure by an RSB to comply with a condition that it participates in appropriate independent investigation and disciplinary arrangements for the firms and individuals it supervises could in principle lead to withdrawal of recognised status.

4.13 The appropriate detailed arrangements for the required independent disciplinary process would be delivered by arrangements between the independent disciplinary body and the RSBs (as the arrangements for the IDB currently envisage). The RSBs would observe the rules of the independent disciplinary body as laid down by it from time to time (section 30 CA 1989 includes within the definition of rules, those rules that the RSB's have power to enforce whether or not laid down by the RSB itself). "Appropriate" would mean those arrangements which the Secretary of State regarded as appropriate, (or any body to which she

delegated the recognition function). The arrangements would provide for such issues as the ability of the independent disciplinary body to call in major public interest cases as well as to have them referred, and to provide for appeals.

4.14 Ministers would wish the independent disciplinary body created by these arrangements to consider serious public interest cases involving accountants as well as auditors and to apply the appropriate sanctions, including the ability to make binding recommendations in appropriate cases that professional membership be removed from an individual. However, we do not consider it necessary to make this a statutory requirement; this would be a novel development given that the professional supervision has in general successfully operated on the basis of self-regulatory arrangements in the UK. Bearing in mind the work that has been done to draft the current IDB scheme, we envisage that the CCAB bodies would wish to provide for an independent disciplinary process for accountants as part of the arrangements which would be required to deliver a scheme for auditors.

A new statutory power for the professional bodies

4.15 ICAS have suggested that the IDB and the professional bodies should be able to ask a court for an order to compel witnesses or require the production of documents. Other professional bodies have suggested such a power is unnecessary to the success of the disciplinary process. In practice the power would need to be accompanied by statutory provisions to define the constitutions of the bodies concerned. We would welcome any further comments on the matter.

The Institute of Chartered Accountants of Ireland

4.16 Special consideration needs to be given to the position of The Institute of Chartered Accountants of Ireland, which is one of the five RSBs recognised by the Secretary of State but whose members are excluded from the currently proposed IDB. Our preferred solution is to provide that the recognition condition will not apply where an RSB is established in another member state and its members are subject to equivalent statutory arrangements. Discussions are underway between the DTI and the Department of Enterprise Trade and Employment in the Republic of Ireland in order to establish whether the proposed new regulatory structure in the Republic does provide equivalent disciplinary arrangements. The implications for Northern Ireland will also need to be considered further

Questions

4.17 We would welcome your views on:

the proposal that it should be a condition of recognition that the recognised supervisory bodies participate in an appropriate independent disciplinary arrangement for auditors.

whether the obligation is, in practice, sufficient to deliver the wider scheme.

the ICAS suggestion that the IDB and the professional bodies should be able to ask a court for an order to compel witnesses or require the production of documents. We would welcome any further comments on the matter.

the proposal that the recognition condition would not apply to an RSB established in another member state where its members are subject to equivalent statutory arrangements. The Institute of Chartered Accountants of Ireland has a special position in this respect. Views welcome on the issues in 4.16 and the appropriate arrangements that should be made.

Monitoring

4.18 Ministers have announced that there should be an independent unit to inspect the audits of listed companies and other entities of public interest. In practical terms, we would wish to see this reporting to the Professional Oversight Board within the new FRC.

4.19 As with an independent disciplinary process, Ministers wish to achieve their policy objective of an independent audit inspection unit with the minimum necessary statutory provision. We propose that similar mechanism of amendment to the recognition criteria in the Companies Act 1989.

4.20 Thus, it would be a condition that, in order to continue to be recognised, an RSB must ensure that its members (both individual auditors and firms) are inspected by an independent inspection unit and

comply with its findings where the member carries out inspection of listed companies and other major public interest entities. It would be part of the requirement that appointments and staffing of the independent inspection unit should be handled by a body independent of the RSBs

4.21 While the recognition condition would provide that an independent inspection unit should be able to impose corrective conditions on the conduct of audits where it identifies matters which present a threat to the public interest, it is not our intention that the independent inspection unit would impose regulatory or disciplinary sanctions on firms or individuals (eg relating to audit eligibility). The unit would generally refer such cases back to the professional bodies concerned for appropriate action and/or, in serious cases, draw the issues to the attention of the independent disciplinary body (which we envisage would be the IDB).

