

November 2016

Public Consultation: Third Country Auditor de-registration procedures

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Section 1: Introduction

Third Country Auditors (**TCAs**) are non-EU auditors of companies incorporated outside the European Economic Area (**EEA**) that have issued securities that are admitted to trading on UK regulated markets, principally on the main market of the London Stock Exchange (**UK market-traded companies**).

The regulatory regime governing TCAs, under EU Directive 2006/43/EC (**the Directive** - which has now been amended by Directive 2014/56/EU, though not in ways directly relevant to the contents of this document) aims to establish a level of oversight similar to that required of the audits of listed companies incorporated within the EU. This is intended to enhance and safeguard public confidence in the annual and consolidated financial statements of UK market-traded companies audited by TCAs.

The arrangements for the registration in the UK and regulation of TCAs are contained in Part 42 and Schedule 12 of the Companies Act 2006 (**the Act**) and the Statutory Auditors and Third Country Auditor Regulations 2013 (**the Regulations**).

The Secretary of State's powers under the Act, in relation to TCAs, have been delegated to the FRC by the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012 (**the Delegation Order**). The FRC Board (**Board**) is responsible for the exercise of these powers and those for registration under the regulations (**the Powers**). These Powers were previously delegated to the Professional Oversight Board (**POB**).

The Powers enable the FRC to do the following in relation to TCAs and, unless otherwise specified, references to 'section' or 'part' are to the corresponding provisions of the Act and references to 'regulation' are to the corresponding provisions in the Regulations:

- Register a TCA if the TCA has made an application in accordance with Regulation 7, unless it considers that the application statement made pursuant to Regulation 8 is incorrect;
- Refuse to register a TCA;
- Require a TCA to notify the FRC, in writing, of matters required by the FRC at specified times and periods, pursuant to section 1243;
- Call on a TCA for such information as the FRC may reasonably require for the exercise of the FRC's functions under Part 42, pursuant to section 1244;
- Seek a Court order requiring the TCA to take steps to comply with an obligation imposed on it under Part 42, pursuant to section 1245;
- Remove a TCA from the Register in the circumstances set out in section 1246 and Regulation 12, including where the TCA's application statement to the FRC made pursuant to Regulation 8 is no longer correct or where the FRC considers that the TCA has failed to comply with certain statutory duties.

The Directive requires Member States to maintain a publicly available register of all auditors and audit firms registered as TCAs (**Register**). Following registration, the FRC requires TCAs to renew their status as a TCA on an annual basis, confirming and, where required, providing evidence to confirm continuing compliance with the Act and Regulations.

To date the FRC has dealt with any non-compliance issues which could require a TCA's registration to be withdrawn in accordance with the Powers by either persuading the TCA to resolve the issue prior to a renewal of registration being granted, or, where there are local restrictions in the country concerned which obstruct the TCA from being able to meet the conditions for registration, by requesting the local authorities to waive the restrictions so that the TCAs can comply with the requirements of the Directive.

In May 2008, as a part of a larger consultation on the implementation of the new TCA regime, the POB consulted on its proposed approach towards withdrawing the registration of TCAs due to unresolved non-compliance issues. The respondents to that consultation agreed with the proposed approach; however no formal procedures were published at that time for the removal of TCAs from the Register between renewal dates.

Whilst there is no statutory requirement to have procedures in place for TCA de-registration, in order to apply a consistent, efficient and transparent process for the de-registration of TCAs (where the Board considers there to be grounds for removing a TCA from the Register) the FRC has developed the Third Country Auditor Register Procedures (**Procedures**), a copy of which is included in Appendix A. Section Two provides a preliminary impact assessment of introducing the Procedures.

The Procedures have not been prepared in response to the outcome of the UK EU referendum.

The FRC applies procedures to ensure that its decisions are fair and consistent and to make transparent the principles it applies when carrying out its responsibilities. The Procedures are non-binding and, in all cases, the decision to exercise the Powers is taken by the Board in accordance with the provisions of the Act and the Regulations.

Feedback on these Procedures is now sought from interested parties on or before [xxx 2016].

How to Respond

Please respond by 16 December 2016 at the latest. Earlier responses are welcomed. Responses should be sent by email to thirdcountryauditors@frc.org.uk

or in writing to:

Shazia Ahmad
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8th Floor
125 London Wall
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All comments will be regarded as being on the public record and will be published on the FRC's website unless you specifically request that your response be treated as confidential.

