New audit independence rules - are you impacted?

Recent changes to audit independence rules will impact businesses of all sizes, as the FRC increases the separation of audit and non-audit services and introduces further restrictions.

What are the changes?

1. Extension to PIE audit restrictions
   Recent changes which take effect from 15 December 2020, extend the provision of non-audit services restrictions applied to PIEs as follows:
   - The majority of non-audit services (including tax but excluding a very limited list of other services) cannot be provided to Other Entities of Public Interest (“OEPI”). An OEPI includes:
     - AIM-listed entities with market cap at or over €200m (on a 3-year average basis);
     - Very large private companies with over 2,000 employees, or with turnover of more than £200 million and gross assets of more than £2 billion;
     - Private sector pension schemes with more than 10,000 members and more than £1 billion of assets;
     - Lloyds syndicates

2. New restrictions for SME listed entities
   With effect from 15 March 2020:
   - There are also new restrictions on the provision of non-audit services that can be provided to SME listed entities (below €200m market cap).
   - All references to SME listed entities (below €200m market cap) have been removed from the new standard: this means all AIM/other listed businesses face further restrictions on what services their auditors can provide. For example, the provision of accounting/tax accounting services is now prohibited.

3. Blanket ban for Auditors on specific services
   With effect from 15 March 2020, there is now a blanket ban for all entities in respect of the following:
   - Internal audit work for an audit client and its significant affiliates
   - Secondments to an audit client and its connected entities
   - Contingent fees for all services provided to an audit client (e.g. R&D claims and Capital Allowances)
   - Advocacy services for any audit client. For example, if HMRC open a tax enquiry, your auditor could provide information to HMRC to explain the tax position taken, but should HMRC disagree, your auditor will not be able to support you in defending that ongoing enquiry.

Pre-15 March 2020 engagements

The FRC has confirmed that where an auditor engaged before 15 March 2020, to provide previously permitted non-audit services, and where work has already commenced, the auditor firm may continue to complete this work, in accordance with the original engagement terms.
Are further changes likely?

In recent years there has been increasing scrutiny on the audit industry, in part driven from a range of high-profile audit scandals. In addition to the FRC recommendations, the Brydon report\(^1\), released in December 2019, was an independent review into the quality and effectiveness of audit. The recommendations focused on re-defining audit, further segregation of audit and non-audit services and improving transparency.

The UK’s Competition and Markets Authority (CMA) also carried out a review in 2019\(^2\), ultimately recommending the “Big Four” audit firms operationally separate their audit practices from non-audit services.

In our view, the clear direction of travel for larger businesses is that audit and non-audit services will continue to be separated to ensure a more independent and robust audit. The OEPI definition is also expected to be broadened to capture an increased number of businesses.

Impact - what are we seeing?

We are increasingly finding that larger businesses are separating their audit and non-audit services, even where no restriction exists, due to perceived independence concerns and what many Boards now consider as ‘best practice’.

What action should businesses take?

Businesses should act now given some of the rules have already taken effect. Next steps may include:

1. Consider whether your business uses the same professional services firm for both audit and tax/other non-audit services and whether there is an independence concern, perceived or actual?
2. Consider whether your business falls within the definition/list of an OEPI and whether the amended rules, or new FRC audit independence rules will apply to you.
3. If you are not impacted by the new independence rules, consider whether the Board are comfortable in using the same advisor for both audit and non-audit services, given perceived independence and changing industry landscape.
4. If impacted by the revisions, consider potential solutions, which may be to begin the process of re-tendering the restricted service to another provider. This should be done as soon as possible to allow enough time for handover and completion of work.

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\(^2\) [https://www.gov.uk/cma-cases/statutory-audit-market-study#final-report](https://www.gov.uk/cma-cases/statutory-audit-market-study#final-report)

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For more information

Alistair Shaw  
*Partner, Business Tax, Smith & Williamson LLP*  
t: 020 7131 4456  
e: alistair.shaw@smithandwilliamson.com

Emily Spooner  
*Associate Director, Business Tax, Smith & Williamson LLP*  
t: 020 7131 8384  
e: emily.spooner@smithandwilliamson.com

Nick Jacques  
*Partner, Assurance and Business Services, Smith & Williamson LLP*  
t: 020 7131 8896  
e: nick.jacques@smithandwilliamson.com

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