

**“REVIEW OF THE REGULATORY REGIME OF
THE ACCOUNTANCY PROFESSION:
LEGISLATIVE PROPOSALS”**

**REPORT ON THE PUBLIC CONSULTATION
AND THE GOVERNMENT’S CONCLUSIONS**

FEBRUARY 2004

CONTENTS OF THIS REPORT

1.	Introduction	Page 3
2.	Legislative approach	Page 5
3.	Auditing standards	Page 7
4.	Investigation and disciplinary arrangements	Page 10
5.	Powers in disciplinary cases	Page 13
6.	Application to the ICAI	Page 15
7.	Audit inspection arrangements	Page 18
8.	Delegation of the recognition function	Page 22
9.	Funding	Page 23
10.	Other issues	Page 26

Appendices

A.	Contact details	Page 28
B.	Index of respondents	Page 29

CHAPTER 1: INTRODUCTION

Background to the proposals

1.1 On 24 July 2002, Patricia Hewitt, Secretary of State for Trade and Industry, announced an immediate review of the regulatory arrangements for the accountancy and audit professions. The purpose of the review was to look at the way the accountancy and audit professions were regulated and to consider whether any changes should be made. The review was to consider, among other things, whether there should be a statutory basis for regulation.

1.2 On 29 January 2003, the Secretary of State announced that she accepted the conclusions of the report of the review team¹. The review report followed a wide-ranging public consultation, and its main conclusion was that the Financial Reporting Council (FRC) should take on the functions of the Accountancy Foundation to create a unified and authoritative independent regulator with three clear areas of responsibility: the setting of accounting and audit standards; their monitoring and enforcement or; and the oversight of the self-regulatory activities of the major professional accountancy bodies. In her statement to Parliament, the Secretary of State said there was a strong case for statutory underpinning to make the new body work, that she would consider this further, and that she would report her conclusions to the House.

1.3 On 11 March 2003 the DTI published a consultation document “Review of the Regulatory Regime of the Accountancy Profession: Legislative Proposals”, and requested comments by 10 June 2003².

The consultation responses and the Government’s intentions

1.4 The Government received 25 written responses to the consultation, and is grateful to all those who responded. A list of those who submitted responses is attached at **Annex B**.

1.5 The Government has considered the responses carefully. This document summarises the comments made by respondents and indicates the Government’s intentions on each of the consultation proposals.

1.6 In summary, the Government welcomes the support that the consultation has demonstrated for its legislative proposals. The main features of the provisions proposed in the March 2003 consultation document are contained in the Companies (Audit, Investigations and Community Enterprise) Bill, which was

¹ Review of the Regulatory Regime of the Accountancy Profession, Report to the Secretary of State for Trade and Industry, available at www.dti.gov.uk/cld/post_enron.htm.

² Review of the Regulatory Regime of the Accountancy Profession: Legislative Proposals, available at www.dti.gov.uk/cld/post_enron.htm

introduced into the House of Lords on 3 December 2003. However, in some respects, the details of the proposals have been amended as described in Chapters 2 – 9 of this report. Chapter 10 covers a couple of issues that were not the subject of consultation (approval of overseas qualifications and the extent of regulation and oversight).

1.7 Following the Secretary of State's announcement in January 2003, the work of implementing the recommendations of the review report has been carried on under the auspices of a Steering Group chaired by the DTI. The aims and objectives of the new FRC and its Boards, and the Boards' present work programmes have been published³. The aim is to bring the new FRC formally into being early in 2004.

³ These can be found at: www.accountancyfoundation.com/neworganisation.cfm

CHAPTER 2: LEGISLATIVE APPROACH

Responses to consultation

2.1 In the consultation document, the Government expressed the view that it was not necessary to put the FRC on a statutory basis in order to deliver independent regulation and oversight which was authoritative, accountable and transparent. The approach proposed by the Government was rather to build on the existing framework for the regulation of the statutory auditor, which devolves to recognised supervisory bodies the day to day responsibility for ensuring the training and authorisation of registered auditors and the supervision of audit firms.

2.2 Respondents were generally supportive of the approach set out in the consultation document. Of the 17 respondents who commented on this issue, 12 were in favour. The others were evenly split between those who thought that no legislation was necessary and those who thought that only a statutory regulator would be effective. The main reasons given for a statutory regulator were that

- without powers to raise funds through a levy, the FRC could not be said to be truly independent; and
- legislation was needed to oblige auditors to abide by the standards set by the Auditing Practices Board in relation to independence, objectivity and integrity.

