CP34/15 Implementing audit committee requirements under the revised Statutory Audit Directive

Comments from ACCA to the Prudential Regulation Authority
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SUMMARY

ACCA welcomes the opportunity to comment on the proposals issued by the Prudential Regulation Authority (PRA) for implementing the requirements of Article 39 of the Statutory Audit Directive. In responding, ACCA’s views are informed by our global forums, which are designed to contribute to ACCA’s technical and research work on issues facing business and the accountancy profession, as well as the views of our members more widely.

Our response is guided by the following high level principles:

- We share and support the PRA’s overall objective of promoting high standards of governance with a view to advancing the effective regulation of firms and protecting policy holders.

- We look for new requirements to be implemented proportionately.

- New requirements should be introduced in a way that is consistent with existing requirements and guidance from other regulators, such as the UK Financial Reporting Council, the Basel Committee on Banking Supervision, and the PRA’s own extant guidance.

With these principles in mind, our main concern is that the PRA has not taken advantage of all the state discretions and derogations afforded by Article 39. The consultation paper seeks to justify this as better supporting the PRA’s statutory objectives to promote the safety and soundness of regulated firms and protect policy holders by ensuring high standards of governance.

However, such benefits need to be considered alongside both their costs and whether those costs are distributed proportionately and fairly between entities of different sizes and complexities. While the paper provides a cost benefit assessment in section 4, we encourage the PRA to continue gathering views from firms that would fall within the scope of the proposals when introducing these new requirements, and to be sensitive to the requirements of proportionality.

SPECIFIC COMMENTS

The PRA groups the provisions of Article 39 into four themes: scope, structure, membership and functions. In the following response, we discuss each of them in turn.

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SCOPE

The PRA proposals apply to Capital Requirements Directive (CRD) credit institutions, Solvency II insurers, the Society of Lloyd's and each Lloyd's management agent, and UK designated investment firms regardless of the size of firms. There are some exemptions available to subsidiary firms.

The Audit Directive provides member states with an option to exempt credit institutions without listed shares, provided that they have 'in a continuous and repeated manner, issued only debt securities admitted to trading in a regulated market' of a value of less than €100 million. The PRA has decided not to take up this option on the basis that the application of the rule should be 'determined by a firm's significance to the financial stability in the UK' and not its listing status, and has therefore extended the scope of the Directive to all credit institutions.

While we agree with the PRA's view that an audit committee can promote sound and effective governance structures for firms, there are related cost implications. In our opinion, the PRA has not done enough to justify these costs to firms that fall within the scope of the member state option. We discuss this point further under the 'membership' section below.

STRUCTURE OF AN AUDIT COMMITTEE

We agree that the audit committee must be established as a formal sub-committee of the board.

MEMBERSHIP OF AN AUDIT COMMITTEE

The independence requirements of the audit committee membership appear to be in line with existing related guidance from other regulators, in particular the UK Corporate Governance Code: paragraphs B.1.1 on independence criteria for non-executive directors (NEDs) and C.3.1 on the establishment of an audit committee.

However, we encourage the PRA to consider the cost aspect of the proposals in light of the proposed extension of scope of the requirements, as noted above. The cost benefit analysis in section 4 of the paper sets out the range of costs of forming an audit committee compliant with the requirements, and the PRA states that it 'does not envisage a significant cost to the majority of firms that are in scope of these requirements'.

This is, however, with the assumption that all firms already have at least one independent NED on the board who could be a member of the audit

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committee. The PRA further assumes that many firms within the scope of the proposals will already have audit committees. These assumptions need to be carefully considered in light of feedback from firms – particularly those that are non-significant and lower impact – to ensure that the assumptions are reasonable, and that the proposed implementation date can be achieved by those firms.

FUNCTION OF AN AUDIT COMMITTEE

We support the PRA’s proposal to implement the functions of the audit committee by transposing the relevant text of the Article into the PRA Rulebook. We also support the view that lower impact firms should be allowed to combine their audit and risk committees, provided the committee is established as a sub-committee of the board and complies with all other relevant structure and membership requirements.

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