

EXPLANATORY MEMORANDUM TO
THE STATUTORY AUDITORS REGULATIONS 2017
2017 No. 1164

1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Department for Business, Energy and Industrial Strategy and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 To continue the implementation of Directive 2014/56/EU (“the Audit Directive”) and Regulation 537/2014 (“the Audit Regulation”) on the audit of limited companies and other undertakings which are classified as “Public Interest Entities” (“PIEs”), that is, entities whose securities are traded on a regulated market, credit institutions and insurance undertakings. To align the audit and accounting framework for LLPs with that of companies.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 The Regulations continue the implementation of the Audit Directive on statutory audits of annual and consolidated accounts and make the necessary legislative provisions to apply certain provisions of the Audit Regulation on specific requirements on the statutory audit of PIEs.
- 4.2 The Regulations amend the following:
- (i) The Companies Act 2006
 - (ii) The Friendly Societies Act 1992
 - (iii) The Building Societies Act 1986
 - (iv) The Statutory Auditors and Third Country Auditors Regulations 2016
 - (v) The Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008
 - (vi) The Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008
 - (vii) The Companies (Revision of Defective Accounts and Reports) Regulations 2008.

The Regulations revoke the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008, and the other enactments listed in Schedule 4. The other revocations are either consequential on the revocation of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008, or are of spent enactments.

- 4.3 The proposal for a Directive of the European Parliament and of the Council amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (1697/11) and the proposal for a Regulation of the Parliament and of the Council on specific requirements regarding statutory audit of public-interest entities (16972/11) were submitted to the Commons and Lords Scrutiny Committees on 19 December 2011. The proposals were cleared by the Commons Scrutiny Committee as politically important on 4 November 2013. The Lords Scrutiny Committee cleared the proposals on 24 July 2012.
- 4.4 A transposition note is submitted with this Explanatory Memorandum and is available on the www.legislation.gov.uk website alongside these Regulations.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is the United Kingdom.
- 5.2 The territorial application of this instrument is the United Kingdom.

6. European Convention on Human Rights

- 6.1 The Minister for Small Business, Consumers and Corporate Responsibility has made the following statement regarding Human Rights:

In my view the provisions of The Statutory Auditors Regulations 2017 are compatible with the Convention rights.

7. Policy background

What is being done and why

- 7.1 The Government believes that effective financial reporting is essential to the functioning of capital markets. Audit is an essential safeguard to provide independent assurance that the financial reporting of businesses properly reflects their circumstances and helps to maintain the integrity of the UK business environment.
- 7.2 The Regulations implement certain requirements of the Audit Directive in respect of miscellaneous forms of insurance undertaking, including insurers that are cooperative or community benefit societies (previously known as industrial and provident societies) in Great Britain and industrial and provident societies in Northern Ireland. However, from 6th April 2018, when certain amendments to the Industrial and Provident Societies Act (Northern Ireland) 1969 (c. 24) made by the Credit Unions and Co-operative and Community Benefit Societies Act (Northern Ireland) 2016 (c. 16) come into force, new societies in Northern Ireland will be co-operative or community benefit societies. The Regulations make further changes to UK law for these miscellaneous insurance undertakings to give effect to the Audit Regulation. In addition the Regulations make certain consequential amendments to the Statutory Auditors and Third Country Auditors Regulations 2016 to reflect these changes and to improve the clarity and consistency of the legislation.
- 7.3 The Regulations also implement changes for Limited Liability Partnerships (LLPs) that have already been made for private companies, though with suitable adaptations,

via amendments to the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008. For most LLPs this is not required by the Directive as LLPs are not usually subject to EU law on statutory audit – the changes are made for reasons of consistency with company law. For this same reason the Regulations also include changes for LLPs consistent with the amendments made to chapter 4 of Part 16 of the Companies Act 2006 by section 18 of the Deregulation Act 2015 and by Schedule 5 to that Act on “auditors ceasing to hold office”. However changes are required by the Audit Directive for those LLPs that are PIEs. An LLP could theoretically act as a credit institution or issue securities that are admitted to trading on a regulated market in the EU (LLPs are not permitted to provide insurance services) and would then be subject to EU law on statutory audit. For these LLPs the Regulations also make further changes to the law to give effect to the Audit Regulation.

- 7.4 The Audit Regulation contains directly applicable provisions specifically for audits of PIEs. This includes for any miscellaneous insurance undertakings or any LLPs that are credit institutions or issuers of securities that are admitted to trading on a regulated market in the EU. The new provisions include a framework for mandatory rotation and re-tendering of audit engagements to require PIEs to put their audit out to tender at least every 10 years and change their auditor at least every 20 years. These Regulations make amendments to Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 to achieve consistency with the Audit Regulation. They also amend the Companies Act 2006, the Friendly Societies Act 1992 (in respect of companies or Friendly Societies that are PIEs) and the Building Societies Act 1986 (in respect of building societies, which are all PIEs) so that they are fully consistent with the Audit Regulation.
- 7.5 The Regulations make changes to audit reporting requirements for auditors of the annual accounts of miscellaneous insurance undertakings and of LLPs, which are necessary for the implementation of the Audit Directive and which build on changes already made by the Audit Regulation and applied in the auditing standards of the Financial Reporting Council. The Financial Reporting Council is the UK’s competent authority under the Audit Directive.
- 7.6 As the Government understands that at present there are no miscellaneous insurance undertakings that need to take further immediate action in line with the requirements of the Audit Regulation on retendering and rotation of auditor appointments; and that all of the audit reporting requirements that are applied under the Audit Directive have already been applied to these undertakings via the Financial Reporting Council’s auditing standards, we have commenced the amendments to the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008 for accounting years beginning on or after 17 June 2016 in accordance with the Audit Directive and Regulation.
- 7.7 As the Government understands that at present there are no LLPs that are PIEs and that all of the audit reporting requirements that are applied under the Directive have already been applied to LLPs via the Financial Reporting Council’s auditing standards, we have commenced the amendments to the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 for accounting years beginning on after 17 June 2016 in accordance with the Audit Directive and Regulation for all LLPs.

