



PROFESSIONAL OVERSIGHT BOARD

**TRANSPARENCY REPORTING BY AUDITORS OF
PUBLIC INTEREST ENTITIES**

**A CONSULTATION DOCUMENT ON THE IMPLEMENTATION OF ARTICLE 40 OF THE
8TH COMPANY LAW DIRECTIVE ON THE STATUTORY AUDIT OF ANNUAL ACCOUNTS**

JULY 2006

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One – Summary and issues for consultation

1.1 This document seeks views on the nature of the statutory provisions to give effect to the requirements in the revised 8th Company Law Directive (2006/43/EC) for transparency reporting by some audit firms.

1.2 The Directive requires that as a minimum auditors of UK companies who have issued securities traded on a regulated market in the UK should publish annual transparency reports, that is reports which give information on the audit firm, including on structure and governance and on the firm's systems for ensuring audit quality. We estimate that some 40 to 50 UK audit firms will be required to publish transparency reports.

1.3 The Government is expected to delegate to the Professional Oversight Board of the FRC the responsibility for setting these requirements, if Parliament approves enabling provisions in the Company Law Reform Bill.

1.4 In setting out the issues for consultation we have had two main considerations in mind:

- that the transparency requirements should promote audit quality; and
- that there should not be compulsory disclosures over and above what the Directive requires, unless a strong case is made out for this in the responses to the consultation.

1.5 The principal issues on which we would welcome views are summarised below. These are considered in more detail in Section 5. The specific questions raised in Section 5 are repeated at the end of this summary.

Issue 1: Which audit firms should be subject to mandatory transparency reporting?

Our inclination is to restrict this to the minimum Directive requirement, that is to the auditors of UK companies which have issued securities traded on a regulated market. For the purposes of this consultation we refer to such entities as **fully listed UK companies**.

Issue 2: Where, how and when should transparency reports have to be published?

The Directive requires publication on the firm's web-site within three months of the end of each financial year. It does not say in terms that there should be a separately identifiable transparency report. However, we see significant advantages in making this an explicit requirement. We think this provides a more helpful presentation to the reader than information scattered throughout an Annual Report, which can be presentational in style, and that it will

encourage the firms to take and sustain their obligations seriously. Against that, we recognise that this is less flexible and may result in some repetition in the Annual Report for the firms concerned.

Issue 3: Should the detailed disclosure requirements in Article 40 be incorporated into UK statutory requirements as they appear in the Directive? Or are there specific adaptations which should be reflected in the UK implementation?

We consider that in a few instances the UK implementation needs to be cast in a way which is clearer or provides for a more effective implementation than using the Directive wording. These points are discussed at paragraph 5.13 below.

Issue 4: Should we require transparency disclosures over and above those set out in the Directive?

Our inclination is not to set additional requirements, although firms would be permitted to present additional information to illustrate how they achieve audit quality.

Questions for Consultation

Q 1: Should we (i) restrict the scope of transparency reporting by audit firms to the minimum required by the 8th Directive, that is to the auditors of fully listed UK companies (Option A2); or (ii) should we align the scope with the (slightly wider) scope of inspection by the Audit Inspection Unit? (Option A1). (Paragraphs 5.5 to 5.8)

Q 2: Which of the three options on how transparency reports should be published do you favour and why? What benefits and burdens do you see with Options B2 or B3 as compared to Option B1? (paragraphs 5.9 to 5.10)

Q 3: What are your views on the points raised in Section 5 below on specific disclosure requirements? Are there other points you would like us to consider? (Paragraphs 5.11 to 5.13)

Q 4: Do you consider that compliance with the specific obligations of Article 40; adapted along the lines discussed in this consultation document, provide a sound basis for transparency reporting by auditors of fully listed UK companies (Option D2)? If not, what additional disclosure obligations do you consider it is important to impose on audit firms (Option D1)? (Paragraph 5.14)

Regulatory Impact Assessment

We would welcome your assessment of the costs and/or benefits for your organisation, or generally, resulting from the proposals in this consultation document, quantifying the costs and benefits where possible (see paragraph 3.9 below).

