

**DEPARTMENT FOR BUSINESS  
ENTERPRISE & REGULATORY REFORM**

**EUROPEAN COMPANY LAW AND  
CORPORATE GOVERNANCE**

Implementation of Directive  
2006/43/EC on Statutory  
Audits of Annual and  
Consolidated Accounts  
(8<sup>th</sup> Company Law Directive)

POLICY CONCLUSIONS AND DRAFT  
REGULATIONS – JULY 2007

## EUROPEAN COMPANY LAW AND CORPORATE GOVERNANCE

### IMPLEMENTATION OF THE DIRECTIVE ON STATUTORY AUDIT OF ANNUAL AND CONSOLIDATED ACCOUNTS – GOVERNMENT RESPONSE AND DRAFT REGULATIONS

The Government is pleased to respond to the comments received in response to its consultation on implementation of the EU Directive on statutory audit of annual and consolidated accounts. The Department for Business, Enterprise and Regulatory Reform invites your views on the attached draft implementing regulations and updated draft Impact Assessment.

The Directive clarifies the duties of statutory auditors and provides for their independence and ethical standards; introduces a requirement for external quality assurance; provides for public oversight of the audit profession, including third country auditors, and improved cooperation between oversight bodies in the EU. It also provides a basis for international cooperation between regulators in the EU and with regulators in third countries.

You are invited to send comments and supporting evidence on any part of this consultation, preferably by email, to:

Mailbox: [AuditDirective@berr.gsi.gov.uk](mailto:AuditDirective@berr.gsi.gov.uk)

Or by post: Jim Bellingham  
Corporate Law and Governance Directorate  
Department for Business, Enterprise & Regulatory Reform  
1 Victoria Street  
London SW1H 0ET

**The deadline for responses is 15 October 2007.**

Additional copies of this document may be made without seeking permission or downloaded from the Department's website on:  
[www.berr.gov.uk/cld/current.htm](http://www.berr.gov.uk/cld/current.htm)

Confidentiality: Your response may be made publicly available. If you do not want all or part of your response or name made public, please state this clearly in the response.

We will handle any personal data you provide appropriately in accordance with the Data Protection Act 1998.

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## Chapter 1

### EXECUTIVE SUMMARY

#### Purpose of this consultation

1.1 This document sets out the Government's conclusions following the responses to the consultation paper published by the Government on 5 March 2007, which set out the policy proposals for the implementation of the EU Directive on statutory audit of annual and consolidated accounts. The response is accompanied by a set of draft implementing regulations on which comments are invited. The final set of regulations, which the Government intends to bring into force in April 2008, will be informed by the comments received.

#### Related consultations

1.2 The Government consulted on implementation of European Directive 2006/46/EC, amending the Fourth, Seventh, Bank Accounts and Insurance Accounts Directives, in parallel with the Statutory Audit Directive. A separate Government response to that consultation has been published in parallel with this response and can be found at <http://www.berr.gov.uk/consultations/closedwithresponse/index.html>

1.3 The Government has also consulted on the wider implementation of the Companies Act 2006. Draft Regulations are being published and can be found at <http://www.berr.gov.uk/bbf/co-act-2006/>

#### How to respond and help with queries

1.4 Comments are welcome on the draft regulations. When responding please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of an organisation, please make it clear who the organisation represents and, where applicable, how the views of members were assembled.

1.5 Responses should be submitted, preferably by email, to

Mailbox: [AuditDirective@berr.gsi.gov.uk](mailto:AuditDirective@berr.gsi.gov.uk)

Or by post: Jim Bellingham  
Corporate Law and Governance Directorate  
Department for Business, Enterprise and Regulatory Reform  
1 Victoria Street  
London SW1H 0ET

Or by fax: 020 7215 0235

### Confidentiality & Data Protection

1.6 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want other information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.7 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department.

1.8 The Department will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

### Help with queries

1.9 Questions about the draft regulations in the document can be emailed to [AuditDirective@berr.gsi.gov.uk](mailto:AuditDirective@berr.gsi.gov.uk) or discussed with Jim Bellingham on 020 7215 3858.

1.10 A copy of the Code of Practice on Consultation is at Annex E.

## Chapter 2

# SUMMARY OF THE CONSULTATION RESPONSES AND THE GOVERNMENT'S CONCLUSIONS

### Introduction

2.1 This chapter sets out, by section of the Directive, a brief summary of the responses received and highlights any particular issues for consideration. More specific drafting points have, where the Government has accepted them, been taken into account in the drafting of the attached draft regulations. The Government's response addresses key points raised and sets out the preferred implementation options.

2.2 The Government received 32 responses to its consultation. A list of respondents is included at Annex D. Copies of all the responses, with the exception of one private response, can be found at <http://www.berr.gov.uk/consultations/closedwithresponse/index.html>

### Approach to implementation

2.3 As set out in detail in Chapter 2 of the previous consultation document, the implementation of the Directive requires a range of provisions to be made in regulations, either by the Department for Business, Enterprise and Regulatory Reform (BERR) or by the Professional Oversight Board; amendments to the Companies Act 2006 to provide statutory underpinning (and updating where necessary) of existing Ethical Standards and Recognised Supervisory Bodies rules; and comitology procedures at EU level. With regards to Article 41 of the Directive, relating to the requirements for an Audit Committee, implementation will be through the rules of the Financial Services Authority (see paragraphs 2.47 – 2.71).

### Implementation for entities other than companies

2.4 The draft Regulations contained in this document are applicable only to companies. HM Treasury is considering parallel regulations or amendments to existing legislation that might be required for entities coming into the scope of the Directive that are not companies but it is expected that implementation for those entities will take a broadly similar approach to that for companies.

### Timetable for implementation

2.5 The Directive must be implemented by 29 June 2008. The Government plans to bring into force the majority of implementing

regulations in April 2008. The provisions would apply to reporting periods beginning on or after the date when the regulations come into force. The timing of implementation of the third country provisions in Articles 45 to 47 may be slightly later, and will take into account the timetable for implementing any decisions taken under comitology.

2.6 Where possible, an indication of the implementation timetable for those provisions which fall to the Professional Oversight Board, the Auditing Practices Board, the Recognised Supervisory Bodies, or the Financial Services Authority is provided in the relevant section below.

## **Education and Qualifications - Articles 3 to 14, and 44**

### Summary of responses

2.7 Thirteen responses to the consultation commented on this part of the Directive. They were broadly supportive of the Government's proposed approach, although there were a number of suggestions and questions on points of detail.

2.8 Several responses from recognised supervisory bodies queried the introduction of the provision in Art 5.3 whereby Recognised Supervisory Bodies are required to notify the Professional Oversight Board when approval is withdrawn from a statutory auditor, so that this information can be conveyed to the authorities in other Member States where the auditor is approved. They expressed concern that they do not currently have details of registrations of auditors in other Member States, and that collecting it before the Directive is implemented in April 2008 would require a new process beyond their normal data collection system.

2.9 Recognised Supervisory Bodies also expressed concern that Article 5.3 would lead to needless work in respect of the auditors who are registered with the same Recognised Supervisory Body to conduct audits in both the UK and the Republic of Ireland.

2.10 Different views were expressed by the Recognised Supervisory Bodies on the precise date of introduction of the revised regulation setting the new examination requirements.

2.11 One response sought clarity on the interpretation of Article 10, which sets out requirements on practical training.

2.12 There were also queries about the details of recognition of auditors from other EU Member States and from third countries. In the EU case, one response sought clarity on the impact of the slightly different scope defined for statutory audit in different Member States. For third country auditors, the question concerned how the Professional Oversight Board would interpret the reciprocity requirement for the recognition of audit qualifications from outside the EU.

## Government response

2.13 In the light of the support expressed by the vast majority of responses, the Government intends to proceed broadly as set out in the consultation document, but with some adjustments in the light of the responses.

2.14 On article 5.3 the Government accepts the need to avoid needless notifications in the case of auditors registered for both UK and Ireland. The regulations will now not apply the requirement for notifications in cases where the same supervisory body has approved the auditor in both jurisdictions. The intention is that this should avoid needless transmission of information, while ensuring that the requirements of the Directive are met.

2.15 The Government understands the concerns expressed by Recognised Supervisory Bodies about the difficulty of having complete information about non-UK registrations by April 2008, to allow for notification when approval is withdrawn. The Government accepts that the Recognised Supervisory Bodies may need to adopt an interim solution, and if this were felt to cause severe problems, would be prepared to consider whether there is scope for delaying the implementation of this requirement of the Directive.

2.16 The regulation setting out examination requirements will be made by the Professional Oversight Board under their delegated powers. The Professional Oversight Board will conduct a separate consultation in the autumn on those regulations in the normal way. The Government notes the views on the timing of the introduction of the new education requirements, and understands that the audit qualifications of the recognised qualifying bodies meet the substantive provisions of Article 8 of the Directive. Subject to the consultation to be conducted by the Professional Oversight Board, the intention is that the new requirements should come into force on 6 April 2008.

2.17 On the practical training requirements in article 10, the view of the Government is that this Article has been implemented in the provisions of paragraph 9 of Schedule 11 of the 2006 Act. The detailed operation of the provision is a matter for the Professional Oversight Board and the Recognised Qualifying Bodies.

2.18 The Government proposes to implement the requirements of Article 14 for the approval of auditors registered in other Member States by setting out the requirements for an aptitude test in an amendment to the Companies Act. The Government understands the concerns of Recognised Supervisory Bodies about the interpretation of Article 14 by other Member States. While this is not part of the UK implementation, and the scope to influence other Member States' implementation is inevitably limited, the Government has raised this issue in discussions in Europe, and will continue to do so where appropriate.

2.19 Finally, on Article 44, this has been implemented in section 1221 of the Companies Act (as it will be amended by the draft regulations) and it is a matter for the Professional Oversight Board to judge on a case by case basis that the reciprocity requirements are met.

## **Registration - Articles 15 to 20**

### Summary of responses

2.20 There were twelve responses to this part of the consultation. They were broadly supportive of the Government's approach. The main issues raised concerned the timing of the introduction of the new requirements for the UK register, in the light of the need to update the IT systems, and gather new information, and how this would be co-ordinated with the introduction of the new register for third country auditors. One response raised concerns about identity theft and the ability of Companies House to check auditors against the register. Other issues raised the question of commercial use of the register, the nature of electronic access and whether it should be possible to download the whole register.

### Government response

2.21 In the light of the broad support for the general approach, the Government proposes to proceed with its plans for the Professional Oversight Board to make the regulations for the UK register, to be maintained by the Recognised Supervisory Bodies as at present, while the Government will make the regulations for the new register for third country auditors, for which the Professional Oversight Board will be responsible.

2.22 On the question of timing, the Government and the Professional Oversight Board accept the arguments that the introduction of the new register requirements for UK auditors should be delayed until June 2009, as allowed by the Directive, to allow for the collection of the additional information required and the development of the necessary IT systems. The details will need to be developed by the Professional Oversight Board and the Recognised Supervisory Bodies, and Professional Oversight Board will consult on these regulations in due course. The present intention is that the register will be available via the internet, but not be downloadable as a whole.

2.23 Some responses raised the question of how the register of UK auditors would be co-ordinated with that for third country auditors. The Government's view is that the register for third country auditors needs to be operational before the time the relevant provisions implementing the Directive come into force (which is currently planned for June 2008) and that therefore the Professional Oversight Board will initially operate the register on an interim IT system until the revised UK system is complete in 2009.

## **Ethics - Articles 21 to 25**

### Summary of responses

2.24 There were fourteen responses which commented on this chapter of the Directive. Respondents were broadly content with the Government's general approach of delegation of most requirements to the Auditing Practices Board or to Recognised Supervisory Bodies, as set out in the consultation.

2.25 Some respondents questioned the need for statutory underpinning of those requirements already covered by the existing rules of the Recognised Supervisory Bodies or by the Ethical Standards set by the Auditing Practices Board. A point which attracted specific comments from several respondents was that of the provision of relevant information to an incoming auditor. In particular, respondents were concerned with regards to the definition of "relevant information".

### Government response

2.26 In the light of the support expressed in the vast majority of responses, the Government intends to proceed broadly as set out in the consultation document.

2.27 In order to implement properly the requirements into UK law, it is necessary to give statutory underpinning to the relevant rules of the Recognised Supervisory Bodies or the Ethical Standards set by the Auditing Practices Board. EU law requires a Directive to be implemented by way of provisions in national legislation, and such rules and standards adopted on a voluntary basis cannot be considered as legislation for this purpose. Therefore, simply referencing the Rules or the Ethical Standards without the related statutory underpinning would not be sufficient for the UK to meet its EU law obligations. The Government intends to make the necessary amendments to Schedule 10 to the Companies Act to reflect the minimum required under the Directive. More detailed rules will be provided for under the Recognised Supervisory Bodies' regulations or the Auditing Practices Board's Ethical Standards.

2.28 The Government will amend Schedule 10 to the Companies Act 2006 to require that the requirements in relation to access to relevant information are provided for under the rules of the Recognised Supervisory Bodies. It is for the Bodies to consider the most appropriate amendments to their rules and we understand that they intend to provide guidance.

## Standards and Reporting - Articles 26 to 28

### Summary of responses

2.29 The Government has discussed the detailed implementation of the requirements on standards and reporting with the Auditing Practices Board and with the Recognised Supervisory Bodies. The proposed implementation takes account of formal responses and of those discussions.

2.30 There were ten respondents to the consultation who commented on the provisions relating to standards and reporting. Most of those respondents indicated their broad support for the approach outlined in the previous consultation document. Three responses called for minimal statutory underpinning for those requirements covered by the Recognised Supervisory Bodies' rules or by the Auditing Practices Board's standards – the necessity for statutory underpinning is discussed in paragraph 2.27 above.

2.31 Three of the respondents made comments with regards to the requirements in Article 26 for statutory auditors and audit firms to carry out statutory audits in compliance with the International Auditing Standards (ISAs) adopted by the Commission. Their comments generally supported the early adoption of ISAs by the EU.

2.32 One response made specific comments about the implementation of the review requirements, which they felt ought to make clear that the group auditor does not need to review the audit work in the case of small subsidiaries that are immaterial to the accounts of the group.

2.33 Two respondents believed that the requirements in Article 27(c), which covers situations where a component of a group of undertakings is not covered by arrangements under Article 47 (on cooperation with competent authorities from third countries), were covered appropriately by existing ISAs. The ACCA response went on to say that existing ISA 230 requirements (the general requirement for documentation) should suffice in the interim period before a revised ISA 600, which might cover more fully the Article 27(c) requirements, is adopted by the EU.

### Government response

2.34 The Government is satisfied that the requirement in Article 27(a), that the group auditor bears the full responsibility for the audit report in relation to consolidated accounts, will not require statutory underpinning in relation to company audits since this is already provided for in section 495 of the Companies Act 2006.

2.35 ISA 600, which is reflected in the Auditing Practices Board's standards, partially covers the requirements in Article 27(b) but the requirements on documentation (paragraph 8 of the current ISA 600) are not as specific as those in the Directive. It is likely that the EU will wish to

ensure that the requirements of Article 27 (b) are covered by the revised ISA 600. This does however leave at least a period of time, between April 2008 and the adoption by the EU of the new ISA, when the current ISA would not cover adequately the requirements in Article 27(b). In the interim, the Government proposes to provide for the requirements by amending Schedule 10 to the Companies Act 2006 and the Auditing Practices Board will consider the appropriate subsequent amendments to its standards.

2.36 The requirements in Article 27(c) are not covered by ISA 600. The Government's conclusion is that, since this concerns access to audit papers rather than the conduct of the audit itself, this should be provided for in the Bodies' rules, with statutory underpinning provided in amendments to Schedule 10 to the Companies Act 2006, and not in Auditing Practices Board standards.

## **Public Oversight, Investigations and Discipline - Articles 29 to 36**

### Summary of responses

2.37 There were twelve responses which commented on this aspect of the consultation. There were no disagreements with the Government's essential assessment that the present structure of our regulatory system complies with the requirements of the Directive. A few responses queried the need for additional statutory underpinning.

### Government response

2.38 In the light of the responses, the Government intends to continue with the approach set out in the March consultation document, and to make no major substantive changes to the UK system. Although some responses queried the need for any additional statutory underpinning, the Government's view, as discussed in paragraph 2.27 is that this is necessary to implement this part of the Directive.

2.39 Parts of the Directive (for instance on third country auditors) set out new duties for the regulatory system, and these have been provided for under Part 42 of the Companies Act 2006 (as it will be amended by the draft regulations). This will require a new delegation order to be made so that they can be carried out by the Professional Oversight Board. The draft of the new delegation order is published for consultation alongside the regulations to implement the Directive. It broadly follows the approach of the existing delegation order, but delegates some new functions, and makes a few minor amendments to the delegation of existing powers.

2.40 The draft regulations include the new provision to implement Article 36.2 which imposes an obligation of confidentiality on the Professional Oversight Board and the Recognised Supervisory Bodies when handling information about individuals or businesses. As

proposed in the consultation, this is based on similar provisions for the Takeovers Panel set out in the Companies Act 2006. The Government would particularly welcome comments on the detailed exclusions from the confidentiality obligations set out in the draft Schedule 11A.

2.41 Separate to the requirement to apply a confidentiality obligation regarding information about individuals and businesses, the Professional Oversight Board will be subject to the Freedom of Information Act as a result of the provisions in Part 42 of the Companies Act, as soon as the new delegation order comes into force.

