EXPLANATORY MEMORANDUM TO

THE STATUTORY AUDITORS AND THIRD COUNTRY AUDITORS REGULATIONS 2013

2013 No. 1672

1. 1.1 This explanatory memorandum has been prepared by the Department for Business, Innovation and Skills and is laid before Parliament by command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument amends that part of the Companies Act 2006 and the regulatory framework under that Act which implements European Union law on relations between the countries of the European Economic Area and other countries on the regulation of auditors of listed multinational companies. This framework derives from Articles 45 to 47 of Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts[1] ("the Audit Directive") and the Commission Decisions issued under it. This instrument implements a new Commission Decision issued under Article 47 of the Audit Directive and makes amendments necessary to facilitate the implementation by the Financial Reporting Council ("the FRC") of two more Commission Decisions issued under Article 46 of the Audit Directive. This instrument also consolidates the provisions of Part 5 of the Statutory Auditors and Third Country Auditors Regulations 2007 on the registration of "third country auditors" (see below). Finally it makes other amendments to the framework in the Companies Act on the regulation of these auditors, completing a package of reforms to the FRC begun in 2012.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 Since it amends primary legislation, the relevant regulations (14 to 17) have been cleared by Parliamentary Counsel.

4. Legislative context

The framework under Part 42 of the Companies Act 2006 on the transfer of audit working papers to third countries

4.1 As part of the implementation of the Audit Directive, sections 1253D to E of the Companies Act 2006 implement the requirements of Article 47, which allow Member States to permit the transfer of audit working papers to the audit regulators of non-EEA states only where a number of conditions have been met, usually including that the Commission has determined that a relevant third country authority has "adequate" requirements as regards the confidentiality of information transferred.

4.2 Sections 1253D to E of the Companies Act provide for the transfer of audit working papers to those audit regulators identified as adequate by the European Commission. This approval by the Commission of certain third country competent

[1] OJ Ref L157 of 9 June 2006, page 87

authorities for the purposes of Article 47 of the Audit Directive follows the Commission's assessment of the legal framework applied in the relevant third Countries and its receipt of undertakings given by those authorities in respect of the handling and use of information transferred. Though a number of third country competent authorities have been granted adequacy under Article 47 of the Audit Directive on an ongoing basis, the adequacy granted to the United States of America in 2010[2] was time limited and was due to expire on 31 July 2013.

4.3 This instrument implements Commission Decision 2013/280/EU on the adequacy of the competent authorities of the United States of America[3], which grants a further time limited adequacy period to the relevant competent authorities of the United States expiring on 31 July 2016.

Consolidation of the framework under Part 42 of the Companies Act 2006 on the registration of "third country auditors"

4.4 This instrument also consolidates those provisions of Part 5 of the Statutory Auditors and Third Country Auditors Regulations 2007[4] ("the 2007 Regulations") on the maintenance of the register of auditors of companies from outside the EEA which issue securities on regulated markets in the EEA ("third country auditors"). The consolidated provisions include all those amendments that have been made to the relevant provisions of the 2007 regulations since they were made. Accordingly this instrument revokes where possible both the original provisions of the 2007 Regulations and of those instruments that have amended them since.

Facilitating implementation by the FRC of Commission Decisions on the equivalence of third countries and on transitional arrangements for other third countries in respect of the regulation of third country auditors

4.5 Further amendments have been made as part of the consolidation discussed above to facilitate the implementation by the FRC of:

- Commission Decision 2013/281/EU on the equivalence of the public oversight, quality assurance, investigation and penalty systems for auditors and audit entities of the United States of America pursuant to Directive 2006/43/EC of the European Parliament and the Council[5]; and,

- Commission Decision 2013/288/EU amending Decision 2011/30/EU on the equivalence of certain third country public oversight, quality assurance, investigation and penalty systems for auditors and audit entities and a transitional period for audit activities of certain third country auditors and audit entities in the European Union[6].

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[2] Adequacy under Article 47 of the Audit Directive was originally granted to the competent authorities of the United States of America (the Securities Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB)) by Commission Decision 2010/485/EU of 1 September 2010 on the adequacy of the competent authorities of Australia and the United States (OJ Ref L 240, 11.9.2010, p6)

[3] OJ Ref L161/4 13/6/2013 available at www. http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:161:0004:0007:EN:PDF

[4] SI 2007/3494

[5] OJ Ref L161/8 13/6/2013 available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:161:0008:0009:EN:PDF

[6] OJ Ref L163/26 15/6/2013 available at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:163:0026:0029:EN:PDF

4.6 The Decisions listed above relate to the registration and regulation of third country auditors. The FRC has responsibility under this instrument for the registration of those third country auditors that audit companies incorporated outside the EEA which have securities listed on UK regulated markets. Under the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc) Order 2012 ("the 2012 Order"), the FRC is also the delegate of the Secretary of State's power[7] to disapply the registration requirements in this instrument as appropriate to implement the European Commission's transitional and equivalence frameworks. It is also the delegate of a similar Secretary of State power[8] to disapply requirements for the regulation of third country auditors. The FRC will issue a written Direction shortly using these powers to complete the implementation of the two Commission Decisions.

