



Audit companies providing non-audit services to listed companies that they audit

The ABI's Response to the APB's consultation

Introduction

1. The ABI is the voice of the insurance and investment industry in the UK. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

General Comments

2. We welcome the opportunity to respond to the APB's consultation which deals with a subject that has over a period of some years been one that has raised concerns for shareholders, including ABI members. It is vital that there should be confidence in the independence of auditors. It is also right that a healthy scepticism should exist as to the ability of audit firms to conduct non-audit work for their audit clients. Inevitably it is the case that perceptions, just as much as reality, will impact on confidence in the independence of auditors.
3. The current consultation is being undertaken to address the House of Commons Treasury Committee's proposal that auditors should not undertake non-audit work for their audit clients and that this be consulted on. However, this is a complex matter and our view is that the post-Enron reforms, including much better arrangements for audit committee oversight, did satisfactorily address most of the concerns in this regard. Levels of non-audit fees, which had been rising significantly relative to audit fees prior to this, have fallen back materially in the subsequent period. We therefore think that the perceptions of a problem, which undoubtedly remain, reflect at least in part problems of the past rather than the present. The current consultation therefore provides a further opportunity to seek to confirm that this is the case but also to consider what incremental improvements would be worthwhile, such as a measure of additional transparency to shareholders.
4. Our detailed comments on the consultation question are provided in the annex to this response.

Questions for Consultation

In respect of listed companies:

1 (a) Do you think that the provision of non-audit services by accounting firms to their audit clients currently impacts confidence in the independence of auditors?

Yes, it is clear that this continues to be the case though we believe that this is now mainly a matter of perception as opposed to reality. Our monitoring of UK-listed companies confirms the academic findings that the incidence of non-audit engagements has declined and we believe this represents a sensible response by companies and their audit committees who have recognised that there is the risk of a perception of a problem and that it would therefore be wise to err on the side of caution in using their auditors for non-audit services. We therefore believe that the shift seen over the period since the post-Enron reforms has addressed the substance of concerns and that it would be wrong to conclude that major changes are required to place further restrictions or prohibitions.

(b) Are you aware of any instances where the provision of non-audit services by accounting firms to their audit clients has or may have adversely affected audit quality? Please give the reasons for your views.

No, we are not.

2 If you do consider that the provision of non-audit services has adversely affected audit quality or currently impacts confidence in the independence of auditors please identify which non-audit services are of concern. Please give the reasons for your view.

The consultation paper identifies that some non-audit services will have greater potential than others to compromise the perceived or actual independence of auditors. We agree. Some 'non-audit' work is in practice an extension of the core statutory audit and undertaking it will not have genuine implications as to compromising the core audit. Indeed, it is clear that some who advocate a complete bar on the provision of non-audit services are either unaware of the status of such work as 'non-audit' or would explicitly extend the definition of audit to allow it to continue to be undertaken by the auditor.

We are unconvinced, though, that these approaches would be right and are supportive instead of the recognition of a gradation of services. The consultation paper itself recognises a number of categories. Others have sought to identify a smaller number of categories in order to seek to separate out those activities where there would be a presumption that they could be undertaken by the auditor from those where there would be a presumption they would not. We are more sympathetic to the notion of allowing the audit committee to make a judgment in the circumstances as to whether the benefits of allocating the work to the auditor e.g.

familiarity with the company-specific circumstances and synergies with audit process, outweigh any disadvantages either actual or perceived.

3 In the light of your answers to questions 1 and 2, do you think that there needs to be a change in the approach taken by APB to the setting of standards relating to the provision of non-audit services by auditors to the entities that they audit? Please give reasons for your view.

No major change is required though we think it would be sensible to give some thought as to the question of whether, and if so in what circumstances, contingent fee arrangements should be permissible. In principle we are against these but there are two important reasons why a prohibition might not serve the best interests of the company and its shareholders. Firstly there may be relatively immaterial engagements best undertaken where the provider is incentivised according to its success. Secondly it is not entirely correct to say that the value and cost of work on projects which do not reach fruition is necessarily the same as on work that does. In the former case, the accounting firm stands behind its work vis a vis the company and also the outside world and the liability implications will be different from cases where the client decides of its own volition not to pursue the matter in question and wishes therefore simply to remunerate the accounting firm for the work it has undertaken up to this point.

4 If you think that there should be a change in the current arrangements, would you advocate:

- o **Complete or more extensive prohibitions on the provision of non-audit services by accounting firms to their audit clients within the Ethical Standards for Auditors;**
- o **The imposition of other requirements through the Ethical Standards for Auditors (and if so which);**
- o **More active corporate governance – e.g. so that non-audit service engagements were required to be pre-approved by the company's board of directors or audit committee;**
- o **Better (and more extensive) disclosure in financial statements. Please provide reasons for your views and any suggested solutions.**

We consider that the focus of any change should be on the last two of these categories. What is important as regards pre-approval arrangements is that a proper framework of decision-making should exist with referrals to the audit committee at a pre-determined level of materiality (or perhaps multi-stage arrangements where the audit committee chairman is required to be consulted at a lower level of materiality) and that the audit committee is also informed periodically over the total level of non-audit work which has been allocated to the auditor. We think there may be merit in considering whether requirements in this regard could be made more explicit under the Smith guidance.

However, shareholders cannot have full confidence unless there is adequate disclosure in this regard. They need to be assured as to the existence and key features of the framework for audit committee oversight and have appropriate disclosure of the type and cost of non-audit work undertaken (if any). It is clearly inadequate for shareholders merely to be informed of the monetary total and the ratio between this and the fee for the audit.

5 In setting the standards relating to auditor independence, do you believe regard should be had to the perceived benefits that are derived by companies from the provision of non-audit services by their auditors? If your answer is yes, please provide specific examples of these benefits and indicate the magnitude of any cost savings that arise.

We believe that audit committees need to be keenly aware of the potential both for companies to reduce costs and derive benefits through having their auditors undertake non-audit work. However, we do not think that APB guidance needs to give additional encouragement in this regard as the pressures on audit committees will already exist to take what is likely to be the route that management will be likely to support, to engage the auditors to do the work. It is the role of the Audit Committee to make the right judgment on whether to follow management's preferred course and, where necessary, to stand firm in deciding on an alternative course.

6 Are there any other views that you would like the APB to take into account?

No, we have nothing specific to add.

29/01/10

[s:\inv\response\apbnonaudoc09