## **Appointment and dismissal - Articles 37 and 38**

### Summary of responses

2.42 Thirteen of the responses commented on this part of the consultation. The central question concerned the arrangements which will need to be put in place in respect of Article 38.1 to ensure that auditors are not dismissed without proper grounds. The responses were supportive of the Government's proposal not to specify in any more detail than in the Directive what might constitute improper grounds for dismissal.

2.43 Almost all the responses on this part commented on the options for enforcement of this provision. Out of the eleven responses which expressed a clear preference, nine preferred, at least to some degree, the Government's favoured option, to use the existing provisions on Unfair Prejudice in the Companies Act.

2.44 One response also expressed concerns about the practical implications of the existing provision in Sections 522-524 of the Companies Act which implements the requirements of Article 38.2 – that the relevant audit authorities are notified of the reasons for the dismissal or resignation of an auditor. The response sought further clarity and guidance from the Government as to procedures to be followed when these notices are received and in particular how they should exercise their discretion as to when in the process to require the information from auditors.

### Government response

2.45 In the light of the preference expressed for the use of the Unfair Prejudice provisions, the Government intends to proceed in this way, and an appropriate amendment to Part 30 of the Companies Act has been included in the draft regulations.

2.46 In response to the concerns of one Recognised Supervisory Body about the implications of the provisions in sections 522-524, the Government is not currently minded to specify procedures further in regulation or guidance. The provisions have been drafted to be flexible

and to allow for the exercise of discretion in particular cases by the expert authorities. This should allow for proportionate and appropriate handling of individual cases.

## **Public Interest Entities - Articles 39 to 43**

### Summary of responses

2.47 Twenty-four respondents commented on the implementation of Article 41, including business representative organisations, investor groups and members of the audit profession.

2.48 The consultation document set out four main options:

1. implementing the new requirements via additions to the FSA's Listing Rules;
2. new regulations requiring Directors to include a statement of compliance in their Annual Report;
3. new regulations imposing a direct obligation on companies to have in place an audit committee;
4. a hybrid of elements of Options 1 and 3, involving enforcement by either the FSA or through the courts depending on the circumstances.

2.49 In addition, the consultation document asked for views on whether it would be helpful to reference the Combined Code under any of these main options; and for views on the extent to which the various exceptions and exemptions provided for in the Directive should be exercised.

2.50 21 respondents commented directly on the choice between the main options set out. A large majority of these supported Option 1, or a variation on this approach. Three respondents supported Option 2 and six supported or gave qualified support to Option 4. No respondents preferred Option 3.

2.51 Those supporting the approach under Option 1 included a number of responses from business organisations, investor groups and members of the audit profession. A number of respondents indicated that they considered this option offered the lightest touch or most flexible approach, and the best fit within the existing framework of corporate governance in the UK. Several respondents indicated they particularly disliked the prospect, involved in the other options, of introducing new criminal offences in the context of corporate governance requirements. A number of respondents commented on the suitability of non-criminal over criminal sanctions in this context, although one respondent (the

CBI) expressly indicated a preference for FSA enforcement over any court-based enforcement procedure.

2.52 While a number of respondents took the opposite view, a substantial majority of those commenting on the option of referencing the Combined Code considered that this would be undesirable. In particular, there was a perception that any referencing of the Code in the context of rules or regulations enforcing mandatory obligations could detract from the non-statutory nature of the Code. A number of these respondents expressly proposed that only the minimum obligations provided for under Article 41.5 of the Directive should be reflected in amendments to the listing rules.

2.53 Nineteen respondents commented on the Member State's options to exempt or exclude classes of entity from the requirements of Article 41, or from Chapter 10 in its entirety under Article 39. While there was a small minority view on some of these, there was clear majority support for the exercise of exemption options.

#### Government response

2.54 In light of the responses to the consultation the Government have, with the agreement of the Financial Services Authority (FSA), concluded that the requirements on audit committees under Article 41 should be implemented via FSA rules, made under Part 6 of the Financial Services and Markets Act 2000.

2.55 The approach decided upon represents a variation on Option 1 as set out in the consultation document, whereby the FSA rules will be amended to include only the minimum requirements necessary under the Member State option provided for in Article 41.5 of the Directive.

2.56 Under this approach the FSA will amend its rules with the effect of including new requirements on issuers to:

- a) have in place a body which:
  - i) fulfils functions equivalent to the functions set out in Article 41.2 of the Directive; and
  - ii) has within its composition at least one independent member and one person with financial expertise (who may or may not be the same individual);
- b) issue a statement which identifies the body and describes how that body is composed.

2.57 The Government have concluded, in accordance with the balance of responses to the consultation, that the Combined Code should not be referenced as a part of the implementation of Article 41. Companies choosing to follow the recommendations of the Combined Code on audit

committees will clearly have an audit committee in compliance with the Directive. However, there is no need to make this explicit in the new FSA Rules. The consultation document asked whether it would be helpful to companies, investors and others to do so. The clear majority view in the responses was that it would not be, and that there should continue to be separate provision in FSA Rules requiring disclosures in respect of compliance with the Combined Code.

2.58 For the avoidance of doubt, the Government's view remains that companies should not be required to follow the recommendations of the Combined Code on audit committees – the minimum requirements required under the Directive are much less prescriptive. And where listed companies choose not to follow the Code's recommendations, they should continue as now to be required under FSA Rules to explain the reasons why (see Listing Rule 9.8.6R(6)(a)). There is, however, scope for the Rules to be framed so as to enable issuers to combine in a single statement, the disclosures required in respect of the Combined Code; the disclosures required under Article 41.5 (see paragraph 3(b) above; and also the new corporate governance statement required under EC Directive 2006/46 (see paragraph 10 below).

2.59 The FSA and the Financial Reporting Review Panel (FRRP) are discussing the practical arrangements for monitoring companies' compliance with these disclosure requirements, with a view to the FRRP including such monitoring in its reviews.

2.60 A failure to comply with the new requirements would leave the issuer open to the range of sanctions available to the FSA for breach of its rules, which presently include financial penalties. As the requirements under paragraph 3(a) above are substantive obligations on the issuer, the FSA must be able to investigate in individual cases whether the minimum arrangements which the issuer has in place are sufficient to meet the requirements for an audit committee or equivalent body. However, there is no requirement for the FSA to depart from its normal risk-based regulatory approach in identifying cases meriting investigation.

2.61 In the Government's interpretation, the Rules should include a minimum requirement that the audit committee or equivalent body must have within its composition at least one member who is independent of the management of the entity, and one with relevant financial expertise. However, as indicated in the March consultation document, the Government does not consider that the Rules need prescribe what would constitute independence or relevant financial expertise. These are matters appropriate to be judged ultimately in the individual circumstances of the company and in relation to the nature and complexity of the business. The Government also consider there is no requirement to make any further provision in the Rules in respect of the composition of the audit committee or equivalent body. A key strength of the chosen approach to implementation is the degree of flexibility it allows for companies and shareholders to establish specific

arrangements which are appropriate to their own circumstances.

2.62 The FSA will, in line with its normal practice, publish for consultation a draft of the new Rules to implement these new requirements. The FSA plans to consult on a draft during the final quarter of 2007. The new requirements must be implemented, at the latest, with effect for financial periods beginning on or after 29 June 2008.

### Corporate Governance Statement

2.63 Separately, under European Directive 2006/46/EC, Member States must implement an obligation on companies whose securities are admitted to trading on regulated markets to issue a corporate governance statement, covering specified matters. The Government issued a separate consultation document on the implementation of that Directive, which can be found at <http://www.berr.gov.uk/consultations/page38068.html>

2.64 In light of the responses to that consultation, the Government has concluded, with the agreement of the FSA, that this requirement to issue a corporate governance statement should also be implemented via the FSA's Part 6 Rules. The sanctions would be as outlined in paragraph 2.60 above. Companies will be required under the new Rules to provide a discrete statement covering the specified information either in their director's report, under the Companies Act 2006, or in a separate corporate governance statement cross-referenced in the director's report.

2.65 As noted above, it would be possible to frame the new Rules so as to enable companies to include within this corporate governance statement, the disclosure required under Article 41.5 of the Audit Directive, as described in paragraph 3(b) above, and the disclosures currently required in respect of compliance with the Combined Code.

2.66 Further details of the Government's plans to implement Directive 2006/46/EC, are set out in a separate policy statement available at <http://www.berr.gov.uk/consultations/closedwithresponse/index.html>

### Scope of application and exemptions

2.67 The Government have concluded that the exemption provided for under Article 39 of the Directive should be exercised. The requirements of Chapter 10 of the Directive, including the requirement under Article 41 to have an audit committee, will therefore apply only to those entities whose transferable securities are admitted to trading on a regulated market<sup>1</sup>. Insurance undertakings that have not issued transferable

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<sup>1</sup>A regulated market is a market place, trading system or exchange which meets the minimum EU standards set out in title III of the Markets in Financial Instruments Directive (2004/39/EC). Under Article 16 of the Investment Services Directive (93/22), the FSA is responsible for maintaining the list of regulated markets for which it is the Home Member State. In the UK currently, the list includes six of the markets operated by the

securities admitted to trading on a regulated market and credit institutions, both of which are classified as public interest entities by the Directive, will not be subject to these provisions.

2.68 The Government have also concluded that the exemptions provided for under Article 41.6 of the Directive, all of which are additional to the broader exemption provided under Article 39, should be exercised, so that the audit committee requirements will not apply to UK issuers:

- which are subsidiaries whose parent is already subject to the requirements at group level;
- whose sole business is to act as issuer of asset-backed securities; or
- which are credit institutions which have only issued debt securities with a value of less than Euro 100 million and have not published a prospectus.

2.69 All remaining entities within the scope of Article 41 are within the scope of the FSA's powers to make Rules and impose penalties under Part 6 of FSMA. No further provision beyond the new FSA rules is required to implement Article 41.

2.70 Under the Directive the definition of public interest entities includes entities whose securities are admitted to trading on a regulated market of any Member State. The Government has therefore concluded that the new rules on audit committees should extend to entities for which the UK is the "home State," just as that term is used in Part 6 of FSMA in relation to the Transparency Obligations Directive 2004/109/EC. The same approach would be adopted in relation to the corporate governance statement requirements under Directive 2006/46/EC. The FSA has agreed to consult on this basis.

2.71 In relation to the corporate governance statement requirements under Directive 2006/46/EC, the Government have also decided to exercise the option in new article 46a.3 of the 4<sup>th</sup> Directive for companies which have only issued securities other than shares admitted to trading on a regulated market to be exempted from certain disclosures in the corporate governance statement (unless they have issued shares which are traded in a multi-lateral trading facility).

## **Third Country Auditors - Articles 45 to 46**

### Summary of responses

2.72 Fourteen of the responses commented on the Government's proposals for these provisions. They were generally supportive of the overall approach proposed by the Government – to work closely with the European Commission to introduce these new provisions in a flexible and pragmatic way, and to rely wherever possible on the regulation of third country auditors in their home countries. As set out in the Directive, this requires decisions by the Commission, acting with Member States under comitology, either that the regulatory regimes of these third countries are equivalent to those in the EU, or that the third country concerned is granted a transitional period.

2.73 Few of the responses commented on the arrangements that will be needed in the UK to implement these provisions in the Directive. Two responses queried whether the Government's proposals would have sufficient legal weight to achieve what the Directive requires. Another commented that it was important that the register should be transparent.

#### Government response

2.74 As discussed in the previous document, the Government is continuing to work with the European Commission and other Member States on the decisions regarding equivalence and transitional arrangements for third countries.

2.75 The regulations being published alongside this document include regulations requiring the Professional Oversight Board to maintain a register of third country auditors. They need to be read in conjunction with Part 42 of the Companies Act 2006 and the delegation order which sets out the powers to be delegated to the Professional Oversight Board. It is the intention that the Professional Oversight Board will have the power to disapply registration and regulation requirements in the Act and the register regulations. They will use these powers to avoid the need to impose the full UK regulatory regime on third country auditors from countries which have audit regulatory regime which have been determined as equivalent under Article 46, or which have been granted transitional periods. The intention is also that they will disapply some of the registration requirements for auditors from such third countries but that they will maintain a publicly accessible register of all auditors who sign audit reports of third country entities with securities traded on UK regulated markets. These regulations may need to be adjusted in the light of the regulations to be made by the Professional Oversight Board for the register of UK statutory auditors, in order to ensure consistency.

2.76 For enforcement in respect of issuers, the Government has concluded that the proposal in the consultation document will be a full implementation of the Directive. The FSA will therefore adjust its disclosure and transparency rules so that third country entities whose securities are admitted to trading on a UK regulated market must have an audit report signed by a third country auditor who is on the Professional Oversight Board register. A breach of this rule would render the third country entity liable to the range of FSA penalties, including

unlimited fines and suspending trading in the issuer's securities. It is the Government's intention to use the exemption allowed in Article 45, so that there is no such requirement on issuers who issue only debt securities with denominations over 50000 Euros.

2.77 The regulations set out the detailed requirements of the register and the procedure for third country auditors to follow to demonstrate that they meet the requirements of the Directive. The intention has been to specify these in a flexible way, so that the Professional Oversight Board can co-ordinate with regulatory bodies in other member States to develop a common application and registration procedure for auditors who audit reports for companies listed in more than one EU Member State.

2.78 The Government's present intention is to apply the requirements of the regulation to audits of third country issuers in respect of reporting periods beginning on or after 29 June 2008.

## **Co-operation with third country authorities - Article 47**

### Summary of responses

2.79 There were fifteen responses to this part of the consultation. The main issue on which responses commented was the choice of enforcement route for the proposed partial prohibition on auditors passing audit working papers to the competent authorities in third countries. Of the fourteen responses on this issue, ten favoured enforcement via the rules of recognised supervisory bodies.

2.80 Several responses commented on the Government's intention to use the option in Article 47.4 of the Directive, to allow the direct transfer of audit papers from audit firms to competent authorities in exceptional cases. Three responses, representing Recognised Supervisory Bodies, were against the use of this provision with one suggesting that all transfers should be routed via the Professional Oversight Board and the other two suggesting that they should be handled by the Recognised Supervisory Bodies.

2.81 Other points raised included questions on whether this prohibition would affect transfers of papers between audit firms; the scope of documents and companies covered by the provision, and the definition of competent authorities.

### Government response

2.82 In the light of the broad support for this approach, the Government proposes to provide for this prohibition to be covered by the rules of the Recognised Supervisory Bodies, and that is reflected in the consultation draft of the regulations.

2.83 In answer to a point raised by a number of responses, the Government is clear that this provision is not designed to control the transfer of papers between auditors whether within the UK, the EU, or to third countries. The purpose is to control, in line with the Directive, the transfer of papers to competent authorities outside the EU.

2.84 On the scope of the provision, the Government notes that there was general support for the view that the competent authorities concerned should be those responsible for the regulation of the audit profession. The Government has taken a wide definition of the documents covered by this provision, as is required by the Directive.

2.85 On the direct transfer of papers by auditors to third country authorities, the Government notes the comments of the Recognised Supervisory Bodies, that this option should not be taken up, and that transfer of papers should only take place via the Professional Oversight Board or via the Recognised Supervisory Bodies. While the Government is open to further discussions with the parties concerned in the light of the draft regulations, the Government is not currently minded to introduce restrictions beyond those required by the Directive. The regulations have therefore been drafted to provide for transfer of papers either via the Professional Oversight Board, or directly from auditors when a third country authority has launched an investigation. The Government notes that these circumstances in which direct transfer is allowed may be further constrained by Commission decisions taken with Member States under comitology.

## **Article 49 – Disclosure of auditor remuneration**

### Summary of responses

2.86 Fourteen of the responses covered this aspect of the consultation. The responses were broadly content with the provision in the Directive, and agreed that it should be implemented via remaking the existing Companies (Disclosure of Auditor Remuneration) Regulations 2005. Just over half the responses were content with the Government's detailed proposal, which was to make only minor amendments to the Regulations to bring them fully into line with the Directive, while otherwise preserving the existing UK approach. However, a significant group of responses, consisting of some of the audit firms and a professional body, argued that there should be a wider review of the UK Regulations, which were felt to go further than the Directive in a number of respects, including the detail required in the disclosure, and their treatment of associates of the auditor and of the company.

### Government response

2.87 In the light of the responses, the Government intends to proceed along the lines set out in the first consultation. In line with the overall approach to this implementation, the draft Companies (Disclosure of

Auditor Remuneration and Liability Limitation Agreements) Regulations 2007 to be published shortly alongside this response therefore propose only the minimum changes to the existing Regulations which are required by the Directive, together with a few drafting changes of no substance. As set out in the March consultation paper, there is a new requirement in Article 49.1(c) of the Directive, that detailed information in respect of medium sized companies on the provision by the auditor of additional non-audit services must be provided on request to the public oversight system. The Government does not expect this provision to be frequently used, and in order to implement it in the least burdensome way, the Government proposes to rely on the powers under S1224 of the Companies Act 2006 which are to be delegated to the Professional Oversight Board, which would allow them to require this information from auditors.

2.88 As regards a wider review of the Regulations, the Government notes that the requests for such a review were made largely by one group of stakeholders, and that the present Regulations were put in place as a result of extensive policy debate earlier in the decade. The purpose of the current consultation process is to implement the requirements of the Audit Directive and the Government is not therefore proposing wider changes to the disclosure Regulations at present.