4.22 The condition would also provide for the firms being inspected to pay the costs of the inspection unit.

4.23 As with an independent disciplinary process, detailed the relationship between the independent inspection unit and the RSBs, which would retain responsibility for inspection of the audit of entities other than companies admitted to the official list and other major public interest entities, would be subject to detailed arrangements between them. These would provide for proper process between the responsible bodies. We currently envisage that the arrangements, would define “other major public interest entities” more fully. As envisaged by the Review Report, we consider that the definition of other major public interest entities would include major pension funds and charities. It would be for consideration whether the inspection of firms auditing major mutuals

should also be the responsibility of the independent unit.

Questions

4.24 We would welcome views on:

the proposal that it should be a condition of recognition that a recognised supervisory body must ensure that its members (both individual auditors and firms) are inspected by an independent inspection unit and comply with its findings where the member carries out inspection of listed companies and other major public interest entities.

the definition of other major public interest entities, for the purpose of defining the independent inspection unit's remit. We envisage that this would include major pension funds and charities. Should it also include the inspection of firms auditing major mutuals?

Delegation of the Secretary of State's auditor recognition functions

4.25 The Secretary of State has accepted the recommendation of the Review that she should delegate her recognition role to an independent body. The functions to be delegated are (with reference to the relevant provisions of the CA89):

- Recognition of supervisory bodies (s30)
- Recognition of qualifying bodies (s32)

- Power to approve overseas qualifications (s33, CA89) – although the reservation in s46(3) relating to s33(3) (lack of reciprocity) should remain, so that the function is exercisable only with the consent of the Secretary of State
- Requirement on the recognised bodies to notify the Secretary of State of certain matters (s37)
- Power to go to court to secure a compliance order if a recognised body is not satisfying the requirements of the Act (s39)

4.26 Fees currently paid to the Secretary of State in relation to applications for recognition (s45) would be to the independent body to which the Secretary of State delegated her role.

4.27 We envisage that the Secretary of State would delegate those functions referred to in paragraph 4.25 to a body established by the Secretary of State by a delegation order under S 46, CA89. The delegated body would be a statutory body carrying out the delegated recognition function on behalf of the Secretary of State and accountable to her for the discharge of that function. In practical terms, we envisage that the delegated body would be the Professional Oversight Board (POB) of the FRC - although, in *legal* terms, the delegated body would be a distinct entity from the POB which would carry out certain day to day non-statutory functions under the overarching direction of the FRC. These non-statutory functions would include the independent oversight and monitoring of the activities of the professional bodies, in particular in relation to the audit function, and the oversight of the independent audit inspection unit for listed and other public interest companies.

4.28 Apart from any delegated status as a statutory body for the sole purpose of the functions set out in paragraph 4.25, the legislative proposals in this chapter mean that the FRC itself (ie the Council) and all of its subsidiary bodies would remain non-statutory, independent and private bodies.

4.29 Section 46 of the CA89 empowers the Secretary of State to establish an independent body to exercise her recognition functions in relation to the supervision of statutory auditors and schedule 13 to the Act makes supplementary provisions as to the nature of the body to which the delegation is made. For example, these provide that the body may retain fees paid to it by the recognised supervisory bodies in relation to an application of recognition; for the Secretary of State to approve fees, and to vary or revoke them; and to require the body to deliver to the Secretary of State an annual report on the exercising of its statutory functions, which the Secretary of State should lay before Parliament. The supplementary provisions of schedule 13 will require little amendment, although we envisage that there should be a change to provide for the Secretary of State to approve the composition of the board of the body which is exercising the delegated recognition function. Thus, assuming the recognition function to be delegated to what in practical terms will be the POB, the FRC would be responsible for making the appointments to the board of the delegated body but the Secretary of State would be asked for her prior consent to them. In legal terms, board members would be carrying two roles – the statutory recognition role and the non-statutory POB oversight role. While the members would be one and the same for the purposes of the distinct functions, they would make decisions wearing different legal hats.