Question 1: Do you consider the Procedures to be clear and understandable?

Question 2: Do you consider there is anything missing from the Procedures that would improve their effectiveness?

Question 3: Do you have any other comments about the Procedures?

Section Two: Preliminary Impact Assessment

Benefits

The benefits of the Directive are difficult to quantify. The risks and costs associated with poor investor confidence in Europe and globally are also difficult to quantify; however the potential costs to investors and employees following a major corporate scandal would be significant.

The purpose of introducing the requirements set out in the Directive was to ensure that high quality audit work is performed by TCAs, thereby protecting investors and maintaining confidence in capital markets in the EU. It follows, therefore, that it is in the interests of investors in UK-traded non-EEA companies audited by TCAs that there should be a robust process to de-register a TCA that is unable to comply fully with the requirements of the Directive

In the May 2008 consultation on the TCA regime, all respondents agreed with the proposed approach for the de-registration of TCAs. Three respondents expressed the need for any de-registration process to be transparent. The Procedures ensure that the FRC applies a consistent and efficient process for the de-registration of TCAs (where the Board considers there to be grounds for removing a TCA from the Register) and make transparent the principles it applies when carrying out its responsibilities.

Costs

Quantifying the costs is equally difficult. However in considering the impact of the new Procedure it is important to note that there will not be an overall increase in regulation. The Procedures put in place are a formal process for the exercise of the existing Powers delegated to the FRC by the Secretary of State.

As at July 2016, there were 101 audit firms registered as TCAs in the United Kingdom. Since the inception of the TCA regime the only removals from the TCA register have been 34 voluntary 'de-registrations' (e.g. when the TCA in question has lost its relevant client(s) and no longer wishes, nor has a requirement to remain on the Register).

To date it has not been necessary to withdraw the registration of any TCA and the FRC has dealt with any non-compliance issues by engaging with the TCA to resolve the issue prior to the renewal of registration being granted. On that basis it is difficult to anticipate how often we may apply the Procedures; this is dependent on circumstances that cannot be predicted.

In cases where the Procedures are followed, it is highly likely that the FRC would utilise in-house counsel, internal staff and existing governance arrangements, only. It is therefore estimated that the number of cases requiring the Procedures to be followed, and the associated costs of the Procedures, would be minimal.

Appendix A: Third Country Auditor Register Procedures

Introduction

1. Third Country Auditors (**TCAs**) are non-EEA auditors of non-EEA incorporated companies that issue securities that are admitted to trade on the UK regulated markets. Directive 2006/43/EC requires Member States to maintain a publicly available register of all approved auditors and audit firms. The arrangements for the registration in the UK and regulation of TCAs are contained in Chapter 5 of Part 42 of, and Schedule 12 to, the Companies Act 2006 (**the Act**) and the Statutory Auditors and Third Country Auditors Regulations 2013 (**the Regulations**).
2. The Secretary of State's powers in relation to TCAs¹ have been delegated to the FRC by the Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012 (**Delegation Order**)², and are set out at paragraph 5 below (**Powers**). The FRC Board (**the Board**) is responsible for the exercise of the Powers.
3. The FRC applies procedures to ensure that its decisions are fair and consistent and to make transparent the principles it applies when carrying out its responsibilities. The procedures are non-binding and, in all cases, the decision to impose the Powers is taken by the FRC in accordance with the provisions of the Act and the Regulations.
4. Unless otherwise specified, references in this guidance to 'section' or 'part' are to the corresponding provisions in the Act and references to 'regulation' are to the corresponding provisions in the Regulations.

Powers

5. The Powers enable the FRC to do the following in relation to TCAs:
 - Register a TCA if the TCA has made an application in accordance with Regulation 7, unless it considers that the statement made by the TCA pursuant to Regulation 8 (**application statement**) is incorrect;
 - Refuse to register a TCA;
 - Require a TCA to notify the FRC in writing of matters required by the FRC at specified times and periods, pursuant to section 1243 (see paragraph 8 below);
 - Call on a TCA for such information as the FRC may reasonably require for the exercise of the FRC's functions under Part 42, pursuant to section 1244 (see paragraph 9 below).
 - Seek a Court order³ requiring the TCA to take steps to comply with an obligation imposed on it under Part 42, pursuant to section 1245 (see paragraph 12 below).
 - Remove a TCA from the Register in the circumstances set out in section 1246 and Regulation 12, including where the TCA's statement to the FRC made pursuant to

¹ Part 42, ss 1243-1246, 2006 Act.

