

# Association of Accounting Technicians response to Auditor regulation: effects of the EU and wider reforms

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### 1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Department of Business, Enterprise and Skills (BIS) discussion document “Auditor regulation: effects of the EU and wider reforms”, released on 17 December 2014.
- 1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit of achieving sound and effective administration in the field of audit and accountancy.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our operationally skilled members in practice.

### 2. Executive summary

- 2.1. AAT considers that there is a need for the approach, legislation and regulation of the audit of Public Interest Entities (PIEs) to be different to that of other entities, but with a need to extend the definition<sup>1</sup> of PIEs to include all entities which are substantially dependent upon public monies. The oversight of such audits needs to be open and transparent to the public at large, whereas the oversight of other entities needs to focus on the needs of their stakeholders (see the response to questions 2 and 5) (3.3.2 & 3.10, below).
- 2.2. In general more stringent audit regulations do not result in improved public confidence in the integrity and independence of auditors. Such is engendered by more informative audit reporting coupled with redefined responsibilities for audit committees and appropriate disciplinary action taken by Recognised Supervisory Bodies (RSBs) against offending auditors. The focus of audit committees for PIEs should be on their responsibilities to protect stakeholders’ interests, reporting but not answerable to governing bodies’ boards, and where any issues of concern are not dealt with satisfactorily, to report to stakeholders (see response to questions 35 and 48) (3.48-3.49 & 3.67-3.68, above).
- 2.3. In order to broaden the market place in respect of the choice of audit firms and to optimise value for money from auditors there needs to be a relaxation of compulsory rotation, tendering periods and the removal of capping of non-audit services, with the facility to appoint auditors for a period longer than one year, and reliance on the disciplinary procedures of RSBs as regards non-compliance with ethical standards (see response to question 2 (3.3.10, 3.3.11,3.3.12 & 3.3.13 below) and 30 to 33 inclusive, 3.41-3.45 below).
- 2.4. AAT is in support of any move to reduce the administration and compliance burdens imposed on smaller entities and for these reasons is in support of the proposals to increase the audit exemption threshold. However, it should be noted that any increase in audit exemption thresholds is likely to be followed by a corresponding reduction in the demand for audits and inevitably the number of firms willing to offer audit services.

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<sup>1</sup> Article 1 paragraph 2 point (f) of [Directive 2014/56/EU](#) (“the new Directive”)

Ultimately leading to increased audit costs, and users of financial statements of audit exempt entities having no assurances as to the reliability of the contents of the financial statements.

- 2.5. It is AAT's view that there is a need to address the credibility and usefulness of financial statements of entities which will be exempt from audit, particularly as some may be of a substantial size with relatively sophisticated management structures and who may have the facility to prepare statutory financial statements in-house, possibly without any need for ethical considerations to be reflected in those financial statements. Users of statutory financial statements not subject to audit need to have assurances as to the reliability of those financial statements (see response to question 4, 3.5-3.9, below).

### **3. AAT response to the BIS discussion document on “Auditor regulation: effects of the EU and wider reforms”**

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

- 3.1. AAT considers it appropriate for the legislation to set out the definition of entities which are required to be subject to statutory audit and to establish the identity of the “single competent authority” as being the Financial Reporting Council (FRC) with authority to delegate responsibilities for regulation of audits to RSBs. Legislation should also set out the definition of “public interest” entities. Beyond those requirements, legislation should only be used to meet the minimum requirements to comply with the Directive and the Regulation, with the FRC normally taking as much responsibility as possible for all other regulatory aspects of audits but delegating such to RSBs to the greatest extent possible.

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

- 3.2. In broad principle AAT supports the view that the implementation of the Member State options<sup>2</sup> should be allocated to the Financial Reporting Council (FRC) as the “single competent authority” with an expectation that there will be further delegation to RSBs wherever practicable.
- 3.3. Specifically, the following are considered to require particular attention in implementing the options available:
  - 3.3.1. All audits (including voluntary audits) should be regulated as statutory audits.
  - 3.3.2. The definition of PIEs needs to be comprehensively expanded to include entities other than banks and insurance institutions. The expanded definition should encompass all entities whose activities have a significant impact on the public at large, including providers of public utilities and public services, entities funded by public monies (both by grants and commercial contracts) and charitable entities in all forms, as well as listed entities.
  - 3.3.3. The approval of a statutory auditor from another Member State should be subject to both an adaptation period and an aptitude test imposed by the Supervisory Bodies with authority delegated from the FRC.
  - 3.3.4. Responsibility should be allocated to the FRC to implement provisions for simplified requirements for audits of certain small undertakings, although AAT

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<sup>2</sup> [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/388846/member-state-options-table-for-regulation-537-2014.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/388846/member-state-options-table-for-regulation-537-2014.pdf)

believes that in the UK very few “small” entities will opt to be voluntarily subjected to an audit, particularly if audit exemption thresholds rise to coincide with those defining a “small” entity for statutory financial reporting purposes.