2.3 Illustrative quotes:

“In general, the approach of the Department has been to propose ‘light touch’ amendments to current legislation and we are in favour of this approach. Indeed, it is a feature of our own regulatory activity and we have found it to be the most effective approach to securing effective and prompt implementation of required changes. The Department’s proposals do not look likely, in our view, to threaten the integrity of the extant, effective elements of the self-regulatory arrangements put in place by the professional bodies.” Audit Commission

“We welcome the proposed ‘light touch’ approach, which we believe is both appropriate to the circumstances and capable of ensuring that implementation can proceed as fast as practicable.” Association of Chartered Certified Accountants

“We agree with the general approach that as few changes as possible should be made to the existing statutory regime provided that the outcome proposed by the review can be achieved. Such an approach is justified by the finding of the review that there were no serious flaws in the existing regulatory regime.” Institute of Chartered Accountants in England & Wales

“We recommend that the approach proposed in the document is reconsidered. Appropriate provisions should ... ensure that the new regulatory framework will operate as intended and command credibility both domestically and internationally. The basic issue is whether truly independent regulation can be achieved by amending a framework designed for self-regulation by the professional bodies (as opposed to creating a new framework conferring appropriate powers on the independent regulator). We have particular concerns about the proposal not to give the new FRC any powers to raise funds.” Financial Services Authority

“As far as auditing is concerned, the Institute has encouraged self-regulatory structures within statutory frameworks – a pattern that has, until now, corresponded to international best practice. We are, however, increasingly finding that the international agencies that sponsor such developments are questioning the appropriateness of self-regulatory structures for auditors. We firmly believe that the current opportunity should be used to put audit regulation for listed companies into a clear statutory framework covering registration, monitoring and enforcement.” Institute of Chartered Accountants of Scotland

The Government’s intentions

2.4 As is described in more detail in Chapters 3 to 9 below, the Government intends to maintain the legislative approach suggested in the consultation document. The Government does not believe that it necessary to turn the FRC into a statutory body in order to achieve the objectives of independent funding and compliance with independently set standards, for the reasons given in Chapters 3 to 9 of this document. The Government’s proposals are in line with the findings of the review of the regulatory regime of the accountancy profession. The review did not uncover evidence of any serious flaw in the existing regulatory framework but concluded that there was scope to strengthen further the independence of the system of regulation and to achieve a clearer, more authoritative and more transparent regulatory structure.

CHAPTER 3: AUDITING STANDARDS

Responses to consultation

3.1 The consultation document asked for comments on the desirability or otherwise of providing clearer statutory backing for auditing standards. Two alternative methods of achieving this were suggested:

- to make it a condition of recognition that a supervisory body requires registered auditors to follow auditing standards and auditor independence requirements set by a body designated by the Secretary of State; or
- to impose a direct statutory requirement on registered auditors to follow auditing standards and auditor independence requirements set by a body designated by the Secretary of State

3.2 Of the 14 respondents who expressed a view, 5 thought that statutory backing was unnecessary. Of the 9 who thought that statutory backing was desirable, 3 thought no action should be taken until it was clear what action might be taken at EU level.

3.3 Illustrative quotes:

“There is concern at the absence of any statutory underpinning for auditing standards. At present the obligation on audit firms to apply APB standards is imposed through the CCAB Participation Agreements – this will disappear under the new arrangements.” Financial Reporting Council

“We believe that statutory backing for auditing standards would strengthen the current arrangements... However, we concur with the views of the Department that it is sensible to await the proposals of the European Commission” Audit Commission

“We see no need for there to be a further statutory imposition on registered auditors to follow such standards. The introduction of a specific statutory requirement would not make any difference to the consequences for individuals and firms which are already potentially liable to both an unlimited fine, loss of registration as an auditor and exclusion from membership of the Institute.” Institute of Chartered Accountants in England & Wales

The Government's intentions

3.4 After further consideration of this issue in the light of the responses to consultation, the Government has concluded that there should be a requirement for auditors to comply with standards that are set independently of the professional bodies. This should include not only technical auditing standards but also standards on auditor objectivity, independence and integrity. The Government believes therefore that it should be a condition of recognition that supervisory bodies should ensure that their members abide by independently set auditing standards.

3.5 The Government intends to define "independence" as meaning that the recognised supervisory bodies should not have any involvement in the appointment or selection of those who set the standards, nor in the way the arrangements operate in other respects.

3.6 The Government anticipates that the recognised supervisory bodies will comply with this condition by requiring the auditors registered with them to follow standards set by the Auditing Practices Board (APB) of the Financial Reporting Council. However, we believe that it is not necessary to require that the standards that auditors follow must be those set by a prescribed body. Such a requirement would change the character of auditing standards into rules that would have legal force. As a rule-making body, the APB would be necessarily subject to certain statutory controls on its operation. Since the Government's policy objective of ensuring that auditors abide by independently set standards can be achieved without designating a particular standard setter, we believe these disadvantages outweigh any benefits.

3.7 One respondent queried whether clarification was needed that the APB's remit is restricted to audit rather than assurance as a whole (which they understood to be the case). The aims, objectives and operating guidelines of the APB⁴ make clear that the remit of the APB covers assurance services as well as audit.

3.8 The consultation document stated that the European Commission is currently considering proposals for the adoption of International Standards of Auditing (ISAs) across the European Union. The document proposed that further consideration of this issue should be deferred until the Commission's proposals had been received.

⁴ The aims and objectives of the new FRC and its Boards, together with the work programmes for each Board can be found at: www.accountancyfoundation.com/neworganisation.cfm.