Two – How to Reply

2.1 We invite comments by Friday 27 October at the latest. Earlier responses would be very welcome.

2.2 Responses should be sent by email if possible to j.grewe@frc-pob.org.uk

Alternatively you should send comments by post to:

John Grewe
Professional Oversight Board
Financial Reporting Council
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

2.3 All responses will be acknowledged. We expect to make comments publicly available on the FRC web-site (www.frc.org.uk/pob) unless respondents specifically request otherwise. If you send an E-mail response which includes an automatically generated notice stating that the content is to be treated as confidential you should make it clear in the body of your message whether or not you wish your comments to be treated as confidential.

Queries

2.4 If you have queries about the issues raised in this consultation document please speak to John Grewe on 0207 492 2345.

Three – Introduction

3.1 The revised 8th Directive on the regulation of statutory auditors (2006/43/EC) came into effect on 28 June 2006. Member States have two years in which to implement its requirements.

3.2 Article 40 of the Directive (text at **Annex A**), when taken with Article 39, requires that auditors of UK companies traded on a regulated market publish annually on their web-site a transparency report including for example information on their structure, governance and systems for ensuring audit quality. For the purposes of this consultation we refer to such entities as fully listed UK companies. In principle Article 40 also applies to the auditors of other “public interest entities”, for example banks and insurance undertakings, though Article 39 allows Member States to exclude them from the requirements.

3.3 The market for the audits of fully listed companies is highly concentrated with the largest four firms auditing around 85% and the ten largest firms around 95% of the market. All in all we estimate that there are some 40 to 50 firms undertaking audits of fully listed UK companies.

3.4 The Company Law Reform Bill, at present before Parliament, includes provisions to facilitate the implementation of Article 40. If Parliament agrees, the Government is expected to extend the delegated powers of the Professional Oversight Board to include responsibility for setting requirements on transparency reporting by audit firms.

3.5 This document seeks views on the nature of the statutory requirements which should be made to give effect to transparency reporting by audit firms in the UK.

3.6 Following this consultation we will prepare and consult on the regulations needed to give effect to this. We will also publish on our web-site a summary of responses and the detailed comments received other than where the consultee has requested that their views are not published.

3.7 We also note that there are separate provisions in Article 45 of the 8th Directive, which require in certain circumstances that the auditors of third country companies whose securities are traded on a regulated market in the UK publish transparency reports with “equivalent disclosure requirements” to those required by Article 40. We expect to consult in due course on detailed implementation of the Directive’s provisions on the regulation of third country audit firms.

Requirements on the Oversight Board

3.8 Section 46(6) and Schedule 13 of the Companies Act 1989, together with Article 4 of the Companies Act (Delegation Order) 2005 place a number of requirements on the Oversight Board before it can make any regulations. In particular the Oversight Board must:

- publish draft regulations in such a way as to bring them to the attention of those affected;
- consult on the draft regulations for at least 12 weeks; and
- take account of responses to the consultation.

Regulatory Impact Assessment (RIA)

3.9 A draft provisional Regulatory Impact Assessment is attached at **Annex D**. One purpose of this consultation is to enable us to develop a more accurate RIA. In addition therefore to your comments on the principal issues set out in Section 5 below, we would welcome therefore your comments on

- (a) The nature of the costs or benefits for your organisation, or generally, resulting from the proposals in this consultation document;**
- (b) A quantification of those costs or benefits**

Four – Audit Quality and Transparency Reporting

4.1 Audit firms enjoy a privileged status in that they alone can act as a statutory auditor. This status is given on the basis that registered audit firms have the skills and the necessary processes in place to enable them to conduct audits objectively and effectively - in other words that they deliver high quality audits. The key to quality lies primarily within the firms themselves - in their cultures, not least the “tone at the top”, in their people, procedures and practices, safeguards and reward systems. But audit regulation sets the framework which encourages and requires the firms to have in place all these elements, appropriate to the type of audits they undertake, and then monitors how this works in practice.

