



Brexit and its potential impact on Audit and Accountancy

1. Purpose of this Paper

This paper has been developed to provide an overview of the various challenges and opportunities that Brexit may bring to the Authority and those entities within its remit. The purpose of the Paper is to stimulate discussion and debate in relation to those challenges and opportunities, to provide input and context for stakeholders' strategic and operational planning over the medium term, and to input into the work of Government in its discussions with relevant stakeholders.

2. Background

The paper attempts to provide the range of possible outcomes for the Authority. What was evident from many of those discussions was the lack of clarity on the part of many entities who may be significantly affected by Brexit as to how best to prepare. This is borne of the lack of clarity around precisely what shape Brexit will ultimately take, expressed reductively in the "Hard Brexit/Soft Brexit" debate. A number of stakeholders have chosen to simply wait it out until clarity emerges. However for some others the potential consequences of Brexit has impelled them to engage to try and shape that debate. In a notice issued on 19 January 2018, the European Commission states that in the absence of a ratified withdrawal agreement, the UK will become a third country on 30th March 2019.

3. Next steps

The Paper will hopefully serve as a useful primer for stakeholder discussions and decisions on strategy in the medium term. The Authority is continuing to engage with all relevant parties as part of its preparations for regulation of the accountancy and audit profession post-Brexit. As the shape of Brexit becomes clearer IAASA's primary objective is to have a seamless transition and a continuation of high professional standards and a properly functioning audit and accountancy profession.

Irish Auditing and Accounting Supervisory Authority

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Brexit and IAASA

Main issues

Audit

Introduction

Historically audit has been an all islands profession, stretching back to the nineteenth century. This is reflected in the mutual recognition of auditors qualifying with and in receipt of audit practising certificates from recognised bodies in both jurisdictions: ICAEW and ICAS (The Institute of Chartered Accountants in England and Wales and the Institute of Chartered Accountants in Scotland) in the UK, ACCA (The Association of Chartered Certified Accountants) which operates internationally including in Ireland, and CAI (Chartered Accountants Ireland) which is an all island body. In practice, most audit authorised members of the above bodies recognised in either State can practise in the other.

In Ireland this is reflected in primary legislation which lists the two primarily UK bodies together with the globally focussed ACCA as Recognised Accountancy Bodies (“RAB’s”), and therefore capable of having their members carry out audits in this State. In the UK, IAASA’s equivalent (FRC) has recognised CAI as an RSB (their equivalent of a RAB). (CPA are recognised for audit purposes in Ireland alone).

While numerous other countries have close relationships with other countries, where audits may be routinely carried out cross border, from both within and outside the EU, we are not aware of any other jurisdiction where the recognition is as broad. This unique situation was possible in the context of our mutual existence within the EU, but if Brexit results in the UK becoming a “third country” then this may have significant implications for UK auditors wishing to audit Irish entities (and vice versa).

Numbers impacted

It is important to set the Brexit issue in context, in that while thousands of auditors may be *potentially* affected by a change in their capacity to carry out audits cross border, the number who carry out such work may be quite small. Using available statistics and extrapolating, there may be approximately 200 firms in one jurisdiction who have clients in the other. This is in the context of over 5,000 firms who are approved to audit in Ireland. Furthermore, some of these firms are parts of networks which will have firms in both jurisdictions, and indeed some individual firms have offices in both jurisdictions so that re-organisation of their work will allow them to retain their clients. Equally, it should be considered that although the number of firms is relatively small, behind these there may be a large number of clients who could be affected

There may also be potential issues in relation to the legal ownership of some of the larger firms. A number of firms are structured as all Island, GB&I and even European firms. They may now need to restructure so that the firm meets the EU ownership requirements. The impact of this depends on exactly how it is currently structured, but as many firms will have a large number of UK partners, and the EU law requires that a majority of partners in a firm must be EU auditors for the firm to be an EU audit firm, this could present a significant challenge for these structures. For international firms the ability to provide services in Europe is a key issue.

Other key impacts for audit firms appear to relate to the portability of the audit qualification and the transfer of people (for particular skills and experience) across borders, so for example, the ability to transfer audit staff from Ireland to the UK and vice versa on secondment as well as transferring from UK to other EU countries and vice versa

Members located in the UK

CAI has an issue in that a substantial proportion of its members are resident in Northern Ireland, which will now fall outside the EU. A number of these may have clients on both sides of the border. This may also be the case for some ACCA members. Following Brexit, and absent a specific policy decision to alter the status quo, it may be that members of CAI and ACCA will be allowed to continue

as auditors in RoI, regardless of their place of residence. Alternatively, it may be that those members who reside in the UK, including Northern Ireland, will be considered third country auditors (TCAs) and therefore, be subject to the requirements applicable to TCAs who wish to be statutory auditors (e.g. reciprocal arrangements between the jurisdictions and an aptitude test).