3.9 The European Commission is expected to put forward proposals to Member States and the Parliament for the modernisation of the Eighth Company Law Directive on statutory auditors in the first part of 2004, which are likely to include proposals on the adoption of ISAs. The Government considers that the proposed way forward is sufficiently flexible to accommodate likely EU developments, and officials are in close contact with the Commission and other member states in order to monitor and influence those developments.

CHAPTER 4: INVESTIGATION AND DISCIPLINARY ARRANGEMENTS

Responses to consultation

4.1 The consultation document sought views on whether it should be a condition of recognition that supervisory bodies participate in independent disciplinary arrangements for auditors. The document also asked whether this obligation would, in practice, be sufficient to deliver the Investigation and Discipline Board (now the Accountancy Investigation and Discipline Board (AIDB)) scheme for the investigation and prosecution of major cases involving accountants and auditors in the UK.

4.2 Of the 18 respondents that commented on this issue, 14 agreed that it should be a condition of recognition that supervisory bodies participate in independent investigation and disciplinary arrangements for their members. One respondent thought that it would be better to have a statutory body responsible for discipline; and one considered that there was a risk that it would not be possible to bring the scheme on-stream quickly without making concessions to the supervisory bodies.

4.3 5 respondents argued that the disciplinary arrangements should apply to accountants more generally, not just to auditors.

4.4 Illustrative quotes:

“A potential flaw with the proposed approach is that any of the professional bodies could elect to relinquish their status as recognized supervisory bodies in order to avoid having to participate in the independent disciplinary scheme. Alternatively, the threat that they will relinquish recognized status might be seen by one or more of the bodies as a way of achieving changes to the scheme. The policy objective is stated to be to bring ‘the long-planned Investigation and Discipline Board ... into being without further delay’. There is a real danger that the proposed approach will not deliver this objective without some concessions having to be made to the professional bodies which might undermine the effectiveness of the scheme.” Financial Services Authority

“We believe that it may well be appropriate to require participation in an appropriate independent disciplinary arrangement for public interest cases relating to auditors provided that the condition is a general one. If the intention is to require the use of a particular arrangement – such as the IDB, then we firmly believe that there should be specific statutory provisions establishing and empowering these arrangements.” Institute of Chartered Accountants of Scotland

“It would be advisable not only to specify participation in an independent scheme as a condition of recognition, but also that the scheme itself should satisfy certain criteria. Such criteria would include a requirement for open disciplinary hearings.” Accountancy Investigation and Discipline Board

“The proposals put forward by the Department in this regard are sensible and pragmatic. We consider that the recognition function currently held by the Secretary of State is a useful means of securing effective self-regulation for the accountancy profession in relation to audit activity. Using this function is an approach which, we believe, will leave the benefits of self-regulation in place, but will also secure delivery of the IDB on a timely basis.” Audit Commission

The Government’s intentions

4.5 The Government has concluded that the legislation should require recognised supervisory bodies, as a condition of recognition, to participate in independent investigation and disciplinary processes in respect of their auditor members as far as public interest cases are concerned.

4.6 The Government intends to define “independence” as meaning that the recognised supervisory bodies should not have any involvement in the appointment or selection of those who carry out investigation and disciplinary processes in respect of public interest cases involving auditors, nor in the way the arrangements operate in other respects.

4.7 The Government anticipates that the recognised supervisory bodies will comply with this condition by requiring the auditors registered with them to comply with the disciplinary scheme adopted by the Accountancy Investigation and Discipline Board (AIDB) of the FRC. However, we believe that it is not necessary to require that the disciplinary arrangements must be those of a prescribed body.

4.8 The Government has carefully considered whether its proposed approach might undermine the effectiveness of the independent disciplinary arrangements. However, it has concluded that the proposed approach would be sufficient to deliver effective independent disciplinary arrangements. The Government has concluded that the legislation should enshrine the desirable elements of an effective independent disciplinary scheme: for example, that the recognised supervisory body should have no involvement in recruitment/appointment or the way the scheme operates; that hearings should be held in public, except where it would not be in the interests of justice to do so; that decisions should apply as if they were the decisions of the supervisory body itself. It would not be open to recognised supervisory bodies to change these elements by threatening not to participate because, by doing so, the body would lose its recognised status and thus those members who wished to continue practising as auditors.

4.9 A number of respondents argued that the disciplinary arrangements should apply to accountants more generally, not just to auditors. The Scheme of the AIDB will cover both accountant and auditor members of the bodies which participate in it. However, the scope of the legislation is limited to the regulation of auditors and the legislation therefore will not require bodies to comply with the Scheme in respect of their accountancy members.

CHAPTER 5: POWERS IN DISCIPLINARY CASES

Responses to consultation

5.1 The consultation document requested further comments on whether the Investigation and Discipline Board (now called the Accountancy Investigation and Discipline Board) and the professional bodies should be able to ask a court for an order to compel witnesses or require the production of documents.