4.2 The FRC, and the Oversight Board in particular, have a specific responsibility to ensure that regulation supports and promotes high quality company audits in practice. For example, the Oversight Board’s Audit Inspection Unit is focused on the quality of audits conducted by the major audit firms and not simply on compliance with regulatory standards. More generally, the Oversight Board and the Auditing Practices Board (APB) are developing a public consultation paper on the drivers of audit quality. The auditing profession itself is also committed, through the Audit Quality Forum (which brings together the audit firms, professional bodies, major investors and regulators), to develop measures to enhance audit quality,

4.3 Transparency reporting by major audit firms, such as envisaged by the 8th Directive, has a significant role to play in encouraging audit quality. First it helps investors and the potential buyers of audit services to understand the strengths of a particular audit firm. There are similarities to the workings of the Combined Code, in that relatively weak or inadequate disclosures by a firm can be seen as adding a risk factor to the use of that firm. Secondly, clear public information on (for example) the firm’s processes and practices for quality control, for ensuring independence, for partner remuneration, on their governance and network arrangements, provide a clear incentive to all within the audit firm to live up to both the spirit and the letter of what the firm promises.

4.4 Whilst this consultation is naturally focused on legal requirements for transparency reports, transparency reporting by audit firms should not simply be a matter of meeting formal requirements. Audit firms are free to publish information over and above any formal requirements and we hope and expect that they will do so where this supports and encourages audit quality and thus helps to develop well-founded public confidence in auditing.

Transparency Reporting by Audit Firms – Current Practice

4.5 Until a few years ago most audit firms published very limited information about themselves. Few were structured as companies, with the requirement to publish accounts and reports; most were organised as partnerships, with no statutory requirement for external reporting.

4.6 Two factors have changed this in recent years, at least for the largest firms. First, following the Limited Liability Partnerships Act 2000, most of the largest firms have adopted or are adopting the LLP form, which requires accounts and reports much as for a limited liability company. In addition the Government, as part of its review of UK auditing in the wake of the Enron scandal in the US, concluded in January 2003 that there was a legitimate public interest in the public availability of information on those firms which audit public interest entities¹. The report set out what might be included in such transparency reports (extract at **Annex B**).

4.7 In response 13 of the 20 largest audit firms gave a voluntary undertaking to meet the proposals from the Government for transparency reporting. We have reviewed the extent and nature of such reporting by audit firms since then. Most of the 13 firms have taken seriously the commitment they gave. Most major audit firms now incorporate “transparency” information as part of their Annual Report and Accounts prepared as an LLP. However, they tend not to identify specific information separately as a “transparency report”, and the presentation tends to be as much promotional as information-giving.

4.8 Those firms which have not adopted LLP status typically make little information publicly available about themselves, at least on their web-sites. This is perhaps not surprising, given that a significant factor where firms have decided to retain the traditional partnership form may be a wish not to have public reporting obligations. However, such firms are required by Article 40 to publish such information in a transparency report, even where they are the auditors of just one public interest entity. As noted at 3.3 above we estimate that some 40 to 50 UK audit firms are likely to have to publish a transparency report.

4.9 Overall our judgement is that most of the 13 firms meet the voluntary commitment they gave to Government in 2003 and now make publicly available considerable information about themselves, including on how they secure audit quality. As noted above, this information is usually worked into the firm’s Annual Report rather than shown either as a separate section of the Annual Report or published as a separate document. This avoids having to repeat information in different reports but it makes it more difficult for the reader to see what specifically the firm has to say in a “transparency report”. And, in many cases the information is

¹ Final Report of the Coordinating Group on Audit and Accounting Issues, 29 January 2003

couched in fairly broad terms, arguably appropriate for an Annual Report but perhaps not precise enough for a specific transparency report designed with audit quality in mind.

4.10 **Annex C** summarises the transparency information available on the web-sites of some of the larger audit firms.

Five – Implementation of Article 40

5.1 Article 40 of the revised 8th Directive (**Annex A**) introduces for the first time a minimum statutory obligation on those audit firms which audit fully listed UK companies to publish on their web-site an annual transparency report which includes specified information. The 8th Directive is in most respects a minimum harmonisation Directive – that is member states are free to go beyond the specific requirements of the Directive.

5.2 We consider that there are two factors in particular which should guide our approach to giving proper effect to Article 40:

- the requirements should promote audit quality through better transparency reporting by audit firms.
- the requirements should not include compulsory disclosures over and above those required by the Directive, other than where this is necessary to make the Directive requirements clearer or more effective.

5.3 Inevitably these considerations can work in opposite directions and there may be a balance to be struck.

5.4 Against this background we would welcome views on the following issues (which are then discussed in more detail):

Issue A: Which audit firms should be subject to mandatory transparency reporting?

