

PARLIAMENTARY DEBATES

HOUSE OF COMMONS
OFFICIAL REPORT

Eighth Delegated Legislation Committee

DRAFT STATUTORY AUDITORS AND THIRD
COUNTRY AUDITORS (AMENDMENT) (EU EXIT)
REGULATIONS 2018

Thursday 10 January 2019

No proofs can be supplied. Corrections that Members suggest for the final version of the report should be clearly marked in a copy of the report—not telephoned—and must be received in the Editor’s Room, House of Commons,

not later than

Monday 14 January 2019

© Parliamentary Copyright House of Commons 2019

This publication may be reproduced under the terms of the Open Parliament licence, which is published at www.parliament.uk/site-information/copyright/.

The Committee consisted of the following Members:

Chair: PHILIP DAVIES

- | | |
|--|--|
| † Berger, Luciana (<i>Liverpool, Wavertree</i>) (Lab/Co-op) | † Ross, Douglas (<i>Moray</i>) (Con) |
| Daby, Janet (<i>Lewisham East</i>) (Lab) | † Rowley, Lee (<i>North East Derbyshire</i>) (Con) |
| † Day, Martyn (<i>Linlithgow and East Falkirk</i>) (SNP) | † Shapps, Grant (<i>Welwyn Hatfield</i>) (Con) |
| † Esterson, Bill (<i>Sefton Central</i>) (Lab) | † Smith, Nick (<i>Blaenau Gwent</i>) (Lab) |
| † Harris, Rebecca (<i>Lord Commissioner of Her Majesty's Treasury</i>) | † Swire, Sir Hugo (<i>East Devon</i>) (Con) |
| † Mills, Nigel (<i>Amber Valley</i>) (Con) | † Tolhurst, Kelly (<i>Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy</i>) |
| † Morris, Anne Marie (<i>Newton Abbot</i>) (Con) | † Zeichner, Daniel (<i>Cambridge</i>) (Lab) |
| † Morris, Grahame (<i>Easington</i>) (Lab) | Bradley Albrow, Matthew Congreave, <i>Committee Clerks</i> |
| † O'Brien, Neil (<i>Harborough</i>) (Con) | |
| Perkins, Toby (<i>Chesterfield</i>) (Lab) | † attended the Committee |

Eighth Delegated Legislation Committee

Thursday 10 January 2019

[PHILIP DAVIES *in the Chair*]

Draft Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2018

11.30 am

The Parliamentary Under-Secretary of State for Business, Energy and Industrial Strategy (Kelly Tolhurst): I beg to move,

That the Committee has considered the draft Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2018.

It is a pleasure to serve under your chairmanship, Mr Davies. Since the UK's 2016 referendum decision to leave the EU, the Department for Business, Energy and Industrial Strategy has undertaken a significant amount of work on the withdrawal negotiations in preparation for a range of potential negotiation outcomes. The best outcome is for the UK to leave with a good deal and we have put forward a serious and credible proposal for the future relationship. Although we remain confident of an agreement, in the meantime we must and will continue to work on preparing for a no deal.

The regulations aim to address the failure of retained EU law to operate effectively, as well as other deficiencies in the field of audit arising from the withdrawal of the United Kingdom from the European Union. They do not implement any new policy.

Although the fundamental elements of the current statutory audit legislation will remain the same after exit, the legislation still needs to be amended to ensure that it will work effectively once the UK has left the EU. That is because UK law on the regulatory oversight of the audit profession is compliant with the EU audit directive and the EU audit regulation.

The audit directive sets out the requirements on the statutory audit of most incorporated businesses, as well as a framework of standards for audit work and independence. It also sets out the responsibilities of the competent authorities for statutory audit in member states.

Meanwhile, the audit regulation sets additional requirements on the statutory audit of businesses defined as public-interest entities, which are banks, building societies, insurers and businesses with securities traded on regulated markets. The regulation forms part of retained EU law under the European Union (Withdrawal) Act 2018 and will therefore continue to apply in the UK after the UK exits from the EU. Our aim is to ensure that the framework for regulatory oversight of the audit profession in the UK works effectively following our withdrawal from the EU. The statutory instrument will help to facilitate that.