Question

4.30 We welcome any views on the nature and scope of the proposed delegation of the recognition function.

Funding

4.31 The Secretary of State has proposed that, with two main exceptions, the core annual running costs of the new FRC should be broadly shared by Government, business and the profession. In her statement, she said the Government would pay its share of core running costs, but she also expected companies and the profession to contribute as it was in all of these parties' interests to make the changes work.

4.32 The costs of the independent audit inspection unit, which the Review report proposed should report to the Professional Oversight Board, should continue to be funded by audit firms, as the professional bodies' arrangements now provide. The costs of the independent body charged with investigating and prosecuting significant public interest disciplinary cases should continue to fall to the professional bodies, which is where they currently lie.

Government grant in aid

4.33 Section 256, Companies Act 1985 enables the Secretary of State to make grants to or for the purposes of bodies concerned with (a) issuing

accounting standards, (b) overseeing and directing the issuing of such standards or (c) investigating departures from such standards or from the accounting requirements of this Act and taking steps to secure compliance with them. We propose that there should be an equivalent power for the Government to make grants towards implementation costs (in practical terms, the FRC's costs in implementing the organisational changes required in assuming the functions of the current Accountancy Foundation), and in respect of the continuing delivery of functions relating to audit. Thus, a new power to make grants would cover:

- (i) the setting of audit standards by the Auditing Practices Board;
- (ii) the costs of a board set up to discipline auditors involved in major public interest cases (but not the costs of the cases themselves, which would be borne by the professional bodies concerned);
- (iii) the activities of the Professional Oversight Board in overseeing the rules, practices and standards of the recognised supervisory bodies, for example, their arrangements for auditor competence (but not the costs of the independent audit inspection unit which the Review report proposed should report to the Professional Oversight Board).
- (iv) the costs of implementing the recommendations of the Review.

4.34. We propose that the grant in aid power should not extend to contributing to the review by the Professional Oversight Board of the professional bodies' arrangements for accountants who are not auditors. As these are expected to be a relatively minor component of overall FRC costs, this would not be necessary to allow the Government to contribute,

with business and the profession, a broadly equal share of the core annual running costs of the FRC.

4.35 As set out in paragraphs 4.11 and 4.22, a new recognition condition would provide for the costs of an independent audit inspection unit, to be funded by audit firms, and for the costs of an independent body charged with investigating and prosecuting serious public interest disciplinary cases to be met by the professional bodies concerned. Applications for recognition of bodies or qualifications would be subject to fees specified by the Secretary of State, as they are now, and would be provided for in legislation as set out above at paragraph 4.30.

4.36 Consistent with our light-touch approach to statutory provision, we do not propose any general power for FRC to raise funds; that would require definition of the FRC's functions, among other things. Our approach is that the FRC should remain an essentially private, and not a statutory, body. The voluntary approach to funding the FRC has worked successfully over many years, and the Government looks forward to contributors' continuing commitment.

Question

4.37 We would welcome views on the proposals set out in this chapter for statutory provisions in relation to funding.

Cost implications

4.38 The draft Regulatory Impact Assessment attached at Annex D seeks comments on the likely costs and benefits of options to support the recommendations of the Review.

Question

4.39 Do you have any views on the costs and benefits (including any quantification) of each option set out in draft Regulatory Impact Assessment?

CHAPTER 5: SUMMARY LIST OF QUESTIONS

5.1 We would welcome your views on the desirability or otherwise of providing clearer statutory backing for auditing standards (see paragraph 2.5) and on the following specific questions as set out in chapter 4.