5.2 Of the 14 respondents that expressed a clear view, 8 believed that the AIDB and recognised supervisory bodies should be able to ask the courts to make an order to compel witnesses to give evidence in investigation and discipline cases or to produce documents. One respondent believed that this right should only be given to the AIDB itself, and that the AIDB would need to be a statutory body. The other 5 respondents were against the proposal or saw no need for it. Of those who expressed no clear view, 4 said that they would not object to such a right if it were considered necessary.

5.3 Illustrative quotes:

“We do have real practical experience of the reluctance of individuals and firms to bring forward evidence in their possession in the absence of an unequivocal legal obligation on them to do so. This reluctance inhibits the full investigation of cases and can even prevent cases from progressing to a disciplinary hearing. We have further practical experience of the reluctance of witnesses to appear before a tribunal dealing with quasi-criminal issues. This reluctance increases in direct proportion to the amount of publicity involved. In our perception, the public is not being well served ... We believe that professional bodies should be expected to pursue white-collar crime and that they should be given the tools to do the job.” Institute of Chartered Accountants of Scotland

“ACCA has led the way in the practice of open disciplinary hearings and has not experienced any difficulties with witnesses failing to attend or give evidence. ACCA considers, therefore, that the need for statutory underpinning may be overstated; indeed, it may encourage unrealistic expectations about the speed of the process and the sanctions which can be imposed.” Association of Chartered Certified Accountants

“The AIDB considers that there should be statutory backing for its Scheme as a minimum on the lines proposed in Clause 24 of the Irish Bill.” Accountancy Investigation and Discipline Board

“We have not had experience of any case where production of documents by a third party has been an impediment to our proceeding with disciplinary action.” Institute of Chartered Accountants in England & Wales

“This could have the effect of greatly expanding the time and expense involved in an investigation for all parties involved, whilst adding little to the quality of the result.” Ernst & Young

The Government’s intentions

5.4 After further careful consideration of this issue, the Government has concluded that such a power is neither necessary nor appropriate.

5.5 This issue has to be seen in the context of the existing regulatory framework for the investigation of companies. There are a number of bodies charged with investigating the activities of companies, to whom recognised supervisory bodies can report any concerns about company misconduct or “white collar crime”. Examples include the DTI’s Companies Investigation Branch, the police, Crown Prosecution Service, Serious Fraud Office and Financial Services Authority. In particular, under section 447 of the Companies Act 1985 the Secretary of State has powers to require the production of company documents and other information where there is good reason to do so. These powers are exercised on her behalf by the DTI’s Companies Investigation Branch.

5.6 The role of the AIDB, and the accountancy bodies and recognised supervisory bodies, is to investigate and discipline those who are subject to their rules. The recognised supervisory bodies have rules that require their members to comply with requirements for information; not to comply is, in itself, a breach of membership requirements and thus a disciplinary matter.

5.7 However, the Government does not believe that the role of the recognised supervisory bodies or the AIDB should extend to the investigation of, for example, white collar crime. It is unclear what locus they would have – as private bodies responsible for regulating their own membership – in requiring information from third parties. The Government believes that it is right that if, as a result of its regulatory activities a recognised supervisory body suspects that the affairs of any company are not in order, it should bring this to the attention of the appropriate body whose function is to investigate such concerns.

5.8 There are information gateways in the Companies Act 1985 which allow the Secretary of State to disclose information arising from an investigation in certain circumstances, including “for the purpose of enabling or assisting a recognised supervisory or qualifying body within the meaning of Part II of the Companies Act 1989 to discharge its functions as such” (section 449(1)(hh)) and “with a view to the institution of, or otherwise for the purposes of, any disciplinary proceedings relating to the exercise by a solicitor, auditor, accountant, valuer or actuary of his professional duties” (section 449(1)(l)). These powers allow Companies Investigation Branch to pass information arising from a company investigation to a recognised supervisory body so that the body can consider whether disciplinary action should be taken, irrespective of whether or not the body had referred the case to them in the first place.

CHAPTER 6: APPLICATION TO THE ICAI

Responses to consultation

6.1 The consultation document specifically considered the position of the Institute of Chartered Accountants in Ireland (ICAI) which is recognised as a supervisory body by the Secretary of State but whose members were excluded from the scope of the proposed IDB (now the AIDB) scheme. The document stated that the preferred solution was to provide that the new recognition requirement for participation in independent investigation and disciplinary arrangements for auditors would not apply where a recognised supervisory body was established in another Member State and its members were subject to equivalent statutory arrangements in respect of investigation and discipline; and asked for views on this proposal.

6.2 The ICAI regulates auditors in both Northern Ireland and the Republic of Ireland and, under legislation passed by the Republic of Ireland parliament on 10 December 2003, its disciplinary arrangements will be subject to the oversight of a new regulatory authority known as IAASA (the Irish Auditing and Accounting Supervisory Authority). The objective of the proposal set out in the consultation document was to avoid making the ICAI subject to both the IAASA and the AIDB investigation and discipline arrangements in respect of the same case.