Amendments on the regulation of third country auditors and third country audits by the FRC in line with reforms already made to the FRC regulatory framework

4.7 Finally, this instrument also amends provisions in Schedules 10 and 12 to the Companies Act 2006, which relate to the regulation of third country auditors and those UK statutory auditors that conduct "third country audits" (i.e. of companies from outside the EEA which issue securities on UK regulated markets).

- Amendments to paragraphs 13 and 23A of Schedule 10 allow administrative sanctions to be applied to UK statutory auditors in respect of any third country audits they may conduct. These amendments are the same as those made by the 2012 Order to paragraphs 13 and 23 of Schedule 10 in respect of UK statutory audits by UK statutory auditors.

- Amendments are also made to Schedule 12 affecting the regulation of third country auditors that are registered in the UK. They amend the framework on investigations and the discipline of those auditors to allow sanctions to be imposed without the need for a formal oral hearing - a third country auditor may now waive this hearing requirement. Again, this is consistent with an amendment made by the 2012 Order for statutory audits.

4.8 These amendments to Schedules 10 and 12 re-implement obligations in the Audit Directive or else make provision for matters which arise out of or relate to these obligations. A revised Transposition Note in respect of the Audit Directive is attached.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom. The UK Government is responsible for company law in England and Wales and in Scotland. The Northern Ireland administration has agreed that, while company law remains a transferred matter within the legislative competence of the Northern Ireland Assembly, the 2006 Act and associated legislation on companies and partnerships should apply to the whole of the United Kingdom.

[7] This power is at section 1239(7) of the Companies Act 2006
[8] This power is at section 1242(4) of the Companies Act 2006

6. European Convention on Human Rights

6.1 The Parliamentary Under Secretary of State for Employment Relations and Consumer Affairs has made the following statement regarding human rights:

In my view the provisions of the Statutory Auditors and Third Country Auditors Regulations 2013 are compatible with the European Convention on Human Rights.

7. Policy background

What is being done and why?

7.1 Regulations 6 to 12 of this instrument make provision in respect of the statutory register of third country auditors and the requirements relating to registration. Regulation 6(1) requires the FRC to keep the register and regulation 6(2) and (3) prescribes the information which the register must contain. Pursuant to regulation 6(4) and (5) the register must be kept in electronic form and be available for inspection. Regulations 7 and 8 set out matters with which a third country auditor must comply in order to become registered. Application is made to the FRC and regulation 9 provides for the circumstances in which the FRC may and will not register the applicant. Regulation 10 provides for the allocation by the FRC to a successful applicant of its "registered number". Pursuant to regulation 11, a registered third country auditor has a duty to provide the FRC with updated information (e.g. to ensure that information on the register concerning the third country auditor remains correct). Regulation 12 concerns the removal of third country auditors from the register.

7.2 Regulation 13 delays the coming into force of amendments to sections 1253D(2), 1253DE(1) and 1253E(8) of the 2006 Act until 1 August 2016.

7.3 Regulations 14 to 17 amend the 2006 Act. Regulation 16 amends Schedule 10 to the 2006 Act to allow an entity carrying out inspections of "third country audit functions" performed by "statutory auditors" (see the definitions at, respectively, paragraph 13 of Schedule 10 to, and section 1210 of, the 2006 Act) to determine sanctions against such auditors where its inspections reveal breaches of the relevant rules of the auditor's professional body. In addition, it obliges the professional body to treat such sanctions as if they were sanctions which the professional body had itself imposed. Regulation 17 amends Schedule 12 to the 2006 Act. It allows the waiving of hearings in connection with disciplinary proceedings involving registered third country auditors.

7.4 The Schedule contains revocations. Most of these revocations are being made because of the consolidation referred to below.

Consolidation

7.5 Regulations 6 to 12 consolidate (with some minor amendments) the existing law relating to the register of third country auditors and the registration process. This was previously provided in:

- Regulations 29 and 34 to 40 of the 2007 Regulations;

- regulation 2(5) and (6) of the Statutory Auditors and Third Country Auditors (Amendment) Regulations 2008[9];
- the Statutory Auditors and Third Country Auditors (Amendment) (No.2) Regulations 2008[10]; and,
- regulation 7 of the Statutory Auditors and Third Country Auditors (Amendment) Regulations 2011[11].

8. Consultation outcome

8.1 The Department for Business, Innovation and Skills has consulted with the FRC on a draft of this instrument.

9. Guidance

9.1 None.

10. Impact

10.1 No impact assessment has been prepared as the cost to UK businesses of the changes made by this instrument are thought to be minimal. Primarily it affects the FRC, a small number of auditors (mostly based outside the EEA), their regulators and client companies (also based outside the EU) that issue securities on UK regulated markets. Given the technical nature of the changes and the fact that the impact on UK businesses is so limited no impact assessment is necessary.

11. Regulating small business

11.1 As this instrument implements EU obligations which do not contain any exemption for small businesses, none can be provided.

12. Monitoring & review

12.1 We would expect to review this instrument at or shortly before the expiry of the time limited period in which certain aspects will apply under the Commission Decisions being implemented. As those aspects continue to apply in general until 1 August 2016, we would expect to review this instrument during the early to middle part of 2016.

13. Contact

Paul Smith at the Department for Business, Innovation and Skills (tel: 020 7215 4164 or email: pauld.smith@bis.gsi.gov.uk) can answer questions about this instrument.

[9] SI 2008/499
[10] SI 2008/2639
[11] SI 2011/1856