- (i) the proposal that it should be a condition of recognition that the recognised supervisory bodies participate in an appropriate independent disciplinary arrangement for auditors.
- (ii) whether the obligation is, in practice, sufficient to deliver the wider scheme.
- (iii) the ICAS suggestion that the IDB and the professional bodies should be able to ask a court for an order to compel witnesses or require the production of documents. Other professional bodies have suggested such a power is unnecessary to the success of the disciplinary process.
- (iv) The proposal that the recognition condition would not apply to an RSB established in another member state where its members are subject to equivalent statutory disciplinary arrangements. The Institute of Chartered Accountants of Ireland has a special position in this respect. Views welcome on the issues in 4.16 and the appropriate arrangements that should be made.
- (v) the proposal that it should be a condition of recognition that a recognised supervisory body must ensure that its members (both

individual auditors and firms) are inspected by an independent inspection unit and comply with its findings where the member carries out inspection of listed companies and other major public interest entities.

- (vi) the definition in the underlying arrangements of other major public interest entities, for the purpose of defining the independent inspection unit's remit. We envisage that this would include major pension funds and charities. Should it also include the inspection of firms auditing major mutuals?
- (vii) the nature and scope of the proposed delegation of the recognition function.
- (viii) the proposals for statutory provisions in relation to funding.
- (ix) the costs and benefits (including any quantification) of each option set out in draft Regulatory Impact Assessment at Annex D?

DTI
March 2003

GLOSSARY

1. Professional Bodies

The profession is represented by a number of different bodies. The following are all members of the **CCAB (Consultative Committee of Accountancy Bodies)**, an umbrella body which produced the profession's own proposals for a new framework of independent regulation for the profession.

ACCA	<i>Association of Chartered Certified Accountants</i>
CIMA	<i>Chartered Institute of Management Accountants</i>
CIPFA	<i>Chartered Institute of Public Finance and Accountancy</i>
ICAEW	<i>Institute of Chartered Accountants in England and Wales</i>
ICAI	<i>Institute of Chartered Accountants in Ireland</i>
ICAS	<i>Institute of Chartered Accountants in Scotland</i>

Under the Companies Act 1989, a number of bodies are recognised to supervise their members for audit work (Recognised Supervisory Bodies). These are: the ACCA, the ICAEW, ICAI, ICAS and the **AAPA (Association of Authorised Public Accountants)**. The ACCA, the ICAEW, ICAI and ICAS also have their audit qualifications recognised under the Companies Act 1989, along with that of the **AIA (Association of International Accountants)**.

2. Existing organisations

The Accountancy Foundation

Formed in 2000, the Foundation's objective is to maintain and enhance the standards of work and conduct of accountants working in the UK and Ireland. It appoints the members of the Boards of its four subsidiary bodies and acts as a channel for finance to them.

The Review Board

The Review Board's task is to monitor the operation of the independent regulation system of the accountancy profession to ensure that it is fully

meeting the public interest. Its remit extends to the work of the other Foundation subsidiary bodies and to the continuing responsibilities of the accountancy bodies.

APB: Auditing Practices Board

Established by the CCAB in 1991 (when it replaced the Auditing Practices Committee) to develop and issue professional standards for auditors in the UK and the Republic of Ireland. Now part of the Accountancy Foundation. Membership is comprised of around 15 members. No more than 40% of the APB's membership may be accountants who are eligible for appointment as company auditors. The remaining 60% of the APB may, at the Accountancy Foundation's discretion, include accountants not eligible for appointment as company auditors.

ESB: Ethics Standards Board

The ESB has the role of securing the development, on a profession-wide basis, of ethical standards for all accountants, whether in practice, industry and commerce, or the public sector. The ESB's role is to specify what standards are needed and the issues that need to be covered in them, rather than to draft detailed standards. It will then be for the CCAB bodies to prepare an appropriate standard. The ESB consists of 10 members, 6 of whom are non-accountants.

IDB: Investigation and Disciplinary Board

The IDB will focus on disciplinary cases of public interest; other cases will continue to be dealt with by the individual accountancy body of the member concerned.

