EXPLANATORY MEMORANDUM TO

THE STATUTORY AUDITORS AND THIRD COUNTRY AUDITORS (AMENDMENT) REGULATIONS 2022

2022 No. 762

1. Introduction

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

2. Purpose of the instrument

2.1 This instrument amends legislation originally made to prepare the United Kingdom's (UK's) audit regulatory regime for its exit from the European Union. It includes changes to that legislation to make indefinite the approval of the United States of America as a fully equivalent third country, and the approval of its audit regulatory authorities as "approved third country competent authorities" on account of the full adequacy of their arrangements for the transfer of audit working papers and investigation reports. These changes will come into effect in advance of 31 July 2022 when the current time-limited periods of the United States' approval for provisional equivalence, and of its authorities' approvals for provisional adequacy, would otherwise expire.

2.2 This instrument is intended to ensure that the UK's audit regulatory regime continues to allow for cross-border listing of securities on the UK's regulated markets by companies incorporated overseas and makes sure there are no obstacles in the UK framework for regulatory cooperation with overseas competent authorities.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

4. Extent and Territorial Application

4.1 The territorial extent of this instrument is the United Kingdom.

4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

5.1 As this instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

6. Legislative Context

6.1 Part 42 of the Companies Act 2006 ("the Act") sets out requirements on the statutory audit of certain businesses that are required to be audited under UK law. It also sets out the responsibilities of the Financial Reporting Council (FRC) as the UK regulator of statutory audit, including audit inspections, investigations and enforcement, and requirements as to the registration of auditors.

6.2 The Statutory Auditors and Third Country Auditors Regulations 2013 provide for the registration by the FRC of auditors of companies from outside the UK. It works together with the Disclosure Guidance and Transparency Rules sourcebook issued the Financial Conduct Authority, which requires that, where non-UK companies issue securities that are admitted to trading on one of the UK's regulated markets, those companies' auditors must be registered by the FRC as "registered third country auditors". Meanwhile Chapter 5 of Part 42 of the Act provides for the regulation of registered third country auditors where this is required.

6.3 Sections 1239(7) and 1242(4) of the Act allow the requirements on the registration and regulation of third country auditors to be disapplied, in whole or in part, by written direction of the FRC as the Secretary of State's delegate. Prior to the UK's exit from the European Union, the FRC made such a direction in respect of an overseas company and its auditor where they were from a third country that had been granted regulatory equivalence by the European Commission on the basis that the third country had a system of audit regulation which was determined as "equivalent" to that required by EU law.

6.4 The Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 (SI 2019/177) ("the EU exit audit regulations") made amendments to the framework for registration and regulation of third country auditors, which have applied from the end of the EU exit transition period. They provided new powers for the Secretary of State to grant equivalence of third countries' audit regulatory regimes, inserted as section 1240A of the Act. The list of third countries granted equivalence status was included in Schedule 1 to the EU exit audit regulations and includes some countries granted time limited 'provisional' or 'transitional' equivalence. When a country's status changes, it is added to one of the lists, or removed, or the date of its expiry is amended or removed, by amendment under section 1240A of the Act. The criteria for a determination of equivalence are set out in the Statutory Auditors and Third Country Auditors Regulations 2020 (SI 2020/108 – "the equivalence and adequacy regulations") which are also made under the new section 1240A power and provide that equivalence may be granted where a third country has a system of audit regulation which is determined as equivalent to that required by UK law.

6.5 Sections 1253A to 1253F of the Act allow the FRC to transfer, or permit the transfer, of audit working papers and investigation reports to a third country competent authority for audit, though only where a number of conditions have been met. Transfers of audit working papers and investigation reports must be on the basis of working arrangements, which can usually only be made where the relevant third country competent authority has been granted the status of an "approved third country competent authority on the basis of the adequacy of its requirements as to the confidentiality of information transferred. Prior to the UK's exit from the European Union approval of a third country competent authority was granted by the European Commission. The EU exit audit regulations made amendments to the framework for the transfer of audit working papers and investigation reports, which have applied from the end of the EU exit transition period. They provided new powers for the Secretary of State to grant approval to a third country competent authority, inserted as section 1240B of the Act. The list of third country competent authorities granted approval is in Schedule 2 to the EU exit audit regulations and includes some authorities whose status is provisional and time limited. When an authority's status changes, it is added to the list, or removed, or the date of its expiry is amended or removed, by amendment under section 1240B of the Act. The criteria for approval of a third country competent authority are set out in

the equivalence and adequacy regulations, made under section 1240B of the Act and are that the competent authority is subject to arrangements that are adequate to achieve comparable outcomes to those required under sections 1253A to 1253F of the Act.