² S7(1) Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012

³ High Court of England and Wales or the Court of Session in Scotland

Regulation 8 is no longer correct or where the FRC considers that the TCA has failed to comply with certain statutory duties (see paragraphs 13 and 14 below).

6. The processes which the FRC will usually follow when exercising these powers are set out in paragraphs 8 - 17 below. These procedures specify where steps are required to be taken by the Board. All other steps will be taken by the appropriate staff in the FRC Executive unless otherwise specified.

Process

7. *Refusal to register a TCA pursuant to regulation 9*

- 7.1. The FRC may refuse to register a TCA at its discretion where it applies for registration in accordance with the Regulations, save where the FRC considers that the Application Statement is not correct, in which case the FRC is prohibited from registering that applicant.
- 7.2. Where the FRC refuses to register a TCA, it shall give the TCA a written notice stating the reasons for such refusal.

8. *Power to require notification pursuant to section 1243 (s1243 Notice)*

- 8.1. Having obtained the Board's prior authority in each case, the FRC may send a s1243 Notice to a TCA requiring the TCA to:
 - a Notify the FRC immediately of the occurrence of a specified event and provide specified information in relation thereto; and/or
 - b Provide the FRC with specified information at stipulated times or in respect of stipulated time periods.
- 8.2. The s1243 Notice shall be in writing and shall identify:
 - a The information or verification of information required;
 - b The manner of provision or verification of such information;
 - c The deadline for compliance.
- 8.3. Subject to paragraph 11 below, the FRC shall usually require notification within 21 days of the occurrence of the event or period or of the date by which the TCA should have been aware of the occurrence of the event.
- 8.4. The TCA's response shall be in writing unless the FRC agrees otherwise.

9. *Power to call for information pursuant to section 1244 (s1244 Notice)*

- 9.1. Having obtained the Board's prior authority in each case, the FRC may send an Information Notice to a TCA requiring the TCA to provide the FRC with specified information.
- 9.2. The s1244 Notice shall be in writing and shall identify:
 - a The information or verification of information required;
 - b The manner of provision or verification of such information;
 - c The deadline for compliance.

- 9.3. Subject to paragraph 11 below, the FRC shall usually require the TCA's response within 28 days of the date of the Information Notice.
- 9.4. The TCA's response shall be in writing unless the FRC agrees otherwise.

10. Warning Notice of non-compliance (Warning Notice)

- 10.1. The FRC may send a Warning Notice to a TCA putting the TCA on notice of suspected non-compliance with any of the TCA's duties or obligations arising out of or in connection with its registration under Part 42.
- 10.2. The Warning Notice shall be in writing and shall identify, specify and/or enclose:
- a The requirement imposed on the TCA by or as a result of Part 42;
 - b The reason(s) why non-compliance is suspected;
 - c Key documents related to the relevant requirement and suspected non-compliance;
 - d If the FRC considers that the Application Statement is no longer correct, an indication of the steps the FRC considers the TCA would need to take to make sure that the statement is correct);
 - e The deadline for compliance or response (**TCA's Response**);
 - f Any evidence reasonably required by the FRC to be provided in support of the TCA's response;
 - g Whether the FRC wishes to reserve the right to apply to the English Court, pursuant to s1245, in the absence of compliance or satisfactory response;
 - h If the FRC considers that the Application Statement is no longer correct, that, in the absence of the steps referred to in sub-paragraph (d) above or a response reasonably satisfactory to the FRC, the matter will be referred to the Board under the mandatory removal steps set out in para 13 below; or
 - i If the FRC considers that the circumstances in para 14.1 may apply, that, in the absence of compliance or a response reasonably satisfactory to the FRC, the matter may be referred to the Board under the discretionary removal steps set out in para 14 below.
- 10.3. Subject to paragraph 11 below, the FRC shall usually require the TCA's Response within 28 days of the date of the Warning Notice.
- 10.4. The TCA's Response shall be in writing and shall include such evidence of compliance (or otherwise in support of the matters set out therein) as the FRC has reasonably required in the Warning Notice.
- 10.5. The FRC shall consider the TCA's Response and may take any of the following steps, singly or in combination:
- a Take no further action - where the FRC is reasonably satisfied that the TCA is now compliant and notify the TCA accordingly;
 - b Recommend that the Board:
 - i Direct the FRC to send a s1224 Notice under paragraph 9 - where further information is considered to be reasonably required in order for the FRC to be reasonably satisfied as to the compliance matters raised in the TCA's response;