*Draft instrument - not yet final - July 2007*

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STATUTORY INSTRUMENTS

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**2007 No. 0000**

**COMPANIES**

**AUDITORS**

**The Statutory Auditors and Third Country Auditors Regulations 2007**

*Made* - - - - - \*\*\*

*Laid before Parliament* \*\*\*

*Coming into force* - - - - - *6th April 2008*

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SCHEDULE — Schedule 11A to the Companies Act 2006

The Secretary of State is a Minister designated<sup>(2)</sup> for the purposes of section 2(2) of the European Communities Act 1972<sup>(3)</sup> in relation to auditors and the audit of accounts.

In exercise of the powers conferred by section 2(2) of that Act and sections 1239, 1241(2)(c), 1246, 1292(1)(a) and (b) and 1292(2) of, and paragraph 8(1)(a) of Schedule 11 to, the Companies Act 2006<sup>(4)</sup>, the Secretary of State makes the following Regulations:

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<sup>(2)</sup> S.I. 2007/1679

<sup>(3)</sup> 1972 c. 68. The enabling powers of section 2(2) were extended by virtue of the amendment of section 1(2) by section 1 of the European Economic Area Act 1993 (c. 51).

<sup>(4)</sup> 2006 c. 46

# PART 1

## CITATION, COMMENCEMENT AND INTERPRETATION

### Citation and commencement

1.—○ These Regulations may be cited as the Statutory Auditors and Third Country Auditors Regulations 2007.

(1) These Regulations come into force on 6th April 2008.

### Interpretation

2.—○ In these Regulations “the designated body” means the body known as the Professional Oversight Board established under the articles of association of The Professional Oversight Board Limited<sup>(5)</sup>.

### Minor definitions

3.—○ Section 1261 of the Companies Act 2006 (minor definitions) is amended as follows.

(1) At the appropriate places in subsection (1), insert the following definitions—

““the Audit Directive” means Directive 2006/43/EC of the European Parliament and of the Council on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC<sup>(6)</sup>”;

““audit working papers” means any documents which—

- (a) are or have been held by a statutory auditor or an overseas auditor, and
- (b) are related to the conduct of a statutory audit, a third country audit or any audit required by the law of a foreign country”;

““EEA auditor” means an individual who is approved in accordance with the Audit Directive by an EEA competent authority to carry out audits of annual accounts or consolidated accounts required by Community law”;

““EEA competent authority” means a competent authority within the meaning of Article 2.10 of the Audit Directive of an EEA State other than the United Kingdom”;

““foreign country” means a country or territory that is not an EEA State or part of an EEA State”;

““overseas competent authority” means a body established in a foreign country exercising functions related to the regulation or oversight of overseas auditors”.

(2) After subsection (2) insert—

“(2A) For the purposes of this Part, Gibraltar shall be treated as if it were an EEA State.”

### Index of defined expressions

4.—○ Section 1262 of the Companies Act 2006 (index of defined expressions) is amended as follows.

(1) At the appropriate places, insert the following entries in the Table—

“Audit Directive	section 1261(1)”;
“audit working papers	section 1261(1)”;
“EEA auditor	section 1261(1)”;
“EEA competent authority	section 1261(1)”;

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<sup>(5)</sup> Registered number 05081885

<sup>(6)</sup> OJ L 157, 9.6.2006, p. 87. The Directive extends to the European Economic Area by virtue of Decision of the EEA Joint Committee No. 160/2006 of 8 December 2006 amending Annex XXII (Company law) to the EEA Agreement (not yet published in the Official Journal).

“foreign country	section 1261(1)”;
“overseas competent authority	section 1261(1)”.

## PART 2

### STATUTORY AUDITORS

#### **Supervisory bodies**

**5.**—○ Section 1217 of the Companies Act 2006 (supervisory bodies) is amended as follows.

(1) In subsection (1) omit the words from “which are binding” to the end.

(2) After subsection (1) insert—

“(1A) The rules must be binding on persons—

- (a) seeking appointment or acting as a statutory auditor, or
- (b) who have sought appointment or acted as a statutory auditor,

who are members of the supervisory body or have been members of the body at any time on or after the commencement of this Part.”

#### **Appropriate qualifications**

**6.** In section 1219(1) of the Companies Act 2006 (appropriate qualifications), omit paragraph (e).

#### **Approval of overseas qualifications**

**7.**—○ Section 1221 of the Companies Act 2006 (approval of overseas qualifications) is amended as follows.

(1) For subsection (2) substitute—

“(2) A declaration—

- (a) under subsection (1)(a) or (b) must, except if no aptitude test is required by virtue of subsection (7B), be expressed subject to the satisfaction of the requirement that any person to whom a declaration relates passes an aptitude test in accordance with subsection (7A), and
- (b) under subsection (1)(b) may be expressed to be subject to the satisfaction of any other specified requirement or requirements.”.

(2) After subsection (7) insert—

“(7A) An aptitude test required for the purposes of subsection (2)(a)—

- (a) must test the person’s knowledge of subjects—
  - (i) that are covered by a recognised professional qualification offered by a qualifying body,
  - (ii) that are not covered by the professional qualification already held by the person, and
  - (iii) the knowledge of which is essential for the pursuit of the profession of statutory auditor;
- (b) may test the person’s knowledge of rules of professional conduct;
- (c) must not test the person’s knowledge of any other matters.

(7B) No aptitude test is required for the purposes of subsection (2)(a) if the subjects—

- (a) that are covered by a recognised professional qualification offered by a qualifying body, and
- (b) the knowledge of which is essential for the pursuit of the profession of statutory auditor,

are covered by the professional qualification already held by the person”.

(3) In subsection (8) for “subsection (2)” substitute “subsection (2)(b)”.

(4) Omit subsection (9).

## PART 3

### COMPETENT AUTHORITIES

#### Notification of matters relevant to other EEA States

8. After section 1223 of the Companies Act 2006<sup>(7)</sup> (matters to be notified to the Secretary of State) insert—

##### “Notification of matters relevant to other EEA States

**1223A.**—(1) A recognised supervisory body must notify the Secretary of State of—

- (a) any withdrawal of a notifiable person’s eligibility for appointment as a statutory auditor; and
- (b) the reasons for the withdrawal.

(2) A recognised supervisory body must also notify the Secretary of State of any reasonable grounds it has for suspecting that a person has contravened the law of an EEA State other than the United Kingdom implementing the Audit Directive,

(3) In subsection (1)(a), a “notifiable person” means a member of the body—

- (a) who is also an EEA auditor; and
- (b) in respect of whom the EEA competent authority is not the recognised supervisory body itself.”.

#### Notification and publication of summary of quality assurance review results

9. After section 1223A of the Companies Act 2006 (inserted by regulation 8 above), insert—

##### “Notification and publication of summary of quality assurance review results

**1223B.**—(1) A recognised supervisory body must, at least once in every calendar year, deliver to the Secretary of State a summary of the results of the quality assurance reviews which have been conducted in relation to its members for the purposes of paragraph 13 of Schedule 10 (quality assurance reviews).

(2) The Secretary of State must, at least once in every calendar year, publish a report summarising the information he has received for the purposes of subsection (1).”.

#### Restrictions on disclosure

10.—○ After section 1224 of the Companies Act 2006 (Secretary of State’s power to call for information) insert—

##### “Restrictions on disclosure

**1224A.**—(1) This section applies to information (in whatever form)—

- (a) relating to the private affairs of an individual, or
- (b) relating to any particular business,

that is provided to a body to which this section applies in connection with the exercise of its functions under this Part or sections 522 to 524 (notification to appropriate audit authority of resignation or removal of auditor).

(2) This section applies to—

- (a) a recognised supervisory body,

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<sup>(7)</sup> 2006 c. 46

- (b) a recognised qualifying body,
  - (c) a body performing functions for the purposes of arrangements within paragraph 23(1) (independent monitoring of certain audits) or paragraph 24(1) (independent investigation of public interest cases) of Schedule 10,
  - (d) the Secretary of State, and
  - (e) a body designated by the Secretary of State for the purposes of section 1252 (delegation of the Secretary of State’s functions).
- (3) No such information may, during the lifetime of the individual or so long as the business continues to be carried on, be disclosed without the consent of that individual or (as the case may be) the person for the time being carrying on that business.
- (4) Subsection (3) does not apply to any disclosure of information that—
- (a) is made for the purpose of facilitating the carrying out by the body of any of its functions,
  - (b) is made to a person specified in Part 1 of Schedule 11A,
  - (c) is of a description specified in Part 2 of that Schedule, or
  - (d) is made in accordance with Part 3 of that Schedule.
- (5) Subsection (3) does not apply to—
- (a) the disclosure by an EEA competent authority of information disclosed to it by the body in reliance on subsection (4);
  - (b) the disclosure of such information by anyone who has obtained it directly or indirectly from an EEA competent authority.
- (6) This section does not prohibit the disclosure of information if the information is or has been available to the public from any other source.
- (7) Nothing in this section authorises the making of a disclosure in contravention of the Data Protection Act 1998.

#### **Offence of disclosure in contravention of section 1224A**

**1224B.**—(1) A person who discloses information in contravention of section 1224A (restrictions on disclosure) is guilty of an offence, unless—

- (a) he did not know, and had no reason to suspect, that the information had been provided as mentioned in section 1224A(1), or
- (b) he took all reasonable steps and exercised all due diligence to avoid the commission of the offence.

(2) A person guilty of an offence under this section is liable—

- (a) on conviction on indictment, to imprisonment for a term not exceeding two years or a fine (or both);
- (b) on summary conviction, to imprisonment for a term not exceeding three months or to a fine not exceeding the statutory maximum (or both).”.

(1) After Schedule 11 to the Companies Act 2006 insert the Schedule 11A set out in the Schedule to these Regulations.

#### **Meaning of “third country auditor”, “registered third country auditor” etc**

**11.** In section 1241(2)(a) of the Companies Act 2006 (meaning of “third country auditor”, “registered third country auditor” etc) for “a country or territory which is not a member State or part of a member State” substitute “a foreign country”.

#### **Cooperation with EEA competent authorities**

**12.** After section 1253 of the Companies Act 2006 (delegation of functions to an existing body) insert—

### **Requests to EEA competent authorities**

**1253A.** The Secretary of State may request from an EEA competent authority or an overseas competent authority such assistance, information or investigation as he may reasonably require in connection with the exercise of his functions under this Part.

### **Requests from EEA competent authorities**

**1253B.**—(1) The Secretary of State must take all necessary steps, unless subsection (3) applies, to—

- (a) ensure that an investigation is carried out, or
- (b) provide any other assistance or information,

requested by an EEA competent authority in accordance with Article 36 of the Audit Directive (cooperation between Member State authorities).

(2) The Secretary of State must—

- (a) take the steps referred to in subsection (1)(b), or
- (b) notify the EEA competent authority which made the request of the reasons why he has not taken the steps,

not more than 28 days after the date on which he receives the request.

(3) This subsection applies if—

- (a) the Secretary of State considers that complying with the request may prejudice the sovereignty, security or public order of the United Kingdom; or
- (b) legal proceedings have been brought in the United Kingdom (whether continuing or not) in relation to the persons and matters to which the request relates.

### **Notification to competent authorities of other EEA States**

**1253C.**—(1) Where—

- (a) the Secretary of State receives notice from a recognised supervisory body for the purposes of section 1223A(1) (notification of withdrawal of eligibility for appointment) of the withdrawal of a person’s eligibility for appointment as a statutory auditor, or
- (b) the Secretary of State has reasonable grounds for suspecting that a person has contravened the law of an EEA State other than the United Kingdom implementing the Audit Directive,

he must notify the relevant EEA competent authority in accordance with subsection (2).

(2) The Secretary of State must—

- (a) in the case of a notification for the purposes of subsection (1)(a), include the name of the person concerned and the reasons for the withdrawal of his eligibility for appointment as a statutory auditor;
- (b) in the case of a notification for the purposes of subsection (1)(b), include the name of the person concerned and the grounds for suspecting that he has contravened the law of an EEA State other than the United Kingdom implementing the Audit Directive.

(3) In this section, “relevant EEA competent authority” means any EEA competent authority which has approved the person concerned in accordance with the Audit Directive to carry out audits of annual accounts or consolidated accounts required by Community law.”.

## Transfer of papers to foreign countries

13. After section 1253C of the Companies Act 2006<sup>(8)</sup> (inserted by regulation 12 above), insert—

### *“Transfer of papers to foreign countries*

#### **Transfer of papers to foreign countries**

**1253D.**—(1) The Secretary of State may deliver to an overseas competent authority audit working papers requested by that authority only if—

- (a) he has entered into arrangements with the authority in accordance with section 1253E (working arrangements); and
- (b) the papers relate to the audit of a body which—
  - (i) has issued securities in the country or territory in which the authority is established, or
  - (ii) forms part of a group issuing statutory consolidated accounts in that country or territory.

(2) A recognised supervisory body may not deliver audit working papers to such a competent authority.

#### **Working arrangements for transfer of papers**

**1253E.**—(1) The Secretary of State may enter into arrangements with an overseas competent authority for the purposes of section 1253D(1)(a) (transfer of papers to foreign countries) only if the arrangements provide that—

- (a) the Secretary of State has the rights and duties referred to in subsections (2) to (5), and
- (b) the overseas competent authority has reciprocal rights and duties.

(2) Any request by the Secretary of State for audit working papers from the overseas competent authority or an overseas auditor in the country or territory in which the authority is established must be accompanied by a statement explaining the reasons for the request.

(3) The Secretary of State may use the audit working papers he requests only in connection with—

- (a) quality assurance functions which meet requirements equivalent to those of Article 29 of the Audit Directive (quality assurance),
- (b) investigation or disciplinary functions which meet requirements equivalent to those of Article 30 of the Audit Directive (investigations and penalties), or
- (c) public oversight functions which meet requirements equivalent to those of Article 32 of the Audit Directive (principles of public oversight).

(4) The Secretary of State’s employees must be subject to obligations of professional secrecy which will apply in relation to the audit working papers he requests.

(5) The Secretary of State may refuse a request from the overseas competent authority for audit working papers—

- (a) on the grounds that legal proceedings have been brought (whether continuing or not) in relation to the person and matters to which the request relates,
- (b) on the grounds that he considers that complying with the request would adversely affect the sovereignty, security or public order of the United Kingdom, or
- (c) on such grounds as are specified in the arrangements.

(6) In subsection (4) the reference to the Secretary of State’s employees is a reference to—

- (a) the Crown servants whose duties relate to the audit working papers he requests, or

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<sup>(8)</sup> 2006 c. 46

- (b) if a body has been designated by the Secretary of State for the purposes of section 1252 (delegation of the Secretary of State's functions), the body's employees.

(7) In this section, "overseas auditor" means a person other than—

- (a) a person eligible for appointment as a statutory auditor, or
- (b) an EEA auditor,

who is authorised in accordance with the law of a foreign country to conduct audits required by the law of that country.

#### **Publication of working arrangements**

**1253F.** If the Secretary of State enters into arrangements for the purposes of section 1253D(1)(a) (transfer of papers to foreign countries), he must publish on a website—

- (a) the name of the overseas competent authority with which he has entered into such arrangements, and
- (b) the country or territory in which it is established.”.

## **PART 4**

### **RECOGNISED SUPERVISORY BODIES**

#### **EEA auditors**

**14.**—○ Paragraph 6 of Schedule 10 to the Companies Act 2006 (holding of appropriate qualification) is amended as follows.

(1) In sub-paragraph (1)(a), after "individual" insert "other than an EEA auditor”.

(2) After sub-paragraph (1)(a), insert—

“(aa) in the case of an individual who is an EEA auditor—

- (i) he holds an appropriate qualification,
- (ii) he has been authorised on or before 5 April 2008 to practise the profession of company auditor pursuant to the European Communities (Recognition of Professional Qualifications) (First General System) Regulations 2005 (S.I. 2005/18) and has fulfilled any requirements imposed pursuant to regulation 6 of those Regulations, or
- (iii) he has passed an aptitude test in accordance with sub-paragraph (2), except if no such test is required in accordance with sub-paragraph (2A).”

(3) For sub-paragraph (2) substitute—

“(2) An aptitude test required for the purposes of sub-paragraph (1)(aa)(iii)—

- (a) must test the person's knowledge of subjects—
  - (i) that are covered by a recognised professional qualification offered by a qualifying body,
  - (ii) that are not covered by the professional qualification already held by the person, and
  - (iii) the knowledge of which is essential for the pursuit of the profession of statutory auditor;
- (b) may test the person's knowledge of rules of professional conduct;
- (c) must not test the person's knowledge of any other matters.

(2A) No aptitude test is required for the purposes of sub-paragraph (1)(aa)(ii) if the subjects—

- (a) that are covered by a recognised professional qualification offered by a qualifying body, and
- (b) the knowledge of which is essential for the pursuit of the profession of statutory auditor,

are covered by the professional qualification already held by the person ”.

### **Meaning of “controlled by qualified persons”**

**15.**—○ Paragraph 7 of Schedule 10 to the Companies Act 2006 (meaning of “controlled by qualified persons”) is amended as follows.

(1) In sub-paragraph (2)(a)(ii) for “a member State” at both places where it occurs substitute “an EEA State”.

(2) For sub-paragraph (2)(b)(ii) substitute—  
“(ii) being an EEA auditor.”.