6.3 The responses to the consultation on this issue were mixed. 6 respondents expressed no view; 10 were broadly in favour of the preferred solution and 9 including, significantly, the ICAI were broadly against. However, it was not clear how many of those in favour wanted to see legislative provision to exempt such a recognised supervisory body from the requirement, and how many wanted instead to see the recognition criterion written in such a way that the recognised supervisory body could meet it by participating in independent investigation and disciplinary arrangements in its home state. Similarly, of these who were against the proposal, it was not clear how many objected in principle and how many simply thought that it was unnecessary.

6.4 Illustrative quotes:

“In principle we believe that bodies recognised under statutes of a given EU Member State should submit to that State’s extraterritorial jurisdiction unless the law of the Member State concerned makes provision formally to recognise “home state” regulation.” Institute of Chartered Accountants of Scotland

“All ‘public interest’ cases should be dealt with by the independent disciplinary body in the territory concerned (IDB in the UK, IAASA in the Republic of Ireland). This will require all bodies recognised for audit purposes in the relevant jurisdiction to be participants in the relevant disciplinary body.” Association of Chartered Certified Accountants

“It would be inappropriate not to apply absolutely consistent treatment to all RSBs regardless of their size or the number of firms they register or the state in which they are established.” Institute of Chartered Accountants in England & Wales

“We believe that all Recognised Supervisory Bodies should be required to participate in independent disciplinary arrangements. We do not believe that the ICAI should be an exception to this requirement. We do not believe that the recognition requirement should designate a particular scheme. This would allow the Secretary of State to separately recognise different schemes as suitable for the purpose and enter into reciprocity arrangements with other regulators.” Institute of Chartered Accountants in Ireland

The Government’s intentions

6.5 The Government has concluded that it should not make provision in the legislation to disapply the criteria in the manner suggested in the consultation document.

6.6 Whilst the Government agrees with the principle that a recognised supervisory body which is operating in two Member States, such as the ICAI, should not be obliged to participate in the AIDB scheme if it is already participating in equivalent arrangements, it does not consider that special provision is necessary to achieve that effect. The Government’s approach is not to require recognised supervisory bodies to participate in the AIDB scheme. Rather, it is to require them to participate in investigation and discipline arrangements that meet certain basic criteria. Specifically, the arrangements must be independent (including independent staffing and appointments); apply to the auditing of cases of serious public interest; be binding on the members of the body; and provide for public hearings except where this would not be in the interests of justice.

6.7 Provided that a recognised supervisory body participates in investigation and discipline arrangements that met these criteria, it is capable of being recognised, and there is then no need to disapply the recognition criterion. If the recognised supervisory body participated in arrangements that did not meet these criteria, the Government could not justify disapplying any of the criteria simply because the body operates in two Member State.

6.8 In their response, the ICAI stated that they did not believe that they should be exempted from the requirement to participate in independent disciplinary

arrangements, provided that the legislation did not designate a specific scheme. Whilst discussions will continue between officials of the various bodies concerned, including the ICAI and the AIDB, to determine precisely how UK disciplinary cases involving Irish citizens should most sensibly be handled, the Government believes that there does not appear to be any need for special statutory provisions.

CHAPTER 7: AUDIT INSPECTION ARRANGEMENTS

Responses to consultation

7.1 The consultation document asked for views on whether it should be a condition of recognition that a recognised supervisory body should ensure that its auditor members are inspected by an independent inspection unit and comply with its findings where the member carries out audits of listed companies and other major public interest entities; and for views on the definition of other major public interest entities.

7.2 Of the 15 respondents that expressed a clear view, 11 agreed that it should be a condition of recognition that recognised supervisory bodies ensure that their members who audit listed companies and other major public interest entities are inspected by an independent inspection unit.

7.3 Illustrative quotes:

“The key distinction between a system based on self-regulation and one based on independent regulation is where the power to make regulatory decisions lies. The proposed approach does not seem to us to address this issue ... We believe that legislation is needed to transfer responsibility for regulatory decisions from the professional bodies to an appropriate independent body (such as the POBA).” Financial Services Authority

“We believe that the inspection, reporting and decision taking should be consolidated within the same structure, and that the structure should be totally within the new FRC family, and should be managed by the POBA.” Institute of Chartered Accountants of Scotland

“We agree with the proposition that to implement the ministerial policy objective of an independent Audit Inspection Unit there should be an amendment to the recognition criteria of RSBs as set out in the Companies Act 1989.” Institute of Chartered Accountants in England & Wales

“This split approach to regulation could subject firms that audit both public interest and non-public interest entities to two separate regimes, one in relation to public interest audits and another in relation to other audit work. We therefore believe that the proposed approach will lead to unnecessary, duplicated costs and inefficiencies for audit firms and clients.” Grant Thornton

“This proposal appears to us to be a sensible and pragmatic means of securing the effective operation of the inspection arrangements.” Audit Commission