- 3.3.5. The procedures provided by legislation for the appointment of auditors need to recognise the practicalities of such in enabling directors to make such appointments (or as recommended by Audit Committees in the case of PIEs) as being the best informed to make an appropriate selection.
- 3.3.6. To avoid unnecessary constraints in the reliance on the work of other auditors in a country outside the EU, legislation should permit the transfer of audit working papers and other documents to that country.
- 3.3.7. The effectiveness of capping non audit service fees and, in particular the question of a “black list” of barred services in ensuring auditor independence needs to be challenged. While such may provide a perception of independence, there may be no threat to independence in providing such services and significant benefits may be derived by both the auditor and the entity audited in terms of the provision of “value-added” services on a cost effective basis, particularly where the entity does not have appropriate in-house skills.
- 3.3.8. The FRC should be given authority to implement standards on audit reports to provide a greater level of information to users of financial statements, particularly as regards assessing the risks attaching to significant matters of judgement, uncertainty and bias.
- 3.3.9. If an audit committee is to fulfil its function as being independent from the directors (albeit as an internal body of the entity) and to maintain an open and confidential relationship with the auditor, it is essential that any reports addressed to the audit committee should only be issued to others if the audit committee, or the auditor chooses to do so.
- 3.3.10. The requirement to appoint auditors annually as a principle is not conducive to the cost effective provision of audit services. Although in practice one year appointments of an auditor are rare, the security of a longer minimum term of appointment of say, five years encourages the auditor to plan audit coverage and risk assessment accordingly, as well as providing security for the period of time over which the necessary investment in audit set up costs can be recovered.
- 3.3.11. On the same basis as set out in 3.3.10 (above) the imposition of a maximum term of appointment as auditors is an unnecessary requirement, bearing in mind the costs arising from a change of auditors, and that independence is not necessarily threatened by having an open ended term of appointment.
- 3.3.12. In the case of a PIE it should be the responsibility of the audit committee to decide when a change is desirable to ensure independence, or for the benefit of improving value for money.
- 3.3.13. Similar considerations to those set out in 3.3.11 (above) also relate to the rotation of lead audit partners.

**Q3. In relation to the measures discussed in both this and the next chapter, what issues do you think arise that have not been considered as part of the discussion? If there are any, how do you think these should be addressed?**

- 3.4. One issue not addressed in these measures is the matter of public assurance and reliance on the financial statements of entities exempt from statutory audit, particularly given the expectation that exemption thresholds could rise significantly in the near future,

the consequences of which are discussed in further detail in the response to question 4 (3.5-3.9, below).

**Q4. In relation to the measures discussed in both this and the next chapter, we would welcome comments on any burdens applied to small and micro sized companies and audit firms in particular by the proposed implementation, which you consider are disproportionate to the wider benefits?**

- 3.5. The proposals do not appear to impose any burdens on small and micro sized companies unless they fall within the definition of a PIE but even then size considerations can provide relief from some of the requirements applicable to PIEs generally. Currently in the UK, charities with a turnover below £500,000 per annum are exempt from statutory audit requirements and such a threshold appears to be a reasonable level to be set for all PIEs. Due to the nature of PIEs, it is essential that such entities should be the subject of a more burdensome level of audit regulation in order to illustrate transparency in their duty for public accountability.
- 3.6. There are clear expectations that more entities are likely to be eligible for audit exemption in the near future. However, AAT believes that there is a significant issue as regards the requirements for audit, and the exemptions available, based on the size of an entity, as set out in the following paragraphs 3.7-3.9 (below).
- 3.7. At present, exemption from audit is available to entities of a substantial size leaving users of their financial statements, particularly suppliers and lenders, with uncertainties as to whether the financial statements reflect any bias or imprudent subjectivity in their preparation, or whether they have been subjected to any independent scrutiny.
- 3.8. On the other hand, the regulatory requirements imposed on auditors are so demanding as to require the application of administration and technical procedures, together with experience levels, which necessitate both dedicated specialisms of audit staff and a minimum cost of audit irrespective of size of the entity subject to audit.
- 3.9. AAT considers that this dichotomy could be addressed by way of a compromise approach to the problem. Entities which are currently exempt from audit on the basis from being below the size threshold should be required to have their financial statements prepared by an independent firm of accountants with a recognised professional qualification and regulated by a professional body who would confirm the basis of preparation and limitations as regards reliance on the reported results and financial position. In this way the independent firm will be responsible for making judgement as regards the application of prudence in particular and for providing users with sufficient information to understand the risks attaching to the financial entitlements especially as regards significant matters of judgement, uncertainty and bias. All financial statements prepared internally by the entity itself or by other unregulated persons should be subject to audit whatever the size other than perhaps a de-minimus exemptions level of say, turnover below £500,000 to match that for the statutory audit of charities.

