

## New UK legislation severely restricts transfer of audit work papers to non-european regulators

Legislation came into force in the UK on 21 October 2009 which will have the effect of largely prohibiting for the time being the transfer of audit working papers to the audit regulators of countries outside of the European Economic Area (EEA), including the PCAOB in the US.

This move, which was implemented with some urgency, brings the UK into line with the rest of the EU and may well prevent UK audit firms cooperating with PCAOB inspections which were due to commence before the end of 2009.

### Background

The new law has been introduced by Statutory Instrument<sup>1</sup> which amends the Statutory Auditors and Third Country Auditors Regulations 2007 (SI 2007/3494) (“the 2007 Regulations”) to remove the transitional provisions applying to sections 1253D and 1253E of the Companies Act 2006 (“the 2006 Act”). These sections were inserted into the 2006 Act by the 2007 Regulations in order to implement the requirements of Article 47 of the EU Directive on Statutory Audits (Directive 2006/43/EC) relating to transfer of audit working papers to audit regulators outside the EEA.

Section 1253 D of the 2006 Act provides that “audit working papers must not be transferred to a third country competent authority by any person other than a statutory auditor acting in accordance with rules imposed under paragraph 16 A of Schedule 10 [to the Companies Act]”. Paragraph 16A of Section 10 requires not only that the third country competent authority has entered into working arrangements with the Secretary of State in accordance with section 1253E, but also provides that audit working papers may not be transferred from the UK to a third country even where such arrangements are in place unless the following four conditions are met:

1. The competent authority has requested the audit working papers for the purposes of an investigation;
2. the competent authority has given to the Secretary of State notice of its request;
3. the papers relate to the audit of a body which:
  - (a) has issued securities in the country or territory in which the competent authority is established, or
  - (b) forms part of a group issuing statutory consolidated accounts in that country or territory;and
4. no legal proceedings have been brought (whether continuing or not) in relation to the auditor or audit to which the working papers relate.

Whereas the old law only applied to audits for financial years beginning on or after 6 April 2008, the new law means that these controls now apply to working papers relating to all audits regardless of their date.

### Ongoing political debate

This change in the law has been effected against the backdrop of an ongoing debate between legislators and regulators in the EU and the US. On 23 September 2009, Charlie McCreevy (European Commissioner for Internal Market and Services) wrote to Acting Chairman of the PCAOB, Daniel Goelzer, noting that proposed legislation in Congress, that would allow the SEC and the PCAOB to exchange audit working papers with their EU counterparts by introducing an amendment to the Sarbanes – Oxley Act (“**the SOX Amendment**”), had been delayed. In these circumstances, Mr McCreevy noted, the necessary legal mechanism which would allow for mutual exchange of audit working papers between EU Member States’ regulators and the competent authorities in the US was not in place. Mr McCreevy also gave notice that until the requirements of Article 47 of the Statutory Audit

Directive (section 1253E and paragraph 16A, Schedule 10 of the 2006 Act in the UK) were met, the public oversight bodies of Member States of the EU, “cannot accept any PCAOB inspections and the EU audit firms or the Member States’ public oversight bodies cannot send any audit working papers, even public ones, to the PCAOB”.

## Implications and conclusion

If working papers were transferred by an audit firm in breach of these regulations, the European Commission would have to initiate infringement proceedings against the Member State concerned, a fact that has been communicated by oversight bodies within the EU to EU audit firms. The PCAOB has been informed by the European Commission that it should not in these circumstances apply sanctions to EU audit firms that are prevented by national law from complying with PCAOB inspection or information requests.

It seems unlikely that audit firms in the UK (or elsewhere in the EU) will want to act in breach of national law. What remains to be seen is whether this will cause the PCAOB to postpone its inspections of EU audit firms scheduled for the end of this year (as urged by Mr McCreevy) or lead to earlier agreement of the planned SOX Amendment coupled with progress on agreeing an appropriate legal mechanism for mutual exchange of working papers.

The ball would appear at the moment to be in the court of US and EU legislators and regulators, rather than EU audit firms.

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1 The Statutory Auditors and Third Country Auditors (Amendment) Regulations 2009 SI 2009/2798

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