It should be noted that the situation as regards CAI members and their ability to practice in the UK is a matter for CAI and the UK Financial Reporting Council (FRC). It may be that the FRC will continue to recognise CAI as an RSB (the UK equivalent of a RAB), in which case there may be no issue for CAI members in the Republic of Ireland auditing in the United Kingdom including Northern Ireland. Alternatively, the FRC may wish to take steps to enter into reciprocal arrangements following which auditors subject to regulation in Ireland may be eligible to audit in the UK. If that approach is taken then it is likely that we would be at the top of the list of countries where such recognition will be established

ICAEW/ICAS/ACCA as RAB's in Ireland

For these bodies, a key IAASA related issue is the possibility of the three UK bodies remaining as RABs in primary legislation where under EU law the UK must be treated as a third country. It is unclear as to what the status would be of the members of these bodies, where the bodies are under Irish primary legislation granted recognition to allow their appropriately qualified members to audit in this jurisdiction, but the majority of those members do not reside within the EU. It may be that they can be allowed to continue to operate as auditors here as long as they are recognised here. However, practical challenges would include how they would be regulated, and whether the operation of the requirements of the 8th Directive and the GDPR both in Ireland and the UK may influence IAASA's capacity to have unrestricted access to their records. There would presumably also have to be an agreement on reciprocal rights with the FRC. IAASA would seek to have the capacity to supervise these bodies, and where appropriate directly sanction their members in relation to audits within this jurisdiction, as is currently the case. However, the capacity to carry out this task, in relation to individuals who are not resident in the EU, may be problematic.

Oversight of UK based auditors of Public Interest Entities (PIE's)

Currently, as the FRC is an EU competent authority, IAASA can rely on its systems of quality assurance and does not need to travel to the UK and carry out inspections on auditors of Irish PIE's in that jurisdiction. There are mechanisms to allow similar reliance for countries outside of the EU, but this is dependent on the European Commission taking a decision to declare the systems equivalent and adequate. There is a question of timing here, whether the decision can be in place at the date of Brexit or whether there would be a timelag. In the absence of such a decision, IAASA could be obliged to carry out inspections there. Further the FRC may wish to come to Ireland and inspect Irish firms, which can only be done jointly with IAASA. Both scenarios would result in increased costs for both the FRC and IAASA and in both cases, levies on audit firms and accountancy bodies in both jurisdictions would increase, ultimately being passed onto the entities subject to audit.

Recognition of education of UK auditors

Schedule 1 to SI 312/2016 sets out the standards relating to training and qualifications for auditors in order to be recognised in the State. While these are phrased broadly, they refer to education and training in statutory audit. The UK's departure from the EU may impact on whether the training and qualifications obtained by members based in the UK would be viewed as sufficient for the purposes of the legislation, and accordingly whether the members of UK bodies can be recognised as auditors. While this may not be an issue at the date of Brexit, members who train post Brexit may not meet these requirements.

Of course it is possible that the UK RABs would decide to keep their training and qualifications processes in compliance with EU law with a view to demonstrating equivalence between qualifications and allowing for reciprocity agreements between EU member states and the UK. At a minimum, this might allow a UK member who moved to the EU to show that they held the same audit qualification as a member of an EU member state. (The issue of the recognition of professional qualifications is a wider Brexit issue that applies across a number of professions).

EU approach to recognition structures

It should be borne in mind that the structures in these islands, where five long established bodies qualify their members as auditors and that is subject to supervision by a statutory body, is not typical across the EU, where the number of professional bodies is generally limited or where the statutory body registers auditors directly. Therefore, this appears to be a distinctly, and post Brexit uniquely, an Irish issue. It is possible that during Brexit negotiations, or at some stage thereafter, the EU may more tightly define what is meant by a Member State auditor. Such definition could be by reference either to the location of the RAB, which would mean that for example ICAEW members resident in Ireland (as well as the UK) would now be third country auditors, or by location of the auditor, which would mean that ICAI members resident in the UK would be third country auditors. EU consideration of this matter may arise in the context that ongoing recognition could potentially enable a firm based in London to audit in France or Germany as an EU auditor based on an Irish recognition.

In this context, it is instructive to note that a paper¹ issued by ESMA relating to the possible relocation of financial services providers in advance of Brexit makes a number of recommendations including that certain key functions including management, IT, internal controls, risk assessment and compliance should be based in the EU 27, and that key executives and senior management should be located in the EU on a proportionate if not a full time basis. Were this approach to be replicated in terms of audit services, this may have significant impacts for UK firm and RAB structures. It also notes that access to data and the capacity for the national regulator to properly carry out its functions in relation to recognised entities is key.