Issue B: Where, how and when should transparency reports have to be published?

Issue C: How should the detailed disclosure requirements in Article 40 be incorporated into UK statutory requirements?

Issue D: Are there any “transparency” disclosures over and above those set out in Article 40 which we should require?

Issue A: Which audit firms should be subject to mandatory transparency reporting?

5.5 Article 40 applies the requirement to auditors of public interest entities. However, Article 39 allows member states to restrict the requirement to auditors of fully listed companies. In practice therefore member states have some flexibility in determining the scope of transparency reporting.

5.6 One consideration is that company law and audit regulation already distinguishes between two groups of audit firms in relation to the arrangements for the external monitoring of their work. The auditors of fully listed companies and of other entities in which there is a major public interest are subject to monitoring and inspection by a regulator independent of the audit profession. In practice this role is undertaken by the Audit Inspection Unit (AIU), which is part of the Oversight Board. The Oversight Board has published criteria to determine which audits fall within the AIU's remit². In addition to fully listed companies this includes for example large charities and pension schemes.

5.7 One option (**Option A1**) is to align the scope of the requirement for transparency reports with the scope of independent inspection of audit firms. This has the advantage of simplicity in that we would not create a further classification of audit firms. It is also arguable that those firms which fall within the remit of the AIU should be those which provide transparency reports. However, this option goes further than the Directive strictly requires. The practical effect is small. It is likely to require only a handful of firms to provide transparency reports over and above those strictly required to do so under the Directive. Those firms will have a small role in the audits of public interest entities overall and by definition will not audit fully listed companies. It is difficult therefore to see a significant public interest in requiring them to publish transparency reports. Our inclination is to restrict the scope to the minimum required by the Directive (**Option A2**).

5.8 It could also be argued, given the high level of concentration in the audit market for public interest entities, that on cost-benefit grounds the Article 40 requirement should apply only to the largest 10 or so audit firms (**Option A3**). However, this is not a viable option, given the requirements of Article 40.

Q 1: Should we (i) restrict the scope of transparency reporting by audit firms to the minimum required by the 8th Directive, that is to the auditors of fully listed UK companies; or (ii) should we align the scope with the (slightly wider) scope of inspection by the Audit Inspection Unit?

² <http://www.frc.org.uk/poba/publications/>

Issue B: What should be the requirements relating to the publication of transparency reports? In other words, where, how and when should such reports have to be published?

5.9 The Directive simply requires publication on the firm's website, within three months of the end of each financial year.

5.10 There are a number of options for giving effect to this, on which we would welcome views:

Option B1: Do not specify the form or manner of publication beyond the requirement to publish on the firm's web-site.

This should enable firms to incorporate the information into an Annual Report, whether worked into the text or as a separate section, or to publish separately. Whilst this is the most flexible option for the firms, and should enable them to avoid giving some of the same information in an Annual Report and a Transparency Report, it will not necessarily result in separately identifiable information.

Option B2: Require a separately identifiable transparency report, either as a part of the firm's Annual Report, or as a separate document.

We see significant advantages in this approach. It would ensure that there is clearly identifiable information in one place, to meet a specific regulatory requirement. This is likely to be helpful to the reader. We also think that it will give firms a clear incentive to take the requirement seriously and pay close attention to what is said. It would also make it more likely that reports would be prepared in a similar format (and thus pave the way for Option B3). However, this is less flexible for the firms and could mean that the firm has to provide some information both in its Transparency Report and in its Annual Report.

Option B3: As Option B2, but in addition require the relevant audit firms to provide the Professional Oversight Board with an electronic copy. All such reports would then be included as a section of our web-site.

This would enable users and other interested parties easily to compare the information given by all the relevant audit firms. Our initial view is that this would be a small but useful addition to the requirements, which would further transparency and the value of the information. We do not consider that it would impose a significant additional burden either on the firms or on the Oversight Board.

Q 2: Which of the three options on how transparency reports should be published do you favour and why? What benefits and burdens do you see with Options B2 or B3 as compared to Option B1?

Issue C: How should the detailed disclosure requirements in Article 40 be incorporated into UK statutory requirements? Should they be incorporated just as they appear in the Directive? Or are there specific adaptations which should be reflected in the UK implementation?