- ii. Seek a Court Order directing the TCA to take such steps as the Court directs for securing compliance with the obligation in question (see para 12 below);
- iii. Direct the FRC to send a Regulation 8 Notice in accordance with the steps at para 13 below and to remove the TCA from the Register in the absence of compliance within 3 months;
- iv. Consider and take steps under paragraph 14 below (discretionary removal from the Register);
- v. Direct the FRC to take such other steps as the Board considers appropriate in all the circumstances.

11. Time periods for compliance or response

- 11.1. The deadline for compliance with a s1243 Notice and an s1224 Notice will be such deadline as the FRC deems reasonably necessary for its exercise of its Part 42 functions. Where the FRC considers that to require notification within the standard times for compliance specified in paragraphs 8-10 above is not appropriate in the circumstances, it shall substitute such other time period for compliance as is reasonable for the exercise of the relevant Part 42 function(s).

12. Power to seek a Court order pursuant to section 1245

- 12.1. Subject to the Board's obligations set out in paragraph 13 below, where the FRC has sent a TCA a Warning Notice and where the FRC is not satisfied that the TCA has complied with the obligation in question or provided a satisfactory explanation within the time limit given for a Response, the Board may seek a Court Order pursuant to s1245 directing the TCA to take such steps as the Court directs for securing compliance with the obligation in question. Such application shall be made in accordance with the procedural rules then in force of the Court.

13. Mandatory Removal from the Register pursuant to section 1246 and Regulation 12

- 13.1. The Board is obliged to remove the TCA from the Register where it considers that the TCA's Application Statement is no longer correct and the TCA has not taken appropriate steps in accordance with Regulation 12(1) to ensure that the statement is correct.
- 13.2. Where there are reasons to suspect that the TCA's application statement is not correct, which have been referred to the Board, the Board may take any of the following steps, singly or in combination:
- a. Where the Board is satisfied that the statement under Regulation 8 is correct, take no further action and direct the FRC to notify the TCA accordingly;
 - b. Where the Board does not consider that it has sufficient information to decide that the application statement under Regulation 8 is not correct, direct the FRC to provide or seek further information; or
 - c. Direct the FRC to: (a) issue a notice under Regulation 12 (**Regulation 12 Notice** – see para 13.3); and (b) remove the TCA from the Register if the Regulation 12 Notice is not complied with, within 3 months.
- 13.3. Where the Board directs the FRC to issue a Regulation 12 Notice to the TCA, the Board must:
- a. Specify the following information to be included in the Regulation 12 Notice:

- i The steps that the Board considers the TCA must take to ensure that the application statement is correct;
 - ii That the TCA has a maximum deadline of 3 months after the date of the direction under point (i) in which to comply.
 - iii That the FRC must remove the TCA from the Register if the steps set out in the Regulation 12 Notice are not complied with, within the deadline under point (ii).
- b. Direct the FRC to remove the TCA from the Register if the Regulation 8 Notice has not been complied with, within 3 months.

14. Discretionary Removal from the Register

14.1. The Board may remove the TCA from the Register if it considers that:

- a The TCA has failed to comply with any of the TCA's duties set out in Annex 1.
- b The TCA has failed to apply the auditing standards and independence requirements set out in the TCA's statement under Regulation 7(3)(d)(iv) (**Regulation 7(3)(d) Statement**);
- c The TCA is not a fit and proper person to conduct audits of the accounts of UK – traded non-EEA companies
- d A competent authority which oversees or regulates the TCA considers that the TCA is not a fit and proper person to conduct audits in the country in which that competent authority is established;
- e A competent authority which oversees or regulates the TCA considers that the TCA is not eligible to conduct audits of the accounts of bodies corporate incorporated or formed under the law of that country.

14.2. Where the Board decides to remove the TCA from the Register the Board:

- a shall decide the effective date of removal taking into consideration all relevant circumstances, including (but not limited to) any period of time which may be desirable in the interests of ensuring adequate notification to the TCA's clients;
- b may direct the FRC to notify the TCA of recommended actions which the TCA should take upon removal (for example timely notification of removal from the Register to affected clients), compliance with which the FRC may take into account should the TCA seek to be re-admitted to the register.