Voluntary de-recognition/re-recognition

It may also, of course, be the case that these bodies, facing increasingly disparate regulatory requirements in two different jurisdictions, may seek to be de-recognised in this State. This would be entirely their prerogative. In practice while this may be an option for bodies with relatively small numbers of members based in Ireland, for others this would be much more of a challenge where they have established a significant Irish base.

The meaning of "Third country" and what it may mean in a UK context

A third country is a country outside of the EU. For auditors outside of the EU, there are two separate ways that they may wish to operate in a Member State and separate requirements to do so.

The first way is that an auditor may wish to audit an Irish registered company. In order to do so, they must be a registered statutory auditor in Ireland. Under Article 44 of the Directive (as transposed by SI 312, Regulation 134), a third country auditor can apply for statutory auditor status in an EU country and thereby gain rights to practice in that country (and potentially in the EU generally). As previously noted, approval of a third country auditor as a statutory auditor in Ireland is subject to reciprocal rights for Irish statutory auditors to practice in that third country and such rights are for negotiation between Ireland and that third country. In that event, IAASA would then be ultimately responsible for the quality assurance and investigation & discipline of such auditors.

The second way is that an auditor may wish to audit an entity registered outside of the EU but which is listed on the Irish Stock Exchange. IAASA is the competent authority in Ireland for the registration of TCAs for this purpose. IAASA is required to assess the competence of the auditor and the organisation of the audit firm and is required to ensure that quality assurance takes place. IAASA can carry out that quality assurance directly, or it can seek to rely on the system of oversight in that country, if it is deemed equivalent.

While it would seem likely that the UK system would pass any EU test for recognition as equivalent (EU audit reform has been implemented in the UK and its systems are therefore based on the same law), it would have to be formally recognised as such before equivalence could be granted, and would likely require confirmation from the UK that the systems will not be subject to significant change post Brexit. As noted earlier, the issue here is the timing of such recognition. Critical for a smooth transfer post Brexit would be that the preparatory work for such recognition, which is at EU level would be

¹ https://www.esma.europa.eu/sites/default/files/library/esma35-43-762_opinion_to_support_supervisory_convergence_in_the_area_of_investment_firms_in_the_context_of_the_united_kingdom_withdrawing_from_the_european_union.pdf

done in advance of the date of Brexit so that immediately thereafter the equivalence process could be finalised. It is not clear as to whether this type of matter will be included as part of the negotiations in the period leading up to Brexit (again, with the caveat of if in fact the mutual recognition policy becomes a Brexit issue).

Potential consequences

If reciprocal rights are not in place, then members of the profession who until now could freely practice throughout these islands, and across the island of Ireland in particular, may now find that considerably more difficult. If it transpires that notwithstanding the mutual recognition across the islands that currently prevails, a hard border for the provision of these services becomes a reality, then those auditors who operate across the jurisdictions would have to adjust. Their options could potentially include:

- Registration as a member with bodies recognised in each jurisdiction, so dual membership with the increased costs and regulatory oversight that this will bring;
- Moving registration wholly to the body where they carry out most of their business, and ceasing operations in the other jurisdiction;
- Splitting of firms across jurisdictions.

Auditing and Ethical Standards

Under EU regulations as transposed into domestic legislation, IAASA now adopts auditing and ethical standards for auditors operating in this jurisdiction. Globally, there are International Standards on Auditing (ISA's) developed by an international body IFAC. Until 2016, the standards in use in Ireland were ISAs (UK & Ireland), which were based on international standards but with some more comprehensive standards (particularly on ethical standards), and were issued by the FRC but with input from this jurisdiction. Historically, standards in these islands were very much more developed than those developed internationally, but in recent times that gap has closed, and many jurisdictions now adopt International Standards, or a domestic variant thereof. And in practice the UK & Ireland standards have used the International Standards as their template, albeit as noted already adding further levels of regulation, in particular in ethical areas.

Following a consultation process in 2016, the purpose of which was to decide whether Ireland in adopting its own standards should continue to mirror the UK approach or move to International Standards, the Board of the Authority recommended that we should continue to use the UK standards as the basis for our own, with minimal amendments for use in Ireland. This was for a number of reasons, including the fact that Irish practitioners were using these currently, that they were and remain of a higher standard than International Standards and that for auditors operating in both jurisdictions, continuing to work from broadly similar sets of auditing standards would be more desirable.