**Q5. Do you agree that the Government should not expand the definition of a PIE beyond the EU minimum requirement – that is listed companies, banks, building societies and insurers? Please provide further information in support of your answer?**

- 3.10. AAT considers that it is vital for the definition of a PIE to include financial institutions such as banks and insurance companies but also that it is important to exercise the right set out by the new Accounting Directive to include other entities. These should include other “public interest” entities such as providers of public utilities and services, as well as charities. In addition commercial entities which are dependent upon publicly funded contracts or grants should fall within the definition of a PIE, as well as “listed entities”. The oversight of such audits needs to be open and transparent to the public at large, whereas the oversight of other entities needs to focus on the needs of their stakeholders.

**Q6. What issues, if any, do you consider arise from the application of the provisions of the Regulation to audits of PIEs as defined in the Directive? How do you consider these should be addressed?**

- 3.11. In the response to question 5 (3.10, above), AAT has concerns as to the omission from the definition of PIEs of entities which are clearly of substantial public interest being significantly reliant on public funds and having a responsibility for public accountability.

**Q7. What issues, if any, do you consider arise from the need to broaden the application of the implementation of the 2006 Directive as amended to include:**

- other entities whose securities are admitted to trading on a regulated market;
- electronic money institutions;
- payment institutions;
- MiFiD investment firms;
- Undertakings for Collective Investment in Transferable Securities (UCITS);

and,

- Alternative Investment Funds (AIFs).

**How do you consider these should be addressed?**

- 3.12. AAT's comments on the general principles to be applied to PIEs are set out above in our response to question 5 (3.10, above). AAT does not wish to make any detailed comments in respect of the activities listed in question 7 other than to agree that they should fall within the definition of a PIE.

**Q8. What do you think are likely to be the familiarisation costs to auditors of PIEs arising from all the changes affecting them. In particular:**

- (a) how many person hours likely to be involved in an individual statutory auditor and their team understanding and preparing for the changes?
- (b) what are the costs to audit firms of updating internal management systems to reflect the changes?
- (c) How this is likely to vary by size of audit firm?

- 3.13. No comments are offered.

**Q9. Do you agree the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight under the 2006 Directive as amended by the new Directive and under the Regulation? (In answering this question, it may help in particular to consider the tasks of audit inspection, investigations and discipline, auditor approval and continuing professional development and the setting of technical and ethical standards for statutory audits and auditors.)**

- 3.14. AAT is of the view that the FRC should be the single competent authority with ultimate responsibility for the audit regulatory tasks and for oversight on the basis that it minimises the changes required to the current arrangements.
- 3.15. Similarly, the responsibilities of RSBs should be retained for regulating approved audit firms and being answerable to the FRC.

**Q10. What issues, if any, do you consider arise from the need to implement a new statutory framework for the setting of auditing standards and for audit inspections, investigations and discipline by the single competent authority to replace the current framework that requires the bodies' rules to provide for this? If there are any, how should they be addressed?**

- 3.16. To avoid duplication of inspections, the responsibility for such should be determined by the auditors activities rather than by the nature of the audits.
- 3.17. AAT considers that inspections, regulation and disciplinary control of auditors who have no audit involvement in PIEs should remain with RSBs, as being professional bodies with

responsibility for regulating all professional activities of the auditor, including non-audit work.

- 3.18. Auditors with involvement in PIEs should be subject to inspection by the FRC, as the single competent authority, but the FRC should be required to pass all disciplinary issues to the relevant RSB for action.
- 3.19. There are clear benefits in the adoption of International Auditing Standards for use within the UK (and the EU) and it would be logical for the FRC to be responsible for ensuring those Standards are relevant to UK audits or for publishing amendments where appropriate.

**Q11. What issues, if any, do you think might arise for the current investigation and disciplinary arrangements between the professional supervisory bodies and the FRC, that apply to accountants generally as opposed to only auditors, given the changes in relation to audit? If there are any, how should they be addressed?**

- 3.20. AAT's response to question 10 (3.16-3.19, above) sets out our views for retaining the present investigation and disciplinary arrangements largely unchanged except for auditors of PIEs who would be liable to inspections by the FRC as the single competent authority in the first instance, but answerable to their RSB for any disciplinary measures.

