

**EXPLANATORY MEMORANDUM TO**  
**THE STATUTORY AUDITORS AND THIRD COUNTRY AUDITORS**  
**REGULATIONS 2017**

**2017 No. 516**

**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.
- 2.2 The Regulations also implement the European Commission Implementing Decision (EU) 2016/1010 of 21 June 2016 on the adequacy of the competent authorities of certain third countries and territories pursuant to Directive 2006/43/EC (“the Commission Decision”).

**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. The Regulations also place restrictions on the choice of auditors.
- 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 Insurance Accounts Directive (Lloyd’s Syndicate and Aggregate Accounts) Regulations 2008
  - (vi) The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012
  - (vii) The Public Interest Disclosure (Prescribed Persons) Order 2014
  - (viii) The Public Interest Disclosure (Prescribed Persons) Order (Northern Ireland) 1999
- 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](http://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 and Third Country 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 friendly societies and syndicates in the Lloyd’s insurance market, and make further changes to UK law in respect of friendly societies to give effect to the Audit Regulation. In addition the Regulations make certain amendments to the Statutory Auditors and Third Country Auditors Regulations 2016 and to provisions inserted by that instrument into the Companies Act 2006 and the Building Societies Act 1986 to improve the clarity of those provisions and ensure consistency of the legislative provisions relating to the entities concerned.
- 7.3 The Audit Regulation introduced directly applicable provisions into EU law specifically for audits of PIEs. This includes for those friendly societies that are

insurance undertakings 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 the Friendly Societies Act 1992 in respect of the relevant friendly societies to achieve consistency with the Audit Regulation. They also amend the Companies Act 2006 (in respect of companies which 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.

- 7.4 The Regulations make changes to audit reporting requirements for auditors of the annual accounts of friendly societies and of Lloyd's syndicates and of the syndicates' aggregate accounts, 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.
- 7.5 The Regulations implement the Commission Decision by amending Part 42 of the Companies Act 2006 to provide that the FRC may enter into working arrangements, as provided for in the Audit Directive, with twelve additional audit regulatory authorities outside the European Economic Area for the exchange of "audit working papers and investigation reports" as defined in that Part of the Act.
- 7.6 The Regulations make consequential changes to the Public Interest Disclosure (Prescribed Persons) Order 2014 and the Public Interest Disclosure (Prescribed Persons) Order (Northern Ireland) 1999, to take account of the changes in functions of the Financial Reporting Council resulting from the Statutory Auditors and Third Country Auditors Regulations 2016 and these Regulations, to maintain protection for whistleblowers who are workers making disclosures in respect of these functions, in Great Britain and Northern Ireland.

### *Consolidation*

- 7.7 At present BIS 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 43 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.

## **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 did not cover impacts on the public sector, although it was felt the changes might increase resource needs for audit inspections, investigations and enforcement. As these are not matters covered by these Regulations we consider they will have a negligible impact on the public sector.

10.3 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](http://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.

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. Therefore it is necessary to apply the higher audit standards of audit regulation in order to comply with the Directive.

## **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 and Third Country 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 amendment to the Statutory Auditors and Third Country Auditors Regulations 2016, as those Regulations are themselves already subject to review, and the amendment will be considered as part of that review."

- 12.3 The amendments to the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012, the Public Interest Disclosure (Prescribed Persons) Order 2014 and Public Interest Disclosure (Prescribed Persons) Order (Northern Ireland) 1999 are also not made subject to review, because the activities affected by these Regulations are not “qualifying activities” under section 29(2) of the Small Business, Enterprise and Employment Act 2015 and so do not constitute regulatory provision under that Act.
- 12.4 A review provision is included at regulation 15(3) of these Regulations in respect of the amendments made to the Insurance Accounts Directive (Lloyd’s Syndicate and Aggregate Accounts) Regulations 2008 (“the 2008 Regulations”).
- 12.5 The Treasury must publish a report setting out the conclusions of the first review of the amendments made by these Regulations to the 2008 Regulations by 1st May 2022.
- 12.6 In carrying out the review the Treasury 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](mailto:pauld.smith@bis.gsi.gov.uk) can answer any queries regarding the instrument.