### **Professional integrity and independence**

**16.**—○ Paragraph 9 of Schedule 10 to the Companies Act 2006 (professional integrity and independence) is amended as follows.

(1) In sub-paragraph (1)(a), after “integrity” omit “and”.

(2) After sub-paragraph (1)(b) insert—

“(c) persons appointed as statutory auditors take steps to safeguard their independence from any significant threats to it,

(d) persons appointed as statutory auditors record any such threats and the steps taken to safeguard the proper conduct of the audit from them, and

(e) remuneration received or receivable by a statutory auditor in respect of statutory audit work is not—

(i) influenced or determined by the statutory auditor providing other services to the audited person, or

(ii) on a contingent fee basis.”.

(3) For sub-paragraph (3) substitute—

“(3) The body must also have adequate rules and practices designed to ensure that—

(a) no firm is eligible under its rules for appointment as a statutory auditor unless the firm has arrangements to prevent any person from being able to exert any influence over the way in which a statutory audit is conducted in circumstances in which that influence would be likely to affect the independence or integrity of the audit;

(b) any rule of law relating to the confidentiality of information received in the course of statutory audit work by persons appointed as statutory auditors is complied with; and

(c) a person ceasing to hold office as auditor makes available to the person appointed to that office immediately after his ceasing to hold it all relevant information which he holds in relation to that office.”.

(4) For sub-paragraph (4) substitute—

“(4) The rules referred to in sub-paragraph (3)(b) (confidentiality of information) must apply to persons who are no longer members of the body as they apply to members and any fine imposed in the enforcement of those rules shall be recoverable by the body as a debt due to it from the person obliged to pay it.”.

### **Technical standards for group audits**

**17.**—○ After paragraph 10 of Schedule 10 to the Companies Act 2006<sup>(9)</sup> insert—

*“Technical standards for group audits*

**10A.**—(1) The body must have rules and practices as to technical standards ensuring that persons appointed as statutory auditors to conduct audits of group accounts—

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<sup>(9)</sup> 2006 c. 46

- (a) review for the purposes of such an audit the audit work conducted by other persons, and;
- (b) record that review.

(2) The body must participate in arrangements within paragraph 22, and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under such arrangements.

(3) The body must also have rules and practices ensuring that persons appointed as statutory auditors to conduct audits of group accounts—

- (a) take all reasonable steps to obtain from persons who have conducted audit work for the purposes of such an audit all documents necessary for a review of that work;
- (b)
  - (i) retain copies of any documents received by them for the purposes of such a review from persons in a relevant foreign country, or
  - (ii) agree with those persons proper and unrestricted access to those documents on request;
- (c) make available on request to—
  - (i) the body,
  - (ii) any other body with which the body has entered into arrangements for the purposes of paragraph 23 or 24 (independent arrangements for monitoring and investigation), and
  - (iii) the Secretary of State,any documents received by them for the purposes of such a review from persons in a relevant foreign country; and
- (d) if they are unable to obtain documents necessary for such a review from persons in a relevant foreign country, record—
  - (i) the steps taken to obtain those documents,
  - (ii) the reasons why they could not be obtained, and
  - (iii) any evidence of those steps or those reasons.

(4) In this paragraph—

“group” has the same meaning as in Part 15 of this Act (see section 474);

“relevant foreign country” means a foreign country in which a relevant overseas competent authority is established; and

“relevant overseas competent authority” means an overseas competent authority which has not entered into arrangements for the purposes of section 1253E (working arrangements).”.

### **Public interest entity reporting and independence requirements**

**18.** After paragraph 10A of Schedule 10 to the Companies Act 2006 (inserted by regulation 17 above) insert—

*“Public interest entity reporting requirements*

**10B.**—(1) The body must have adequate rules and practices designed to ensure that persons appointed by public interest entities to which this paragraph applies as statutory auditors provide a report for the public interest entity’s audit committee at least once in each calendar year for which (in whole or in part) they are appointed.

(2) The report must include—

- (a) a statement confirming the person’s independence from the public interest entity;
- (b) a description of any services provided by the person to the public interest entity other than in his capacity as statutory auditor;
- (c) a description of any significant threats to the auditor’s independence;
- (d) an explanation of the steps taken by the person to safeguard his independence from those threats;

- (e) a description of any material weaknesses arising from the statutory audit in the public interest entity's internal control in relation to the preparation of accounts; and
- (f) any other significant matters arising from the statutory audit.

(3) The body must participate in arrangements within paragraph 22A (arrangements for setting standards), and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under such arrangements.

(4) This paragraph applies to a public interest entity other than an exempted issuer.

(5) In this paragraph—

“exempted issuer” means an issuer—

- (a) which is a credit institution within the meaning of Article 4.1(a) of Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions<sup>(10)</sup> which has—
  - (i) issued debt securities of less than 100 million euros in value,
  - (ii) not issued any other transferable securities admitted to trading on a regulated market, and
  - (iii) not published a prospectus for the purposes of Article 3 of the Prospectuses Directive;
- (b) which is a subsidiary undertaking of a parent undertaking for the purposes of the Companies Acts (see sections 1161 and 1162 of, and Schedule 7 to the Companies Act 2006<sup>(11)</sup>), if the parent undertaking is a public interest entity; or
- (c) whose sole business is to act as issuer of asset-backed securities within the meaning of Article 2(5) of Commission Regulation (EC) No. 809/2004 implementing the Prospectus Directive<sup>(12)</sup>; and

“the Prospectus Directive” means Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC<sup>(13)</sup>.

*Public interest entity independence requirements*

**10C.**—(1) The body must have adequate rules and practices designed to ensure that—

- (a) an individual does not accept an appointment by a public interest entity as statutory auditor if—
  - (i) he has been the statutory auditor of the entity for a continuous period of more than seven years, and
  - (ii) less than two years have passed since he was last the statutory auditor of the entity;
- (b) where a firm has been appointed by a public interest entity as statutory auditor, an individual may not be the senior statutory auditor if—
  - (i) he has been the senior statutory auditor in relation to audits of the entity for a continuous period of more than seven years, and
  - (ii) less than two years have passed since he was last the senior statutory auditor in relation to an audit of the entity.

(2) The body must participate in arrangements within paragraph 22B (arrangements for setting standards), and the rules and practices mentioned in sub-paragraph (1) must include provision requiring compliance with any standards for the time being determined under such arrangements.

(3) The body must also have adequate rules and practices designed to ensure that—

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<sup>(10)</sup> OJ L177, 30.6.2006, p. 1  
<sup>(11)</sup> 2006 c. 46  
<sup>(12)</sup> OJ L149, 30.4.2004, p. 1  
<sup>(13)</sup> OJ L345, 31.12.2003, p. 64

- (a) an individual who has been appointed by a public interest entity as statutory auditor may not be appointed as a director or other officer of the entity during a period of two years commencing on the date on which his appointment as statutory auditor ended;
- (b) the senior statutory auditor of a firm which has been appointed by a public interest entity as statutory auditor may not be appointed as a director or other officer of the entity during a period of two years commencing on the date on which his work as senior statutory auditor ended.

(4) The rules referred to in sub-paragraph (3)(a) and (b) must apply to persons who are no longer members of the body as they apply to members and any fine imposed in the enforcement of those rules shall be recoverable by the body as a debt due to it from the person obliged to pay it.

(5) An auditor of an audited person is not to be regarded as an officer of the person for the purposes of sub-paragraph (3)(a) and (b).

(6) For the purposes of this paragraph, “senior statutory auditor”—

- (a) in relation to a firm appointed as a company’s auditor, has the meaning given in section 504 (senior statutory auditor);
- (b) in relation to a firm appointed as a group’s auditor, means each individual identified by the firm as being primarily responsible for the audit work relating to a material subsidiary;
- (c) in relation to a firm appointed as auditor of a public interest entity other than a company, means the individual identified by the firm as being primarily responsible for the audit work relating to that entity.”.

### **Monitoring and enforcement**

**19.**—○ Paragraph 12 of Schedule 10 to the Companies Act 2006 (monitoring and enforcement) is amended as follows.

(1) For sub-paragraph (1) substitute—

“(1) The body must—

- (a) have adequate resources for the effective monitoring and enforcement of compliance with its rules, and
- (b) ensure that those resources may not be influenced improperly by the persons monitored.

(1A) The body must—

- (a) have adequate arrangements for the effective monitoring and enforcement of compliance with its rules, and
- (b) ensure that those arrangements operate independently of the persons monitored.”.

(2) After sub-paragraph (2) insert—

“(3) The arrangements for enforcement must include—

- (a) provision for sanctions which include—
  - (i) the withdrawal of eligibility for appointment as a statutory auditor; and
  - (ii) any other disciplinary measures necessary to ensure the effective enforcement of the body’s rules; and
- (b) the body making available to the public information relating to steps it has taken to ensure the effective enforcement of its rules.”.

### **Monitoring of audits**

**20.** For paragraph 13 of Schedule 10 to the Companies Act 2006<sup>(14)</sup> (independent monitoring of audits of listed companies and other major bodies) substitute—

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<sup>(14)</sup> 2006 c. 46

*“Monitoring of audits*

**13.—(1) The body must—**

- (a) in the case of members of the body who do not perform any statutory audit functions in respect of major audits, have adequate arrangements for enabling the performance by its members of statutory audit functions to be monitored by means of inspections;
- (b) in the case of members of the body who perform any statutory audit functions in respect of major audits, the body must participate in arrangements within paragraph 23(1); and
- (c) have rules designed to ensure that members of the body take such steps as may reasonably be required of them to enable their performance of any statutory audit functions to be monitored by means of inspections.

(2) Any monitoring of members of the body under the arrangements within paragraph 23(1) is to be regarded (so far as their performance of statutory audit functions in respect of major audits is concerned) as monitoring of compliance with the body’s rules for the purposes of paragraph 12(1) and (1A).

(3) The arrangements referred to in sub-paragraph (1)(a) must include a quality assurance review which is conducted in relation to each person eligible for appointment as a statutory auditor at least once every six years.

(4) A quality assurance review conducted in relation to a firm may be treated as a quality assurance review of all individuals responsible for statutory audit work on behalf of that firm, if the firm has a common quality assurance policy with which each such individual is required to comply.

(5) A quality assurance review must be conducted by persons who—

- (a) hold—
  - (i) an appropriate qualification for the purposes of Chapter 2 of Part 42 (see section 1219), or
  - (ii) a corresponding qualification to audit accounts under the law of an EEA State, or part of an EEA State, other than the United Kingdom;
- (b) have experience of statutory audit work;
- (c) have received adequate training in the conduct of quality assurance reviews;
- (d) do not have any interests likely to conflict with the proper conduct of the quality assurance review.

(6) A quality assurance review must review one or more statutory audits in which the person to whom the quality assurance review relates has participated.

(7) A quality assurance review must include an assessment of—

- (a) the person’s compliance with the body’s rules established for the purposes of paragraphs 9 (professional integrity and independence), 10A (technical standards) and 10C (public interest entity independence requirements);
- (b) the resources allocated by the person to statutory audit work;
- (c) in the case of a review in relation to a firm, its internal quality control system;
- (d) the remuneration received by the person in respect of statutory audit work.

(8) The main conclusions of a quality assurance review must be recorded in a report which is made available to—

- (a) the person to whom the review relates, and
- (b) the body.

(9) In this paragraph—

“major audit” means a statutory audit conducted in respect of—

- (a) a public interest entity, or
- (b) any other person in whose financial condition there is a major public interest;

“statutory audit function” means any function performed as a statutory auditor.”.

## **Transfer of papers to foreign countries**

**21.** After paragraph 16 of Schedule 10 to the Companies Act 2006 insert—

*“Transfer of papers to foreign countries*

**16A.**—(1) The body must have adequate rules and practices designed to ensure that persons eligible under its rules for appointment as a statutory auditor deliver audit working papers to an overseas competent authority only if—

- (a) the authority has entered into arrangements with the Secretary of State in accordance with section 1253E (working arrangements); and
- (b) the requirements of sub-paragraphs (2) to (4) are met.

(2) The first requirement referred to in sub-paragraph (1) is that the competent authority has requested the audit working papers for the purposes of an investigation.

(3) The second requirement is that the papers relate to the audit of a body which—

- (a) has issued securities in the country or territory in which the competent authority is established, or
- (b) forms part of a group issuing statutory consolidated accounts in that country or territory.

(4) The third requirement is that the competent authority has given to the Secretary of State notice of its request.”.

## **Interpretation**

**22.** After paragraph 20 of Schedule 10 to the Companies Act 2006, insert—

*“Interpretation*

**20A.** In this Part of this Schedule—

“public interest entity” means an issuer—

- (a) whose transferable securities are admitted to trading on a regulated market; and
- (b) for which the United Kingdom is the home State; and

“issuer”, “transferable securities”, “regulated market” and “home State” have the same meaning as in Part 6 of the Financial Services and Markets Act 2000 (see sections 102A to 103).”.

## **Arrangements for setting technical standards**

**23.** In paragraph 22 of Schedule 10 to the Companies Act 2006 (arrangements for setting technical standards)—

- (a) for “paragraph 10(2)” substitute “paragraphs 10(2) and 10A(2)”; and
- (b) in paragraph (a) for “paragraph 10(1)” substitute “paragraphs 10(1) and 10A(1) respectively”.

## **Arrangements for setting standards relating to public interest entity reporting and independence requirements**

**24.** After paragraph 22 of Schedule 10 to the Companies Act 2006, insert—

*“Arrangements for setting standards relating to public interest entity reporting requirements*

**22A.** The arrangements referred to in paragraph 10B(3) are appropriate arrangements—

- (a) for the determining of standards for the purposes of the rules and practices mentioned in paragraph 10B(1), and
- (b) for ensuring that the determination of those standards is done independently of the body.

*Arrangements for setting standards relating to public interest entity independence requirements*

- 22B.** The arrangements referred to in paragraph 10C(2) are appropriate arrangements—
- (a) for the determining of standards for the purposes of the rules and practices mentioned in paragraph 10C(1), and
  - (b) for ensuring that the determination of those standards is done independently of the body.”.

**Arrangements for independent monitoring of audits of listed companies and other major bodies**

**25.**—○ Paragraph 23 of Schedule 10 to the Companies Act 2006 is amended as follows.

(1) In sub-paragraph (1) for “paragraph 13(1)” substitute “paragraph 13(1)(b)”.

(2) After sub-paragraph (1) insert—

“(1A) The arrangements referred to in sub-paragraph (1)(b) must include a quality assurance review which is conducted in relation to each person eligible for appointment as a statutory auditor at least once every three years.

(1B) Sub-paragraphs (4) to (8) of paragraph 13 apply in relation to the quality assurance review.”

## PART 5

### RECOGNISED PROFESSIONAL QUALIFICATIONS

#### Practical training

**26.** In paragraph 9(4)(b) of Schedule 11 to the Companies Act 2006<sup>(15)</sup> (practical training) for “a member State” in both places where it occurs substitute “an EEA State”.

## PART 6

### REGISTRATION OF THIRD COUNTRY AUDITORS

#### Register of third country auditors

**27.**—○ The designated body must keep a register of third country auditors.

(1) The register must contain the following information in relation to each third country auditor who is an individual—

- (a) his name and address;
- (b) his registered number;
- (c) an indication that he is a third country auditor;
- (d) if he is responsible for third country audit work on behalf of a third country auditor which is a firm, the firm’s name, address and, if it has a website, its address;
- (e) in the case of a third country auditor who has registered with an EEA competent authority—
  - (i) the name and address of that authority, and
  - (ii) the registration number which that authority has allocated to it;
- (f) the name and address of any body which has authorised the third country auditor to conduct audits required by the law of a foreign country; and

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<sup>(15)</sup> 2006 c. 46

- (g) if he has entered into arrangements with a body for the purposes of section 1242(1) of the Companies Act 2006 (duties of registered third country auditors), the name and address of that body.

(2) The register must contain the following information in relation to each third country auditor which is a firm—

- (a) its name and address;
- (b) the address of each of its offices in which it carries out third country audit work;
- (c) its registered number;
- (d) an indication that it is a third country auditor;
- (e) its contact information and, if it has a website, its address;
- (f) its legal form;
  - - in the case of a third country auditor which is a body corporate other than a limited liability partnership, the name and address of each person who is a director of the body or holds any shares in it,
    - (i) in the case of a third country auditor which is a limited liability partnership, the name and address of each member of the partnership,
    - (ii) in the case of a third country auditor which is a corporation sole, the name and address of the individual for the time being holding the office by the name of which he is the corporation sole, or
    - (iii) in the case of a third country auditor which is a partnership, the name and address of each partner;
- (g) the name and address of each individual who performs third country audits on behalf of the firm;
- (h) in the case of a third country auditor which is a member of a network—
  - (i) a list of the names and addresses of the other members of that network, or
  - (ii) an indication of where that information is available to the public;
- (i) in the case of a third country auditor which has registered with an EEA competent authority—
  - (i) the name and address of that authority, and
  - (ii) the registration number which that authority has allocated to it;
- (j) the name and address of any body which has authorised the third country auditor to conduct audits required by the law of a foreign country; and
- (k) if it has entered into arrangements with a body for the purposes of section 1242(1) of the Companies Act 2006 (duties of registered third country auditors), the name and address of that body.

(3) The register of third country auditors must be kept in electronic form.

(4) The register must be kept available for inspection by any person by electronic means.

### **Application for registration of third country auditor**

**28.**—○ A third country auditor may apply to the designated body for registration in accordance with this regulation.

(1) An application for registration must be in writing.

