

AUDITING PRACTICES BOARD : APB ETHICAL STANDARDS

CONSULTATION : AUDIT FIRMS PROVIDING NON-AUDIT SERVICES TO LISTED COMPANIES

CBI RESPONSE

January 2010

I INTRODUCTION AND SUMMARY OF CBI POSITION

1. The Confederation of British Industry (CBI) is pleased to respond to this consultation.
2. We note that this consultation has arisen following a House of Commons Treasury Committee report into the financial crisis, who were concerned by the large amount spent by banks on non-audit services. The Treasury Committee expressed the view that investor confidence, and trust in audit, would be enhanced by a prohibition on audit firms conducting non-audit work for the same company, and recommended that the FRC should consult on this proposal at the earliest opportunity.
3. CBI members would be very strongly opposed to any proposal to ban non-audit services. Non-audit services are highly valued by companies. Audit firms know their clients, and for many services, audit firms are best placed to provide the service on the most cost effective basis. Audit firms can in fact often gain a better understanding of the business, and therefore enhance audit quality, through the information gained through the provision of non-audit services. Clearly it is necessary that appropriate ethical standards and disclosure requirements are in place to provide information and transparency to investors on the provision of non-audit services and to ensure that auditor independence and other ethical requirements are safeguarded and maintained.
4. Moreover the decision to engage the audit firm is made by the company, and it should be for the company to decide whether to procure the desired service from the audit firm.
5. The Combined Code recommends at Code provision C.3.2 that the Audit Committee develop and implement policy on the engagement of the auditor to supply non-audit services, taking into account relevant ethical guidance, and to report to the board, identifying any matters in respect of which the Audit Committee considers that action or improvement is needed and making

Clive Edrupt Company Affairs
DL: 0207 395 8042 E: clive.edrupt@cbi.org.uk

recommendations as to the steps to be taken. The Combined Code also recommends at Code provision C.3.7 that the annual report should explain to shareholders how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded. The CBI supports these provisions, and we note that no change is proposed to them by the FRC in its current consultation on proposed Code amendments.

6. Further guidance is also available in the FRC Guidance on Audit Committees (October 2008), which the CBI also supports, but would also be suitable for review in due course, to reflect the outcome of this consultation.

7. The scope of the existing ethical standards is broadly appropriate. What is an issue, and where there is scope for reform, is making the existing ethical standards and / or the statutory Disclosure of Auditor Remuneration Regulations clearer and easier to understand and apply – particularly in explaining the different types of non-audit services that exist and providing guidance why it so often makes good practical sense to obtain the service from the audit firm, which would assist in addressing perceptions about the impact of providing non-audit services on auditor independence and objectivity.

8. At present, the existing rules on disclosure broadly cover three categories :

- fees payable for the company's audit;
- fees payable for other services, including fees for the audit of subsidiaries;
- and separate disclosure in respect of ten specified categories, such as services pursuant to legislation, IT services, internal audit services, valuation and actuarial services, recruitment and remuneration services, corporate finance services, and litigation services.

This has led to complex disclosures, and the requirements of the statutory Disclosure Regulations could be improved to make them easier for companies to apply, whilst improving the quality of the information disclosed for the benefit of shareholders, and leading to improved transparency and consistency in reporting.

There is also a need to remove some anomalies. For example, in respect of the fees for audits of subsidiaries which presently fall, not under fees payable for the company's audit, but under fees payable for other services.

9. Therefore the response to the Treasury Committee should be, not a ban or major new restrictions on non-audit services, but better disclosure of the services provided.

For example in respect of banks and in respect of businesses listed in the US, huge expense is incurred due to auditors providing information and filings to regulatory authorities, not in providing services directly related to the bank's or company's business as such.

10. All proposed changes should also be based on a full impact analysis drawing on input from the corporate sector.

11. It is also pertinent to note that the size of non-audit fees as a percentage of audit fees has steadily declined since 2001, when non-audit fees seemed to be at their peak (at around three times the audit fees). The ratio had steadily fallen since, and in 2008 non-audit fees averaged only 70% of the audit fee.

12. If the requirements of the ethical standards and the statutory disclosure requirements were updated and made clearer, then this could also be reflected in updated guidance for audit committees.

13. We set out below our responses to the specific consultation questions.

II RESPONSES TO CONSULTATION QUESTIONS

In respect of listed companies:

Q.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?

We recognise and respect the need for ethical standards to regulate the provision of non-audit services. However, CBI members would be strongly opposed to any proposal to ban non-audit services. On the contrary, non-audit services are highly valued by companies.