Arrangements made by the UK and Irish Institutes:

The UK and Irish Institutes have made their own arrangements to pool resources to carry out certain functions in joint organisations. The other professional bodies carry out the tasks for themselves. The joint organisations are:

JDS: Joint Disciplinary Scheme

The JDS covers the ICAEW and ICAS. It carries out independent investigations into matters of public concern affecting the professional and business conduct, efficiency and competence of individuals and firms who are members of the participating professional bodies.

CCAB Ethics Group

Recently created to provide a common point of contact for the Ethics Standards Board.

JMU: Joint Monitoring Unit

The JMU monitors firms for compliance with audit regulations on behalf of the ICAEW, ICAS and ICAI. It also monitors firms authorised for investment business.

Financial Reporting

FRC: Financial Reporting Council

The FRC is a private sector body whose role is to promote good financial reporting and to act as the overarching and facilitating body for its two operational bodies, the ASB and the Financial Reporting Review Panel.

ASB: Accounting Standards Board

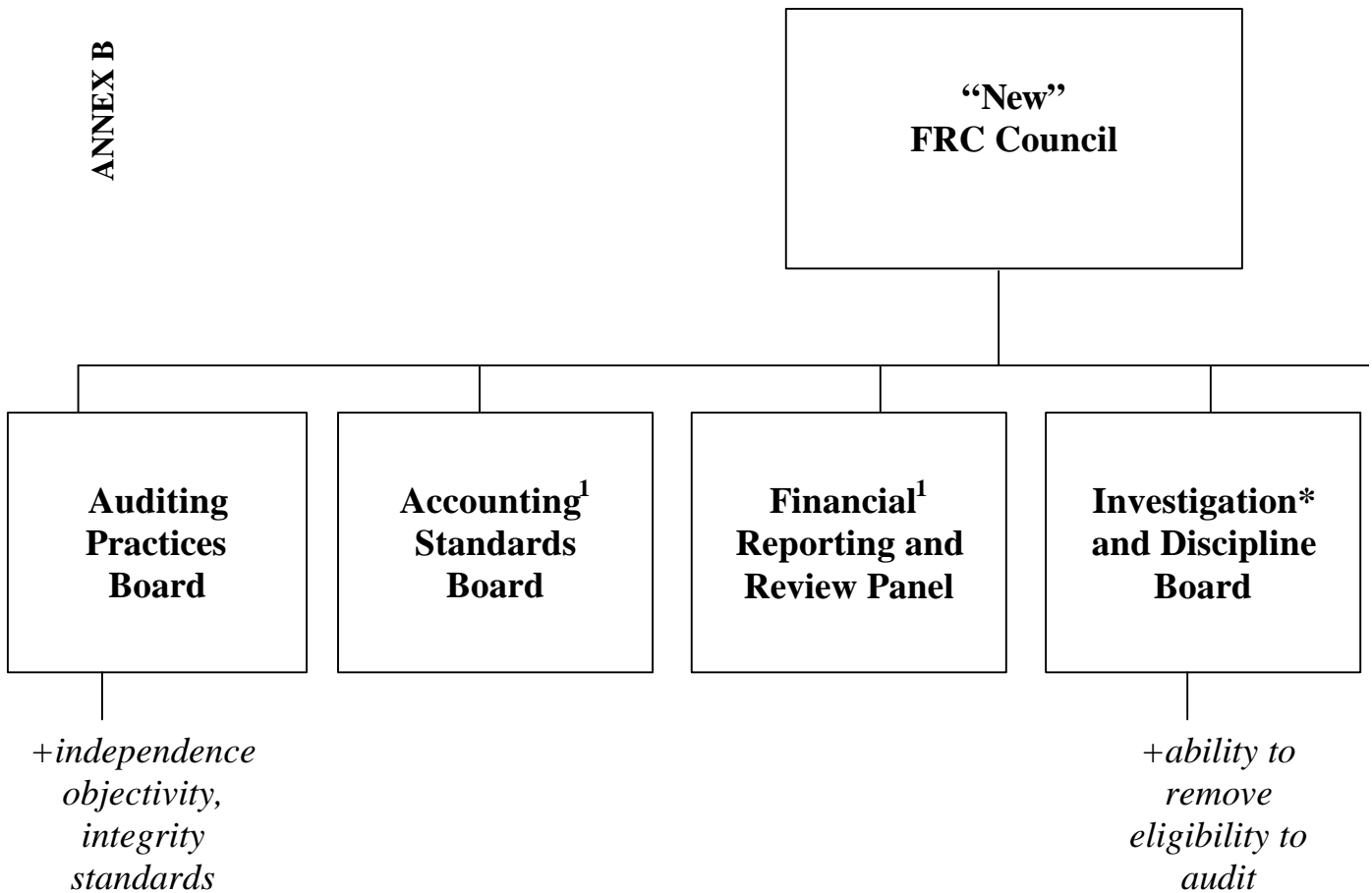
The ASB sets accounting standards for companies. It has three committees – the Urgent Issues Task Force, the Financial Sector and Other Special Industries Committee, and the Public Sector Not-for-Profit Committee.

