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19 March 2015

Dear Sirs,

BIS Consultation – Auditor Regulation: Discussion document on the implications of the EU and wider reforms

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Financial Reporting and Corporate Governance Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Groups is at Appendix A.

Response

We welcome the opportunity to respond to this consultation. We note that we are also responding to the FRC's consultation on Auditing and ethical standards – Implementation of the EU Audit Directive and Audit Regulation.

We welcome BIS' commitment to putting in place the "best possible regime, one that will most effectively respond to the modern, fast moving, highly developed business economy". We particularly support the development of an auditor regulatory regime which must serve the needs of companies. Regarding the implementation of the European Union (EU) Audit Directive and Audit Regulation in the UK, we have a few overarching remarks.

In considering the implementation of the Directive and the Regulation, we would urge BIS to provide clear guidance to the FRC on the circumstances under which options should be taken up. We believe it would be beneficial for BIS to clearly state that it expects options to be taken up where they are de-regulatory. If options are taken up that do not meet this objective, we would expect BIS to clearly set out the rationale that needs to be followed to justify the additional regulation. In our opinion, a continuation of current UK

practice is not enough of a justification to support additional regulation (ie goldplating) without empirical evidence of the value of the additional regulation. It should be a requirement to show that the benefits clearly outweigh the costs in these cases.

Our main concern is the intention of the FRC to apply the requirements as set out in the Directives and Regulations as applicable to Public Interest Entities (PIEs), in part or in full, to listed entities as currently defined by the FRC. BIS does not propose to widen the EU definition of PIEs for statutory purposes and will not designate other entities as such. However, the FRC raises this as a possibility by consulting on whether to apply the PIE requirements to entities listed on recognised stock exchanges, not just EU regulated exchange, as required by the definition of PIE. If the FRC proceeds on this basis, it will in effect be widening the definition of PIE – something that the Government has openly stated it will not do. We believe that it is crucial that the additional requirements applicable to PIEs are not applied to other entities, as it would not align with Government policy and would impose significant additional regulation on growth companies.

We note that the Audit Directive and Regulation purposely leave outside of their scope companies listed on growth markets, such as AIM or ISDX. It is up to the Member States of the EU extend the definition of PIE and thus extend the application of stricter rules to other entities. We find it disproportionate that, in this case, the UK would consider goldplating these rules, going beyond what is deemed fair and necessary.

We believe that over-regulating the audit process would undermine the trust that has been built on audit committees over the years. The focus should be in building market confidence through fair and proportionate rules, which do not hinder small and mid-size quoted companies' abilities to grow. The Quoted Companies Alliance Audit Committee Guide for Small and Mid-Size Quoted Companies (a copy of which is enclosed) outlines best practice for audit committees and their role in inspiring trust and integrity.

Our members, small and mid-size quoted companies, do not have the resources to address dramatic changes in regulation. In this case, applying the requirements developed for application to PIEs would be costly and time-consuming, with very little perceived benefit for small and mid-size quoted companies or investors. Audits of small and mid-size quoted companies on AIM and ISDX do not pose a systematic risk to the UK economy. Therefore, we firmly believe that there should be a careful balance between the difficulty of coping with strict regulations and the risks posed to external shareholders.

In addition to the above, extending the application of the EU regulations would also mean increased responsibilities for the FRC, which translate into increased levies to fund its activities. The costs of this would be inevitably and disproportionately borne by small and mid-size quoted companies. We believe that this should not be the case. The current position of the FRC is to impose regulations on all AIM listed companies but only monitor the audit of those with a market capitalisation in excess of £100m. This approach alone has meant that the FRC have imposed costs and greater restrictions on some 1009 AIM listed companies, when only 190 of those companies are deemed of sufficient interest to be monitored by the FRC.

We, therefore, urge BIS not to allow the FRC to effectively widen the EU definition of PIEs for statutory purposes and by applying the stricter requirements to other entities.

We have responded in more detail below to the questions which we believe would most significantly affect our constituency.

Responses to specific questions

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?