Audit firms know their clients, and for many services, audit firms are best placed to provide the service on the most cost effective basis. Audit firms can in fact often gain a better understanding of the business, and therefore enhance audit quality, through the information gained through the provision of non-audit services.

Clearly it is necessary that appropriate ethical standards and disclosure requirements are in place to control the provision of non-audit services to ensure that auditor independence and other ethical requirements are protected and maintained.

However, in broad terms we do not consider that the objectives of the existing Ethical Standards in their provisions on Non-Audit Services impact on confidence in the independence of auditors.

That does not mean there is not scope for some review and refreshment of the Ethical Standards and the associated statutory Disclosure in this area, which we discuss elsewhere in this response.

(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.

Not so far as we are aware.

Q.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.

No. See our comments above and in response to Q.1.

Q.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.

There is scope for reviewing and re-presenting the ethical standards on non-audit services and / or the statutory Disclosure of Auditor Remuneration Regulations to make them clearer, and easier for companies to apply, and to make further provision on appropriate disclosures to improve understanding and transparency for investors and consistency in reporting. Any changes however need to be based on a full impact analysis drawing on input from the corporate sector.

Q.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.**

Please provide reasons for your views and any suggested solutions.

As discussed above, the scope of the existing ethical standards is broadly appropriate overall.

What is an issue, and where there is scope for reform, is making the existing ethical standards and / or the statutory Disclosure of Auditor Remuneration Regulations clearer and easier to understand and apply – particularly in explaining the different types of non-audit services that exist and providing guidance why it so often makes good practical sense to obtain the service from the audit firm, which would assist in addressing perceptions about the impact of providing non-audit services on auditor independence and objectivity.

At present, the existing rules on disclosure broadly covered three categories - fees payable for the company's audit; fees payable for other services, including fees for the audit of subsidiaries; and separate disclosure in respect of ten specified categories, such as services pursuant to legislation, IT services, internal audit services, valuation and actuarial services, recruitment and remuneration services, corporate finance services, and litigation services.

This has all led to complex disclosures, and the requirements could be improved and information disclosed made clearer. There is a need to remove some anomalies, such as in respect of the fees for audits of subsidiaries fall not under fees payable for the company's audit, but under fees payable for other services.

Therefore our principal message is that there should not be a ban or major new restrictions on non-audit services, but better disclosure of the services provided through appropriate updating of the Ethical Standards and the Disclosure of Auditor Remuneration Regulations, to make the Regulations easier to apply by companies, improve the quality of the information disclosed for the benefit of shareholders, and improved transparency and consistency in reporting.

For example in respect of banks and in respect of businesses listed in the US, huge expense is incurred due to auditors providing information and filings to regulatory authorities, not in providing services directly related to the bank's or company's business as such.

Another example, where some change has been advocated is in respect of restructuring services. However this is a very important service to business, particularly such as now following the financial crisis, when there is a downturn in the economy and increased numbers of companies in difficulties, who need to restructure to survive and save or protect jobs. Speedy action and help from the audit firm is required if the restructuring is to be successful.

Corporate finance and transaction related services are already dealt with in Ethical Standard 5, and further guidance is provided in the APB Bulletin 2008/10 which specifically includes a section which deals with a range of restructuring services.

We would be very concerned if further restrictions over the provision of restructuring services made it even harder for UK businesses, and the employment generated, to survive.

Another example of an important non - audit service arises out of takeover activity, in particular in the event of a hostile bid, where the audit firm can provide important assistance in connection with the production of defence documents.

We acknowledge the important role for audit committees to oversee the nature, extent and cost of non- audit services that are provided, as well as the audit. Guidance for audit committees is available in the FRC Guidance on Audit Committees (October 2008), which the CBI also supports, and which might become suitable for review in due course to reflect the outcome of this consultation.

However, we would not support a requirement for the audit committee to pre-approve all non - audit services. This would be unworkable and impractical. It should be for the individual audit committee to lay down its broad policy and parameters in discharging its responsibilities in this area, and when it should be informed, consulted, or give approval.

Q.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.

Yes. See our comments above.

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

We note that since the consultation was launched the FRC has issued a statement in connection with the provision of internal audit services. We agree that it is appropriate to review the Ethical Standards on this issue, but we do not pre-judge whether any change in Ethical Standards is appropriate.

We are also conscious of the benefits that small companies, in particular, derive from their auditors in this area, so we would need to consider very carefully any proposals for reform which might have significant adverse consequences for small companies.