7.4 Illustrative quotes (definition of other major public interest entities):

“We believe there would be merit in confining the new arrangements to listed companies at the outset, and extending them to other entities over time as the system beds in, and using the appropriate legislative channels for each type of entity.” The Institute of Chartered Accountants of Scotland

“We would be concerned if the scope of the new regime were to be drawn too widely. One effect of doing so would be the widening of the range of audits that would need to be covered by the resources of the new bodies, which will not be unlimited: their application to the highest risk sector (namely audits of listed companies) should not be diluted by an unduly large range of other bodies whose audits would need to be monitored.” Grant Thornton

“We have consistently argued that the definition of ‘public interest entities’ should include public sector bodies and we wish to re-iterate this viewpoint.” Audit Commission

“The definition should include major pension funds, major charities and major mutuals. There is a need for a flexible definition to ensure that public interest issues that arise from time to time in other entities will be caught. Such an entity may be a recipient of a large amount of public funding.” Deloitte & Touche

The Government’s intentions

Requirement for independent audit inspection

7.5 After further consideration of this issue in the light of the responses to consultation, the Government has concluded that there should be a requirement for recognised supervisory bodies to ensure that their auditor members are inspected by an independent inspection unit where the member carries out audits of listed companies or other major public interest companies.

7.6 The Government intends to define “independence” as meaning that the recognised supervisory bodies should not have any involvement in the appointment or selection of those who carry out the audit inspections, nor in the way the arrangements operate in other respects.

7.7 The Government anticipates that the recognised supervisory bodies will comply with this condition by requiring the auditors registered with them that audit listed companies or other major public interest companies to submit to inspection by the Audit Inspection Unit (AIU) of the FRC. However, it will remain possible for recognised supervisory bodies to participate in other audit inspection arrangements, provided those arrangements meet the criteria which will be set out in the legislation.

7.8 The consultation document indicated that auditors would be obliged to comply with the findings of the AIU. However, after a further examination of the issues, the Government has concluded that this would not be appropriate, as it would seriously undermine the role that the recognised supervisory bodies play in regulating their membership. It is the Government's intention that the Audit Registration/Licensing Committee of the relevant recognised supervisory body should continue to be responsible for imposing regulatory action on its members; the AIU will report on its findings and make recommendations, and it will be for these committees to decide what action to take in response. This reflects the nature of the actions that are appropriate in cases where an inspection visit reveals problems – that is, regulatory actions that relate to the auditor's registration.

7.9 The Government considers that the registration of auditors is, and should continue to be, the function of the recognised supervisory bodies through their registration/licensing committees. For the AIU to have the power to take regulatory action directly would be, in effect, to remove decisions on registration of auditors from the recognised supervisory bodies, which would be a profound change and one that is not considered to be proportionate in the light of the finding of the review that there is no serious flaw in the existing regulatory system.

7.10 However, this approach does not mean that the recognised supervisory bodies would be able simply to ignore the recommendations of the AIU. If the registration/licensing committee of a recognised supervisory body consistently failed to give due weight to AIU findings and recommendations, this may call into question whether the body was complying with the statutory requirement that it should have effective enforcement of compliance with its rules and practices. In such circumstances the body may face a compliance order (obtained by the POBA through the courts) or, ultimately, de-recognition. The recognised supervisory bodies will continue to publish annual reports on the regulatory actions taken by their registration/licensing committees following monitoring visits.

Major public interest entities

7.11 The Government recognises that it will take some time for the AIU to recruit a full complement of inspection staff and considers that it would be appropriate for the AIU to take a stepped approach towards its workload. The work of the AIU will initially place emphasis on audit work concerning the FTSE 350 listed companies, which would cover 11 audit firms. The emphasis will then be increased to cover audit work in relation to all listed companies and other companies whose financial condition is of public interest. In practice, it is envisaged that the AIU will monitor important non-company audit work concerning, for example, major charities, major pension funds, major mutual organisations although this would be outside the scope of the application of the conditions of recognition of supervisory bodies.

CHAPTER 8: DELEGATION OF THE SECRETARY OF STATE'S RECOGNITION FUNCTION

Responses to consultation

8.1 The consultation document noted that the Secretary of State had accepted the recommendation of the review that she should delegate her role in recognising supervisory bodies and qualifications to an independent body. The document envisaged that the Secretary of State would delegate her functions to a body established by a delegation order under section 46 of the Companies Act 1989, and that this body would be a statutory body having the same membership as the Professional Oversight Board (now called the Professional Oversight Board for Accountancy (POBA)) of the FRC, but being legally distinct from the POBA.

8.2 Of the respondents who expressed a view on the proposal, 11 respondents were in favour. A couple of respondents were against the proposal.