Yes, we agree that the Government should not expand the definition of a PIE beyond the EU minimum requirement. To extend the definition of PIE to include other entities, particularly companies listed on AIM and ISDX would cause them particular harm, as these companies do not have the necessary resources to address the more stringent requirements which would be imposed to them. It would add costs and hinder their growth, while providing no real benefits for companies or investors.

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

We do not have any particular issues with the application of the provisions of the Regulation to audits of PIEs as defined in the Directive, provided the definition of PIE is not expanded to include companies quoted on AIM and ISDX.

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?

Provided the definition of PIE is not expanded to include companies listed on AIM and ISDX, we have no comments on this issue.

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.

No, we do not agree. Only options that are de-regulatory in nature should be taken up.

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?

Whilst such a power should be available, to allow flexibility in the case of unforeseen circumstances, we would expect the power to be exercised extremely rarely and only in conditions of 'emergency' as currently defined in Ethical Standards. There are multiple providers of non-audit services in the UK market and Audit Committees should be capable of ensuring that the cap is not breached by the use of these alternative suppliers.

We note that the application to the FRC should be made by the audit firm. We consider that it is important that any request to exempt an audit firm from this requirement should be originated from, and approved by, the Audit Committee of the audited entity.

Our response would be different if the cap is applied, by the FRC, to entities listed on AIM and other growth markets, as these smaller companies tend to have smaller audit fees and as such an acquisitive, high

growth company may struggle to apply a cap on non-audit fees bearing in mind it is the auditor that is generally best placed to provide reporting accountant duties.

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.

As noted above only options that are de-regulatory should be taken up. The FRC should not have the power to goldplate regulation except in the most extreme circumstances.

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.

Yes we agree. We believe that aligning the disclosure with the information reported to the competent authority is the most cost effective solution.

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.

Yes, we believe that all of these alternative systems for the appointment of an auditor should continue to operate in the UK as they do at present.

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?

Yes, we agree.

Q31 We are seeking views on the proposal that for companies that are PIEs the company's plans on retendering should be part of a new element of the annual report setting out key matters for the audit committee on the appointment of auditors. Do you agree that the report should include: a) when the current auditor took up the audit engagement at that company? (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.

(a) Yes, we agree.

(b) Yes, we agree.

(c) No, we do not agree. The audit committee should indicate its general approach to tendering and why this is in the best interests of shareholders but we think it unreasonable to ask them to commit to a date possibly 10 years in the future.

(d) See (c) above.

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.

The Audit Committee should be left with the maximum discretion in respect of the timing of audit tenders as they are best placed to judge when is appropriate. Given this a further 10 year maximum period should commence from the date of the last tender (option (b) above).

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?

The requirement is consistent with International Standards on Auditing (ISAs) already in force in the UK and hence we do not see any issues arising.

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

The application of the provisions will not change current UK practice significantly and hence we do not see any significant issues arising.

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.

Inclusion of the amendments in International Standards on Auditing (UK and Ireland) would seem to be the most pragmatic way of implementing the requirements.

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?

These are matters that we would expect auditors to be reporting to the audit committee at present and hence we do not anticipate any issues arising.

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?

Reporting to the audit committee is one of the key outputs from the audit approach at present and we do not consider that the additional costs will be significant.

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?

Given that the UK currently adopts ISAs we do not foresee any adverse implications providing the EU adopts ISAs in their entirety. We consider that ISAs have helped to enhance audit quality around the world and are of particular benefit to international groups in giving assurance of audit carried out to a common standard. We would consider it a backward step for the EU to amend the ISAs and thereby bring about an inconsistency between application in the EU and outside the EU. UK representatives should be aware of this risk and should monitor any adoption process closely.

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.

Other than as required by UK law, the FRC should not impose any additional requirements in auditing standards beyond what is required by the Audit Directive and Regulation, as this would constitute goldplating of EU regulations. The Commission is planning on undertaking a process to adopt ISAs and we believe that this will be a thorough approach to ensure that these standards are rigorous and appropriate for use on the European capital markets. There are benefits for international businesses in having a consistent set of high quality auditing standards in use worldwide and these benefits are watered down if the UK makes unnecessary amendments. We note that with the requirements of the Regulation and with changes due to be made in ISAs an enhanced audit report, which investors do value, will continue to be issued and hence this matter alone does not justify continued UK enhancements to ISAs.