5.11 Article 40 requires that the transparency report includes at least the following:

- (a) a description of the legal structure and ownership;
- (b) where the audit firm belongs to a network, a description of the network and the legal and structural arrangements in the network;
- (c) a description of the governance structure of the audit firm;
- (d) a description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;
- (e) an indication of when the last quality assurance review referred to in Article 29 took place;
- (f) a list of [fully listed UK companies] for which a statutory audit has been carried out during the last year by the audit firm;
- (g) a statement about the audit firm's independence practices which also confirms that an internal review of independence compliance has been conducted;
- (h) a statement on the policy followed by the audit firm concerning continuous education of statutory auditors referred to in Article 13;
- (i) financial information showing the importance of the audit firm such as the total turnover divided into fees from the statutory audit of annual and consolidated accounts, and fees charged for other assurance services, tax advisory services and other non-audit services; and
- (j) information about the basis for the partner remuneration.

5.12 **Option C1** is to set the requirements exactly as they appear in the Directive. However, whilst many of these requirements can be readily incorporated directly into UK requirements, a number are lacking in precision and may benefit from greater clarity when developed into a

suitable UK provision. **Option C2** therefore is still to restrict the requirements to those in the Directive but to develop the wording of some requirements to provide for clearer regulation, as discussed in the following paragraph.

5.13 We comment on these below. **We welcome your thoughts on points raised for discussion.**

Point (d) Internal Quality Control Systems: The focus on internal quality control procedures is valuable but perhaps too narrow. In particular **we would welcome views** on whether we should require the firm to explain how it defines the drivers of audit quality, what steps it then takes to ensure the quality of its audit work, (including its systems of internal quality control), how it measures audit quality and how it assesses its performance against those measures.

Point (f) List of the public interest entities audited in the last year: We recognise that, at least for the four largest firms, this list is likely to be long, even if we restrict the requirement to listed entities. It may not be suitable for example for publication as part of the Annual Report. We would expect, however, that firms can meet this requirement by use of a suitable reference in the Transparency Report and a link within the firm's web-site. **We would welcome comments on how this requirement should be met.**

There is a further aspect, on which **we would welcome comments.** The information required by the Directive is a snap-shot and in our view likely to be of limited value and interest. It will not for example provide an accurate guide to the firm's current listed clients. What arguably would be of more value would be a list of the firm's current listed clients – that is a list which is kept up to date by the firm. We note for example that such information is made available on the web-site of the Canadian Public Accountability Board and would welcome views on (i) the value and (ii) the practicality of something similar in the UK, either on the firm's own web-site or on the Oversight Board's web-site.

Point (g) Auditor Independence: This requirement is worded somewhat vaguely. Should it be re-cast more precisely in the UK implementation? For example, should we require audit firms (i) to set out the firm's own requirements and procedures to ensure that auditors act with independence and integrity; (ii) to confirm that the firm has carried out an internal review of compliance with its procedures within the preceding 12 months (iii) confirm that any necessary actions have been or are being taken to remedy any weaknesses identified from that review or in any review of independence undertaken by the firm's external regulators.

Point (i) Financial Information: The Directive requirement is not worded very precisely; and although it refers to a breakdown of fees charged for audit and non-audit services, it does not seek a breakdown of non-audit services provided to audit and to non-audit clients. Overall we

see some attraction in limiting the financial information required for transparency reports to a breakdown of the firm's income into audit and non-audit fees, with a requirement to give a further breakdown of non-audit fees into fees from audit clients and from non-audit clients. Our understanding is that many of the firms already have systems in place which collect information in this way. **We should welcome comments** on this proposal, particularly any additional costs of producing information in this form.

Point (j) Partner Remuneration: The Directive requirement is again somewhat vague - "information about the basis of partner remuneration". Our assessment is that existing disclosures by audit firms on this point vary considerably in how informative they are. We would welcome comments on how this provision might best be reflected in the UK implementation. For example should we require audit firms not only to explain the basis on which partners are remunerated but also include a specific requirement to confirm that audit partners are not remunerated for selling non-audit services to their audit clients?

Q 3: What are your views on the points raised above on specific disclosure requirements? Are there other points you would like us to consider?

