

Written evidence submitted by Dr Ilias G Basioudis (BBP0006)

Dear BEIS Chair and BEIS Select Committee members,

I am writing this as a response to your Committee's inquiry into the Businesses and Brexit Preparedness.

My name is Ilias Basioudis and I am a senior lecturer of Financial Accounting & Auditing in the Accounting Department at Aston University Business School in Birmingham. I am also the Chairman of the Auditing Special Interest Group of the British Accounting and Finance Association. I hold a fellowship in the UK Academy of Higher Education and am editor of the *International Journal of Auditing*.

In a meeting last year in the UK Parliament, I provided oral evidence to some of you when I was invited by the BEIS Committee to give evidence as expert witness in the Parliamentary inquiry/investigation on the future of audit. I have authored many research articles regarding audit quality, auditor reporting, auditor specialisation, and accounting education.

I am responding this time to your call for evidence in your inquiry into businesses and Brexit preparedness. I have been involved in a research project in the last 3-4 years where my co-author, Dr Mike Kend from RMIT University in Australia, and I have been looking into the implications of Brexit on the professional audit and assurance services market in the UK. A number of personal interviews have taken place and I will report here some findings from these interviews which I believe are related directly to your current inquiry. I trust you will find my evidence and the research findings interesting and useful in your consideration of business preparedness for Brexit.

Aston University – Aston Business School

Aston University is a public research university situated in the city centre of Birmingham. Aston is a long established *research-led* University known for its world-class *teaching* quality and strong links to industry, government and commerce. Aston pioneered the integrated placement year concept over 50 years ago, and more than 70% of Aston students take a placement year, the highest percentage in the UK. Only last week, the university received the Guardian University of the Year 2020.

Aston Business School is part of an elite group of business schools across the globe who hold the triple accreditation from AACSB, AMBA and EQUIS, and internationally recognised by top accrediting bodies and independent rankings for the quality of teaching and the employability of its graduates.

All staff in Aston Business School pride ourselves on our teaching which has been recognised by being awarded Gold in the recent Teaching Excellence Framework (TEF) for teaching quality – the highest possible accolade and the benchmark used by the Government to evaluate the quality of university teaching. All academic programmes of study are informed by research with a strong professional dimension as evidenced through accreditations and professional endorsements.

Aston Business School is a research-led business school. The School achieved an outstanding rating in the UK's most recent Research Excellence Framework (REF). The School's strategic focus on relevance and rigour has led to the School's excellent reputation in the business world and has attracted highly regarded corporate connections. There is clear integration of theory/reflection and practice in Aston Business School's programmes with emphasis on workplace education and experience to ensure relevance to the careers and aspirations of the graduates.

Business Preparedness for Brexit

At present, the accounting profession cooperates extensively throughout the UK and EU to serve the needs of businesses, their stakeholders and investors, underpinning the integrity and stability of capital markets. The UK and EU economies currently rely on the cross-border provision of professional accounting and audit services. For example, in 2016, UK accounting firms provided over 14 per cent of EU audit and accountancy imports, and professional and business services firms provide 32% (£96 billion) of the total UK's service exports and 15% of all UK exports.

The existing EU regulatory framework for statutory audit allows the UK-EU auditors and audit firms to cooperate and perform EU-wide audits efficiently. In turn, this contributes to the sustenance of trust and confidence in the UK-EU capital markets, and enhances the quality of companies' financial reporting, especially in cross-border groups, throughout the UK and EU.

However, as the transition period comes to an end, there are still a number of appropriate provisions and arrangements for professional accounting services that still need to be negotiated and agreed in order for the sector to remain competitive and eliminate any risk to UK jobs and revenue.

I discuss below some of the points raised in our research project.

Evidence

The independent and topical research is undertaken since 2016 and after the UK-EU membership referendum and is ongoing. Views from relevant key stakeholders in the UK market for audit and assurance services have been obtained. The main aim of this research has been to understand what implications Brexit will have on the accounting and auditing profession in the UK.

A number of face-to-face semi-structured office interviews were conducted in the UK (mainly in London and Edinburgh) with audit firms partners, audit committee chairs of FTSE listed companies, financial market regulators, accounting standard setters, investors, industry consultants, professional accounting bodies representatives and listed company directors (all key stakeholders in the UK). The research has considered the views of smaller and larger audit practitioners.

The participants in the research study raised a few major issues revolving mainly around professional auditor qualifications, passporting and other potential travel restrictions on audit partners and staff, as well as the potential for loss of influence of the UK regulator in the EU discussion table.