Under the audit directive, powers are provided to the European Commission to grant equivalence to third countries for their audit regulatory framework and

adequacy to third countries' competent authorities for their framework on audit regulatory co-operation. The instrument transfers those powers to the Secretary of State and provides powers to set out the criteria and procedure for assessment.

In future, equivalence or adequacy status decisions will be granted by regulations. Regulations could also be used in the months immediately following the UK's departure to set out a framework for future assessment of equivalence and adequacy by the Financial Reporting Council. Following the UK's exit from the EU, European economic area states would be treated like other third countries and, therefore, would be granted equivalence and adequacy status by the FRC.

The instrument extends the powers granted to the UK competent authority, the Financial Reporting Council. Certain powers that have been granted to the FRC by the Secretary of State will need to apply more broadly to reflect the UK's exit.

The instrument extends the FRC's ability to enter into mutual recognition agreements to recognise audit qualifications to allow such agreements to be made with EEA states and Gibraltar. It also extends the FRC's ability to register third country auditors to include the registration of EEA auditors and Gibraltar auditors.

The instrument transfers the European Commission's power for the adoption of international auditing standards to the FRC. As the FRC already sets UK standards in line with international standards, we anticipate no immediate change.

The instrument provides certain transitional arrangements for auditors affected and their client businesses. To ensure companies and investors remain confident in UK markets, these will apply until the end of 2020. During that period we will continue to recognise EEA audit qualifications, EEA firm registrations and approvals, EEA audit regulatory frameworks as equivalent and EEA competent authorities as adequate. These transitional arrangements will mean that there will be no cliff edge for EEA companies that list securities on the UK market. It will also allow the FRC the time to put in place the procedures necessary to determine the full equivalence of EEA states, as well as the adequacy of their competent authorities.

The Government have carried out a de minimis impact assessment of the regulations, as the overall costs to business were expected to be small. This confirmed that the impact on business would be minimal, with only a limited sector being affected by most of the substantial changes. This is because the amount of cross-border business affected by this instrument is small. The most significant effects are for EEA businesses that are listed on UK markets, whose auditors will have to register with the FRC, and for UK businesses that only trade securities in the EEA, as these auditors will be subject to less regulation than before.

Recent statements by the Republic of Ireland Government have suggested that some individual UK auditor practices across the border may be affected by the UK's exit. However, the numbers are small and officials are already in discussion with officials in the Republic of Ireland about them. These regulations maintain access to the UK for the Republic of Ireland auditors for the transitional period. During this period, we hope to agree a mutual recognition agreement with the Republic

of Ireland, which will enable continued long-term access for both sides. The Government have worked closely with business and regulatory bodies, to ensure that the instrument before you now achieves continuity wherever possible, while addressing the deficiencies arising from the UK's withdrawal from the EU.

In conclusion, these regulations aim to provide continuity for businesses operating in the audit sector wherever possible, while addressing deficiencies arising from the UK's withdrawal from the EU. In the unlikely event that the UK leaves the EU without an agreement, the measures contained in the regulations will be crucial in ensuring that the audit regulatory framework in the UK works effectively. I therefore commend the draft regulations to the Committee.

11.37 am

Bill Esterson (Sefton Central) (Lab): It is always a pleasure to serve under your chairmanship, Mr Davies. I take the opportunity to wish you and all hon. Members a happy new year.

I noted from the Minister's opening remarks that we are still very much in the pantomime season. She only had to look behind her to see the truth of that statement as in her opening comments, when she confidently articulated the likelihood of Tuesday's vote succeeding in the House. I do not want to disabuse her, but I sincerely doubt that that will happen. Nevertheless, here we are. We will play the game and address the regulations before us in the spirit intended, with the assumption that the deal will go through on Tuesday, even though we all know that is not going to happen.

The Minister rightly said how important it is that we have a successful, sustainable and workable audit regulatory framework in the UK after leaving the European Union. I wholeheartedly agree with that sentiment, but her speech and the information before us raises a number of questions, which we can usefully address, regardless of how we leave the European Union and whether the vote goes through on Tuesday.