- 7.8 Some amendments to the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 mirror amendments made to the Companies Act 2006 by the Companies, Partnerships and Groups (Accounts and Non-Financial Reporting) Regulations 2016, to ensure that the parent LLP of a small group cannot benefit from an exemption from the requirement to produce group accounts if a member of the group is established under the law of an EEA state and is one of the types of entities listed in section 399(2B). These amendments took effect for companies for financial years beginning on or after 1st January 2017, and that has been mirrored for LLPs in these Regulations.
- 7.9 The Regulations make consequential changes to the Companies (Revision of Defective Accounts and Reports) Regulations 2008, to take account of the changes to the requirements in respect of audit reporting in the Statutory Auditors and Third Country Auditors Regulations 2016 and 2017 and in these regulations.
- 7.10 Finally, as there are not expected to be any miscellaneous banks in existence for any accounting years beginning on or after 30 November 2018, the Regulations revoke the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008 for accounting years beginning on or after that date. The Regulations also make various revocations, which are either consequential to the revocation of the Bank Accounts Directive (Miscellaneous Banks) Regulations 2008 or are of spent enactments.

Consolidation

- 7.11 At present BEIS does not intend to consolidate this legislation.

8. Consultation outcome

- 8.1 In December 2014, the Department published a discussion document seeking stakeholder views on the approach to implementation of the Audit Directive and providing for the application of the Audit Regulation. The forty three responses received showed general support for the Government's approach of not making additional unwarranted changes. The consultation responses of those who did not request their response to remain confidential have been published at:
<https://www.gov.uk/government/consultations/auditor-regulation-effects-of-the-eu-and-wider-reforms>
- 8.2 The Department also consulted between October and December 2015, seeking views on the technical implementation of the Audit Directive and Regulation. Twenty five responses were received. There was overall support for the Department's approach, which aims to ensure maximum flexibility for auditors, their clients and the relevant regulatory bodies. The consultation responses have been published at:
<https://www.gov.uk/government/consultations/eu-audit-directive-and-regulation-implementing-the-requirements>
- 8.3 Following these consultations and the making of the Statutory Auditors and Third Country Auditors 2016, BEIS has continued to work with the Financial Reporting Council, HM Treasury and interested groups in the accountancy profession and the corporate and investment sectors on the development of these Regulations.
- 8.4 The Department consulted between November 2009 and January 2010 on "Notices of Auditors Leaving Office" seeking views on proposals to make deregulatory changes

to chapter 4 of Part 16 of the Companies Act 2006. The consultation found general support for its proposals and stated that it intended to apply them to LLPs.

9. Guidance

- 9.1 The implementation of the Regulations is supported by the Financial Reporting Council's auditing standards, changes to its corporate governance code on audit committees and other guidance. Guidance on audit requirements is also available from Companies House.

10. Impact

- 10.1 The impact on business, charities or voluntary bodies of the implementation of the Directive for all affected entities was estimated to be £24.71 million a year.
- 10.2 The original Impact Assessment is published alongside the Explanatory Memorandum to the Statutory Auditors and Third Country Auditors Regulations 2016 on the www.legislation.gov.uk website.

11. Regulating small business

- 11.1 The Regulations apply to activities that are undertaken by small businesses.
- 11.2 No specific action was proposed as part of the implementation of the Directive and the Regulation to minimise regulatory burdens on small businesses. The EU Accounting and Audit framework imposes lower burdens for SMEs, however it does not permit PIEs to benefit from this.
- 11.3 The basis for the final decision on what action to take to assist small businesses was determined by the nature of the business operations of PIEs. These entities, by their nature, have a significant impact on the UK's economy and society so it is necessary to apply higher standards of audit regulation.

12. Monitoring & review

- 12.1 In accordance with sections 28(2)(b) and 31(2)(b) of the Small Business, Enterprise and Employment Act 2015 (c. 26), the Minister for Small Business, Consumers and Corporate Responsibility has made the following statement:
- 12.2 "I consider that it is not appropriate to make provision for review of the amendments to the Building Societies Act 1986, the Friendly Societies Act 1992 and the Companies Act 2006, made by the Statutory Auditors Regulations 2017, as the Regulations are amending regulatory provision that is contained in primary legislation, which is outside the scope of the policy objectives as set out in the statutory guidance. It is also not appropriate to make provision for review of the amendments to the Statutory Auditors and Third Country Auditors Regulations 2016, as those Regulations are themselves already subject to review, and the amendments will be considered as part of that review."
- 12.3 A review provision is included in respect of the amendments made to the Insurance Accounts Directive (Miscellaneous Insurance Undertakings) Regulations 2008. The pre-existing review provision in the Limited Liability Partnerships (Accounts and Audit) (Application of Companies Act 2006) Regulations 2008 is amended to take account of the amendments made by these Regulations.

- 12.4 BEIS must publish a report setting out the conclusions of the first review of the amendments made by these Regulations by 1st May 2022.
- 12.5 In carrying out the review BEIS must, as far as is reasonable, consider how the article 28 of the Audit Directive is implemented in other Member States.

13. Contact

- 13.1 Paul Smith at the Department for Business, Energy and Industrial Strategy Tel: 0207 215 4164 or email: pauld.smith@bis.gsi.gov.uk can answer any queries regarding the instrument.