Issue D: Are there any "transparency" disclosures over and above those set out in Article 40 which we should require?

5.14 As suggested earlier our working assumption is against adding additional information requirements; and that a strong case would need to be made for doing so. Our initial view is that the Directive requirements, implemented perhaps along the lines suggested above, should provide a sound basis for transparency reports which focus on the drivers of audit quality, provided that the firms respond to the requirements in spirit as well as in form. Firms are also of course free to include additional information and we would hope that they will do so where this is necessary to give a rounded picture.

Option D1 is to include UK requirements over and above those required by Article 40. **We would welcome** specific proposals for additional disclosures and would consider carefully the costs to the firms and the likely public benefits of such requirements. For example, should firms be required to disclose, as part of a transparency report, material outstanding litigation or regulatory action? **Option D2** is not to include any additional requirements.

Q 4: Do you consider that compliance with the specific obligations under Article 40; adapted along the lines discussed in this consultation document, provide a sound basis for transparency reporting by auditors of public interest entities? If not, what additional disclosure obligations do you consider it is important to impose on audit firms?

July 2006

EXTRACT FROM DIRECTIVE 2006/43/EC**Article 39****Application to non listed public interest entities**

Member States may exempt public interest entities, which have not issued transferable securities admitted to trading on a regulated market within the meaning of Article 4(1) point 18 of Directive 2004/39/EC, and their statutory auditor(s) or audit firm(s) from one or more of the requirements in this chapter.

Article 40**Transparency report**

1. Member States shall ensure that statutory auditors or audit firms that carry out statutory audit(s) of public interest entities publish on their website, within three months of the end of each financial year, an annual transparency report that includes at least the following:
 - (a) a description of the legal structure and ownership;
 - (b) where the audit firm belongs to a network, a description of the network and the legal and structural arrangements in the network;
 - (c) a description of the governance structure of the audit firm;
 - (d) a description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning;
 - (e) an indication of when the last quality assurance review referred to in Article 29 took place;
 - (f) a listing of public interest entities for which a statutory audit has been carried out during the last year by the audit firm;
 - (g) a statement about the audit firm's independence practices which also confirms that an internal review of independence compliance has been conducted;
 - (h) a statement on the policy followed by the audit firm concerning continuous education of statutory auditors referred to in Article 13;
 - (i) financial information showing the importance of the audit firm such as the total turnover divided into fees from the statutory audit of annual and consolidated accounts, and fees charged for other assurance services, tax advisory services and other non-audit services; and

(j) information about the basis for the partner remuneration.

Member States may in exceptional circumstances disapply the requirement in (f) to the extent necessary to mitigate an imminent, significant threat to the personal security of any person.

2. The transparency report shall be signed by the statutory auditor or audit firm, as the case may be. This can for example be done by means of an electronic signature within the meaning of Article 2 (1) of Directive 1999/93/EC of the European Parliament and of the Council.

Extract From Chapter 3 of Report of Coordinating Group on Audit and Accountancy (January 2003):

Comments on Content of Transparency Report by Major Audit Firms

General

- a) The public report should cover three areas – financial information, governance/organisation, and quality
- b) The report should cover the whole firm and not just the audit practice.
- c) Each firm should cover all the aspects but should decide how much detail to give. It is not the intention that the contents are seen as a checklist, nor that there is one size fits all. Each report should be appropriate to the firm's circumstances and be written in a way that gives material information clearly and concisely and in a way which is likely to be valued by interested parties.

Financial Information

The financial information required by the Statement of Recommended Accounting Practice for Limited Liability Partnerships. This would apply also to firms that are partnerships and have not converted to LLPs.

Operating and Financial Review (OFR)

An OFR, initially in accordance with the ASB's statement on the OFR; then in accordance with statutory requirements, if, as expected, the Government proposes a statutory OFR for companies and LLPs, and Parliament approves.

Governance

The report should summarise the governance arrangements of the firm and, where applicable, the relationship with its international umbrella organisation and associates in the UK or overseas.

The disclosures would explain the way the firm is managed and governed, covering matters such as the management structure and responsibilities of the main committees and senior partners.

An explanation of the basis of partner remuneration including in particular remuneration related to the provision of non audit services to audit clients.