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

- 3.21. As set out in the response to question 10 (3.16-3.19, above) AAT considers that the RSBs are ultimately in the best position to regulate and discipline their members across the full spectrum of their activities and so should be delegated such responsibilities by the single competent authority.

**Q13. For any tasks where responsibility is allocated to the single competent authority for it to delegate, what limitations, if any, do you consider would be needed to ensure that authority only retained responsibilities or reclaimed delegated responsibilities in appropriate circumstances? What do you consider these circumstances should be?**

- 3.22. Again the response to question 10 (3.16-3.19, above) indicates the view that the single competent authority should only have responsibility for auditing standards and the inspection of auditors of PIEs.

**Q14. In relation to each of the tasks provided for in the Directive and Regulation, are there any tasks, or any aspects of those tasks, that you consider it is important should continue to be covered by provisions in legislation on the content of the rules of the supervisory bodies? Please provide further information in support of your answer.**

- 3.23. Once again, AAT considers that the tasks provided for in the Directive and Regulations should continue to be the responsibility of the RSBs as being in the best position to exercise control and discipline of auditors.

**Q15. Do you consider that both the registration of statutory auditors and their removal from the register should be covered by regulations under the Companies Act (The Statutory Auditors (Registration) Instrument 2008 currently applies for this purpose, having been made by the FRC using powers in section 1239 of the Companies Act, which are delegated to it.)? If so, which body or bodies do you think should have statutory powers for the removal of statutory auditors from the register?**

- 3.24. AAT is of the opinion that the current arrangements for the regulation and removal of statutory auditors should remain unchanged.

**Q16. Do you consider that, for consistency with a framework of ultimate responsibility, single competent authority approval should be required for the rules of the supervisory bodies?**

- 3.25. AAT considers that there must be an implied approval of the rules of RSBs by the single competent authority in that recognition of the RSB is clearly dependent upon approval by the single competent authority.

**Q17. What do you consider are the costs and benefits in monetary terms and in terms of the effectiveness of audit regulation of the proposals in this chapter and of your preferred approach to implementation of these provisions?**

- 3.26. AAT is not in a position to evaluate in monetary terms the costs and benefits but its preferred approach to the designation and delegation of tasks to competent authorities is based on minimising changes from the current position and so would be expected to result in minimising costs while maintaining benefits.

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

- 3.27. On the basis that AAT does not consider that non-audit services are a threat to auditor independence and the capping of such is a totally arbitrary constraint that cannot be justified, the cap should not be reflected in the FRC's ethical standards for auditors.

**Q19. What issues, if any, do you consider arise from the application of the provisions on the cap on non-audit services? If there are any, how do you consider these should be addressed?**

- 3.28. The consequences of the cap on non-audit services are:

- 3.28.1. An adverse impact on the cost effectiveness of audits.
- 3.28.2. An adverse impact on the technical effectiveness of audits.
- 3.28.3. Limitations on the size of audit firms able to offer audit services.
- 3.28.4. An adverse impact on the cost effectiveness of non-audit services required by audited entities.

- 3.29. AAT considers that there is no need for Regulations to provide a cap, with reliance being placed on the RSBs to take disciplinary measures in the event of any ethical breaches by audit firms and individuals.

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

- 3.30. AAT has declined to make specific comment in response to this question other than to observe the comments made in our response to Q19 (3.28-3.29, above) are equally relevant to question 20.

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

- 3.31. As set out in AAT's responses to questions 18, 19 and 20 above (3.27-3.30, above), AAT considers the capping requirement of the Directive to be totally inappropriate so that the FRC should avail itself of all opportunities to optimise any exemptions from the capping requirements.

**Q22. Do you agree that the subject matter of Article 5 of the Regulation on the blacklist of nonaudit services, including the possibility of setting more stringent requirements, should be included in amendments to the FRC's ethical standards for auditors? Please provide information to support your answer.**

- 3.32. The capping of fees for allowable non-audit services provided by auditors at 15% of their total fee income is a wholly arbitrary measure and not necessarily effective in achieving auditor independence. Consequently, given that the requirement already exists in the EU Directive, a more stringent capping is not desirable with a view to avoiding unnecessary changes to the present situation.