FRRP: Financial Reporting Review Panel

The FRRP looks into departures from the accounting requirements of the Companies Act 1985 in the annual accounts of large companies and seeks remedial action where necessary. It has powers under the Act to apply to the courts for that purpose if needed.

REFORMED INDEPENDENT REGULATC

ANNEX B



¹ Current FRC subsidiaries, not part of Review's remit.

* New statutory provisions proposed, plus new SoS grant provision.

¹ Current FRC subsidiaries, not part of Review's remit.

Review Report: Summary of recommendations

The following text has been extracted from the Review report.

(i) that the FRC should take on the functions of the Accountancy Foundation, creating a new body, referred to in this report as “the independent regulator”. This option was widely supported in responses to the consultation. We consider that this would result in a simpler and clearer regulatory structure and would maximise co-ordination of related regulatory functions – in particular between the setting of accounting and audit standards.

(ii) that the independent regulator should have clear arrangements for accountability and transparency and should be outward facing in its role.

(iii) that the Auditing Practices Board should take over the professional bodies’ responsibility for setting standards for independence, objectivity and integrity for auditors. Responsibility for setting all other ethical standards should remain with the professional bodies and should be overseen by an appropriate board within the independent regulator.

(iv) that a new audit inspection unit should report to a board within the independent regulator. It would take over from the professional bodies responsibility for monitoring the audit of those entities whose activities have the greatest potential to impact on financial and economic stability – specifically listed companies and major charities and pensions funds. It would report to the successor board to the Review Board which, for the purposes of this report, we call the Professional Oversight Board.

(v) that the Professional Oversight Board, as the successor to the Review Board, should retain its wider accountancy remit within a reformed structure, but that its primary focus should be oversight of audit, and this should be enshrined in the body’s key objectives.

(vi) that the Secretary of State should delegate her recognition role to the independent regulator and that this role should be assumed by the Professional Oversight Board. That is, recognition of professional supervisory bodies and qualifications for the purposes of the framework

set out in the Companies Act 1989 for the supervision of the statutory auditor.

(vii) that the long planned Investigation and Discipline Board should be brought into being without further delay to provide, as intended, a demonstrably independent forum for hearing significant public interest disciplinary cases. We consider it should become a subsidiary of the independent regulator and should be able to impose appropriate sanctions including removal of eligibility to audit.

(viii) that Ministers should consider putting certain parts of the independent regulator on a statutory basis, and should seek to bring forward any appropriate provisions at the earliest opportunity.

(ix) that the annual running costs of the independent regulator should be broadly shared by Government, business and the professional bodies, with the exception of the costs of cases coming before the Investigation and Discipline which we consider should continue to fall to the professional bodies, as the draft arrangements currently envisage, and the costs of an independent audit inspection unit which should be borne by audit firms.