However, in taking this decision, the Authority is mindful of the possibility that post Brexit, the UK standards may move away from the rest of the EU. While the main standards should continue to parallel international standards, and indeed lead the way in development, there is a heightened risk that some of the ethical standards in particular may move in a manner which could leave them in breach of EU law or falling short of the EU requirements, as there will no longer be a requirement for the UK standards to comply. While IAASA would not be required to adopt any changes that the UK make going forward, the Authority would reconsider the decision if standards diverge or if auditors cannot widely continue to operate in both jurisdictions.

Also relevant in this regard is that the European Commission has the power to adopt international auditing standards and if it does so, it limits the ability of Member States to impose additional requirements in those areas.

Financial Reporting Standards

This is not an IAASA issue, but does pertain to the Irish accounting market more broadly. The Companies (Accounting) Act specifies the FRC as the accounting standard setter for Ireland, for those entities who do not wish to use International Financial Reporting Standards (IFRS), and are not required to do so. In practice this means any company which is not preparing consolidated financial statements, or is not a Public Interest Entity. Local accounting standards are not a primary focus of the EU, and indeed the thrust is to reduce the need for accounting requirements below the level of PIEs.

However post Brexit there is a risk that UK and Irish GAAP as currently structured could result in local financial reporting standards being in breach of EU law. In such a scenario, Ireland would need to move away from UK and Irish GAAP and decide either to follow IFRS for SME's (Small and Medium Sized Entities) or adopt its own accounting standards, perhaps based on UK standards but with amendments for breaches of the law or other specific Irish market issues. This would parallel the structure currently in place for auditing standards.

Following international IFRS for SME's, would result in changed financial reporting standards for thousands of Irish entities. Although in many cases the visible impact would be small if at all, this would have significant effects for the profession in terms of training and awareness of the subtle differences between IFRS and UK and Irish GAAP, of which there are many.

Non-audit members/Prescribed status

In addition to the five recognised accountancy bodies, there are a further three which are prescribed. Their members are subject to regulatory oversight as accountants by IAASA but the bodies are not allowed to issue audit practicing certificates in Ireland. These are all bodies whose main centre of management and exercise of their regulatory processes is in the UK. The potential Brexit impact on these bodies may be somewhat more limited as their activities are not subject to the EU Audit Directive but there may be other issues relating to the recognition of their education and qualifications. These issues may also apply to the non-audit members of the five RAB's, depending on whether such qualifications emanate from Ireland or the UK. There may also be increase challenges to regulation, for example due to data protection, see below.

Other issues

Data protection

Although this paper focusses on the purely accounting and audit issues arising from Brexit, it is inevitable that many other aspects of Britain leaving the EU will impact on IAASA's work. Perhaps one of the most pervasive, affecting not just the accountancy profession but every aspect of engagement between the EU and the UK, is data protection. The consequences of the UK leaving the EU for data transfer will no doubt form the basis of considerable discussion and negotiation which are beyond the scope of this paper. The European Commission issued a notice on 19 January 2018 outlining the implications of this, which will impact on every business, including audit, accountancy and regulation. While in no way a full synopsis of the situation, our understanding is that the UK is to seek adequacy under EU Data Protection legislation which would allow free movement of data. If this is not achieved, the UK runs the risk of issues similar to those with data transfer to the US. This would of course present enormous challenges both for the accountancy/audit profession, as well as for regulation, for example in terms of supply of information to IAASA from UK audit firms and regulatory bodies to give just one.

Legal profession

To provide an example of a profession facing similar challenges, the legal profession is grappling with a much reduced role for UK lawyers in a post Brexit world where their work will be limited to giving UK advice in the UK only. Anecdotal evidence is that some UK solicitors are seeking recognition in

Ireland under their mutual recognition rules in the hope that they will be recognised as Irish lawyers prior to Brexit. In dealing with the issues facing lawyers, accountants, and to include another example architects, we understand that the British are attempting to establish a “professional business services” solution in Brexit negotiations.

Loss of FRC as fellow EU regulator

The UK and Ireland have been able to work together at EU level to ensure that the particular context relating to statutory auditors in these islands have been properly reflected and acknowledged in European legislation. Without the benefit of that support, it will be more difficult for Ireland on its own to ensure that that context continues to be recognised.

Conclusion

This paper attempts to synthesise the known knowns in relation to Brexit and its impact on both the accounting and auditing profession in Ireland and on the work of IAASA. However as with much of Brexit, it is entirely likely that matters not contemplated in this paper may in time come into focus and perhaps supersede all of the matters listed. IAASA will continue to work with our fellow regulators, in the UK and across the EU, and other stakeholders to ensure early identification of issues and to hopefully ensure that appropriate resources are deployed in addressing those issues. Part of this will no doubt include contribution to Ireland’s negotiating position at the EU table. In this way, we hope to manage as best we can the risks associated with Brexit.