**Q23. What issues, if any, do you consider arise from the application of the provisions on the blacklist of non-audit services? If there are any, how do you consider these should be addressed?**

- 3.33. AAT has concerns that the "black list" of non-audit services an audit firm would be prevented from supplying to its audit client is an unnecessary restriction which is disadvantageous to both audit firms and their clients. The provision of many of these services can provide auditors with detailed knowledge and assurances concerning their client and assist in minimising audit costs. Their clients can benefit from such services being provided externally by a firm with knowledge of the entity and appropriate skills which are not available in-house.
- 3.34. As indicated in the responses to questions 18 to 22 (3.27-3.32, above), AAT does not support the concept of applying a "black list" of prohibited non-audit services and believes that it is the responsibility of each audit firm to demonstrate an independent approach to its audit responsibilities if called upon to do so by its RSB in a similar manner to its need to demonstrate its technical abilities to carry out its audit assignments. The ultimate sanction for any breach of ethical or technical conduct is one of disciplinary measures to be imposed by the relevant RSB.

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

- (a) underpin the standards? And,
- (b) introduce simplifications for audits of small non-PIEs?

**Please provide further information to support your answer.**

- 3.35. As indicated in the response to questions 18 to 23 (3.27-3.34, above), AAT is concerned about the adverse impact of implementing the revised requirements for auditor independence, but to the extent that such are unavoidable they should be implemented primarily through ethical standards with the objective of minimising amendments to existing legislation.

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

- 3.36. AAT supports the concept of full disclosure of all fees paid to auditors of PIEs, to ensure that the public have the same information as the competent authority.

**Q26. For our impact assessment on the changes we would welcome any estimates that could be provided on:**

- (a) the percentage of non-audit services that are likely no longer to be provided by auditors due to their inclusion on the blacklist?**
- (b) the additional costs associated with reallocating some of the non-audit services that would otherwise have been provided by the same statutory auditor?**
- (c) the extent to which these additional costs vary by the size of PIEs?**
- (d) the person hours likely to be involved in a non-audit team at an audit firm understanding and preparing for the changes given that they will not be able to provide certain non-audit services to the firm's audit clients?**

- 3.37. No comments are offered.

**Q27. Audit Committees must submit a recommendation to the board for the appointment of an auditor. However, under Article 16(1) sub-paragraph (2) of the Regulation, this does not apply where the Member State has provided an alternative system for the appointment of the auditor. The current alternative systems set out in the Companies Act 2006 are where:**

- the directors appoint the auditor before the company's first accounts meeting;
- the directors appoint the auditor to fill a casual vacancy in the office of auditor; and where,
- the Secretary of State appoints the auditor because a public company failed to do so.

**Do you consider that all of these alternative systems for the appointment of an auditor should continue to operate in the UK as they do at present? Are there any other systems that should also be provided for on the grounds that a competitive tender process is not appropriate? Please provide further information to support your answer.**

- 3.38. AAT agrees that these provisions should continue to operate in the UK on the basis of avoiding unnecessary changes.

**Q28. Where the PIE is exempted from having an audit committee (e.g. because it is an unlisted bank), there is no provision as to which body should fulfil the audit committee's role. Do you agree that in this situation the directors should determine the recommendations that should be put to shareholders of the audited entity? Please provide information in support of your answer.**

- 3.39. AAT considers that all PIEs should be required to have an audit committee on the basis that AAT considers it essential for stakeholders' interests to be so represented.

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

- 3.40. Given the inefficiencies, logistical problems and additional costs which usually arise from joint audits, and consequently the likely existence of special circumstances making a joint audit desirable, any such appointment, including that which involves a previous sole auditor, should be on the basis of a tendering process for the avoidance of any misunderstandings as to the full terms of the joint audit.

**Q30. We are considering whether provision should be made so that, where a PIE has stated in its annual report it will appoint an auditor based on a tender process before the expiry of the maximum duration of 10 years, it should still be able to**

**take advantage of an extension of the maximum duration beyond ten years, following that tender. Do you agree?**

- 3.41. AAT agrees that a PIE should be able to take advantage of extending the auditors appointment duration beyond ten years where it has stated on its annual report that the tender process will take place before the expiry of the ten years period.

**Q31. We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the annual report setting out key matters for the audit committee on the appointment of auditors. Do you agree that the report should include:**

- a) when the current auditor took up the audit engagement at that company? (Yes / No)
- b) when the audit engagement was last retendered? (Yes / No)
- c) the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender? (Yes / No)
- d) the directors' reasons for considering that the proposed year is in the best interests of the company's members? (Yes / No)

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

- 3.42. AAT agrees that that the report should include:

3.42.1. when the current auditor took up the audit engagement at that company;

3.42.2. when the audit engagement was last retendered;

but not include:

3.42.3. the start of the next accounting year in relation to which the company expects that the auditor appointment will be based on a tender; and

3.42.4. the directors' reasons for considering that the proposed year is in the best interests of the company's members.