(2) An application for registration of a third country auditor must include—

- (a) the information required for his entry in the register (see regulation 27), other than
  - (i) his registered number, or
  - (ii) the name and address of any body with which he has entered into arrangements for the purposes of section 1242(1) of the Companies Act 2006 (duties of registered third country auditors);
- (b) the statement required by regulation 29 (application statement); and

(c) evidence demonstrating that the matters included in the statement required by regulation 29 (application statement) are correct.

(3) For the purposes of paragraph (3)(c) a statement by an overseas body to the effect that the third country auditor is a fit and proper person to perform third country audits may be treated as evidence demonstrating that the statement required by regulation 29(c) is correct.

(4) An application for registration must—

- (a) in the case of a third country auditor who is an individual, be signed by the third country auditor;
- (b) in the case of a third country auditor which is a firm, be signed by a person authorised by the firm to sign on its behalf.

(5) An application may be delivered to the designated body by electronic means, if the designated body so agrees.

(6) In this regulation, “overseas body” means any body which in accordance with the law of a foreign country has authorised the third country auditor to conduct audits required by the law of that foreign country.

### **Application statement**

**29.** A third country auditor must make a statement for the purposes of his application under regulation 28 (application for registration of third country auditor) to the effect that—

- (a) in the case of a third country auditor who is an individual, he holds a qualification which meets requirements equivalent to those which apply to an appropriate qualification for the purposes of section 1219 of the Companies Act 2006;
- (b) in the case of a third country auditor which is a firm—
  - (i) a majority of the members of the firm’s administrative or management body hold qualifications which meet requirements equivalent to those which apply to an appropriate qualification for the purposes of that section, and
  - (ii) each individual who performs third country audits on behalf of that firm holds a qualification which meets requirements equivalent to those which apply to an appropriate qualification for the purposes of that section;
- (c) he is a fit and proper person to perform third country audits;
- (d) he performs third country audits in accordance with standards equivalent to those required by Articles 22, 24 and 25 of the Audit Directive (independence, objectivity and audit fees);
- (e) he performs third country audits in accordance with standards equivalent to those determined under arrangements within paragraph 22 of Schedule 10 to the Companies Act 2006 (independent determination of technical standards); and
- (f) he publishes on a website an annual transparency report equivalent to that required for auditors of public interest entities by Article 40 of the Audit Directive (transparency report).

### **Acceptance and refusal of application for registration**

**30.**—○ The designated body may register a third country auditor if he has made an application in accordance with regulation 28 (application for registration of third country auditor).

(1) The designated body may not register a third country auditor if it considers that the statement required by regulation 29 (application statement) made by him is not correct.

(2) If the designated body refuses to register a third country auditor, it must give him written notice to that effect stating the reason for the refusal.

### **Allocation of registered number**

**31.** The designated body must allocate a number to each third country auditor which it registers, which shall be known as the third country auditor’s registered number.

### **Duty to provide updated information**

**32.** A registered third country auditor must take all reasonable steps to notify the designated body without undue delay of—

- (a) the name and address of any body he has entered into arrangements with for the purposes of section 1242(1) of the Companies Act 2006 (arrangements for monitoring of audits of traded non-Community companies);
- (b) any information or event which may lead the designated body to consider that the statement required by regulation 29 (application statement) made by the third country auditor is not correct;
- (c) any information necessary to ensure that the information in the register relating to him is correct.

### **Removal of third country auditor from the register**

**33.**—○ If the designated body considers that the statement required by regulation 29 (application statement) made by the third country auditor is no longer correct, it must—

- (a) notify the third country auditor of the steps he must take to ensure that the statement is correct, and
- (b) if the third country auditor has not taken those steps on or before the date three months after the notification, remove him from the register.

(2) The designated body may remove a third country auditor from the register if it considers that the third country auditor has failed to comply with his obligations under—

- (a) regulation 32 (duty to provide updated information),
- (b) section 1242 of the Companies Act 2006<sup>(16)</sup> (duties of registered third country auditors),
- (c) section 1243 of that Act (matters to be notified to the Secretary of State), or
- (d) section 1244 of that Act (Secretary of State’s power to call for information).

## **PART 7**

### **OTHER AMENDMENTS AND REVOCATIONS**

#### **Grounds for petition by company member**

**34.**—○ In section 994 of the Companies Act 2006 (protection of members against unfair prejudice: petition by company member), after subsection (1) insert—

“(1A) For the purposes of subsection (1)(a), a removal of the company’s auditor from office—

- (a) on grounds of divergence of opinions on accounting treatments or audit procedures, or
- (b) on any other improper grounds,

shall be treated as being unfairly prejudicial to the interests of some part of the company’s members.”.

(1) This amendment does not apply in relation to an auditor appointed for a financial year of a company beginning before 6 April 2008.

#### **Definition of “traded non-Community company”**

**35.**—○ A large debt securities issuer is excluded from the definition of “traded non-Community company” for the purposes of Part 42 of the Companies Act 2006 (see section 1241(2)).

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<sup>(16)</sup> 2006 c. 46

(1) A “large debt securities issuer” means a company whose only issued transferable securities admitted to trading on a regulated market are debt securities, the denomination per unit of which is not less than—

- (a) 50,000 euros, or
- (b) in the case of debt securities denominated in a currency other than euros, a sum equivalent at the date of issue to 50,000 euros.

(2) In paragraph (2) “debt securities”, “transferable securities” and “regulated market” have the same meaning as in Part 6 of the Financial Services and Markets Act 2000<sup>(17)</sup> (see sections 102A to 103).

## Revocations

**36.**—o The Company Auditors (Examinations) Regulations 1990<sup>(18)</sup> are revoked.

(1) The Companies Act 1989 (Register of Auditors and Information About Audit Firms) Regulations 1991<sup>(19)</sup> are revoked.

(2) The European Communities (Recognition of Professional Qualifications) (First General System) Regulations 2005<sup>(20)</sup> are revoked for the purposes of their application to the profession of company auditor.

[Date]

Department for Business, Enterprise and Regulatory Reform

## SCHEDULE

Regulation 10(2)

### Schedule 11A to the Companies Act 2006

#### “SCHEDULE 11A

Specified persons, descriptions, disclosures etc for the purposes of section 1224A

#### PART 1

##### Specified persons

1. The Secretary of State.
2. The Department of Enterprise, Trade and Investment for Northern Ireland.
3. The Treasury.
4. The Bank of England.
5. The Financial Services Authority.
6. The Commissioners for Her Majesty’s Revenue and Customs.
7. The Lord Advocate.
8. The Director of Public Prosecutions.

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<sup>(17)</sup> 2000 c. 8

<sup>(18)</sup> S.I. 1990/1146

<sup>(19)</sup> S.I. 1991/1566

<sup>(20)</sup> S.I. 2005/18. The 2005 Regulations were revoked for all other purposes by [insert reference to 2007 Regulations when made].

- 9.** The Director of Public Prosecutions for Northern Ireland.
- 10.** A constable.
- 11.** A procurator fiscal.
- 12.** The Scottish Ministers.
- 13.** A body designated by the Secretary of State under section 1252 (delegation of the Secretary of State's functions).
- 14.** A recognised supervisory body.
- 15.** A recognised qualifying body.
- 16.** A body with which a recognised supervisory body is participating in arrangements for the purposes of paragraph 23 (independent monitoring of audits) or 24 (independent investigation for disciplinary purposes) of Schedule 10 to this Act.

## PART 2

### Specified descriptions of disclosures

- 17.** A disclosure for the purpose of enabling or assisting a person authorised under section 457 of this Act (persons authorised to apply to court) to exercise his functions.
- 18.** A disclosure for the purpose of enabling or assisting an inspector appointed under Part 14 of the Companies Act 1985 (investigation of companies and their affairs, etc) to exercise his functions.
- 19.** A disclosure for the purpose of enabling or assisting a person authorised under section 447 of the Companies Act 1985 (power to require production of documents) or section 84 of the Companies Act 1989 (c. 40) (exercise of powers by officer etc) to exercise his functions.
- 20.** A disclosure for the purpose of enabling or assisting a person appointed under section 167 of the Financial Services and Markets Act 2000 (c. 8) (general investigations) to conduct an investigation to exercise his functions.
- 21.** A disclosure for the purpose of enabling or assisting a person appointed under section 168 of the Financial Services and Markets Act 2000 (investigations in particular cases) to conduct an investigation to exercise his functions.
- 22.** A disclosure for the purpose of enabling or assisting a person appointed under section 169(1)(b) of the Financial Services and Markets Act 2000 (investigation in support of overseas regulator) to conduct an investigation to exercise his functions.
- 23.** A disclosure for the purpose of enabling or assisting the body corporate responsible for administering the scheme referred to in section 225 of the Financial Services and Markets Act 2000 (the ombudsman scheme) to exercise its functions.
- 24.** A disclosure for the purpose of enabling or assisting a person appointed under paragraph 4 (the panel of ombudsmen) or 5 (the Chief Ombudsman) of Schedule 17 to the Financial Services and Markets Act 2000 to exercise his functions.
- 25.** A disclosure for the purpose of enabling or assisting a person appointed under regulations made under section 262(1) and (2)(k) of the Financial Services and Markets Act 2000 (investigations into open-ended investment companies) to conduct an investigation to exercise his functions.
- 26.** A disclosure for the purpose of enabling or assisting a person appointed under section 284 of the Financial Services and Markets Act 2000 (investigations into affairs of certain collective investment schemes) to conduct an investigation to exercise his functions.

**27.** A disclosure for the purpose of enabling or assisting the investigator appointed under paragraph 7 of Schedule 1 to the Financial Services and Markets Act 2000 (arrangements for investigation of complaints) to exercise his functions.

**28.** A disclosure for the purpose of enabling or assisting a person appointed by the Treasury to hold an inquiry into matters relating to financial services (including an inquiry under section 15 of the Financial Services and Markets Act 2000 (c. 8)) to exercise his functions.

**29.** A disclosure for the purpose of enabling or assisting the Secretary of State or the Treasury to exercise any of their functions under any of the following—

- (a) the Companies Acts;
- (b) Part 5 of the Criminal Justice Act 1993 (c. 36) (insider dealing);
- (c) the Insolvency Act 1986 (c. 45);
- (d) the Company Directors Disqualification Act 1986 (c. 46);
- (e) Part 42 of this Act (statutory auditors)
- (f) Part 3 (investigations and powers to obtain information) or 7 (financial markets and insolvency) of the Companies Act 1989 (c. 40);
- (g) the Financial Services and Markets Act 2000.

**30.** A disclosure for the purpose of enabling or assisting the Scottish Ministers to exercise their functions under the enactments relating to insolvency.

**31.** A disclosure for the purpose of enabling or assisting the Department of Enterprise, Trade and Investment for Northern Ireland to exercise any powers conferred on it by the enactments relating to companies or insolvency.

**32.** A disclosure for the purpose of enabling or assisting a person appointed or authorised by the Department of Enterprise, Trade and Investment for Northern Ireland under the enactments relating to companies or insolvency to exercise his functions.

**33.** A disclosure for the purpose of enabling or assisting the Pensions Regulator to exercise the functions conferred on it by or by virtue of any of the following—

- (a) the Pension Schemes Act 1993 (c. 48);
- (b) the Pensions Act 1995 (c. 26);
- (c) the Welfare Reform and Pensions Act 1999 (c. 30);
- (d) the Pensions Act 2004 (c. 35);
- (e) any enactment in force in Northern Ireland corresponding to any of those enactments.

**34.** A disclosure for the purpose of enabling or assisting the Board of the Pension Protection Fund to exercise the functions conferred on it by or by virtue of Part 2 of the Pensions Act 2004 or any enactment in force in Northern Ireland corresponding to that Part.

**35.** A disclosure for the purpose of enabling or assisting—

- (a) the Bank of England,
- (b) the European Central Bank, or
- (c) the central bank of any country or territory outside the United Kingdom, to exercise its functions.

**36.** A disclosure for the purpose of enabling or assisting the Commissioners for Her Majesty's Revenue and Customs to exercise their functions.

**37.** A disclosure for the purpose of enabling or assisting organs of the Society of Lloyd's (being organs constituted by or under the Lloyd's Act 1982 (c. xiv)) to exercise their functions under or by virtue of the Lloyd's Acts 1871 to 1982.

**38.** A disclosure for the purpose of enabling or assisting the Office of Fair Trading to exercise its functions under any of the following—

- (a) the Fair Trading Act 1973 (c. 41);
- (b) the Consumer Credit Act 1974 (c. 39);
- (c) the Estate Agents Act 1979 (c. 38);
- (d) the Competition Act 1980 (c. 21);
- (e) the Competition Act 1998 (c. 41);
- (f) the Financial Services and Markets Act 2000 (c. 8);
- (g) the Enterprise Act 2002 (c. 40);
- (h) the Control of Misleading Advertisements Regulations 1988 (S.I. 1988/915);
- (i) the Unfair Terms in Consumer Contracts Regulations 1999 (S.I. 1999/2083).

**39.** A disclosure for the purpose of enabling or assisting the Competition Commission to exercise its functions under any of the following—

- (a) the Fair Trading Act 1973;
- (b) the Competition Act 1980;
- (c) the Competition Act 1998;
- (d) the Enterprise Act 2002.

**40.** A disclosure with a view to the institution of, or otherwise for the purposes of, proceedings before the Competition Appeal Tribunal.

**41.** A disclosure for the purpose of enabling or assisting an enforcer under Part 8 of the Enterprise Act 2002 (enforcement of consumer legislation) to exercise its functions under that Part.

**42.** A disclosure for the purpose of enabling or assisting the Takeover Panel to perform any of its functions under Part 28 of this Act (takeovers etc).

**43.** A disclosure for the purpose of enabling or assisting the Charity Commission to exercise its functions.

**44.** A disclosure for the purpose of enabling or assisting the Attorney General to exercise his functions in connection with charities.

**45.** A disclosure for the purpose of enabling or assisting the National Lottery Commission to exercise its functions under sections 5 to 10 (licensing) and 15 (power of Secretary of State to require information) of the National Lottery etc. Act 1993 (c. 39).

**46.** A disclosure by the National Lottery Commission to the National Audit Office for the purpose of enabling or assisting the Comptroller and Auditor General to carry out an examination under Part 2 of the National Audit Act 1983 (c. 44) into the economy, effectiveness and efficiency with which the National Lottery Commission has used its resources in discharging its functions under sections 5 to 10 of the National Lottery etc. Act 1993.

**47.** A disclosure for the purpose of enabling or assisting a qualifying body under the Unfair Terms in Consumer Contracts Regulations 1999 (S.I. 1999/2083) to exercise its functions under those Regulations.

**48.** A disclosure for the purpose of enabling or assisting an enforcement authority under the Consumer Protection (Distance Selling) Regulations 2000 (S.I. 2000/2334) to exercise its functions under those Regulations.

**49.** A disclosure for the purpose of enabling or assisting an enforcement authority under the Financial Services (Distance Marketing) Regulations 2004 (S.I. 2004/2095) to exercise its functions under those Regulations.

**50.** A disclosure for the purpose of enabling or assisting a local weights and measures authority in England and Wales to exercise its functions under section 230(2) of the Enterprise Act 2002 (c. 40) (notice of intention to prosecute, etc).

**51.** A disclosure for the purpose of enabling or assisting the Financial Services Authority to exercise its functions under any of the following—

- (a) the legislation relating to friendly societies or to industrial and provident societies;
- (b) the Building Societies Act 1986 (c. 53);
- (c) Part 7 of the Companies Act 1989 (c. 40) (financial markets and insolvency);
- (d) the Financial Services and Markets Act 2000 (c. 8).

**52.** A disclosure for the purpose of enabling or assisting the competent authority for the purposes of Part 6 of the Financial Services and Markets Act 2000 (official listing) to exercise its functions under that Part.

**53.** A disclosure for the purpose of enabling or assisting a body corporate established in accordance with section 212(1) of the Financial Services and Markets Act 2000 (compensation scheme manager) to exercise its functions.

**54.** A disclosure for the purpose of enabling or assisting a recognised investment exchange or a recognised clearing house to exercise its functions as such.

“Recognised investment exchange” and “recognised clearing house” have the same meaning as in section 285 of the Financial Services and Markets Act 2000.

**55.** A disclosure for the purpose of enabling or assisting a person approved under the Uncertificated Securities Regulations 2001 (S.I. 2001/3755) as an operator of a relevant system (within the meaning of those regulations) to exercise his functions.

**56.** A disclosure for the purpose of enabling or assisting a body designated under section 326(1) of the Financial Services and Markets Act 2000 (designated professional bodies) to exercise its functions in its capacity as a body designated under that section.

**57.** A disclosure with a view to the institution of, or otherwise for the purposes of, civil proceedings arising under or by virtue of the Financial Services and Markets Act 2000.

**58.** A disclosure for the purpose of enabling or assisting a body designated by order under section 1252 of this Act (delegation of functions of Secretary of State) to exercise its functions under Part 42 of this Act (statutory auditors).

**59.** A disclosure for the purpose of enabling or assisting a recognised supervisory or qualifying body, within the meaning of Part 42 of this Act, to exercise its functions as such.

**60.** A disclosure for the purpose of making available to an audited person information relating to a statutory audit of that person’s accounts.