Where applicable, firms should explain the structure of their international networks and, in respect of regulated areas, such as statutory audit, explain how that work is the responsibility of the partners who are appropriately recognised, and responsible, under UK legislative, regulatory and other applicable requirements.

Quality

The report should explain how quality output (and audit quality in particular) is achieved, e.g. through procedures and training, including quality control procedures. It should also explain how that quality is monitored through, for example, annual reviews.

Firms should not disclose details about the results of their internal quality assurance reviews or the external JMU monitoring reviews. This should be dealt with between the firm and the JMU and Audit Registration Committee.

The heading “quality” does not have to be used by firms. Each firm should decide on the most appropriate heading(s) to deal with the section(s) where the objective is to demonstrate and assure current and potential clients and the public that the firm takes quality seriously.

Auditor Independence

The firm’s requirements and procedures to ensure that auditors act with independence and integrity

TRANSPARENCY REPORTING BY MAJOR AUDIT FIRMS

NB Figures are an estimate, as at March 2006, of the number of major public interest audits (i.e. within the remit of the Audit Inspection Unit) undertaken by those audit firms with the largest number of such audits.
Numbers are not definitive.

FIRM	STRUCTURE	NO OF RELEVANT AUDITS	%	ANNUAL REPORT AND/OR TRANSPARENCY REPORT AVAILABLE ON WEB-SITE?
PwC	LLP	555	27	Annual Report and Accounts to 30 June 2005 Includes transparency information
KPMG	LLP	440	21	Annual Report and Accounts to 30 September 2005 Includes transparency information
Ernst & Young	LLP	392	19	Annual Report and Accounts to 30 June 2005 Includes transparency information
Deloitte	LLP	354	17	Annual Report and Accounts to 31 May 2005 Includes transparency information
BDO Stoy Hayward	LLP	49	2	Annual Report and Accounts to 30 June 2005. Includes transparency information
Grant Thornton	LLP	44	2	Accounts and Transparency Report to June 2005 includes section "Governance and Accounts" which includes transparency information. .
RSM Robson Rhodes	LLP	42	3	Annual Review to April 2004. Includes transparency information. No equivalent review published for 2005.
Baker Tilly	Partnership	40	2	No Annual Review or transparency information available on web-site

FIRM	STRUCTURE	NO OF RELEVANT AUDITS	%	ANNUAL REPORT AND/OR TRANSPARENCY REPORT AVAILABLE ON WEB-SITE?
PKF	LLP	32	2	PKF became an LLP in May 2005 - it has not yet published any Annual Accounts and Reports on its web-site
Horwath Clark Whitehill	LLP	15	0.73	Horwath Clark Whitehill became an LLP on 1 April 2004 and published its first Annual Accounts and Report for the year to March 2005. Includes transparency information.
Moore Stephens	Partnership	7	0.34	No Annual Review or transparency information on web-site.
Mazars	LLP	6	0.29	Annual Accounts and Review to August 2004. Includes transparency information. Mazars, as an international partnership, published a global Annual Report for the year to 31 August 2005, including consolidated financial statements and transparency information.

Draft Provisional Regulatory Impact Assessment on the Implementation of Article 40 of the revised 8th EU Company Law Directive on Statutory Auditors (2006/43/EC) Transparency Reports by Auditors of Public Interest Entities

1. Proposal

1.1 Directive 2006/43/EC on statutory auditors (the revised 8th Directive) came into force on 28 June 2006. Member States have two years from that date in which to take the necessary implementing measures.

1.2 Article 40 sets out the minimum information which statutory auditors must give, if they wish to audit certain public interest entities, in particular companies with securities traded on a regulated market.

1.3 The Company Law Reform Bill, at present before Parliament, takes the necessary enabling powers. Setting the detailed requirements is likely to be delegated to the Professional Oversight Board.

1.4 The Department of Trade and Industry published a Regulatory Impact Assessment on the Commission's overall proposals for the 8th Directive in February 2005.

1.5 The proposals set out in this consultation document would give effect to the UK's obligations under the revised 8th Directive.

2. Purpose and intended effect

(i) Objective

2.1 Imposing requirements on certain audit firms to provide 'transparency' information about themselves is intended (i) to give investors and buyers of audit services ready access to information about the major audit firms, and (ii) to provide an incentive on all within an audit firm to live up to what the firm says publicly about its processes and practices. Overall this should have a positive effect on audit quality and may help promote greater competition in the market for major audits.

