Regulation of auditors of companies incorporated outside the European Economic Area that have issued securities admitted to trading on a UK regulated market

Information for Investors

Introduction

In accordance with the requirements of European law[1], the UK has provided for the regulation by the FRC of the auditors of certain companies incorporated outside of the European Economic Area (EEA) that have issued securities admitted to trading on a UK regulated market ("UK market-traded companies), principally on the London Stock Exchange's Main Market. Audit firms that undertake such audits are termed 'third country auditors'.

The regulatory regime governing third country auditors aims to establish a level of oversight similar to that required of the audits of listed companies incorporated within the EU. However, the EU regime recognises the costs and complexities that would be involved in extensive cross border regulation of audit firms. It therefore provides for Member States to rely on the work of regulators in the countries concerned and grants wide-ranging exemptions from a requirement to apply the Member State's own regulation.

Accordingly, no presumption should be made that an audit firm included on the FRC's Register of Third Country Auditors is subject to oversight and inspection by the FRC.

The summary of the requirements below and the more detailed information on the regime governing Third Country auditors are to assist those who invest in the relevant companies through the UK capital market.

Categories of Third Country Auditors

The EU classifies third country auditors into three groups, to which different requirements apply.

"Equivalent" Third Country Auditors: This group comprises auditors in those countries that the EU has determined have systems for auditor oversight, monitoring of audit firms, and for investigations and discipline equivalent to those required within the EU.

That determination by the EU is based on a detailed technical assessment of the regulatory system against the requirements in the EU, but the EU does not test the application of that system in practice.

The main "equivalent" countries in which UK market-traded companies are incorporated are Australia, Canada, China, Dubai, Japan, South Africa, South Korea, Switzerland and Singapore.

Third country auditors from "equivalent" countries are required to register with the FRC and to provide limited information. However, they are not subject to detailed regulation by the FRC and the FRC does not carry out inspections of equivalent auditors, other than in exceptional circumstances. In practice, therefore, the regulation of "equivalent" third country auditors is dependent on the system in the country of incorporation of the market traded company.

1 Articles 45 and 46 of the Statutory Audit Directive (2006/43/EC)

"Transitional" Third Country Auditors: This group comprises auditors in those countries which the EU has decided are developing systems of auditor oversight and regulation that will be equivalent to those required in the EU and which should be given a period to achieve equivalence. Auditors from those countries are exempted from regulation by Member States, though must register with the FRC and provide limited information.

The main "transitional" countries in which UK market-traded companies are incorporated are Bermuda, Cayman Islands, Egypt, Russia and Turkey. The current transitional period applies to audits of companies for financial periods starting during the period 2 July 2010 to 31 July 2015.

"Article 45" Third Country Auditors: This group comprises auditors from countries that are neither "equivalent" nor "transitional". As it is unlikely that such auditors are subject to regulatory requirements in their home country that are comparable to those applying to EU audit firms, they are subject to EU regulatory requirements.

"Article 45" third country auditors of UK-market traded companies come from a wide range of countries around the world, including Hong Kong, India, Israel, Kazakhstan, Kuwait, Lebanon, Nigeria and Qatar.

As Article 45 third country auditors are subject to EU regulation, they must register with, and are subject to a system of monitoring by, the FRC.

Monitoring the Work of "Article 45" Third Country Auditors.

Following consultation the FRC concluded that its monitoring of relevant audit firms should be tailored to the risks and significance of each UK market-traded company for UK investors. There are wide variations in their size and significance.

The FRC is carrying out a programme of inspections of the audits by those "Article 45" third country auditors of those UK market-traded companies that it considers to be of significance for UK investors (based for example on the turnover of the issuer, its market capitalisation on the UK market, and the nature of the securities traded in the UK).

A possible exception is where another independent audit regulator has carried out a quality assurance review of the firm. In other instances, the FRC may monitor the relevant audit, by for example commissioning a review by a local body, or by reviewing quality assurance work carried out by the network to which the audit firm belongs. The FRC may also inspect audits of UK market-traded companies undertaken by equivalent auditors that are outside the scope of the inspection system in the equivalent country.

The FRC started inspections of third country auditors in 2013-14 and completed three inspections by March 2014. The FRC's annual report for 2013/14 on its inspections of third country auditors can be found at ***https://www.frc.org.uk/Our-Work/Publications/Audit-Quality-Review/Inspections-of-Third-Country-Auditors-Annual-Repor.pdf***

Limitations

There can be significant legal and practical difficulties to carrying out inspections of audits in some "Article 45" countries. For example there may be local legal restrictions on audit firms providing access to the FRC to the audit working papers; there may be language difficulties; and in some cases the advice may be that a country is not sufficiently secure for inspectors to visit. We will try where possible to find ways to carry out an inspection, though these complications may limit what it is possible to achieve.

Sanctions

The FRC has a range of sanctions available where a firm fails to comply with its obligations as a third country auditor, for example where it fails to cooperate fully with an FRC inspection, or where the FRC identifies serious deficiencies in the firm's conduct of an audit. Possible sanctions include removal from the register, setting additional conditions of registration, and/or imposing a financial regulatory penalty.

More detailed information about the regime governing third country auditors can be found at ***http://www.frc.org.uk/Our-Work/Publications/Professional-Oversight/Third-Country-Auditors-Detailed-Information-for-In.pdf***