8.3 Illustrative quotes:

"We are concerned about the complex structure proposed for the POB to enable its members to carry out both statutory and non-statutory functions." Financial Services Authority

"The proposed delegation of the recognition function to the Professional Oversight Board is, we consider, an effective means of enhancing the authority and effectiveness of the new regulatory arrangements. Although the statutory arrangements will mean that the board members of the POB will have to act with 'two hats' on occasion, we consider that this will not impede effective decision making." Audit Commission

"We cannot see why the recognition of bodies under the 1989 Act should be an issue ... There have only been two applications since the Act came into being over thirteen years ago. Why change the procedure now?" Association of Certified Public Accountants

The Government's intentions

8.4 The Government has considered further the way in which the Secretary of State's functions in relation to company auditors should be delegated and has concluded that the method outlined in the consultation document is unnecessarily complex. The policy remains that the delegated body should be the POBA. The Government has decided that the most appropriate way of achieving this policy aim is to widen the delegation power in section 46 of the Companies Act 1989 to allow delegation of the statutory functions to an existing body, as well as to a body created by the delegation order.

CHAPTER 9: FUNDING

Responses to consultation

9.1 The consultation document proposed that there should not be a general power for the FRC to raise funds; the recommended approach was that the FRC should remain a private, and not a statutory body. The document recognised that the voluntary approach to funding the FRC had worked successfully over many years. The document also proposed that the grant in aid power should not extend to contributing to the review by the Professional Oversight Board of the professional bodies' arrangements for accountants who are not auditors.

9.2 Eighteen respondents commented on the proposed funding arrangements. A range of views were expressed.

9.3 A couple of respondents thought that the voluntary nature of the existing funding arrangements should be maintained, whilst a couple of respondents considered that there should be a statutory levy. Four respondents argued that the tripartite funding regime should extend to the costs of the POBA's activities in relation to the regulation of accountants.

9.4 Four respondents, whilst accepting the principle of charging the profession for the costs of inspections conducted by the AIU and the costs of disciplinary tribunals, expressed concern that this should be done in a way that did not compromise the independence of the AIU and the AIDB. One respondent argued that, since the accountancy profession was going to be asked to pay for inspections and disciplinary tribunals, the costs of the Financial Reporting Review Panel (FRRP) should be met solely by companies and not through the tripartite funding regime.

9.5 Illustrative quotes:

"We have significant concerns about the proposal not to give the FRC any power to raise funds ... The principles for auditor oversight published in October 2002 by IOSCO reflect an international consensus that the funding of auditor oversight bodies should not be under the control of the auditing profession. The proposal that 33% of the funding should be provided on a voluntary basis by the profession does not appear to be consistent with this principle ... We do not consider it sensible to rely on listed companies' continuing goodwill given the changing nature of the FRC and the need to raise substantially more funds from them in future." Financial Services Authority

"We strongly disagree with the proposal that the grant power should not extend to the POB's review of arrangements for qualified accountants other than auditors ... We urge the Government to accept that the one-off costs of implementing the new arrangements, as well as any costs arising from the duplication of activities during the transitional implementation period, should be met by government outside the normal FRC funding arrangements." Association of Chartered Certified Accountants

"The proposals for statutory provisions in relation to funding should assist in securing a timely implementation of the new arrangements. We believe that the proposed split of the costs between government, the profession and business is an appropriate one ... We note that there will be no general power provided to the FRC to raise funds ... We are in agreement with this view as we consider that the voluntary approach to funding this body has worked effectively for many years." Audit Commission

“It is CIPFA’s view that this sharing of the costs should extend to all components of the new regime. CIPFA also considers that the implementation costs of the new regime should be met in full by government.” Chartered Institute of Public Finance and Accountancy

“Given the very wide remit of the proposed new body, the NAPF does not consider it appropriate for the existing ad hoc private sector funding arrangements to be continued ... The NAPF considers that there are three separate interested parties involved: the UK listing authority, government and the accountancy profession ... The NAPF considers therefore that funding should come entirely from these three sources.” National Association of Pension Funds

“We do not agree with the proposals to differentiate between the work of the Professional Oversight Board in relation to accountants and that relating to auditors. The Review Team concluded that the new arrangements should apply to all accountants therefore it is inappropriate to attempt such an artificial distinction. For example, the proposed project on Continuing Professional Development relates to all accountants including auditors. It would be impossible to divide these costs into two separate constituencies.” Institute of Chartered Accountants in Ireland

The Government’s intentions

9.6 As noted in the consultation document, the Government remains committed to the principle that it should contribute one third of the costs of the FRC under the new regime (with the other two thirds coming from business and the accountancy profession). The Government therefore proposes to legislate to extend the purposes for which grants may be paid (the existing power in section 256 of the Companies Act 1985 does not allow the Secretary of State to make grants in relation to anything other than issuing or enforcing accounting standards).

9.7 The Government is keen that the FRC’s current voluntary funding arrangements should continue. However, the Government has also carefully considered the views of those respondents who raised concerns that voluntary funding by business and the profession could call into question the independence – or the perception of the independence - of the FRC, particularly among overseas regulators. The Government has therefore concluded that there should be a power for the Secretary of State to impose a levy on business and the accountancy profession in respect of their contribution to the FRC’s costs, but that this levy power should only be used if it appeared that the voluntary arrangements were unlikely to provide adequate certainty and independence of funding.