These issues are in turn briefly discussed in a bit more detail below:

Professional business qualifications

The major concern of the participants in our research has been whether the UK accounting qualifications are going to be equivalent to the EU qualifications. The future recognition of UK accounting qualifications after the transition period is important to be included in the framework of recognition agreements for professional qualifications between the UK and EU.

The UK accounting profession has always been reputable and trustworthy. It has also been a big exporter of skilled staff, but the British accountants' ability to continue providing services in other EU countries is still not resolved for the post-Brexit period between the UK and the EU. This potentially causes a considerable concern after the transition period. The question is whether the UK qualifications would be fully recognised in the future UK-EU relationship on professional business services. The danger is that UK accountants and auditors may have to be double checked on qualifications or fully retrain and requalify in the EU. This in turn will cause waste of valuable time and efforts from everyone involved as well as will pose a real risk to UK jobs and revenue.

Similarly, for those EU companies that are listed in the UK, their EU auditors would need to register in the UK as statutory auditors. Again, in the absence of an agreement currently between the two parties, this causes some generic uncertainty and may limit the future UK-EU trade. So this would need some agreement in conjunction with the future recognition of UK accounting qualifications in the EU.

Therefore, the future UK-EU partnership should include ambitious provisions urgently on the recognition of professional qualifications, including a system for the mutual recognition of professional qualifications, enabling all professionals to provide services freely across the UK and EU.

Passporting

UK business service firms and, more specifically, UK accounting firms rely on the ability to move and attract EU talent to support their European and global operations, and at the same time to send their UK accounting staff to provide services across Europe.

Indeed, mobility is a key element of economic cooperation, ensuring UK professional accounting, audit and assurance service providers can reach their clients in EU and *vice versa*. Free movement of people between the UK and EU will cease when the transition period expires.

After Brexit, passporting, work permits and other potential travel restrictions on business services firms staff and audit partners and other audit staff stand to restrict UK professionals to provide services in the EU and to move their staff to the EU and *vice versa*. Such squeeze in capacity in the professional and business services industry in both the UK and EU, as well as the increase in the fragmentation of the business services activities, including accounting, audit and assurance services functions, will eventually result in higher costs of those services provided to the UK and EU consumers and businesses.

Reaching the end of the transition period in the next 4 weeks, it is vital that reciprocal provisions and arrangements need to be agreed between the UK and EU to allow some future intra-firm mobility and transfers that would permit UK and EU-based professional accounting service firms to train staff, move them between UK-EU cross-border offices and to deploy expertise where it is needed transnationally. According to the participants in our research, this will be critical to maintain the commitment to preserve financial stability, markets integrity, investor and consumer protection and fair competition across UK-EU borders.

UK accounting regulator (FRC /ARGA)

Historically, the UK accounting regulator, the Financial Reporting Council (FRC) and indeed the UK have tended to lead the way in seeking to shape and adopt financial, professional accounting and audit reforms and policy in Europe. Audit is a highly regulated activity and clarity on audit regulation is very important to financial and audit markets. The FRC and the UK have always been very influential at the European Commission when discussions have involved EU reforms to audit markets.

Participants in our research project have expressed the concern that the process of leaving the EU could lead to a diminution of the reach and power of the FRC as its scope of influence may well be reduced in the longer term. They have also commented that Brexit potentially creates new opportunities for the UK, given European countries are the UK's main trading partner.

The FRC itself in its 2011/12 Plan and Budget indicated that it needed to provide “*a strong UK voice in the EU and international debate on the future regulation of corporate governance, reporting and auditing*”.

Other issues and priorities for the UK professional accounting firms are:

Applicable regulatory frameworks

Both the UK and EU have adopted and currently follow international accounting standards and accounting and audit regulatory frameworks which allow the pan-European accounting and audit profession to continue to cooperate. However, many of the respondents in the research project have expressed the opinion that there may be some deviations in sharing the same conducive regulatory frameworks between the

UK and EU in the future, and consequently, this may increase the burden on the UK accounting firms and the ability to provide their services to the entities in the EU.

For example, it is currently uncertain whether the EU Audit Regulation and Directive, that continues to apply in the UK during the transition period, will be retained in its entirety or be subject to certain amendments as domestic retained EU law after the transition period.

Further, it is anticipated that the UK Government will introduce some audit reforms in the market soon, following BEIS recent recommendations and reports from Sir Donald Brydon, Sir John Kingman, and the Competition and Markets Authority (CMA). Given many professional business service firms operate through a global network, such audit reforms would require coordination from other countries' regulators for them to be effective; Brexit may potentially make it harder for UK representatives to persuade their EU counterparts to adopt similar reforms.