- 3.43. In broad principle, there appears to be no benefit to the users of financial statements for the entity to commit itself to the timing of the tendering process or the reasons for it. Circumstances may develop over time which will determine when the tendering process is best carried out and only needs disclosure in the financial statements when the commitment to tender has been made.

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

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

**Which option would you prefer? Please provide further information in support of your answer.**

- 3.44. AAT does not favour compulsory retendering even in relation to PIEs. It is a matter of commercial decision for the audited entity to consider the value for money achieved from its auditors and to seek tenders at the appropriate time.

- 3.45. Similarly it is a matter of commercial decision as to whether better value for money can be achieved by giving the auditors security of tenure for a number of years (subject to

conditions). Consequently, if a tendering date is to be compulsory, it should be after the longest period possible.

**Q33. What issues, if any do you consider arise from the UK's obligation to apply effective, proportionate and dissuasive sanctions for failure to comply with the UK's implementation of the framework on mandatory rotation and retendering? If there are any such issues, how do they should be addressed?**

- 3.46. Although AAT does not favour mandatory rotation and retendering, any sanctions for failure to comply with the UK's framework on such have to be dependent upon statutory provisions in order to take appropriate action against entities who do not comply.

**Q34. For our impact assessment on the changes we would welcome any estimates that could be provided on:**

- (a) resources that are likely to be deployed by PIEs to tender audit appointments?**
- (b) resources that are deployed by auditors to tender for audit work?**
- (c) additional familiarisation costs that arise for both auditors and the audit client when a new auditor takes up an audit engagement?**
- (d) the extent to which this varies by the size of the PIE?**

- 3.47. No comments are offered.

**Q35. What issues, if any, do you consider arise from the inclusion in legislation on audit reporting of a requirement for the auditor to include a statement in the audit report where there is a material uncertainty relating to events or conditions that may cast significant doubt about the entity's ability to continue as a going concern? How do you consider these should be addressed?**

- 3.48. AAT supports the concept that the content of audit reports should be more comprehensive and informative to users of financial statements particularly as regards significant matters of uncertainty, judgement or bias. This information should be given in all audit reports, not just where there is a threat to the going concern, so that the users of the financial statements can understand the degree of any such threats, as well as the margins of subjectivity inherent in the financial statements. The auditor should not need to refer to going concern in his report unless uncertainty clearly exists.
- 3.49. Entities which are currently exempt from audits on the basis of being below the size thresholds should be required to have their financial statements prepared by an independent firm of accountants with a recognised professional qualification and regulated by a professional body that would confirm the basis of preparation and limitations as regards reliance on the reported results and financial position.
- 3.50. In this way the independent firm will be responsible for making judgement as regards the application of prudence in particular and for providing users with sufficient information to understand the risks attaching to the financial entitlements. All financial statements prepared internally by the entity itself or by other unregulated persons should be subject to audit whatever the size other than perhaps a de-minimus exemption limit to match that for charities with turnover under £500,000 per annum.

**Q36. Do you agree that the provisions of Article 10 of the Regulation on the audit report should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.**

- 3.51. The approach to audit reports suggested in the response to question 35 (3.48-3.49, above) is considered relevant to all audits, including PIEs, and so supports the provisions of Article 10 of the Regulations in respect of PIEs.

**Q37. What issues, if any, do you consider arise from the application of the provisions of the Regulation on the audit report? If there are any, how do you consider they should be addressed?**

- 3.52. No significant issues are expected to arise from the implementation of the suggestions set out in the response to question 35 (3.48-3.49, above).

**Q38. Do you agree that the provisions in Article 11 of the Regulation on the additional report to the audit committee should be included in amendments to the FRC's International Standards for Auditing (UK and Ireland)? Please provide information to support your answer.**

- 3.53. AAT agrees that the provisions of Article 11 of the Regulations as regards the auditor's report to the audit committee should be included in the amendment to the FRC's International Standards for Auditing (UK and Ireland) on the basis of being the primary element of providing the audited entity with value for money from the audit exercise.

**Q39. What issues, if any, do you consider arise from the application of the provisions of Article 11 of the Regulation on the additional report to the audit committee? If there are any how should they be addressed?**

- 3.54. There are no issues expected to arise from the implementation of Article 11 of the Regulations.

**Q40. For our impact assessment on the changes, we should particularly welcome data on:**

- (a) additional resources are likely to be needed by the auditor to produce the additional report for the audit committee?
- (b) the additional annual cost of the audit committee considering the additional report?
- (c) how these costs vary by size of PIE?

