



Paul Smith
Corporate Frameworks, Accountability and Governance
Department of Business, Innovation and Skills
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By email: pauld.smith@bis.gsi.gov.uk

9 December 2015

Dear Sirs

Re: BVCA response to consultation on the technical legislative implementation of the EU Audit Directive and Regulation

The British Private Equity and Venture Capital Association (“BVCA”) is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of almost 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. This submission has been prepared by the BVCA’s Legal & Technical Committee, which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry.

Our members have invested over £30 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 490,000 people and almost 90% of UK investments in 2014 were directed at small and medium-sized businesses. As major investors in private companies, and some public companies, our members have an interest in reporting matters, the conduct and information presented by such companies, and the burdens placed on the management of such companies.

Development of the Consultation

We have held a number of productive discussions with the FRC over recent months and we would like to thank the FRC for its openness throughout these discussions. In particular, in respect of the Consultation, we welcome the amendment of the definition of a Listed Entity to clarify that an entity whose securities are technically listed but which are not in substance freely transferrable or tradeable would not be a Listed Entity.

Further, we welcome the decision of the FRC not to expand the definition of a PIE with respect to the implementation of the EU regulations. We would ask the FRC not to apply the more stringent requirements over and above the Regulations to non-listed PIEs (such as rotating partners every five years not seven), in order to reduce the administrative and cost burden falling on our



members and their investee companies, given that a BVCA member might hold investments in a number of unlisted credit institution or insurance company PIEs.

We support the objective of seeking to increase quality and independence in the audit market and we have been pleased with the level of engagement of the FRC with the BVCA during the consultation period.

However, we do have a number of concerns with the extent of some of the suggestions in the Consultation, especially in the context of the potential impact on choice of accounting firms to provide services to our members and private equity-backed portfolio companies. We consider that the transition period regarding implementation of the restrictions and the introduction of the cap on non-audit services will be practically difficult to administer and will result in an additional cost burden being incurred.

We restrict our response to the consultation, in this letter, to discussion of these practical considerations for our members.

Background to Private Equity and Venture Capital

Private equity and venture capital firms are long-term investors, typically investing in companies for around 5-7 years. This means a commitment to building lasting and sustainable value in the businesses they invest in. Typically firms will sell their stake in a company by listing on the public markets or selling to a strategic buyer.

Private equity and venture capital firms raise capital to invest from sources such as pension funds, endowments, insurance companies, banks, family offices/high net worth individuals and sovereign wealth funds.

A private equity or venture capital manager manages one or more funds, often set up as limited partnerships. The funds are closed-ended meaning that they have a limited life span, the industry standard being 10 years. The funds will invest in companies in the earlier part of a fund's life until an agreed date (e.g. 5 to 6 years) and exit investments in the run up to the fund's tenth anniversary. The life span of a fund can be extended (if permitted in the fund's constitutional agreement) and this is typically up to 2 additional years.

Private equity and venture capital managers operating in the UK will be authorised and regulated by the Financial Conduct Authority ("FCA") and now (for funds which are in-scope Alternative Investment Funds ("AIFs")) must be authorised and regulated by the FCA as an Alternative Investment Fund Manager.



Practical considerations regarding the provision of Reporting Accountant Non-Audit Services

We do have some concerns as to the application of the FRC ES to reporting accountant services which are services required by our members relatively frequently. These concerns stem largely from the fact that reporting accountant appointments are in respect of individual transactions, unlike financial statement audits, for instance, which are recurring engagements.

Previously it has been common for private equity-backed companies to choose their auditor to perform reporting accountant services, however, the application of new ES4.31 could reduce the choice of providers of these services due to the fee cap in place.

The FRC have indicated (pages 8-9 of their consultation) that the exclusion will mean “Entities which engage their statutory auditors to carry out work to comply with regulatory requirements would not be prevented from doing so under the cap, and will not incur any additional burden as a result of having to undertake additional tenders for the provision of such services”.

We understand this to mean that Reporting Accountant engagements would be excluded from the non-audit services cap as the service is required by the listing rules. As you will be aware the listing rules require:

- A short form report prepared by the reporting accountant;
- A declaration by the sponsor; and
- A declaration by the directors.

In making their declarations the sponsor and directors often require the reporting accountant to prepare a long form report and working capital comfort letter. We would urge BIS to press upon the FRC the need to confirm that all these reports will be excluded from the non-audit fees cap.

Whilst we acknowledge the FRC’s ability to act in this matter is restricted given the definition provided in the Regulation, we would encourage the FRC to work with the FCA to explore ways in which a company’s auditor could continue to provide the various reports which are currently market practice without reference to the cap on non-audit services.

Practical considerations regarding the transition to the new proposed regime relating to the restriction of non-audit services

Under the proposed FRC Ethical standard, non-permitted non-audit services are prohibited for the whole of the period from the start of the accounting year for which the audited accounts will be prepared until the filing of those audited accounts. In addition, services advising on accounting, internal control and risk management systems at the audited entity are also prohibited for the year before that for which the audited accounts are prepared. These prohibitions apply to the PIE itself and also to its parent and subsidiary undertakings within the EU.



We are concerned regarding the implications of this in transitional situations around the time of a transaction. For example:

- A private equity house makes an offer for a listed company and secures over 90% acceptances, at which point it declares the offer unconditional. It then implements a process to squeeze out the minority but which takes time (perhaps 6 months) to complete. Depending on the precise facts, the private equity house could be the parent undertaking of what would be a Listed entity (and hence an entity to which the widened restrictions in the Ethical Standards coming from the Regulation would apply) for the period from when the offer is declared unconditional until the squeeze out is completed (at which point the portfolio company would cease to have any listed shares and hence would cease to be a Listed entity). Hence, there would be an issue if the private equity house were obtaining non-permitted services from the accounting firm that audits the listed entity during that transitional period when the portfolio company was controlled but still listed. Suspending or transferring the service to another provider would be a very unfortunate requirement.
- A portfolio company becomes a listed entity and the private equity house (which could be the parent as above) has non-permitted services in progress from the accounting firm that audits the relevant portfolio company.

We believe that where it is within the FRC's remit, for example if the UK opts to go beyond the Regulation in its implementation, further consideration is desirable on transitional provisions that could be put into place. This could probably be subject to some time limit and cover services that are in flight but for whatever reason become restricted. This would particularly be the case where those services have no relevance to the financial statements of the actual listed entity. Changing provider mid-way through a project is disruptive and invariably results in additional cost. We believe that, if at all possible, there should be transitional or 'grandfathering' provisions to minimise the incidence of such situations.

The BVCA would of course be willing to discuss this submission with you further and, if you so wish, please feel free to contact me.

Yours faithfully

A handwritten signature in black ink that reads 'Gurpreet Manku'. The signature is written in a cursive style and is underlined with a single horizontal stroke.

Gurpreet Manku
BVCA, Director of Technical and Regulatory Affairs