Registration of UK business service firms in the EU and vice versa

After the transition period where Brexit will be fully concluded, the UK auditors would be perhaps reclassified as third country auditors to the EU, and they would be subject to a different authorisation regime, being the one applicable to third country auditors. As a result, the UK auditors may not be able to sign an audit report for an EU company listed in an EU stock exchange. Similarly, the UK may not allow EU auditors to sign an audit report for an EU company listed in the UK stock market. This is related to the mutual recognition of professional qualifications discussed above, but a reciprocal agreement would be required between the UK and the EU to allow the auditors of the two parties to register in each other's jurisdictions. This will be costly and maybe unnecessary if the UK-EU future trading relationship will not cover this topic adequately.

Further, a number of the participants in our research have also focused their minds on the likelihood of auditors having to resign from existing audits after the transition period and due to the Brexit decision, especially if the negotiation and agreement on the future UK-EU relationship does not address this issue adequately.

Transfer of working papers

After Brexit and the transition period, the UK auditors would probably become third country auditors to the EU. The EU Audit Directive (2006/43/EC Directive) adopted in the UK allows transfers of papers to those third countries whose audit regulatory authorities are approved as 'adequate' by the EU, but care must be taken to make sure that the UK authorities will enter into working arrangements with the EU authorities. In essence, a determination of adequacy would need to be signed between the UK and the EU before the end of the transition period to permit the continuation of transfer of working papers and documents in the future.

Firm ownership

The future UK-EU relationship should include supplementary provisions for professional services related to continued joint UK-EU ownership of professional business firms. The UK Government has already stated that such supplementary provisions would not replicate Single Market membership, and it is expected that professional business service firms would have rights in the UK and the EU which differ from current arrangements.

Currently, during the transition period, those with EU accounting/audit qualifications count towards the required majority of appropriately qualified owners or managers of a UK professionally accounting firm. Likewise, people with a UK accounting/audit qualification are still recognised as being entitled to be owners and managers of EU-based professionally firms. However, this only applies during the transitional period.

Post-transition, this is not clear, but it is expected that this may not be the case and only owners or managers with equivalent qualifications recognised in the UK will count towards the majority of appropriately qualified owners or managers of a UK professional business services firm. Similarly, a UK professional business services firm that wishes to own part of, or be part of the management body of, an EU firm will no longer be recognised among the required majority of EU qualified owners or managers.

Clarifications and reciprocal agreements need to be signed between the UK and EU by the end of December 2020 to allow joint ownership in UK-EU professional business services firms. It is also envisaged that those EU qualified individuals that were recognised as part of the management body prior to Brexit will continue to be recognised in the future and after the transition period.

Summary and closing remarks

In sum, our research interviews with key UK stakeholders and subsequent analysis of their responses finds that for the accounting and auditing profession in the UK, the Brexit decision has created concern regarding the future recognition of UK accounting qualifications, pass-porting and other travel restrictions on auditors. There is also concern that the influence of the new UK regulator, the Audit, Reporting and Governance Authority (ARGA), in Europe will decline if it is no longer involved in the future EU accounting and audit reform processes.

The above submitted evidence is based on the findings of the research project that is running since the referendum in June 2016. I hope that you find the information in this letter helpful as you investigate the UK businesses' preparedness for Brexit. The time since the end of the transition period is approaching fast (less than 4 weeks), and there are currently no UK-EU trading arrangements or agreements on professional business services and this can have a significant impact on UK registered professional individuals and professional services firms and the UK economy.

Specifically, the existing uncertainty does not help professional individual accountants and auditors and professional accounting firms to make plans for the future without reciprocal and equivalent arrangements being in place.

During the time left in the transition period, it is in the UK's best interest to reach new economic and regulatory arrangements for professional services with the EU. These arrangements should be stable and long-term agreements with the EU which must preserve the mutual benefits of integrated markets and ultimately protect financial stability.

The UK should actively seek EU decisions on audit equivalence and adequacy and accounting and auditing equivalence in order for access to capital markets is maintained, investor confidence is fostered, and the cross-border provision of accounting and audit services is facilitated.

If you have any questions in relation to the content and evidence provided in this letter, you are welcome to contact me by email in the first place.

Your sincerely,

ilias G Basioudis.

ilias G Basioudis PhD, FAIA, FHEA, MSc, BSc

Senior Lecturer in Financial Accounting and Auditing, Aston University Business School.

Chairman of the Auditing Special Interest Group of British Accounting & Finance Association.

Adjunct Senior Lecturer in University of South Australia.

Editor, *International Journal of Auditing*.

November 2020