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Dear Hazel

CONSULTATION ON AUDIT FIRMS PROVIDING NON-AUDIT SERVICES TO LISTED COMPANIES THAT THEY AUDIT

ACCA (the Association of Chartered Certified Accountants) is pleased to respond to the Auditing Practices Board's (APB) consultation on audit firms providing non-audit services to listed companies that they audit. The consultation arises from a recommendation in the Treasury Select Committee report *Banking crisis: reforming corporate governance and pay in the city*. ACCA provided written and oral evidence to that Committee and we did not, at that time, nor do we now, consider there to be a significant problem with investor confidence in relation to the provision by auditors of non-audit services.

ACCA is the largest and fastest-growing global professional accountancy body with 131,500 members and 362,000 students in 170 countries.

We aim to offer the first choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management. ACCA works to achieve and promote the highest professional, ethical and governance standards and advance the public interest.

This response should be read in conjunction with that of the Consultative Committee of Accountancy Bodies, in which ACCA is an active participant.

Overall

We congratulate the APB on presenting a consultation paper that itself acts to educate certain stakeholders who might not otherwise be fully aware of the current regulatory environment affecting the provision of non-audit services.

We note that the consultation is only in relation to listed companies; this rightly focuses on the issue of investor confidence in such public interest entities. We also note that the APB will undertake a further detailed consultation if, in the light of the responses to this consultation paper, it wishes to consider more general changes to the existing ethical standards for auditors. We do not believe that there is a persuasive case for widening the scope of proposals concerning non-audit services to include companies and other entities that are outside of the listed company sector.

In the remainder of this response we answer the questions posed in the consultation paper.

Question 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?

Public perception is important and confidence in the effectiveness of audit can be undermined by non-audit services delivered to listed companies by their auditors. This is recognised in the existing regulatory environment. It is the subject matter of APB Ethical Standard 5 (Revised) *Non-audit services provided to audited entities*. In addition, the *Combined Code on Corporate Governance* identifies the main role and responsibilities of the audit committee as including: ‘to develop and implement policy on the engagement of the external auditor to supply non-audit services . . .’. It is our experience that audit committees are concerned currently about being seen to be overly close to the company’s external auditors and that this pervades their consideration of both the commissioning of non-audit services and indeed the tendering process for the audit itself.

Whether, given the above, there is an actual current impact on confidence in the independence of auditors is a question of degree. Certainly the Treasury Select Committee expressed a strong belief that investor confidence and trust in audit would be enhanced by a prohibition and there are investors and members of audit committees who would agree. Conversely, there are those who believe that the current regulatory regime provides appropriate safeguards: standards, monitoring and enforcement are working and audit committees are taking their responsibilities seriously.

Had the impetus for this consultation not arisen from the report of the Treasury Select Committee, it would be difficult to argue from recent history that now is an appropriate time for any further regulatory measures. As set out in the consultation paper, from a peak of 191% in 2002, the proportion of fees earned by auditors from non-audit services to listed companies that they audit declined to 71% by 2008. Concerns over ‘lowballing’ (undertaking audit work for an artificially low fee in the expectation that fees for non-audit work from the same client will provide sufficient compensation), while once making headlines and giving rise to academic studies, is currently not perceived to be of any real importance. Such changes demonstrate the impact of the regulatory measures already introduced, mainly post-Enron, to address auditor independence issues.

Question 1. (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?

There is a perception that, in relation to Enron, the level of involvement of the audit firm in non-audit services compromised the quality of the audit. We are not aware of current instances of impairment of audit quality arising from the provision of non-audit services. ACCA members serving on audit committees, consulted when formulating this response, cautioned that a committee would be reluctant to make public any such problems that became known to it, so there may be little evidence available on this matter.

Communication with audit committees is dealt with in auditing standards, which specifically require that, for listed companies, audit engagement partners must:

- disclose in writing to the audit committee all relationships between the audit firm and the client that may reasonably be thought to bear on the firm’s independence and the objectivity of the audit engagement partner and staff (including arrangements for ensuring that independence remains when non-audit services are commissioned) and the related safeguards that are in place; and
- confirm that, in their professional judgement, the firm is independent and the objectivity of the audit engagement partner and audit staff is not impaired.