The Minister mentioned the fact that a transition period in the withdrawal agreement lasts until the end of 2020, and that this avoids a cliff edge in the changes that she described. Can I ask her about the FRC's confidence in its ability to negotiate new mutual recognition agreements to avoid simply delaying a cliff edge until the end of 2020? What have other countries said on the same subject? My understanding, from talking to the FRC, is that negotiating mutual recognition agreements on those subjects is by no means straightforward—they are extremely complex. I must ask where her confidence comes from, because I could not find in the paperwork before us any kind of clarification or assurance that would lead her to be so confident.

The Minister mentioned the commentary of the Government of the Republic of Ireland. She also mentioned that the number of businesses affected cross-border on the island of Ireland is small. Can she tell us how small, how many businesses are affected and what their turnover is? Similarly, can she say exactly how many businesses overall will be affected by the anticipated changes, and what their turnover is? I note that again—as for similar statutory instruments that we have discussed in the last few months—we have no impact assessment. The last impact assessment we had, which was on accounting

standards, suggested that 20,000 businesses were affected. That is a sizeable number, and I would be interested to know whether it is a similar sort of number in this case. Perhaps she can get that figure for us.

As with the accounting standards regulations, the responsibility for oversight moves from the European Commission to the Secretary of State, and is delivered by the Financial Reporting Council. I ask the Minister, as I did last time, what the arrangements are. There are arrangements for scrutiny of the European Commission's activities, but what arrangements will we have to scrutinise the Secretary of State's activities and, more importantly, how will resourcing of the FRC be changed to address the additional workload resulting from what she set out in her remarks?

We are discussing regulations for significant additional third-country operation of auditors in the UK, and the regulation of that activity. Those are very important areas. Public confidence in our auditing profession is low, with some very high-profile cases—Carillion springs readily to mind—so anything that undermines or further devalues public confidence in how audits are carried out would be extremely damaging. What assurances can she give that the FRC will be in a position to ensure that no further damage done to the reputation and quality of audit? That is extremely important. Twenty-one months is not a long time. The changes are significant and additional reassurance would be extremely welcome.

I mentioned the Irish Republic. The chartered accountants body in Ireland is calling for negotiation on the mutual recognition of professional qualifications. My understanding is that a significant number of EU citizens are working in our large audit firms, which audit the FTSE 350, for example. What arrangements are being put in place to ensure that their qualifications are recognised and that they will be able to continue auditing businesses of all sizes in this country? The Irish Government want to deliver a bilateral mutual recognition agreement. As some of these issues will not just apply in the Irish Republic, is something similar being suggested by other EU countries, and have those discussions taken place with the Minister's Department?

The regulations are in the event of the withdrawal agreement going through. However, if the agreement does not go through, what planning has been done on these subjects in the event of no deal? I was heartened to hear the Secretary of State's comments that he is doing everything in his power to avoid no deal, which he reiterated this morning in response to the very bad news about the job losses at Jaguar Land Rover. Knowing him, I am sure that is true, but in the event of no deal, what would be the impact on the regulations before us? More importantly, what would be the impact on the auditing that is relevant to these regulations? As with so many other parts of our economy and country, no deal would have serious consequences for the audit sector. Arrangements need to be put in place—a point that has also been made in the information that is in front of us, and in the Minister's opening remarks. To be fair, she set that out very well.

With the exception of a small number of people in this House, we can perhaps all agree that avoiding no deal is extremely important. With these regulations, we have yet another example of why it is so important that we avoid no deal, and that the proper arrangements are put in place to make sure—whether for the audit sector

[*Bill Esterson*]

or for many other areas of the economy—we have an agreement that we can all get behind. As I said before, that is not going to be the agreement that the Prime Minister puts forward on Tuesday, but we are certainly going to need to agree something in the coming weeks and months. The prospect of no deal, whether for these regulations or for other areas, is utterly disastrous for us all.

11.48 am

Grant Shapps (Welwyn Hatfield) (Con): Following on from the comments made by the hon. Member for Sefton Central, I wanted to clarify a simple point with my hon. Friend the Minister. From reading through the detail, it is my understanding that this instrument deals with what happens when we leave on 29 March, regardless of whether a withdrawal agreement has been approved by this House. I cannot see anything in here that alters the nature of the instrument one way or another, but perhaps the Minister can let me know if I have read that incorrectly.

