
EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations implement obligations in [Directive 2014/56/EU](#) of the European Parliament and of the Council of 16 April 2014 amending [Directive 2006/43/EC](#) on statutory audits of annual accounts and consolidated accounts⁽¹⁾ and Regulation (EU) 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission [Decision 2005/909/EC](#)⁽²⁾ (“the Audit Regulation”). The amended [Directive 2006/43/EC](#) is known as “the Audit Directive”. The Audit Regulation is directly applicable, but changes have been made to domestic law to remove inconsistencies between domestic law and the Audit Regulation.

Section 1210 of the Companies Act 2006 (c. 46) sets out what statutory auditor means in relation to Part 42 of that Act. A statutory auditor is a person appointed as auditor under the legislative provisions specified in section 1210 (including a person appointed as auditor of a prescribed person under a prescribed enactment authorising or requiring the appointment, see section 1210(1)(h)). In Part 42 of that Act, an audited person is the person in respect of whom a statutory audit is conducted (section 1210(2)), and a range of audited entities are audited persons whose auditors are statutory auditors subject to the regime in Part 42. These Regulations implement the obligations of the Audit Directive and the Audit Regulation in relation to companies and building societies. For other entities subject to statutory audit, these Regulations implement some of the obligations by way of amendments to Part 42 of the Companies Act 2006. Further legislation will be made to implement the remaining obligations for the other entities.

Part 1 of the Regulations concerns introductory matters, including the application of the Regulations. Some aspects of the Regulations apply only in relation to financial years beginning on or after 17th June 2016, and these concern the controls which currently apply in relation to the sharing of audit working papers with third country competent authorities being extended to the sharing of audit investigation reports with those competent authorities (see sections 1253D to 1253E Companies Act 2006 for details of the controls). There are transitional arrangements relating to investigations and enforcement action beginning before these Regulations come into force.

Part 2 concerns the functions of the competent authority under these Regulations and the Audit Regulation. The competent authority is the Financial Reporting Council Limited (see the definition of “competent authority” in regulation 2). Regulation 3 sets out the responsibilities of the competent authority and permits the authority both to delegate tasks arising from its responsibilities to any recognised supervisory body, and also to subsequently reclaim tasks it has delegated. It also introduces Schedule 1, which prescribes requirements for the standards the competent authority must determine in relation to the obligations of statutory auditors in relation to professional ethics, independence, objectivity and confidentiality. Regulation 4 sets out the requirement that statutory auditors must comply with certain standards when conducting a statutory audit, which include the standards set under Schedule 1.

Regulation 5 sets out the powers of the competent authority to impose sanctions on statutory auditors who breach the relevant requirements (as defined in regulation 5(11)), which include the requirements in these Regulations (including the requirement in regulation 4), the requirements in the Audit Regulation, and in various enactments which govern statutory audit for a range of audited persons. The competent authority is required by regulation 6 to publish details of sanctions imposed

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(2) OJ L 158/77 27.05.14.

under regulation 5. Regulation 7 concerns the ability of the competent authority to enforce sanctions which have not been complied with by way of application to court for a court order. Regulation 8 provides that if a financial penalty is not paid when due, it will attract interest and may be recovered by the competent authority as a debt.

Regulation 9 requires the competent authority to monitor the conduct of statutory audit work which relate to public interest entities (public interest entities are defined in regulation 2 as an entity which issues securities which are admitted to trading on a regulated market, a credit institution or an insurance undertaking). The monitoring must take the form of a system of inspections which satisfy Article 26 of the Audit Regulation. Regulation 9 sets out the requirements for monitoring the conduct of statutory audit work for all other audited persons, which include having arrangements which operate independently of the persons being monitored, having adequate resourcing for effective monitoring, using suitably qualified and experienced persons to carry out inspections and avoiding conflicts of interest between those carrying out inspections and those being monitored. Regulation 10 gives effect to Schedule 2, which concerns powers of investigation of the competent authority.

Regulation 11 concerns the performance of third country audit functions, defined in regulation 11(8). The entities concerned are incorporated outside the EEA, but are traded in the United Kingdom or their transferable securities are admitted to a regulated market in an EEA state. Regulation 11 applies the system of requirements for audits, monitoring of audits and sanctions and enforcement in regulations 4 to 9 and Schedule 2 to the performance of third country audit functions, with appropriate modifications.

Regulation 12 in Part 3 provides that any term in a contract which, in relation to the conduct of a statutory audit of an audited person, has the effect of restricting the audited person's choice of statutory auditor to certain categories or lists of statutory auditors, has no effect (unless the audited entity is a public interest entity).

Part 4 concerns miscellaneous matters. Regulation 13 gives power to the competent authority to grant to a statutory auditor, where exceptional circumstances exist, an exemption from the requirements of Article 4(2) of the Audit Regulation (which sets a limit for fees for non-audit services over a three year period of 70% in relation to the audit fees for an entity). The exemption may be granted for up to two consecutive financial years.

Schedule 3 makes amendments to the Companies Act 2006. In particular, amendments are made to Part 16 of that Act in relation to rotation and retendering for statutory auditors for public interest entities. A maximum engagement period of ten years is introduced, although this can be extended to twenty years provided that there is a selection procedure at least every ten years. There are transitional arrangements in relation to the application of the maximum engagement period.

Schedule 4 makes amendments to Part 8 of the Building Societies Act 1986 which mirror the amendments made to Part 16 of the Companies Act 2006 in Schedule 3. Building societies are all public interest entities.

Schedule 5 makes consequential amendments to the Companies (Audit, Investigations and Community Enterprise) Act 2004. Amendments are also made to the Local Audit and Accountability Act 2014 to provide that the amendments to Part 42 of the Companies Act 2006 do not apply in relation to local audit under that Act.

Regulations 14, 18, 19 and 20 make amendments to other secondary legislation.

Regulation 21 excludes a large debt securities issuer from the definition of "UK-traded non-EEA company" for the purposes of Part 42 of the Act.

Regulation 23 requires the Secretary of State to review the provisions of these Regulations, and to publish a report within five years after these Regulations come into force and within every five years after that. In carrying out a review the Secretary of State must, so far as is reasonable, have regard to how the Audit Directive is implemented in other member states. Following a review it will fall to

the Secretary of State to consider whether the provisions should remain as they are, or be revoked or be amended. A further instrument would be needed to revoke or amend the provisions.

A full regulatory impact assessment of the effect that this instrument will have on the costs of business and the voluntary sector is available from the Business Environment Directorate, Department for Business, Innovation and Skills, 1 Victoria Street, London SW1H 0ET or from www.gov.uk/bis, and is also available alongside this instrument at www.legislation.gov.uk.