ANNEX D

REVIEW OF AUDIT AND ACCOUNTANCY REGULATION – LEGISLATIVE PROPOSALS

PARTIAL REGULATORY IMPACT ASSESSMENT

1. Issue

1.1 Whether the new regulatory functions of the Financial Reporting Council should be supported by statutory provisions.

2. Purpose and intended effect

Objective

2.1 The purpose is to ensure that the accountancy and audit professions are regulated in the most effective way.

Background

2.2 The term ‘accountant’ is not defined in statute and there are no qualification requirements in order for someone to practice as an accountant, although most accountants choose to qualify under the auspices of one of the professional accountancy bodies and pay to be a member of such a body. The Companies Act 1989 prescribes a statutory scheme for the regulation of auditors, under which the Secretary of State for Trade and Industry recognises certain accountancy bodies for the training and supervision of auditors.

2.3 In 2000, new non-statutory oversight arrangements for the regulation of the accountancy profession were established by the six members of the Consultative Committee of Accountancy Bodies (CCAB). The system comprises of four boards established under the overall ambit of the Accountancy Foundation: the Review Board (to monitor the operation of the regulatory system to ensure that it serves the

public interest); the Auditing Practices Board (to establish and develop auditing standards); the Ethics Standard Board (to secure the development of ethical standards for all accountants); and the Investigation and Discipline Board (to investigate disciplinary cases of public interest).

2.4 Following a recommendation of the Co-ordinating Group on Audit and Accounting Issues (set up jointly by the Secretary of State for Trade and Industry and the Chancellor of the Exchequer to review the situation in the UK following the Enron and WorldCom scandals to see if measures were needed to restore public confidence or toughen up the UK system), the Secretary of State for Trade and Industry announced to Parliament on 24 July 2002 an immediate review of the way in which the accountancy industry as a whole is regulated, including the role of the Accountancy Foundation and its related bodies. A consultation document seeking views on the main issues was published in October 2002.³ Comments were invited by 7 January 2003.

2.5 The Secretary of State published the final report of the review on 29 January 2003 and accepted all the report's recommendations⁴. The main recommendations were:

- that the Financial Reporting Council should take on the functions of the Accountancy Foundation to create a new unified and authoritative structure with three clear areas of responsibility: the setting of accounting and audit standards; their enforcement or monitoring; and the oversight of the major professional accountancy bodies;
- that the independent regulation and review of audit should be significantly strengthened. Specifically, that responsibility for setting independence standards for auditors and for monitoring the audit of listed companies and other significant entities should be transferred from the professional accountancy bodies to the independent regulator.

2.6 In her statement to Parliament, the Secretary of State said that there was a strong case for statutory underpinning to make the new body work, that she would consider this further, and that she would report her conclusions to the House.

³ "Review of the Regulatory Regime of the Accountancy Profession" [URN 02/1340]

⁴ "Review of the Regulatory Regime of the Accountancy Profession – Report to the Secretary of State for Trade and Industry" [URN 03/589]

Risk assessment

2.7 High standards of audit and accounting are essential for the UK economy, companies and capital markets, and the millions of people who invest in them (either as individuals and through their pension funds). It is important that the Government ensures that the public interest in the way the accountancy profession operates is fully met by securing public confidence in the impartiality and effectiveness of the profession.

2.8 The October 2002 consultation document asked for any views on the case for statutory underpinning of the Accountancy Foundation arrangements. A majority of respondents who commented on the issue were in favour of some legislative provision, although views varied on the breadth and purpose of this. For example, a number thought that the disciplinary processes of the investigation and Discipline Board should have statutory support, whilst others argued that the independent body's funding should be on a statutory basis.

Business sectors affected

2.9 The consultation will affect the market for accountancy services. Accountancy services comprise statutory audit (a regulated activity⁵ which is restricted to suitably qualified accountants⁶) and a number of other services which, in principle, anyone is free to perform irrespective of whether they hold a relevant qualification or are members of an appropriate professional body.