- 3.55. No comments are offered.

**Q41. Do you consider that the small companies audit exemption thresholds should:**

- (a) remain aligned with those for the small companies accounting regime, so that the number of audit exempt small companies will increase in line with the increase in the small companies accounting thresholds;
- (b) remain unchanged so that the turnover and balance sheet thresholds are considerably lower than the thresholds for access to the small companies accounting regime; or,
- (c) be amended in some other way (please set this out)?

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

- 3.56. As set out in the response to questions 3 and 4 (3.4-3.9, above) AAT has significant concerns as to the consequences of comparatively large entities being exempt from audit.
- 3.57. AAT suggests that exemption from audit is also conditional upon an entity's financial statements being prepared independently with disclosures on the basis of preparation as regards matters of judgement, uncertainty and bias, in which case there is less concern of increasing the audit exemption thresholds to reduce the number of audited entities.
- 3.58. However, any reduction in the number of audited entities is also likely to result in a reduction in the number of audit firms offering audit services and a likely increase in audit costs.

**Questions from chapter 5**

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

3.59. No comments are offered.

**Q43. For the purpose of our impact assessment, we would welcome any information you can provide on the expected costs and benefits of the measures considered in this chapter, particularly any estimates of costs or benefits that you consider it would be possible to quantify? In addition we remind you that the general questions asked at the start of chapter 4 also apply to the measures discussed in this chapter.**

3.60. No comments are offered.

**Q44. Do you agree that the implementation of EU requirements on technical standards should be primarily through changes to the FRC's ISAs (UK and Ireland)?**

3.61. AAT supports the view that the implementation of EU requirements on technical standards through changes to the FRC's ISAs (UK and Ireland) rather than by statute so as to retain flexibility in the event of the need for further changes in the future is desirable.

**Q45. For the purpose of our impact assessment on the changes we would welcome any estimate you could provide of the percentage of PIE audits for which the quality control review will now have to be undertaken by an individual auditor from outside the appointed audit firm (where there is a lack of detachment from the audit or knowledge of the client sector) where this was not previously required?**

3.62. No comments are offered.

**Q46. What issues do you consider arise from the implementation of EU adopted ISAs in the UK that UK representatives should raise with the European Commission?**

3.63. It appears to be logical for the EU to adopt ISAs as fully as possible for the benefit of consistency of the approach to audits on an international basis outside of the EU and to allow Member States to modify or refine them to meet local statutory requirements.

3.64. As a general basis this approach should not necessitate any modifications to ISAs by the EU itself but only at Member State level.

**Q47. Do you agree that following any adoption of ISAs by the European Commission, the FRC should have the discretion to:**  
**(a) apply standards where the Commission has not adopted an ISA covering the same subject-matter; (Yes / No) and,**  
**(b) impose procedures or requirements in addition to adopted ISAs if these national procedures or requirements are necessary to give effect to national legal requirements or to add to the quality of financial statements? (Yes / No)**  
**Please provide further information in support of your answer.**

3.65. AAT agrees that the FRC should have the discretion to:

3.65.1. Apply standards where the Commission has not adopted an ISA covering the same subject-matter.

3.65.2. Impose procedures or requirements in addition to adopted ISAs if these national procedures or requirements are necessary to give effect to national legal requirements or to add to the quality of financial statements.

- 3.66. As stated in the response to question 46 (3.63, above), it should be expected that the EU would adopt ISAs fully and that the discretion available to the FRC would deal with variations relevant to the UK.

**Q48. What issues, if any, do you consider arise from the implementation of the new requirements on audit committees via amendments to the existing DTR 7.1 in the FCA Handbook (for companies with securities admitted to trading on a regulated market)?**

- 3.67. AAT is of the view that, in principle, audit committees should be representatives of the stakeholders and while appointed by the governing board of an entity, should be totally independent of the board as regards powers and duties of reporting. Initial reporting should be from the audit committee to the governing board, but with reporting to stakeholders where significant concerns arise. Consequently membership of the audit committee requires expertise from external sources as well as internal experience of the entity concerned, with a clear bias towards financial skills.
- 3.68. It appears that the proposals of the EU Directive would allow for such an approach if strengthened by local UK amendments.

**Q49. What issues, if any, would you consider arise from the implementation via provisions in PRA rules of the new requirements on audit committees for those banks, building societies and insurers that are not required to have an audit committee under DTR 7.1?**

- 3.69. It is considered vital for all PIEs to be properly accountable to the public, so that the introduction of audit committees where they are currently not required, is considered a necessity and those entities affected have to face the issues arising from a reorganisation of responsibilities.
- 3.70. Any issues arising from the introduction of audit committees where none exist at present would not be expected to be significant as even those PIEs not required to have an audit committee would be expected to have equivalent procedures of best practice in public accountability.