11.49 am

Nigel Mills (Amber Valley) (Con): I have just a few comments and questions about what we are doing here. To start with a slightly trivial one, the exemptions from having a statutory audit are set by EU regulation, and are based on thresholds for turnover and balance sheet size that are set in euros and then, every so often, are converted into sterling. I think the current ones we use set a turnover size of £10.2 million and a balance sheet size of £5.1 million. As we implement these regulations, would it not make sense to pick a nice round turnover and balance sheet number that can stay the same until we choose to change it, rather than having a slightly odd un-round number because of a conversion from euros?

I have two more substantive questions. First, while we obviously have some important ongoing discussions about how we reform our audit regulations and industry to make sure they are meeting the needs of the various stakeholders, our audit industry and professional services are well regarded around the world for the high quality of their work, their training, their standards and their regulation. They form quite an important export market. Can the Minister assure us that with all the stuff that we are carrying out on mutual recognition, we are aware that this is quite an important export for us? Ensuring that our UK businesses and our UK trading staff will continue to work in Europe and around the world is equally as important as ensuring that EU or EEA firms and others can work in the UK.

My second point is on what happens in the unlikely event of a no-deal exit at the end of March. There are many companies listed on our stock exchanges that are not based here and are therefore audited by non-UK audit firms. It is okay to have the powers to authorise non-UK firms to carry out these audits, but are we sure that in the event that an audit needs signing off and documents need filing in April, or pretty quickly after we leave, audit firms that are not UK-based will have been authorised so that those audited accounts are valid for listing purposes? Will we effectively just grandfather

those approvals until the end of 2020, regardless of there being a deal or not, or will the FRC have to authorise a whole load of audit firms very quickly to ensure that we can continue to have firms meeting their listing requirements?

There have been various concerns about the ability of the FRC and its resourcing to meet all the very demanding roles that it already has. Is the Minister sure that it can at some speed meet these new demanding requirements that we have? Just for safety, I should declare that I am still a member of the Institute of Chartered Accountants in England and Wales. I used to work for audit firms, and I think I have a very small pension from one somewhere.

11.52 am

Kelly Tolhurst: I will try to answer as many of the questions that have been put by hon. Members as I can. The hon. Member for Sefton Central referred to the people behind me as thinking that I was not speaking the truth. I want to clarify my point: as a member of this Government, I am committed to getting to a position where the UK has a deal with the European Union. However, any responsible Government, as we are, would be preparing for a no-deal scenario. The regulations before us will put us in a position where UK business confidence remains. We have confidence in the UK markets and are acting responsibly to ensure that in the event of no deal, we are in a situation where the law works correctly.

I would like to go back to the point made by my right hon. Friend the Member for Welwyn Hatfield. Should a deal be agreed, we might not see many changes. We are in this particular agreement, which is retained EU law, so EU laws are being introduced in the UK. It sets out how we will deal with certain audit provisions. Whether there is a deal or not, further changes will come through, because we will take decisions on how to work things and lay out further guidance on how we will assess qualifications and how we will assess the competency of authorities in the future. Fundamentally, this applies whether there is a deal or not, but obviously it focuses on a no-deal scenario.

As the hon. Member for Sefton Central will know, the transitional agreement is under this SI. For example, up to 2020, under the SI, there is confidence that we will be accepting the relevant professional qualifications and competent authorities within EEA states for the transitional period, so as not to be at a cliff edge.

The hon. Gentleman asked whether the FRC is confident that it will be able to establish mutual agreements, and whether it is in a position to do so. Currently it carries out—fundamentally speaking—oversight with respect to the regulation as it stands. I am therefore confident that it will be in a position to deal with further work that is necessary in the event of no deal—and in a situation where there is a deal, although we are talking about a no-deal scenario at the moment.