(ii) Devolution

2.2 The Company Law Reform Bill at present before Parliament and which includes measures on the statutory framework for audit regulation, applies on a UK basis.

(iii) Risk Assessment

2.3 The obvious risk associated with no change is that as of July 2008 the UK would be in breach of its obligation to implement Directive 2006/43/EC. This would in due course lead to infraction proceedings against the UK Government.

2.4 The main risk of going ahead with the proposals is that the requirements on audit firms may be seen as burdensome and expensive, particularly by those firms which at present carry out only a relatively small number of relevant audits and which do not already publish annual reports. The result could be that some such firms decide to withdraw from auditing listed companies. Although the overall impact of this on the market is likely to be very small, it could work against the wish to increase competition in the market for major or public interest audits.

3. Options

3.1 Doing nothing is not a viable option, given the Directive requirements.

3.2 The options are best considered as a menu from which one item is selected for each of four courses, as follows:

A) Scope of transparency reporting.

Option A1: All audit firms within the scope of inspection by the Audit Inspection Unit.

Option A2: Minimum Directive requirement: auditors of UK entities which have issued securities traded on a regulated market.

Option A3: Largest ten audit firms only (but does not meet Directive requirements).

B) Publication

Option B1: Do not specify, beyond the Directive requirement of publication on the firm's web-site.

Option B2: Require a separately identifiable 'transparency' report, either as part of the firm's annual report or as a separate document.

Option B3: As B2, but in addition require relevant audit firms to provide the Oversight Board with an electronic copy, with a view to all such reports being available on the Oversight Board's web-site.

C) Directive requirements

Option C1: Directive requirements as stated

Option C2: Directive requirements with clarifications

D) Additional requirements

Option D1: Include additional UK requirements

Option D2: No additional UK requirements.

4. Benefits

4.1 It is difficult to quantify the benefits from a statutory requirement on audit firms to publish specific information about themselves and their policies and processes. Given that many firms already publish an Annual Report, the main benefits are likely to result from:

- the availability of information about relevant firms presented on a more consistent basis, in less of a promotional style, and more readily available (perhaps via the Oversight Board's web-site) to help users compare the principal audit firms more easily
- the ability of users of audit services and regulators to measure the audit firm's performance against what they say in their transparency reports.

4.2 As to the differences in benefits arising from the different options:

- on **scope**, it is unlikely that Option A1 offers significant benefits over A2.
- on **publication**, we think that Options B2 and B3 offer a significant benefit over Option B1, in that it may prove more difficult for users to disentangle useful information where the transparency reporting is intertwined with an Annual Report (whose focus is often as much promotional as it is information-giving).
- on the **Directive requirements on content**, we think that there is a good case on some aspects to clarify the requirement in the implementing regulations.
- on **additional content**, we do not at present believe that there are disclosure requirements over and above those in the Directive that would add substantially to the benefits.

5. Costs

5.1 We think that it is unlikely that any of the options for **publication** has a significant cost difference over another. Whilst Option B2 or B3 may for some firms necessitate duplication of some information (in both the transparency report and the firm's annual report), there is no requirement for the firm to publish or distribute the transparency report in hard copy.

5.2 On **content** we think that it is also unlikely that there is any significant difference in costs as between Option C1 and C2. Option C3, which envisages disclosures over and above those required by the Directive, would add to the costs, the extent depending on the nature of any additional requirements.

5.3 More generally, our view is that whilst the overall costs of meeting these requirements are modest in relation to the overall turnover of the audit firms within scope, there are significant differences between the costs for the largest and the smallest audit firm within scope, when considered in relation to the value of the relevant audit work. In particular the marginal costs of preparing a transparency report for a major audit firm which already publishes an annual report will be, in relative terms, much smaller than the marginal costs for an audit firm many times smaller, which would otherwise not publish an annual report.

6. Enforcement

6.1 Enforcement is likely to be fairly straightforward, given the small number of firms likely to be within scope and the ease of checking whether the requirements have been met. In serious cases of non-compliance it will be open to the Oversight Board to take criminal proceedings against the audit firm and/or to refer the firm to its recognised supervisory body for investigation and disciplinary action.



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