9.8 The Government agrees with the views of those respondents who argued that the mechanisms by which the accountancy profession pay for the costs of inspections (the AIU) and disciplinary tribunals (the AIDB) must not compromise the independence of the inspection and discipline regimes. We believe that the non-legislative arrangements that the FRC are currently putting in place are sufficient to ensure that firms and individual auditors do not have control over the budgets of the AIU or the AIDB. Moreover, the Government proposes that it will be a condition of recognition that where the arrangements provide for the payment of costs of maintaining the arrangements, these are to be paid by the recognised supervisory bodies in accordance with the arrangements.

9.9 The Government has also concluded that the costs of the POBA's activities in relation to the regulation of accountants should be met through the tripartite funding arrangement, as should the costs of the FRRP in ensuring compliance with accounting standards and requirements.

CHAPTER 10: OTHER ISSUES

Approval of overseas qualifications

10.1 The Government has become aware of a need to make a technical amendment to section 33 of the Companies Act 1989 in order to improve the operation of the Secretary of State's power to approve overseas qualifications as equivalent in the UK. It is intended that this power, with other functions under Part 2 of the Companies Act 1989, will be delegated to the POBA.

10.2 At present, it is only possible for the Secretary of State to recognise either all or none of the people who hold a particular overseas qualification (for example, all those who hold a particular accounting diploma). However, there are circumstances where it would in fact only be appropriate to recognise some of those people, for example:

- where an overseas qualification originally fell below the criteria for approval in section 33 but was subsequently changed so that it met those criteria, it may be appropriate to recognise the qualification provided it was gained after the date the change was made; or
- where different combinations of learning modules and examinations offer alternative routes to the same qualification, it may be appropriate to recognise the qualification provided that the audit-related modules and examinations have been undertaken.

10.3 The Government therefore has concluded that section 33 should be amended to give the Secretary of State the flexibility to approve particular qualifications if certain specified requirements have been met.

Extent of regulation and oversight

10.4 The Review of the Regulatory Regime of the Accountancy Profession considered specifically whether the remit of external regulation should solely focus on audit or should extend to accountants in general. The review concluded that there continued to be a strong public interest in independent oversight of the arrangements made by the major accountancy bodies for the education, training, discipline and professional standards of their members. The review therefore recommended that the new independent regulator should retain its wider accountancy remit but that its primary focus should be on audit. This approach is reflected in the new aims and objectives of the FRC and the POBA.

10.5 These regulatory arrangements are not necessarily restricted to those accountants who are members of a CCAB body; nor is there a requirement that all accountancy bodies or all accountants come within its scope. It will be open to other accountancy bodies to approach the FRC with a view to bringing their regulatory activities within the remit of the work that the POBA will be undertaking.

10.6 The Government considers that the benefit in introducing a statutory regime for all accountants would be outweighed by the drawbacks involved in statutory regulation of all persons undertaking accountancy work. Restricting the practice of accountancy to individuals who hold certain accountancy qualifications would be bureaucratic and would add significantly to costs. It could be anti-competitive by restricting choice and by proving a disincentive to innovation in the supply of services. All of these consequences would particularly affect smaller businesses. The Government also believes that such a measure would be at variance with the OFT analysis of competition in the professions, which was published in March 2001. The Government has therefore concluded that the case has not been made for the significant increase in regulation which would be involved in introducing a statutory regime for all accountants.

APPENDIX A: CONTACT DETAILS

An electronic copy of this document can be found on the DTI website at www.dti.gov.uk/cld/post_enron.htm.

Written responses (excluding those where confidentiality is requested) may be viewed by appointment with the DTI's Information and Library Services at 1 Victoria Street SW1H 0ET, telephone 0207 215 6226.

For more information on the Accountancy Review, please contact:

Rob Cottam
Accountancy and Audit Regulation
Corporate Law and Governance Directorate
Department of Trade and Industry
Room 499
1 Victoria Street
London SW1H 0ET

Email: Rob.Cottam@dti.gsi.gov.uk

APPENDIX B: INDEX OF RESPONDENTS

1. The Accountancy Investigation and Discipline Board
2. Association of Accounting Technicians
3. Association of Certified Public Accountants
4. Association of Chartered Certified Accountants
5. Association of International Accountants
6. Audit Commission
7. Central Bank of Ireland
8. Chartered Institute of Management Accountants
9. Chartered Institute of Public Finance & Accountancy
10. Deloitte & Touche
11. Ernst & Young
12. Stella Fearnley & Richard Brandt, University of Portsmouth
13. Financial Reporting Council (Board chairs)⁵
14. Financial Services Authority
15. Grant Thornton
16. Institute of Certified Practicing Accountants
17. Institute of Chartered Accountants in England & Wales
18. Institute of Chartered Accountants in Ireland
19. Institute of Chartered Accountants of Scotland
20. KPMG
21. Peter Layhe
22. London Society of Chartered Accountants
23. National Association of Pension Funds
24. National Consumer Federation
25. David Sandground

⁵ A separate response was submitted by the Accountancy Investigation & Discipline Board of the FRC.