I want to touch on a question from my hon. Friend the Member for Amber Valley about recognition of qualifications, and authorisations. Under the SI—and the FRC is agreed—in the case of businesses whose financial years fall after 29 March there will be a requirement for auditors to register prior to the audit being signed. Effectively, there could be up to an extra

year for auditors to do that, after 29 March. That is exactly so that it can be managed. There may be benefits for some auditors, because there is potential for them to say, as a selling point, they have done it ahead of time. Obviously that will not be before 29 March, and they will have until the time when they need to sign the audit to register. I hope that that gives my hon. Friend some confidence.

Nigel Mills: I think I understand what the Minister is trying to say, but just to confirm it, let us say a firm had the year end of 28 February 2019 and had to submit audited financial statements to a listing authority by some such time as the end of April or early May, and we had a no-deal Brexit. The auditors could not register for that before 29 March; but would they have to register before they could submit those accounts—so that they would have to do it very quickly in early April—or would they be grandfathered, in the event of no deal?

Kelly Tolhurst: My hon. Friend has outlined a situation where the company's end of year would fall before the withdrawal date. As things stand the new registry would be only for instances where the financial year started after 29 March. It depends on where the years fall. In the case he gave, effectively, the auditors would not have to do it.

As to the number of companies affected, there are currently 291 EEA companies registered on the UK markets, and approximately 240 UK companies that have registered securities on EEA markets. The regulations affect a small number of organisations and in some cases a few other European countries. We are talking about a small number of companies. To give the Committee an idea of the scale, there are 1,000 listed companies in the UK. We have 3.8 million companies registered in the UK, 98.5% of which are small businesses, 20,000 large businesses and 35,000 medium-sized businesses, so the direct impact will affect a small number of companies and audit firms that are registered within the EEA.

On the point about the Secretary of State taking those powers regarding approval of adequacy and competence that have lain with the European Commission under the EU regulation, there would be full parliamentary scrutiny, as there is, with the Secretary of State having that power. As the hon. Member for Sefton Central knows, all Secretaries of State face full parliamentary scrutiny, and I would argue that our Secretary of State having those powers represents far more scrutiny than the European Commission under the current position. It is a positive move for the Secretary of State to have those powers, and it is right that they are held at parliamentary level rather than being delegated, at this particular time, to an arm's-length body such as the FRC.

Regarding what the hon. Gentleman says about my confidence in the FRC and its ability, this particular regulation deals with a no-deal scenario, but as he and the Committee know, Sir John Kingman's report into the FRC was published at the end of last year. We also have the work that has been done in the audit market regarding competitions. Whether we have a no-deal or a deal scenario, those pieces of work on what we do in this area to ensure that our markets are working effectively and that our public bodies are acting effectively will be ongoing. If there were to be any changes in the future, this SI would be taken into account. That is what Governments do. In a no-deal situation we would be in a position to change whatever we might want to in this area. I do have confidence in the FRC and in how we would manage that, and that the FRC would be in a position to deliver what is required in both a no-deal and a deal situation.

Regarding bilateral agreements, the hon. Gentleman mentioned the position with Ireland and asked whether we had had those discussions with other European states. Currently, 200 of the around 240 companies affected operate in the Irish market, so Ireland is the main EU member state that we will need to work more closely with in the future. Our officials are in discussions with our European neighbours all the time across a number of topics in this area, and more of that will go on as we head toward European Union exit date and after 29 March, whether or not we are in a deal situation and working toward a future relationship. We are committed to ensuring that we are able to deliver those agreements with our neighbours in the future.

It is paramount that, as the UK exits the EU, we maintain the integrity of the UK system for audit regulatory oversight. These regulations will help to facilitate that by ensuring that oversight of the audit profession continues to work effectively following our withdrawal from the EU. The regulations do not introduce a change in policy. As I explained, the fundamental elements of the current statutory audit legislation will remain the same after exit. The regulations before the Committee make only the amendments that are necessary to ensure that audit legislation remains operable in the UK following our withdrawal from the EU. The measures in these regulations will ensure that, and mean that the UK system for regulatory oversight will remain coherent and understandable for the businesses that rely on it. I therefore commend the regulations to the Committee.

Question put and agreed to.

Resolved,

That the Committee has considered the draft Statutory Auditors and Third Country Auditors (Amendment) (EU Exit) Regulations 2018.

12.5 pm

Committee rose.