While we assume that the APB will liaise with the Audit Inspection Unit (AIU), even if an audit failure is identified it would be difficult to ascribe its cause to the provision of non-audit services. In its reviews of firms that audit listed companies, the AIU pays considerable attention to the correct application of APB Ethical Standard 5, to the related requirements in ISAs (UK and Ireland) and to the need for firms to demonstrate that audit engagement partners are evaluated and remunerated based on the quality of their audits and not the selling of non-audit services to their audit clients.

The question deals only with the potentially adverse effect of non-audit services on audit quality. Many auditors would argue that the provision of certain of the non-audit services currently allowed by the existing ethical standards improves their knowledge of the client and so contributes positively to audit quality. There are also indirect benefits because the skills and experience of audit staff can benefit from carrying out, or interacting with those carrying out, non-audit work. In addition, the attractiveness to recruits, of firms carrying out audits of listed clients, would be maintained as their experience would not be constrained to one aspect of accountancy. This would facilitate the continuing recruitment of staff with the personal characteristics essential to quality auditing.

Question 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.

Because of our answers to question 1, we do not answer this question.

Question 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?

We believe that the existing APB standards are operating as intended to promote an appropriate balance between safeguarding auditor independence and allowing entities the freedom to procure non-audit services from their auditors.

The question refers to 'the approach taken by the APB to the setting of standards'. In our view it would be better if the APB approach to the setting of ethical standards was consistent with that for standards of auditing: the adoption of the pronouncements of the recognised international standard setter.

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

- **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;**
- **The imposition of other requirements through the Ethical Standards for Auditors (and if so which);**
- **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;**
- **Better (and more extensive) disclosure in financial statements.**

Corporate governance and transparency have changed considerably in recent years and are still changing in ways that will affect the procurement of non-audit services. There are several existing categories of non-audit work for which disclosure can be made but, in general, such disclosure does not allow users to evaluate whether a particular non-audit service is best provided by the auditor or another. This may be an area, therefore, where appropriate fee disclosure and comment from the audit committee would be beneficial. The audit committee can address both the relevance of the non-audit service to the audit and its degree of significance. To counter a perception that auditors are invited to undertake non-audit services by default, there should be careful consideration and challenge by the audit committee of such arrangements.

Question 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.

In assessing whether there should be a prohibition on firms conducting non-audit work for an audit client, it is neither feasible nor appropriate to consider just whether audit quality is, or is perceived to be, adversely affected. Instead, a balanced public interest assessment must necessarily take into account the benefits.

The companies that procure non-audit services from their auditors clearly believe that by doing so they secure benefits. It can be more convenient and cheaper to use the non-audit services of an auditor because a third party does not possess as much knowledge of the business. While those we consulted in companies were certain that there would be adverse cost implications if they were prevented from procuring non-audit service from their auditors, we are not able to provide specific examples.

The provision of non-audit services can enhance an auditor's knowledge of the client and hence improve audit quality. We are not able to provide specific examples of where or how this benefits the client.

As we said in our response to question 1.(b), there are indirect benefits arising from the provision of non-audit services to audit clients. It is not only the actual provision of such services that can bring benefits but the availability of the auditor as a supplier of non-audit services can itself widen choice and promote competition. There are also indirect benefits to business of having a regulatory environment that is no more restrictive of such services than is generally accepted internationally. Jurisdictions reduce their commercial attractiveness by imposing burdens or restrictions that are out of line with international norms.

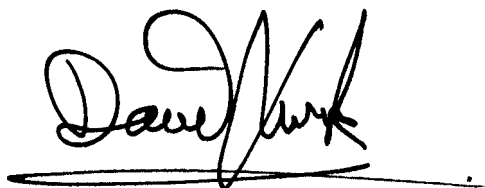
Question 6. Are there any other views that you would like the APB to take into account?

The consultation is essentially about whether the concerns of the Treasury Select Committee are shared by the users of the financial statements of listed companies and hence whether there is a case for change. Restrictions on non-audit services, over and above those recognised internationally would in our view be appropriate only if there was an overwhelming body of evidence identifying a significant problem.

We consulted ACCA members and staff globally and in no major market was there recognisable pressure from investors to move towards a complete prohibition on audit firms conducting non-audit work for the same company.

In our view, there is insufficient evidence to suggest that this is perceived as an important issue by the vast majority of users of financial statements. We would encourage the APB to take into account, therefore, the views of this 'silent majority', which supports the status quo.

Yours sincerely

A handwritten signature in black ink, appearing to read 'David York', with a horizontal line underneath.

David York
Head of Auditing Practice