6.6 The Explanatory Memorandum relating to the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 can be found here:

http://www.legislation.gov.uk/uksi/2019/177/memorandum/contents

The Explanatory Memorandum relating to the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2020 can be found here:

http://www.legislation.gov.uk/uksi/2020/108/memorandum/contents

7. Policy background

What is being done and why?

7.1 This instrument makes the following changes by amending Schedules 1 and 2 to the EU exit audit regulations based on the Secretary of State's determinations as to the equivalence of the United States and the adequacy of its audit competent authorities' arrangements for the confidentiality of audit working papers and investigation reports:

- the equivalence of the United States should now be made indefinite and the expiry date of the current period of provisional equivalence should be removed so as to grant full equivalence indefinitely; and,
- the adequacy of the competent authorities of the United States (the Public Company Accounting Oversight Board (PCAOB) and the Securities and Exchange Commission (SEC)) should also now be made indefinite and the expiry dates of their current statuses as "approved third country competent authorities", which apply on the basis of their provisional adequacy, should now be made indefinite so as to grant full adequacy status indefinitely.

7.2 This instrument also includes amendments to Schedules 1 and 2 of the EU exit audit regulations, in order to remedy a technical problem in these regulations. The statuses that were originally granted using powers in the European Union (Withdrawal) Act 2018, might not have been viewed as causing a relevant third country or third country competent authority to fall within the definitions in the Act of an "equivalent third country" or an "approved third country competent authority". The amendments make clear that the UK's approvals of the equivalence of third countries, where they are granted afresh under the power in section 1240A of the Act by this instrument, cause them to fall within the definition of an "equivalent third country"; and that its approvals of the adequacy of third country competent authorities, where they are granted afresh under the power in section 1240B of the Act by this instrument, cause them to fall within the definition of an "approved third country competent authority".

7.3 This instrument applies to Company Law which is a transferred matter for Northern Ireland under section 4 of the Northern Ireland Act 1998. The Companies Act 2006 provides for a single company law regime applying to the whole of the UK, so that companies are UK companies rather than GB companies or Northern Ireland companies. EU Exit legislation which amends the Companies Act or legislation made under it therefore applies to the whole of the UK. This does not affect the legislative competence of Northern Ireland: company law remains a transferred matter, and the

Companies Act could be amended separately or repealed in Northern Ireland if that were so desired.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not trigger the statement requirements under the European Union (Withdrawal) Act 2018.

9. Consolidation

9.1 This instrument is not a consolidation.

10. Consultation outcome

10.1 This instrument was developed in the Department for Business, Energy and Industrial Strategy on the basis of assessments of the equivalence of the United States and the adequacy of its audit regulatory authorities by the FRC. The assessments were completed by the FRC during the 2021/22 financial year in accordance with the equivalence and adequacy regulations after they were commissioned by BEIS on behalf of the Secretary of State in late 2020.

11. Guidance

11.1 Guidance is not required.

12. Impact

12.1 There is no, or no significant, impact on business, charities or voluntary bodies.

12.2 There is no, or no significant, impact on the public sector.

12.3 An Impact Assessment has not been prepared for this instrument because of the low level of impact on business in the UK. Comparatively few auditors audit UK companies that issue securities that are admitted to trading on overseas regulated markets or that are subsidiaries of overseas parent undertakings and therefore are the subject of transfers of audit working papers and investigation reports. In any case only a small number of such transfers are made each year through inspections by the PCAOB of UK audits. Meanwhile the registration and regulation of third country auditors has no impact on UK businesses.

13. Regulating small business

13.1 This instrument applies to activities that are undertaken by small businesses.

13.2 To minimise the impact of the requirements on other small businesses in the UK (employing up to 50 people), as these would only be any small audit firms auditing UK companies, or possibly any small audited companies, whose audit working papers and investigation reports are transferred to the United States, the approach taken in this instrument is only to seek to continue the existing arrangements without also making changes to their operation.

14. Monitoring & review

14.1 The instrument does not include a statutory review clause and, 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 Business, Energy and Corporate Responsibility at the

Department for Business, Energy and Industrial Strategy, Lord Callanan, has made the following statement:

14.2 "A review provision is not included in respect of the provisions of the Statutory Auditors and Third Country Auditors (Amendment) Regulations 2022 or the amendments made by those regulations to the Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2019 because these provisions and amendments have no, or no significant, impact on business, charities or voluntary bodies".

15. Contact

15.1 Paul Smith at the Department for Business, Energy and Industrial Strategy Telephone: 0207 215 4164 or email: pauld.smith@beis.gov.uk can be contacted with any queries regarding the instrument.

15.2 Andrew Death, Deputy Director, at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.

15.3 Lord Callanan, Minister for Business, Energy and Corporate Responsibility at the Department for Business, Energy and Industrial Strategy can confirm that this Explanatory Memorandum meets the required standard.