15. Post-removal notifications

15.1. Where the FRC has decided to remove a TCA from the Register, the FRC shall notify:

- a the TCA;
- b the UK Listing Authority;
- c the competent authority or government in the TCA's home jurisdiction; and
- d any other individuals, entities, UK authorities or Member State Competent Authorities that the FRC considers appropriate in the circumstances.

15.2. Notifications shall state:

- a that the FRC has decided to remove the TCA from the Register;
- b the reason(s) for the removal; and

c the effect of the removal.

15.3. Additionally, the notification to the TCA shall include matters (if any) decided by the Board under paragraph 14.2.

16. *Post-removal publication*

16.1. The FRC may, but is not obliged to, publish a notice of its decision to remove a TCA from the Register.

16.2. This notice may include the reason for the removal and shall include the effective date of the removal.

16.3. Within 21 days of the effective date of the removal of the TCA from the Register the FRC shall ensure that the removed TCA no longer appears on the published register of TCAs.

17. *Post-removal applications for (re) registration*

17.1. The (removed) TCA may apply for (re) registration in accordance with regulation 7 of the Regulations. When considering an application for reregistration, in addition to the mandatory criteria for registration required by Regulation 7 and 8 of the Regulations, and without prejudice to its general discretion to as to registration of an applicant, the FRC may consider other matters such as:

- a The applicant's history of compliance with the:
 - i. the Act and the Regulations;
 - ii. arrangements to which it is subject under Schedule 12 to the Act; or,
 - iii. any requests made or requirements imposed by the FRC under that legislation or those arrangements or these procedures.
- b The period of time between the former TCA's removal from the Register and its new application for registration;
- c Whether the applicant has provided evidence that it notified its clients in a timely and transparent manner of its previous removal from the Register in accordance with any direction given by the FRC under para 14.2;

18. *Referral to the Conduct Committee*

18.1. Before taking any steps under this Procedure which are not reserved to the Board, the FRC may, but is not required to, refer the matter to the Conduct Committee for the Committee's advice to the FRC or onwards recommendation to the Board.

18.2. The Board may, but is not obliged to, seek advice or recommendations from the Conduct Committee at any time in relation to its exercise of the Powers.

Annex 1

Section 1242 of Companies Act 2006 - Duties of registered third country auditors giving rise to the

- (1) A registered third country auditor who audits the accounts of a UK-traded non-EEA company] must participate in –
 - (a) arrangements within paragraph 1 of Schedule 12 (arrangements for independent monitoring of audits), and
 - (b) arrangements within paragraph 2 of that Schedule (arrangement for independent investigation for disciplinary purposes).
- (2) A registered third country auditor must –
 - (a) take such steps as may be reasonably required of it to enable its performance of audits of accounts of UK-traded non-EEA companies to be monitored by means of inspection carried out under the arrangements mentioned in subsection 1(a), and
 - (b) comply with any decision as to disciplinary action to be taken against it made under the arrangements mentioned in subsection 1(b).
- (3) Schedule 12 makes further provision with respect to arrangements in which registered third country auditors are required to participate.

Regulation 12 of the Statutory Auditors and Third Country Auditors Regulations 2013 – Removal of registered third country auditor from the register

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- (2) The designated body may remove a third country auditor from the register if it considers that the registered third country auditor has failed to comply with any of the obligations of the registered third country auditor -
 - (a) regulation 11 (duty to provide information),
 - (b) Section 1242 of the Act (duties of registered third country auditors),
 - (c) section 1243 of the Act (matters to be notified to the Secretary of State)
 - (d) section 1244 of the Act (Secretary of State's power to call for information)
 - (3) The designated body may remove a registered third country auditor from the register if –
 - (a) it considers that the registered third country auditor –
 - (i) has failed to apply the auditing standards and independence requirements set out in the statement referred to in paragraph (iv) of regulation 7(3)(d), or
 - (ii) is not a fit and proper person to conduct the audits of the accounts of UK-traded non-EEA companies, or
 - (b) it appears to the designated body that a competent authority which oversees or regulates the registered third country auditor considers that the registered third country auditor –
 - (i) is not a fit and proper person to conduct audits in the country in which the authority is established, or
 - (ii) is not eligible to conduct the audits of the accounts of bodies corporate incorporated or formed under the law of that country.



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