If the power to amend is given to the FRC we urge BIS to provide clear guidance to the FRC over when these powers should be exercised. “[T]o add quality to the quality of financial statements” is a wide threshold with no consideration of costs and benefits of any proposal. In our opinion, if this justification is used it should be sparingly and only where there is a clear risk of audit failure, focussing on systemic risk.

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

We note that the requirement for committee members as a whole to have competence in the sector in which the audited entity operates could be difficult to define in practice. It is generally difficult for companies to have an audit committee made out of the right people, which present a broad range of views and are simultaneously required to "as a whole" have competence in the sector. This could be particularly difficult to achieve in the case of small and mid-size quoted companies. Furthermore, it could be very difficult to assess how to define the sector case by case.

We believe that this requirement could present restrictions to membership, which could be difficult to overcome by smaller companies. Most of our members have an Audit Committee; we find that, in their experience, the range of necessary skills varies considerably. In some cases, having experience in a particular jurisdiction is a more valuable competence to add, for example.

If you would like to discuss this in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Financial Reporting Expert Group

Matthew Stallabrass (Chairman)	**Crowe Clark Whitehill LLP**
Jonathan Lowe Paul Watts Nick Winters	Baker Tilly
Anna Draper	BDO LLP
Amy Shepheard	Deloitte LLP
David Gray	DHG Management
Shalini Kashyap	EY
Gary Jones	Grant Thornton UK LLP
Anthony Carey	Mazars LLP
David Pugh	Nationwide Accident Repair Services PLC
Nigel Smethers	One Media iP Group PLC
Joseph Archer	PKF Littlejohn LLP
Donna Caira	Saffery Champness
Matthew Howells	Smith & Williamson LLP
Jack Easton	UHY Hacker Young
Ian Davies	Vislink PLC
Edward Beale	Western Selection Plc

Quoted Companies Alliance Corporate Governance Expert Group

Edward Craft (Chairman)	**Wedlake Bell LLP**
Colin Jones (Deputy Chairman)	UHY Hacker Young
Nathan Leclercq	Aviva Investors
David Isherwood	BDO LLP
Nick Graves	Burges Salmon
Nick Janmohamed	Charles Russell Speechlys LLP
David Fuller	CLS Holdings PLC
Nicholas Stretch	CMS Cameron McKenna LLP
Louis Cooper	Crowe Clark Whitehill LLP
Nick Gibbon	DAC Beachcroft LLP
Tracy Gordon	Deloitte LLP
Andrew Hobbs	EY
Eugenia Unanyants-Jackson	F&C Investments
Melanie Wadsworth	Faegre Baker Daniels LLP
Rob Burdett	FIT Remuneration Consultants
Richie Clark	Fox Williams LLP
Michael Brown	Henderson Global Investors
Bruce Duguid	Hermes Equity Ownership Services
Julie Stanbrook Bernard Wall	Hogan Lovells International LLP
Claire Noyce	Hybridan LLP
James Hodges	Hydrodec Group PLC
Peter Swabey	ICSA
Jayne Meacham	Jordans Limited
Andy Howell	KBC Advanced Technologies PLC

Nicola Green Eleanor Kelly Jane Mayfield	LexisNexis
Anthony Carey	Mazars LLP
Mebs Dossa	McguireWoods
Cliff Weight	MM & K Limited
Caroline Newsholme	Nabarro LLP
Jo Chattle Julie Keefe	Norton Rose Fulbright LLP
Amanda Cantwell	Practical Law Company Limited
Kelly Millar	PricewaterhouseCoopers LLP
Dalia Joseph Marc Marrero	Stifel
Peter Fitzwilliam	The Mission Marketing Group PLC
Philip Patterson	TMF Corporate Secretarial Services Ltd
Edward Beale	Western Selection Plc
Alexandra Hockenhull	Xchanging PLC