**Q50. For our impact assessment on the changes, we would welcome data on:**

- (a) the numbers of non-listed PIEs that currently do not have an audit committee?**
  - (b) the cost of recruiting members to be part of an audit committee?**
  - (c) the annual cost of attendance of a member?**
  - (d) the auditor's fees for attending audit committee meetings?**
  - (e) how these costs vary by size of PIE?**
- 3.71. No comments are offered.

**Q51. Do you consider that the single competent authority with responsibility for regulation of audit should be designated to receive the information required to be provided to supervisors of PIEs when it is provided to:**

- (a) the PRA for banks, building societies and insurers?**
  - (b) the FCA for other PIEs? or**
  - (c) both?**
- 3.72. The single competent authority with responsibility for the regulation of audit should be designated to receive the information required to be provided to supervisors of PIEs when it is provided to both the Prudential Regulation Authority (PRA) for banks, building societies and insurers and the Financial Conduct Authority (FCA) for other PIEs in order to ensure that it has complete and full information to enable it to discharge its oversight role.

**Q52. For the purpose of our impact assessment on these changes we should be grateful for any estimates you can provide of:**

**(a) the costs of the auditor providing this information to supervisors of PIEs?**

**(b) the frequency with which the PRA is provided with this information for banks building societies and insurers under existing requirements?**

**(c) the frequency with which the FCA is provided with this information for other PIEs in practice already?**

3.73. No comments are offered.

**Q53. Do you agree that we should enable the single competent authority to exercise the choices of aptitude test and/or adaptation period for the approval in the UK of individual statutory auditors from other Member States? Please provide further information in support of your answer.**

3.74. The single competent authority should be able to exercise the choice of aptitude tests and/or adaptation periods for the approval in the UK of individual statutory auditors from other Member States, although RSBs should have the responsibility for implementing the approval procedures to confirm appropriate competency.

**Q54. Were the single competent authority to have this role, what do you consider would be the implications for the operational provision (currently by the professional supervisory bodies) of:**

**(a) aptitude tests; and**

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

**How would this be affected by the CEAOB progressing discussions “with a view to achieving a convergence of the requirements of the adaptation period and the aptitude test” across the EU?**

3.75. A “convergence of the requirements of the adaptation period and the aptitude test” across the EU is not seen as a viable objective given divergence in company law, accounting requirements, tax legislation and commercial legislation among Member States.

3.76. As stated in the response to question 53 above (3.74, above), AAT considers that the confirmation of the competency of statutory auditors from other Member States should remain with RSBs.

#### **4. Conclusion**

4.1. Many of the proposals included in the discussion document are designed to illustrate publicly an ethical approach to audits, although in reality do not necessarily achieve that aim but do incur significant costs and constraints on the audit market place and entities subject to audit (for example in 3.35 above).

4.2. AAT believes that public confidence in audits is better established by providing informative and useful audit reports, together with strong disciplinary procedures imposed by RSBs (2.2 & 3.48, above).

4.3. It is inevitable that the proposals for greater regulation of auditors, particularly as regards non-audit services and a reduction in the number of entities required to have audits, will result in lesser choice in the market place and an increase in audit costs. While such may be considered justifiable as regards PIEs, other entities will not see benefits from the proposals other than those currently subject to audit which will become exempt. Even so, PIEs may not benefit from more stringent audit regulations. However, it is thought that substantial audit cost benefits could arise by reducing the constraints placed on the provision of non-audit services by auditors of entities other than PIEs.

- 4.4. AAT recognises that some of the proposals made in the foregoing response would necessitate changes to the EU Audit Directive and Audit Regulation and in order to keep within that framework, and at the same time to relieve the audit burdens on PIEs as much as possible by the introduction of more detailed audit reports, it may be necessary to opt to adopt the EU definition of a PIE, being generally financial institutions and listed entities, but to categorise other entities which ought to be considered PIEs (as set out in the response to question 5 above (3.10, above)) as, say, "Publicly Accountable Entities", being required to have audit committees to represent stakeholders interests, but being relieved of the more stringent regulations required to be applied to PIEs by the EU.

## **5. About AAT**

- 5.1. AAT is a professional accountancy body with over 49,800 full and fellow members and 83,700 student and affiliate members worldwide. Of the full and fellow members, there are over 4,100 Members in Practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types (figures correct as at 31 December 2014).
- 5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

## **6. Further information**

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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