2.10 A recent survey⁷ suggests that in 2001 there were over 64,000 UK businesses or firms operating primarily in the accounting area, of which some 22,000 were members of the CCAB bodies. 65% of all firms in the sector had turnovers below £100,000 per year, a further 31% between £100,000 and £1 million, and only 1% in excess of £5 million. In the same year, there were around 11,300 entities holding registered auditor status, but this includes sole practitioners who would not necessarily feature in the survey described above. It has been estimated that the total

⁵ The consultation does not cover the other two areas of statutory regulation of the accountancy profession: investment business and insolvency. Only statutory audit is restricted exclusively to the accountancy profession.

⁶ These must be members of one of the professional bodies recognised for the supervision of auditors under the Companies Act 1989.

⁷ Key Note Ltd Accountancy Market Report 2002

fees charged by the accountancy profession equate to about 0.4% of UK GDP.

3. Options

3.1 A number of possible options have been identified:

- **Option 1.** Retain the current statutory regulatory system.
- **Option 2.** Provide relatively light touch statutory provisions to support the recommendations of the Review.
- **Option 3.** Confer statutory powers on the FRC.

4. Benefits and Costs of Options

4.1 The following table indicates the areas where we believe that costs and benefits are most likely to occur in relation to each option. At this stage it has not been possible to quantify these benefits and costs. Comments on the benefits and costs, including any quantification, would be very welcome. If consultees think there are likely to be other costs and benefits, information on these would also be welcome.

<i>Option</i>	<i>Description</i>	<i>Additional Benefits</i>	<i>Additional Costs</i>
1.	Retain current statutory regulatory system	None	None
2.	Provide relatively light touch statutory provisions to support the recommendations of the Review	Would ensure that the recommendations of the Review are supported with the minimum necessary statutory provision. Builds on the current framework for the regulation of audit.	Costs to professional bodies of ensuring that they comply with additional recognition criteria.
3.	Confer statutory powers on the FRC	Would ensure that the recommendations of the Review are supported	Costs to auditors of ensuring that they comply with the statutory provisions

5. Effect on Small Businesses

5.1 We do not consider that providing legislative support for the independent regulator would adversely affect small accountancy firms and small businesses. We do not believe that the changes would lead to increased costs for audit and accountancy services for customers, including small businesses. We would be interested to hear from small businesses about the effects on them of any changes in the statutory basis for regulation.

6. Competition Assessment

6.1 We have considered the impact of the proposed options in paragraph 3.1 on competition between accountancy firms and we do not believe that any of these would have a detrimental impact on competition.

6.2 This view is based on the fact that the provision of a statutory basis for certain functions of the independent regulator would not change the functions of the regulator. The costs (and savings) of the changes to the regulatory structure detailed in the options would not represent a significant proportion of the income of accountancy firms. As such, we do not believe that any of the options would be likely to affect the structure of the market, nor lead to higher costs for new or potential audit or accountancy firms as compared to existing firms. We have not carried out a detailed assessment but believe the overall effect of the options on competition would be neutral.

CODE OF PRACTICE ON WRITTEN CONSULTATIONS

THE CONSULTATION CRITERIA

- 1. Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.*
- 2. It should be clear who is being consulted, about what questions, in what timescale and for what purpose.*
- 3. A consultation document should be as simple and concise as possible. It should include a summary, in two pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.*
- 4. Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others) and effectively drawn to the attention of all interested groups and individuals.*
- 5. Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for a consultation*
- 6. Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and the reasons for decisions finally taken.*
- 7. Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure the lessons are disseminated.*

The complete code is available on the Cabinet Office's web site, address www.cabinet-office.gov.uk/servicefirst/index/consultation.htm.

COMMENTS OR COMPLAINTS

If you wish to comment on the conduct of this consultation or make a complaint about the way this consultation has been conducted, please write to Mr P Martin, DTI Consultation Co-ordinator, Room 725, 1 Victoria Street, London SW1H 0ET or telephone him on 020 7215 6206 or email philip.martin@dti.gsi.gov.uk.