**61.** A disclosure for the purpose of making available to the public information relating to monitoring or inspections carried out under arrangements within paragraph 23(1) of Schedule 10 to this Act (arrangements for independent monitoring of audits of listed companies and other major bodies), provided such information does not identify any audited person.

**62.** A disclosure for the purpose of enabling or assisting an official receiver (including the Accountant in Bankruptcy in Scotland and the Official Assignee in Northern Ireland) to exercise his functions under the enactments relating to insolvency.

**63.** A disclosure for the purpose of enabling or assisting the Insolvency Practitioners Tribunal to exercise its functions under the Insolvency Act 1986 (c. 45).

**64.** A disclosure for the purpose of enabling or assisting a body that is for the time being a recognised professional body for the purposes of section 391 of the Insolvency Act 1986 (recognised professional bodies) to exercise its functions as such.

**65.** A disclosure for the purpose of enabling or assisting an overseas regulatory authority to exercise its regulatory functions.

“Overseas regulatory authority” and “regulatory functions” have the same meaning as in section 82 of the Companies Act 1989.

**66.** A disclosure for the purpose of enabling or assisting the Regulator of Community Interest Companies to exercise functions under the Companies (Audit, Investigations and Community Enterprise) Act 2004 (c. 27).

**67.** A disclosure with a view to the institution of, or otherwise for the purposes of, criminal proceedings.

**68.** A disclosure for the purpose of enabling or assisting a person authorised by the Secretary of State under Part 2, 3 or 4 of the Proceeds of Crime Act 2002 (c. 29) to exercise his functions.

**69.** A disclosure with a view to the institution of, or otherwise for the purposes of, proceedings on an application under section 6, 7 or 8 of the Company Directors Disqualification Act 1986 (c. 46) (disqualification for unfitness).

**70.** A disclosure with a view to the institution of, or otherwise for the purposes of, proceedings before the Financial Services and Markets Tribunal.

**71.** A disclosure for the purposes of proceedings before the Financial Services Tribunal by virtue of the Financial Services and Markets Act 2000 (Transitional Provisions) (Partly Completed Procedures) Order 2001 (S.I. 2001/3592).

**72.** A disclosure for the purposes of proceedings before the Pensions Regulator Tribunal.

**73.** A disclosure for the purpose of enabling or assisting a body appointed under section 14 of the Companies (Audit, Investigations and Community Enterprise) Act 2004 (supervision of periodic accounts and reports of issuers of listed securities) to exercise functions mentioned in subsection (2) of that section.

**74.** A disclosure with a view to the institution of, or otherwise for the purposes of, disciplinary proceedings relating to the performance by a relevant lawyer, foreign lawyer, auditor, accountant, valuer or actuary of his professional duties.

In this paragraph—

“foreign lawyer” means a person (other than a relevant lawyer) who is a foreign lawyer within the meaning of section 89(9) of the Courts and Legal Services Act 1990;

“relevant lawyer” means—

- (a) a person who, for the purposes of the Legal Services Act 2007, is an authorised person in relation to an activity which constitutes a reserved legal activity (within the meaning of that Act),
- (b) a solicitor or barrister in Northern Ireland, or
- (c) a solicitor or advocate in Scotland.

**75.** A disclosure with a view to the institution of, or otherwise for the purposes of, disciplinary proceedings relating to the performance by a public servant of his duties.

“Public servant” means an officer or employee of the Crown.

**76.** A disclosure for the purpose of the provision of a summary or collection of information framed in such a way as not to enable the identity of any person to whom the information relates to be ascertained.

**77.** A disclosure in pursuance of any Community obligation.

## PART 3

### Overseas regulatory bodies

**78.** A disclosure is made in accordance with this Part of this Schedule if—

- (a) it is made to an EEA competent authority in accordance with section 1253B (requests from EEA competent authorities), or

- (b) it is made to the competent authority of a foreign country in accordance with section 1253D (transfer of papers to third countries).”.

## EXPLANATORY NOTE

*(This note is not part of the Regulations)*

The Regulations implement parts of Directive 2006/43/EC of the European Parliament and of the Council on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC<sup>(21)</sup> (“the Audit Directive”). Other parts of the Audit Directive are to be implemented in Parts 16 and 42 of the Companies Act 2006<sup>(22)</sup>, in regulations to be made by the Treasury and in rules to be made by the Financial Services Authority. It is also intended that the Professional Oversight Board will make regulations implementing other parts of the Directive, following the delegation to it of functions of the Secretary of State by an order made under section 1252 of the Companies Act 2006.

Regulations 5 to 13 amend provisions in Part 42 of the Companies Act 2006 (statutory auditors). Regulation 5 requires the rules of supervisory bodies to extend to their former members. Regulation 7 requires an aptitude test in connection with the recognition of the qualifications of overseas auditors. Regulation 10 and the Schedule impose an obligation of confidentiality in relation to the regulatory bodies for the audit profession. Regulation 12 requires those bodies to cooperate with regulatory bodies in other EEA States, and regulation 13 imposes requirements in relation to the transfer by them of papers to regulatory bodies outside of the EEA.

Regulations 14 to 26 amend provisions in Schedules 10 and 11 to the Companies Act 2006, which have the effect of requiring recognised supervisory bodies to have certain rules with which their members must comply. Regulation 14 requires an aptitude test in connection with the recognition of the qualifications of EEA auditors. Regulation 17 requires certain technical standards in relation to group audits, and regulations 18 and 24 introduce additional reporting and independence requirements in relation to audits of public interest entities. Regulations 19, 20 and 25 concern monitoring and enforcement requirements, including the conduct of quality assurance reviews. Regulation 21 imposes requirements in relation to the transfer by statutory auditors of papers to regulatory bodies outside of the EEA.

Regulations 27 to 33 provide for the registration of third country auditors. Regulation 22 requires the Professional Oversight Board to keep the register.

Regulation 34 amends section 994 of the Companies Act 2006. It allows a company member to petition a court if the company’s auditor has been dismissed on improper grounds.

Regulation 36 revokes the Company Auditors (Examinations) Regulations 1990<sup>(23)</sup> and the Companies Act 1989 (Register of Auditors and Information About Audit Firms) Regulations 1991<sup>(24)</sup>. It is intended that both will be replaced by regulations to be made by the Professional Oversight Board. Regulation 36 also revokes the European Communities (Recognition of Professional Qualifications) (First General System) Regulations 2005<sup>(25)</sup>, the provisions of which are replaced by regulation 14, insofar as they relate to statutory auditors.

An Impact Assessment in respect of these Regulations has been produced and copies are available from the Company Law and Governance Directorate, Department for Business, Enterprise and Regulatory Reform, 1 Victoria Street, London, SW1H 0ET or on [www.berr.gov.uk/consultations/open-consultations/index.html](http://www.berr.gov.uk/consultations/open-consultations/index.html).

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<sup>(21)</sup> OJ L 157, 9.6.2006, p. 87. The Directive extends to the European Economic Area by virtue of Decision of the EEA Joint Committee No. 160/2006 of 8 December 2006 amending Annex XXII (Company law) to the EEA Agreement (not yet published in the Official Journal).

<sup>(22)</sup> 2006 c. 46

<sup>(23)</sup> S.I. 1990/1146

<sup>(24)</sup> S.I. 1991/1566

<sup>(25)</sup> S.I. 2005/18. The 2005 Regulations were revoked for all other purposes by [insert reference to 2007 Regulations when made].

*Draft instrument - not yet final - July 2007*

*Draft Order laid before Parliament under sections 504(4), 1252(11), 1289, 1290 and 1292(4) of the Companies Act 2006, for approval by resolution of each House of Parliament.*

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D R A F T   S T A T U T O R Y   I N S T R U M E N T S

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**2008 No. 0000**

**COMPANIES**

**AUDITORS**

**The Statutory Auditors (Delegation of Functions etc) Order 2008**

*Made* - - - - - \*\*\*

*Coming into force* - - - - - *in accordance with article 1(2)*

It appears to the Secretary of State that the Professional Oversight Board is willing and able to exercise the functions transferred by this Order.

It appears to the Secretary of State that the Professional Oversight Board has arrangements in place relating to the exercise of those functions which are such as to be likely to ensure that the functions in question will be exercised effectively and to ensure that the functions will be exercised in accordance with the requirements specified in this Order.

It appears to the Secretary of State that it is no longer in the public interest that the Companies Act 1989 (Delegation) Order 2005<sup>(26)</sup> should remain in force.

The Secretary of State laid a draft of this Order before Parliament in accordance with sections 504(4), 1252(11), 1289, 1290 and 1292(4) of the Companies Act 2006, and the draft was approved by a resolution of each House of Parliament.

Now, therefore, the Secretary of State in exercise of the powers conferred upon him by sections 504(1)(b)(ii), 1252(1) and (4)(a) and (8), 1253(4) of, and paragraphs 7(3), 11(2) and (3)(a) of Schedule 13 to the Companies Act 2006<sup>(27)</sup> hereby makes the following Order:

**Citation, commencement and interpretation**

**37.**—○ This Order may be cited as the Statutory Auditors (Delegation of Functions etc) Order 2008.

(1) It comes into force—

- (a) for the purposes of transferring any function conferring a power to make regulations, on 1st March 2008; and
- (b) for all other purposes, on 6th April 2008.

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<sup>(26)</sup> S.I. 2005/2337

<sup>(27)</sup> 2006 c.46

(2) In this Order—

“the Act” means the Companies Act 2006<sup>(28)</sup>;

“designated body” means the body known as the Professional Oversight Board established under the articles of association of The Professional Oversight Board Limited<sup>(29)</sup>.

### Transfer of functions

**38.**—○ All the functions of the Secretary of State under Part 42 (statutory auditors) of the Act (other than those specified in section 1252(4)(b) of the Act<sup>(30)</sup>) are hereby transferred to the designated body, subject to—

- (a) the exceptions specified in paragraph (2); and
- (b) the reservations specified in paragraphs (3), (4) and (5).

(2) The functions of the Secretary of State under—

- (a) section 1210 of the Act (meaning of “statutory auditor”),
- (b) section 1214 of the Act (power to specify connection between persons for purposes of independence requirement),
- (c) section 1231 of the Act (laying report by independent supervisor before each House of Parliament),
- (d) section 1237(3) of the Act (provision in revoking order for pending proceedings),
- (e) section 1239(1)(b) of the Act (register of third country auditors),
- (f) section 1241(2)(c) of the Act (exclusion of bodies corporate from definition of “traded non-Community company”),
- (g) section 1246 of the Act (removal of third country auditors from the register of auditors),
- (h) section 1261(3) of the Act (power to modify Part 42 of the Act (statutory auditors) for purposes of application to certain bodies), and
- (i) section 1263 of the Act (power to make provision in consequence of changes affecting accountancy bodies),

are not transferred by this Order.

(3) The transfer of the functions of the Secretary of State under—

- (a) section 1224 of the Act (power to call for information from recognised bodies etc),
- (b) section 1239(8) of the Act (obligations relating to register enforceable by injunction etc),
- (c) section 1244 of the Act (power to call for information from registered third country auditors), and
- (d) section 1254 of the Act (directions to comply with international obligations),

is subject to the reservation that the functions remain exercisable concurrently by the Secretary of State.

(4) The transfer of the functions of the Secretary of State of—

- (a) refusing to make a declaration under section 1221(1) of the Act (approval of overseas qualification) on the grounds referred to in section 1221(4) (lack of comparable treatment), and
- (b) withdrawing such a declaration under section 1221(7) of the Act on those grounds

is subject to the reservation that the functions are exercisable only with the consent of the Secretary of State.

(5) The transfer of any function of the Secretary of State conferring a power to make regulations is subject to the reservation that such regulations must not come into force before 6th April 2008.

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<sup>(28)</sup> 2006 c.46

<sup>(29)</sup> Registered number 05081885

<sup>(30)</sup> Section 1252(4)(b) provides that functions of the Secretary of State in relation to the designated body itself and functions under section 1228 of the Act (appointment of independent supervisor) are not transferred by this Order.

### **Consultation requirement**

**39.**—○ The designated body must, unless paragraph (2) applies, before making any regulations in exercise of the functions transferred to it by this Order—

- (a) publish the proposed regulations in such manner as appears to the body to be best calculated to bring them to the attention of persons who may be affected by the proposed regulations;
- (b) publish at the same time a statement that representations in respect of the proposals may be made to the body within a specified period which must not be less than 12 weeks following the date of publication of the proposed regulations; and
- (c) have regard to any representations duly made in accordance with the statement before making the regulations.

(2) Paragraph (1) does not apply in any case in which the body considers that the delay involved in complying with that paragraph would be prejudicial to the public interest.

(3) Documents published by the designated body before the date on which this Order comes into force shall be treated as meeting the requirements of paragraph (1)(a) and (b) (publication of proposed regulations and statement regarding representations) if documents published in the same way after that date would have met those requirements.

### **Requirements for recording decisions**

**40.** The designated body must have satisfactory arrangements for—

- (a) recording decisions made in the exercise of the functions transferred by this Order; and
- (b) the safekeeping of those records.

### **Matters notified to the designated body**

**41.**—○ If the designated body requires a notification or the provision of information for the purposes of section 1223(1) or 1243(1), it must notify the Secretary of State of the requirement without undue delay.

(1) The Secretary of State may require the designated body to send to him a copy of any such notification or information received pursuant to the requirement.

### **Time limits for prosecution of offences**

**42.** Section 1256(1), (2), (4) and (6) of the Act (time limits for prosecution of offences) has effect as if the references to the Secretary of State were references to the Secretary of State or the designated body.

### **Appointment of body to issue guidance on senior statutory auditors**

**43.** The body known as the Auditing Practices Board established under the articles of association of The Auditing Practices Board Limited<sup>(31)</sup> is appointed for the purposes of sections 504(1)(b)(ii) of the Act (body to issue guidance on meaning of senior statutory auditor).

### **Companies Act 1989 (Delegation) Order 2005**

**44.** The Companies Act 1989 (Delegation) Order 2005<sup>(32)</sup> is revoked.

[Date]

Department for Business, Enterprise and Regulatory Reform

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<sup>(31)</sup> [Registered number to be inserted.]

<sup>(32)</sup> S.I. 2005/2337

## EXPLANATORY NOTE

*(This note is not part of the Order)*

This Order transfers most of the functions of the Secretary of State under Part 42 of the Companies Act 2006<sup>(33)</sup> (statutory auditors) to the Professional Oversight Board. By virtue of section 1252(3) of that Act, the Order also has the effect of designating the Professional Oversight Board for the purposes of the Freedom of Information Act 2000<sup>(34)</sup>.

Article 2 of the Order describes the exceptions and reservations to the transfer of functions. Articles 3, 4 and 5 impose requirements on the Professional Oversight Board of consultation, record keeping and notification of certain matters to the Secretary of State.

Article 7 appoints the Auditing Practices Board to issue guidance on the meaning of senior statutory auditor for the purposes of sections 504(1)(b)(ii) of the Companies Act 2006.

Article 8 revokes the Companies Act 1989 (Delegation) Order 2005<sup>(35)</sup>, which is replaced by this Order. That Order transferred to the Professional Oversight Board for Accountancy the functions of the Secretary of State under Part 2 of the Companies Act 1989<sup>(36)</sup>. Part 2 of the 1989 Act is repealed and replaced by the Companies Act 2006.

An Impact Assessment has not been produced for this Order as it has only a negligible impact on the costs of business, charities or voluntary bodies.

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<sup>(33)</sup> 2006 c. 46  
<sup>(34)</sup> 2000 c. 36  
<sup>(35)</sup> S.I. 2005/2337  
<sup>(36)</sup> 1989 c. 40

## ANNEX C

<b>Department for Business, Enterprise &amp; Regulatory Reform</b>		<b>Draft impact assessment of the implementation of the EU Directive on the statutory audit of annual and consolidated accounts</b>
<b>Stage Consultation</b>	<b>Version 1 July 2007</b>	<b>Related Publications:</b> Implementation of Directive 2006/43/EC on statutory audits of annual and consolidated accounts: - A consultative document, March 2007 - Policy Conclusions and Draft Regulations, July 2007

**Available to view or download at:** [www.berr.gov.uk/consultations](http://www.berr.gov.uk/consultations)

**Contact name for enquiries:** Amita Randhawa

**Email address:** [amita.randhawa@berr.gsi.gov.uk](mailto:amita.randhawa@berr.gsi.gov.uk)

**What is the problem under consideration? Why is government intervention necessary?**

The Directive aims to establish minimum levels of investor protection across the EU. This will enhance the level of confidence in EU capital markets and, whilst these measures cannot guarantee the prevention of another financial scandal, they will mitigate the risks of corporate malpractice occurring.

**What are the policy objectives and the intended effects?**

The Directive clarifies the duties of statutory and provides for their independence and ethical standards; introduces a requirement for external quality assurance; provides for public oversight of the audit profession, including third country auditors, and improved cooperation between oversight bodies in the EU. It also provides a basis for international cooperation between regulators in the EU and with regulators in third countries.

**What policy options have been considered? Please justify any preferred option.**

**Option 1**

Do nothing to implement the Directive, continuing with the current UK regime, which already reflects many but not all of the provisions in the Directive;

**Option 2**

Implement the Directive by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice; or

**Option 3**

Implement the Directive without taking up optional exemptions and/or through a less efficient and more complex means of implementation.

Option 2 represents the Government's assessment of the best means of implementation within these flexibilities and is, therefore, the Government's preferred option.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The majority of the provisions of the Directive will have to be implemented by 29 June 2008. In line with Government policy on common commencement dates, it is envisaged that the implementing regulations will come into force on 6 April 2008 and will apply to reporting periods beginning on or after that date. Actual costs and benefits, and the achievement of the desired effects, will be evident after the first reports which are subject to the new requirements are published in 2009.

**Ministerial Sign-off:**

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options***

Signed by the responsible Minister:

Date:

**Policy Option:** Option 2: Implement the Directive by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice.

<p><b>ANNUAL COSTS</b></p> <p>One off (Transition)                      Yrs <input style="width: 40px; text-align: center;" type="text" value="1"/></p> <p style="margin-left: 40px;"><input style="width: 100px; text-align: center;" type="text" value="£9,400,000"/></p> <p><b>Average Annual Cost</b> (excluding one-off)</p> <p style="margin-left: 40px;"><input style="width: 150px; text-align: center;" type="text" value="£6,655,000"/></p>	<p>Public register – up to £4.5 million (one off)          Audit reporting – up to £10,000 (per annum)          Cooperation between oversight systems – up to £30,000 (per annum)          Dismissal and resignation – up to £215,000 (per annum)          Transparency reports – up to £1 million (per annum)          Audit Committees – up to £3.8 million (£1.5 million one off, £2.3 million per annum)          International provisions – up to £3 million (£2 million one off, £1 million on-going) + £650 per instance          Cooperation between third countries – up to £100,000</p> <p style="text-align: right;"><b>Total cost (PV)</b>      <input style="width: 100px; text-align: center;" type="text" value="16,055,000"/></p>
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**Other key non-monetised costs**  
None

<p><b>ANNUAL BENEFITS</b></p> <p>One off <input style="width: 100px; height: 20px;" type="text"/> Yrs <input style="width: 20px; height: 20px;" type="text"/></p> <p><b>Average Annual Benefit</b> (excluding one-off)</p> <p style="margin-left: 40px;"><input style="width: 150px; height: 20px;" type="text"/></p>	<p>Not possible to quantify.</p> <p style="text-align: right;"><b>Total Benefit PV</b>      <input style="width: 150px; height: 20px;" type="text"/></p>
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**Other key non-monetised BENEFITS**

It is difficult to monetise the benefits of the Directive. The aim of the Directive is to raise the standard of, and public confidence in, the audit function across the European Internal Market. Greater confidence should reduce investor costs and have a favourable impact on the cost of capital. It should also give greater confidence in corporate reporting systems that underpin capital markets.

Companies involved in corporate scandals lose significant market value and are often forced to restructure, with consequent job losses. It has been estimated that the loss in stock market wealth in the US, as a result of the Enron and Worldcom scandals, has been at least 9% or 0.36% of Gross Domestic Product (GDP) - \$38.2 billion in the first year.<sup>37</sup>

**KEY Assumption/Sensitivities Risks**  
There is a legal obligation to implement the Directive into UK law.

Price Base Year 2006/2007	Time Period Years Year 1	Net Benefit Range (NPV) £-£ not possible to quantify	<b>NET BENEFIT</b> (NPV Best Estimate) £ not possible to quantify
What is the geographic coverage of the policy/option?			UK
On what date will the policy be implemented?			6 April 2008
Which organisation(s) will enforce the policy?			FRC (POB and APB), FSA,

<sup>37</sup> See Graham, Carol/Litan, Robert/Sukhtankar, Sandip (2002) 'The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance.'

	RSBs			
What is the total annual cost of enforcement for these organisations?	TBC			
Will implementation go beyond minimum EU requirements?	The implementation proposals fit with the established UK audit framework, which is more developed than EU requirements in some respects.			
What is the value of the proposed offsetting measure per year?	n/a			
What is the value of changes in green gas emissions?	n/a			
Will the proposal have a significant impact on competition?	No			
Annual cost per organisaton (excluding one-off)	Micro 0	Small 0	Med TBC	Large TBC
Are any of these organisations exempt?	Yes	Yes	No	No
<b>Impact on Admin Burdens Baseline (2005 prices)</b>				
Increase of	£1,320,000	Decrease of	0	<b>Net Impact</b> + £1,320,000

# Evidence Base for Summary Sheets

## THE EUROPEAN DIRECTIVE ON THE STATUTORY AUDIT OF ANNUAL AND CONSOLIDATED ACCOUNTS (2006/43/EC)

Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

### 1 Background

1.1 On 16 March 2004 the European Commission presented a proposal for a Directive of the European Parliament and of the Council on Statutory Audit of Annual and Consolidated Accounts.

1.2 On publication of the proposal the Commission omitted to prepare and publish a cost impact assessment. In the absence of this assessment, the Department of Trade and Industry (DTI) produced a partial impact assessment that was attached to its consultation document of 10 September 2004. After consideration of the responses to that consultation the Department published an updated regulatory impact assessment (RIA) that can be found at: [www.berr.gov.uk/files/file22807.pdf](http://www.berr.gov.uk/files/file22807.pdf)

1.3 After consideration by the European Parliament, the European Commission and Member States, political agreement was reached on the Directive. This was published on 9 June 2006. The full text of the Directive can be found at: [www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004PC0177:EN:HTML](http://www.eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:52004PC0177:EN:HTML)

### **The current UK framework**

1.4 Following the recommendations of the Co-ordinating Group on Audit and Accounting Issues, the Government made a number of changes to audit and accounting regulation. Many of these changes were implemented by the Companies (Audit, Investigations and Community Enterprise) Act 2004.

1.5 In addition, the Companies Act 2006 sets out provisions (in parts 16 and 42) for the audit of companies and those carrying out statutory audit. These Parts include restatements and modification of earlier company law and some of the

new provisions contained in this Directive. Part 42 provides that auditors of banks, building societies and insurers are also subject to the statutory auditor regime. This UK regime therefore covers all statutory audits within the scope of the Directive.

1.6 The effect of this is that the UK framework for statutory audit already meets a significant number of the requirements of the Directive. However, not all Member States are as far advanced. As recent financial scandals have shown, confidence is a European, not just UK, concern. A harmonised approach is therefore desirable.

### Impact of the Directive

1.7 This Impact Assessment primarily covers implementation of the Directive through the draft Statutory Auditors and Third Country Auditors Regulations. It also includes an assessment of those provisions in the Directive which are implemented by Part 42 of the Companies Act and those which are to be implemented by the Professional Oversight Board.

1.8 In assessing the impact of the Directive, the Department has considered the extent to which it differs from the measures that have been introduced by the UK Government. The Directive is one of a number of EU measures aimed at creating an efficient and harmonised EU capital market. These include:

- (a) The adoption of International Accounting Standards (Regulation EC1606/2002);
- (b) The Directive on Market Abuse (Directive 2003/71/EC on Insider Dealing and Market Manipulation);
- (c) The Prospectus Directive (Directive 2003/71/EC on the Prospectus to be published when securities are offered to the public or admitted to trading);
- (d) Amendments to the 4<sup>th</sup> Company Law Directive 78/660/EEC of 25 July 1978 (Annual Accounts of certain types of companies) and the 7<sup>th</sup> Company Law Directive 83/349/EEC of 13 June 1983 (on consolidated accounts);
- (e) Directive 86/635/EEC on the Annual Accounts and Consolidated Accounts of Banks and other financial institutions; and
- (f) The Insurance Accounting Directive 91/674/EEC on the Annual Accounts and Consolidated Accounts of Insurance undertakings.

## 2 Scope of the Directive

2.1 The Directive's requirements affect the statutory audit of the following entities:

- Companies required to produce annual accounts under the Fourth Company Law Directive (78/660/EEC);
- Companies required to produce annual and consolidated accounts under the Seventh Company Law Directive (83/349/EEC);

- Banks and other financial institutions required to produce annual and consolidated accounts under Council Directive 86/635/EEC;
- Insurance undertakings required to produce annual and consolidated accounts under Council Directive 91/674/EEC.

2.2 Chapter 10 of the Directive (Articles 39 to 43) sets additional requirements for companies who are defined in the Directive as public interest entities<sup>38</sup>. Whilst it is an option in the Directive, the Government does not intend to specify any other entities as ‘public interest entities’ for the purposes of Chapter 10 of the Directive. The Government proposes, as set out in the discussion of them in paragraphs 2.47 – 2.71 of the policy conclusions accompanying this draft IA, to take up the options to exempt certain entities as provided for in Articles 39 and 41.6. The exemption in Article 39 narrows the application of the requirements in Chapter 10 to those entities whose securities are admitted to trading on a regulated market in the UK, and the scope is narrowed further by the exemptions for specific entities in Article 41.6.

2.3 There are around 1,100<sup>39</sup> companies registered in the UK whose shares are traded on the London Stock Exchange’s main market. These companies cover a diverse range of sectors and operate in a variety of EU and non-EU competitive environments. The following table provides an indication of the scope of the provisions applying to those companies:

Companies covered by the Government’s proposed implementation of Chapter 10 of the Directive

UK registered companies trading on the LSE (SEAQ and SETS)*			
	By turnover (in millions)	By assets (in millions)	By no. of employees
Smallest company	£0.002	£0.013	1
Largest company	£152,618	£683,573	402,375
Average size	£1,358	£4,568	9491
Median size	£170	£138	1240

\*Information from FAME database, 2004 figures. Data does not include stocks from the Alternative Investment Market.

2.4 There are an additional 300 overseas companies<sup>40</sup> with a total market capitalisation of £2000 billion.

<sup>38</sup> ‘Public Interest Entities’ are defined by the Directive as entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC, credit institutions within the meaning of Article 1(1) of European Parliament and Council Directive 2000/12/EC and insurance undertakings as defined in Article 2 of Council Directive 1991/674/EEC. (The UK may also designate other entities as public interest entities, for instance entities that are of significant public relevance because of the nature of their business, their size or their number of employees).

<sup>39</sup> LSE Main Market statistics, August 2006: 1,161 companies registered in the UK. FAME database, August 2006: 1,066 companies registered in England, Scotland and Wales.

<sup>40</sup> LSE Main Market statistics, August 2006.

2.5 Small companies make up around 20%<sup>41</sup> of the companies coming into the scope of this part of the Directive. We do not consider that the Directive's requirements will add a disproportionate burden upon them, as they would already be expected to meet UK requirements associated with their listing.

### **3 Small Firms Impact Test**

3.1 The Audit Directive applies to those entities that are already subject to statutory audits under the requirements of existing Community law. Under the 4<sup>th</sup> and 7<sup>th</sup> Company Law Directives, small companies are exempt from the requirement to have a statutory audit. In the UK, companies that qualify as 'small'<sup>42</sup> and meet the turnover and balance sheet thresholds can be exempt and will not, therefore, be subject to the requirements of the Audit Directive<sup>43</sup>.

3.2 Small companies that are also public companies are not exempt from the requirement to have a statutory audit. They are, therefore, subject to the requirements of the Statutory Audit Directive, including those in Chapter 10 if they are deemed to be Public Interest Entities (as defined in the footnote [2] above).

3.3 Some small companies, which are not required by law to have their accounts audited nonetheless elect to do so because they see economic benefits in doing so.

3.4 European Directive 2006/46/EC, published on 16 August 2006, amends the 4<sup>th</sup>, 7<sup>th</sup>, Bank Accounts and Insurance Accounts Directives. The Directive must be implemented by 5 September 2008. The Department consulted separately on the implementation of this Directive and the Government's conclusions on that consultation can be found at: <http://www.berr.gov.uk/consultations/index.html>

### **4 Risk Assessment**

4.1 This Directive seeks to reduce the risk of future corporate scandals such as those at Worldcom, Enron and Parmalat and the subsequent collapse of Andersens, by setting out provisions to ensure regulation of and transparency in the statutory audit function. The Directive aims to establish minimum levels of investor protection across the EU. Whilst these measures cannot guarantee the

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<sup>41</sup> FAME database, August 2006.

<sup>42</sup> In the UK small companies are defined as: a balance sheet total of up to £2.8 million; and/or an annual turnover of up to £5.6 million

<sup>43</sup> The UK audit exemption works differently to that in EU legislation. Under EU legislation, all small companies are exempt, where a small company is defined as one which meets two out of the following three conditions: balance sheet less than 4.4 million Euros; turnover less than 8.8 million euros; fewer employees than 50. In the UK, conditions on turnover and balance sheet must BOTH be met.

prevention of another financial scandal, they will further mitigate the risks of such corporate malpractice occurring in the future.

4.2 It is difficult to quantify the risk of poor investor confidence across Europe and globally. Companies involved in corporate scandals lose significant market value and are often forced to restructure, with consequent job losses. It has been estimated that the loss in stock market wealth in the US, as a result of the Enron and Worldcom scandals, has been at least 9% or 0.36% of Gross Domestic Product (GDP) - \$38.2 billion in the first year.<sup>44</sup>

## **5 Options**

5.1 The majority of the provisions of the Directive will have to be implemented by 29 June 2008. In line with Government policy on common commencement dates, it is envisaged that the implementing regulations will come into force on 6 April 2008 and will apply to reporting periods beginning on or after that date. In practice, in most cases, these are likely to be the same reporting periods as the requirements would apply to were the Regulations commenced on 29 June and early implementation will, therefore, provide an additional period within which businesses can familiarise themselves with the requirements.

5.2 The previous consultation document noted a number of provisions in respect of which the Government identified that there were choices to be made as to the way in which the requirements of the Directive are to be implemented. These options fell into two categories:

- Optional exemptions as provided for in Articles 39, 41 and 46; or
- Alternative mechanisms for implementing, as identified in relation to Articles 21 to 25, and 37 to 49.

5.3 Recognising these choices, we identified three broad alternative options for implementation:

### **Option 1**

Do nothing to implement the Directive, continuing with the current UK regime, which already reflects many but not all of the provisions in the Directive;

### **Option 2**

Implement the Directive by building on the existing UK framework and adopting the implementing options as proposed in the attached consultation document; or

### **Option 3**

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<sup>44</sup> See Graham, Carol/Litan, Robert/Sukhtankar, Sandip (2002) 'The bigger they are, the harder they fall: an estimate of the costs of the crisis in corporate governance.'

Implement the Directive by building on the existing UK framework but adopting some or all of the alternative implementing options identified in the attached consultation document.

## **6. Cost-Benefit Analysis**

### **OPTION 1 – Do nothing to implement the Directive, continuing with the current UK regime, which already reflects many but not all of the provisions in the Directive**

6.1 As identified in the revised draft RIA published in February 2005, it is not feasible to ‘do nothing further’ as the UK Government is under a legal obligation to implement this Directive. Whilst there will be no implementation costs associated with this option there will be potential costs for the UK economy. These include:

- (a) Lack of confidence in UK’s capital markets;
- (b) Potential increased costs for investors associated with different regimes and the need for ‘greater due diligence checks’;
- (c) Potential increased costs for UK business in dealing with different auditing regulatory regimes and standards across the EU; and
- (d) Potential disadvantages for UK auditors seeking business in other Member States.
- (e) Risk of infraction proceedings brought against the UK Government by the Commission.

### **OPTION 2 – Implement the Directive by building on the existing UK framework and taking advantage of the flexibilities provided in the Directive, where these are considered to be the preferred policy choice**

6.2 The aim of the Directive is to raise the standard of, and public confidence in, the audit function across the European Internal Market. Greater confidence should reduce investor costs and have a favourable impact on the cost of capital. It should also restore faith in corporate reporting systems that underpin capital markets.

6.3 Attached at Appendix A is a table identifying the estimated costs of implementing the Directive by means of Option 2. This table is based on our analysis and on the figures supplied by stakeholders in response to the Government’s previous consultations on the draft Directive and on the policy options, which can be found using the link in paragraph 1.2 above. In particular, we continue to discuss with the regulators the costs relating to their implementation of the provisions for which they are responsible. The most significant costs identified are:

- Updating the current register of auditors to include additional information (Article 15);
- Submission of a dismissal notice in cases where the auditor has been dismissed (Article 38);
- Publication of a transparency report by audit firms who perform the statutory audit of public interest entities (Article 40);
- Supply of information by Third country auditors to the oversight body required under Articles 45 and 46;
- Changes required to ensure that proper systems are in place to meet requirements on the cooperation between third country competent authorities (Article 47); and
- Provisions for Public Interest Entities to have audit committees or bodies performing equivalent functions.

6.4 We note that there may also be occasional or minimal costs related to some of the provisions which have not been explicitly identified in this assessment. We welcome evidence in relation to such costs.

6.5 The Directive provides optional exemptions from some requirements and allows flexibility in the approach adopted by Member States in the implementation of others. The Government's objective is to maintain the benefits of the existing UK framework whilst avoiding unnecessary costs in implementing the additional requirements in the Directive. The Government intend to use all exemptions and flexibilities which they consider offer the least burdensome route for implementation. There are a small number of requirements for which the least costly and least complex implementation approach is to maintain the established UK framework, and where the benefits of moving to the minimum EU requirement would be outweighed by the cost of doing so.

**6.6 Option Two represents the Government's assessment of the best means of implementation within these flexibilities and is, therefore, the Government's preferred option.**

### **OPTION 3 – Implement the Directive without taking up optional exemptions and/or through a less efficient and more complex means of implementation**

6.7 This option is similar to option 2 except that we would not seek to use as many of the flexibilities provided for in the Directive and identified in the consultation document and would adopt some or all of the alternatives to the preferred options identified. On the basis of our current assessment of the issues to date, we have not identified significant overall cost differentials between options 2 and 3. The choice between them is, therefore, primarily policy based and will depend on what is likely to be the most appropriate balance of protections and

regulations, and the most efficient and least complex means of implementation. However, respondents are invited to submit further information on potential cost differentials between the various options.

## **7 Business Sectors Affected**

7.1 This Directive will affect all companies and financial institutions, such as banks and Insurance undertakings, which are required to have a statutory audit. There are additional requirements on companies classified as public interest entities and for public interest entities' audit firms. This Directive will affect statutory auditors, audit firms and their Recognised Supervisory Bodies. There are also some new requirements for the Financial Reporting Council.

7.2 The Financial Reporting Council is funded by the Government, companies (via listing fees) and the accountancy profession. For Recognised Supervisory Bodies, costs will be met on a cost recovery basis via increases in membership fees and, therefore, falls on auditors and audit firms.

## **8 Issues of Equity and Fairness**

8.1 The Government considers that the measures introduced by the Directive will not bring disproportionate benefits or have a disproportionate effect on particular groups.

## **9 Competition Assessment**

9.1 The Directive's requirements will affect all accountancy companies that carry out statutory audits, and all companies and financial institutions, such as bank and insurance undertakings, which are subject to the requirement to have a statutory audit. It is not anticipated that the Directive will: affect any of these businesses more than others; affect market structure; change the number or size of those businesses; lead to higher start-up costs for those businesses; or lead to higher on-going costs. Certain provisions of the Directive apply only to the audits of Public Interest Entities<sup>45</sup>, some of which may be small companies. These provisions are unlikely to affect competition as they apply equally to all Public Interest Entities that will be subject to the UK implementation of them.

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<sup>45</sup> 'Public Interest Entities' are defined by the Directive as entities governed by the law of a Member State whose transferable securities are admitted to trading on a regulated market of any Member State within the meaning of point 14 of Article 4(1) of Directive 2004/39/EC, credit institutions within the meaning of Article 1(1) of European Parliament and Council Directive 2000/12/EC and insurance undertakings as defined in Article 2 of Council Directive 1991/674/EEC. (The UK may also designate other entities as public interest entities, for instance entities that are of significant public relevance because of the nature of their business, their size or their number of employees).

## **10 Consultation**

10.1 The Government is committed to working closely with UK stakeholders during the consultation process to ensure the effective implementation of the provisions in the Directive to ensure that each element of the Directive brings economic benefits that justify legislation. BERR will endeavour to ensure that the final implementation proposal offers business flexibility that keep burdens and disruption to a minimum.

10.2 The DTI published a consultation document on the proposed Directive on 10 September 2004. The report on the responses received and an updated RIA, published in February 2005, can be found at the link identified in paragraph 1.2 above. Prior to publication of this consultation document, the Department held meetings with a range of stakeholder representatives. Since then, we have continued to maintain regular contact with our key stakeholders for assistance in developing the proposals set out in the previous consultation document and to gain informal views on the draft regulations attached. We will continue to work with stakeholders throughout the implementation process.

**Department for Business, Enterprise and Regulatory Reform  
July 2007**

## BREAKDOWN OF COSTS

The following table shows the best estimate of costs, based on responses to the Government's consultation during negotiation of the Directive and on the implementation options. The assessment has been updated in relation to the cost of the audit committee requirements in Article 41 of the Directive, based on the additional data provided by stakeholders. The Department would be grateful for any further evidence.

Article	Subject Matter	Cost	Comment
3,4 and 5	Auditor Approval	Minimal cost	The Directive's requirements will not impose any significant additional cost.
6, 7, 8, 9, 10, 11, 12 and 13	Auditor Education	No additional cost	The Directive's requirements will not impose any additional cost.
14	Approval of Auditors from other Member States	Minimal cost	The Directive's requirements will not impose any significant additional cost.
15, 16, 17, 18, 19 and 20	Public Register	Up to £4.5 million as one off policy cost.	There will be costs associated with obtaining and storing information that is not currently held on the public register and making the information available electronically. These costs will, however, be offset against savings relating to stakeholders' search costs (see note 1 below).
21 to 24	Ethics, Independence and Confidentiality	Minimal cost	The Directive's requirements will not impose any significant additional cost.

			Any future proposals from the Commission for comitology provisions might have cost implications (see note 2 below).
25	Auditor Fees	No additional costs	The Directive's requirements will not impose any additional cost.
26	Standards	No additional costs	The UK has already adopted International Standards on Auditing and the APB will consider any updating required in lieu of EU adoption of ISAs.
27	Consolidated Accounts	No additional costs	The Directive's requirements will not impose any additional cost. (see note 3 below).
28	Audit Reporting	Up to £10,000 cost per annum (split between policy and admin costs).	The changes required to the current UK system should largely be cost neutral. The figure of £10,000 per annum represents the cost of exemptions (see note 4 below).
29 and 43	Quality Assurance	No additional costs	The Directive's requirements will not impose any additional cost. (see note 5 below).
30	Investigations	No additional costs	The Directive's requirements will not impose any additional cost.
32	Public Oversight	No additional costs	The Financial Reporting Council (FRC), Professional Oversight Board (POB) took the oversight of statutory auditors from April 2005.
33, 34, 35 and 36	Co-operation between oversight systems	Up to £30,000 per annum in policy costs	There are likely to be increased costs for the POB (see note 6 below).
37	Auditor	No Additional	The Directive's

	Appointment	costs	requirements will not impose any additional cost.
38	Dismissal and Resignation	Up to £215,000 administrative cost per annum	Instances of auditor dismissal will be notified to the POB. The figure of £215,000 per annum covers the preparation and transmission of dismissal letters (see note 7 below).
40	Transparency Report	Up to £1 million per annum in administration costs	The requirement for published annual transparency reports are likely to apply in the UK to only a small number of audit firms, 30 or 40 at most. Many of these already prepare annual reports and the additional costs for those firms are likely to be low. Firms within this requirement that do not at present prepare an annual report will have more significant costs – see note 8.
41 and 42(1)	Audit Committees	(a) One off policy cost of £2.9 million  (b) Up to £4.3 million policy cost per annum	The revised figures are based on new survey evidence (see note 9 below).  The figures relate to the costs of recruitment resulting from the changes required to companies' audit committees.
40(2) and (3)	Auditor Rotation/Auditor 'cooling off	No additional costs	The Directive's requirements will not impose any additional cost.
44, 45 and 46	International Provisions	Under Article 46, up to £2 million to set-up and £1 million on-going costs.	Responsibility for the approval of third country auditors under Article 45 is proposed to be delegated to the POB. Responsibility for the assessment of the

		Third country auditor registration £650 administration cost per instance.	<p>equivalence of third countries' systems of oversight, quality assurance, investigations and sanctions under article 46 falls to the Commission and to the POB (see note 10 below). The costs comprise the following elements:</p> <ul style="list-style-type: none"> <li>• Costs of inspecting non-EU audit firms (costs would be passed to non-EU auditors and thus to issuers);</li> <li>• Costs of setting up a system of registration of third country audit firms; and</li> <li>• Costs to the audit firms of registering and of any inspection (e.g. management time).</li> </ul>
47	Co-operation between third countries	Possibly £100,000 per annum of administration cost (based on 50 cases per annum)	The figures relate to cost of transferring information between competent authorities. The 'on going' costs will depend on the number of requests (see note 11 below).
49	Disclosure	No additional costs	The Directive's requirements will not impose any additional cost.

**Notes:**

1. There are approximately 9000 audit firms. Additional information will be required from those firms to allow for the recognised supervisory bodies (ICAEW, ICAS, ICAI, ACCA and AIA) to comply with the public register requirements. Audit firms are already expected to complete annual returns with respect to the register.

Based on information provided by the POB we do not now consider that the costs identified in the report on responses to the consultation on negotiation are accurate. We consider the costs on audit firms will be substantially lower. The cost of updating and implementing the register are estimated as follows:

5 supervisory bodies (at £150,000 each\*)  
= £750,000

Top 12 audit firms (50 hours each for completion of annual return at £200 per hour) = £120,000

8986 Firms at average of £400 (2 hours for annual return completion at £200 per hour) = £3.6 million

(\* This cost is based on the amount incurred to update a similar computer system by a supervisory body).

Once the register has been updated to include the additional information the directive requires we do not consider that there will be any further cost on auditors or audit firms to ensure that information is accurate as that requirement already exists.

2. The Directive allows audit firms to provide non-audit services to audit clients in accordance with the existing UK 'threats and safeguards approach'. The implementation of the requirement should, therefore, have no cost impact and it is important to emphasise that costs would only occur if the Commission decided, under comitology provisions, to set restrictions on the provision of non audit services.

Costs would depend on the restrictions imposed but would be likely to result from efficiency losses. For example, excluding the auditor from the provision of some non-audit services would add cost since it is more efficient for some services to be provided by the auditor who already knows the business. Excluding the auditor may also decrease the choice of non-audit service providers for the company.

One estimate from audit firms puts costs at £30 million and is based on the following assumptions:

- (a) Large companies are audited by large audit firms which would – if a ban was introduced - separate their audit and non audit services teams;
- (b) Businesses would not incur new costs following the separation of their audit and non audit service providers;
- (c) The separation of audit and non audit service providers would cost, on average, £3000 per business; and

- (d) Some 95,000 businesses are required by law to have a statutory audit and could, therefore, be affected by a more restrictive approach.

This figure is at odds with the figure provided by the Recognised Supervisory Bodies. They estimate a one off cost of up to £100 million. This divergence demonstrates the difficulties in assessing potential additional costs in this area.

The Government considers that this range of estimates is very high and that a more restrictive approach under comitology would be an issue only for the largest firms and audits of listed companies. Though there may be some one-off costs for larger audit firms, the Government considers that most costs would result from the loss of efficiency savings resulting from the on-going separation of services.

3. Although we do not envisage any additional costs, it is possible there could be additional activity for the Professional Oversight Board associated with reviewing the work of overseas subsidiaries. Any costs would depend on factors, such as: (a) the decision when to carry out the review; (b) the location of the subsidiary; (c) the ability for documentation to be transferred electronically, or in hard copy.

4. The Directive provides exemptions from disclosure where the requirements would give rise to imminent and significant threats to an auditor's personal security. Utilising the exemption, while probably unusual, would have associated costs. We have estimated that these will be £1000 per instance. This exemption was one identified by the Audit Profession and those entities affected. This exemption imposes in part a policy and administrative cost (we estimate the admin cost is £200 per instance). However, it will provide for companies to appoint an auditor where otherwise it might be impossible.

5. No significant changes to the UK system are envisaged.

6. The POB will be responsible for co-ordinating requests (under Article 34) from other Member States authorities. There are likely to be increased costs for the POB if, as expected, these provisions result in significantly greater coordination and cooperation between and amongst Oversight Bodies within the EU. It is difficult to put a figure on this but it might be of the order of £30,000 a year.

7. The Directive will require companies to notify the POB when they dismiss their auditors. (This is currently not a requirement under UK company law but will be upon enactment of provisions in the 2006 Companies Act). Our cost estimate is based on the number of dismissals and resignations during the years 1990 to 1999. During this period, on average, 2138 firms were dismissed each year. Assuming each dismissal and resignation notification costs some £100 the per annum cost of the new requirement will be £213,800. Whilst this is an

administrative cost it will provide for greater transparency into the reasons why a company dismisses auditors. We consider that this transparency will allow investors to make informed choices.

8. Costs based on up to 20 firms having to prepare a report for the first time at an estimated cost of £50,000 per firm. The POB will have responsibility for ensuring that auditors and audit firms comply with the new requirement. Its costs have not been included.

9. The Directive applies to all regulated markets in the UK<sup>46</sup>. The London Stock Exchange has 1461 listed companies and this analysis is based on the cost implications for those companies. It is possible that the costs for companies trading on other UK regulated markets may be different.

Surveys indicate that all or virtually all FTSE 350 companies have an audit committee, and that 88%<sup>47</sup> of these are fully independent. In addition, an analysis of a sample of over 300 listed companies outside the FTSE 350, carried out for the FRC by Manifest, found that 99% of them have an audit committee and that 52% of these committees are also fully independent. Taken together these surveys therefore indicate that around 60% of listed companies currently have a fully independent audit committee. We currently have no survey data to indicate how many of the remaining 40% of listed companies do not at least have an audit committee with at least one independent member (the minimum required to meet the Directive requirements). The Government consider it probable that the number of such companies is likely to be small. However, for the purposes of estimation we have assumed the number to be around half (i.e. around 287) of the estimated 40% without a fully independent committee. The costs reflected in this assessment relate to the cost of recruiting an independent member for those companies who do not already have at least one. We estimated previously that the cost to a company of hiring an independent member will be some £15,000 per annum. In addition, we estimate a cost of £10,000 for the recruitment of each member.

Deloitte's annual survey, "At the Helm: 2007 survey of board structure and NEDs", which is based on a sample of 103 companies, further suggests that 97% of committees contain a member with recent and relevant financial expertise.

10. The Companies Act 2006 makes provision for POB costs of assessments under Article 45 to be charged to third country auditors. Costs will depend on the

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<sup>46</sup> A regulated market is a market place, trading system or exchange which meets the minimum EU standards set out in title III of the Markets in Financial Instruments Directive (2004/39/EC). Under Article 16 of the Investment Services Directive (93/22), the FSA is responsible for maintaining the list of regulated markets for which it is the Home Member State. In the UK currently, the list includes six of the markets operated by the London Stock Exchange (including the LSE Domestic Market but not AIM), two markets operated by virt-x Exchange Ltd, one operated by EDX and one operated by Liffe Administration and Management.

<sup>47</sup> Grant Thornton's FTSE 350 Corporate Governance Review 2006.

number of applications dealt with under Article 45, which in turn will be influenced by the Commission's assessment under Article 46.

The scale of costs depends on a range of factors, in particular (i) the extent to which we can disapply the Article 45 regime using the exemptions under Article 46 (the Commission is consulting in this area); (ii) the numbers and geographical spread of third country issuers with securities traded on UK regulated markets, and the number of third country auditors (POB estimates 600 issuers and 200 audit firms in 50 countries); and (iii) how we apply any system in practice.

The POB estimate costs of setting up a registration system and carrying out an inspection programme, assuming equivalence for only a relatively small number of countries under Article 46, to be £1.5 to £2 million in the set-up phase and £1 million in steady state. At the other extreme, assuming equivalence for all, the cost would be almost zero.

In the draft RIA published with the Government's report on responses to the consultation document on the negotiation on the Commission's proposal we estimated that third country auditor's costs would be £650 per instance. As identified above, the assessment of how many third country auditors will be required to register is dependent upon the application of the provisions in Article 46.

11. As the implementation of this article is likely to involve increased restriction on audit firms passing papers to third country authorities, it is unlikely to result in increased costs to business. It may, however, result in increased cooperation and transfer of papers between regulatory authorities. It is extremely difficult to estimate the costs which may result from this provision. However, we would expect the number of such cases to be relatively small. If there were 50 cases a year, with an average cost of transferring information of £2000, we estimate an annual cost of £100,000.

We do not expect that this will involve the setting up of expensive IT systems but we welcome views on this.

## Specific Impact Tests - Checklist

Type of testing undertaken	<i>Results in Evidence Base? (Y/N)</i>	<i>Results annexed? (Y/N)</i>
Competition Assessment	Y	N
Small Firms Impact Test	Y	N
Legal Aid	N	N
Sustainable Development	N	N
Carbon Assessment	N	N
Other Environment	N	N
Health	N	N
Race Equality	Y	N
Disability Equality	Y	N
Gender Equality	Y	N
Human Rights	Y	N
Rural Proofing	N	N

## List of respondents to the consultation

The full text of the responses can be seen at  
<http://www.berr.gov.uk/consultations/closedwithresponse/index.html>

Association of British Insurers

Association of Chartered Certified Accountants

Association of Investment Companies

Baker Tilly

BDO Stoy Hayward

British Bankers Association

Chartered Institute of Management Accountants

Confederation of British Industry

European Securitisation Forum

Deloitte & Touche

Ernst and Young

Financial Services Authority

Grant Thornton

Industry Governance Institute

International Capital Markets Association

Institute of Chartered Accountants England and Wales (2 responses)

Institute of Chartered Accountants Scotland

Institute of Chartered Secretaries and Administrators

Institute of Credit Management

Institute of Directors

Investment Management Association

KPMG

Law Society

London Investment Bankers Association

London Stock Exchange

Management Audit LLP

PricewaterhouseCoopers

Prudential

Quoted Companies Alliance

Tallaght Business School

Timothy Boatman (former Chairman of the audit committee of John Laing PLC)

One private response was also received

### CODE OF PRACTICE ON CONSULTATIONS

#### The Consultation Code of Practice Criteria

1. Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
2. Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
3. Ensure that your consultation is clear, concise and widely accessible.
4. Give feedback regarding the responses received and how the consultation process influenced the policy.
5. Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
6. Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

The complete code is available on the Cabinet Office's web site, address <http://www.cabinetoffice.gov.uk/regulation/consultation/index.asp>

#### 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:

Nick Cooper  
BERR Consultation Co-ordinator  
1 Victoria Street  
London  
SW1H 0ET

Telephone Nick on 020 7215 0346  
or e-mail to: [nick.cooper@berr.gsi.gov.uk](mailto:nick.cooper@berr.gsi.gov.uk)

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