

The Consultative Committee of Accountancy Bodies

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The Institute of Chartered Accountants in England and Wales
The Institute of Chartered Accountants of Scotland
The Institute of Chartered Accountants in Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Chartered Institute of Public Finance and Accountancy

By email: h.osullivan@frc-apb.org.uk

Dear Hazel

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

The Consultative Committee of Accounting Bodies (CCAB) Ethics Group is pleased to respond to your request for comments on the APB's consultation on audit firms providing non-audit services (NAS) to listed companies that they audit, issued in October 2009.

The member bodies of the CCAB represent over 450,000 members and students in the United Kingdom in all areas of business, practice and the public sector.

We set out below our responses to the questions asked in the consultation paper.

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?

In responding to this question we need to distinguish between whether the provision of NAS constitutes an insuperable threat to auditor independence and whether it is perceived to do so.

As regards the first aspect NAS provision clearly does pose threats, as discussed in the Ethical Standards and the consultation paper. However the degree of threat and whether it is insuperable or not, varies from case to case. We are not aware of academic, legal or regulatory evidence which conclusively indicates that these threats have resulted in a reduction in the quality of listed company audits. This suggests that the current independence regime, which builds on the underlying professional requirements with certain specific prohibitions, a general requirement to assess threats and apply safeguards or decline the engagement, discussion with the audit committee and disclosure of NAS fees, is effective.

We accept that there remains a perception in a few quarters that NAS provision diminishes audit quality, as confirmed by some of the academic research referred to in the consultation paper. We do note that the Treasury Select Committee report that precipitated the consultation was focused primarily on remuneration and governance issues in the banking sector and accepted that there was no suggestion that auditors had not fulfilled their duties properly. We also note:

- the lack of pressure for change, observed in the APB's consultations over the last two years, referred to in paragraph 5.2 of the consultation paper; and
- the decline in NAS fees for FTSE100 companies in absolute and relative terms, referred to in paragraph 5.4 of the consultation paper.

We believe that that the absolute level of impact on confidence is now less than when it was last addressed as a major potential issue, post-Enron, and that the demand for change is not widespread across all stakeholder groups, nationally or internationally.

(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.

We have considered the UK and Irish listed audit market since the advent of the post-Enron reforms. We are not aware of any instances where adverse audit quality can be attributed to the provision of non-audit services by accounting firms

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 'Dart' survey referred to in the academic research appended to the consultation paper, notes that investor concerns are mainly being about internal audit, valuation, investment advice, bookkeeping and actuarial advice. However, we note that it also commented that investors perceive the requirements of the Ethical Standards to be sufficient safeguards.

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: as noted above, we believe the current regime is appropriate. To the extent that there are potential improvements (see below), we do not believe they fall within the scope of the Ethical Standards.

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 noted above, we do not believe that further restrictions are needed in NAS provisions of the Ethical Standards. We do believe, as the issue being addressed is one of perception, that transparency in NAS provision is vital. To that end we advocate a change in the legal requirements on NAS fee disclosure to improve clarity as to what is audit, what is audit-related and the nature of other significant NAS provision.

We do not see that there is a strong case for requiring pre-approval of all NAS by the audit committee provided there is proper disclosure of the policy adopted by the audit committee. Sometimes NAS can be needed rapidly and an indiscriminate pre-approval process can be impractical.

The corporate governance requirements for listed entities recognise the key role of audit committees by requiring them to establish a policy for the approval of NAS and to make appropriate disclosures. The best current practice involves setting out the approval policy and commenting on major NAS provision. We commend this for all listed entities.

This combination of disclosures gives investors the opportunity to make their own assessment.

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.

The underlying principles of professional ethical behaviour, including objectivity, are absolute. Adherence to independence requirements is one of a number of means to ensuring objectivity. Where there are alternatives, we believe any absolute independence requirements should be subject to impact assessment.

The provision of NAS by the auditors is often more timely, effective and cost-efficient than by others. In the case of small businesses in particular, the realistic option to the auditors being involved is often no professional at all.

Examples of situations where the provision of NAS is of crucial importance to preserving UK jobs include companies in financial distress, and those subject to hostile takeover bids. In such circumstances, the work usually needs to be performed to a tight deadline and auditors' cumulative knowledge will often make them the only realistic provider.

While the consultation is restricted to listed companies (itself a much wider sector than the Treasury select Committee was considering in its report), there are many companies within the APB's definition of 'listed', including those on AIM and Plus-Markets, which are very small, as are a number of other entities which might be considered to be public interest entities (for example some charities). The potential benefits of NAS provision will be particularly noticed by them.

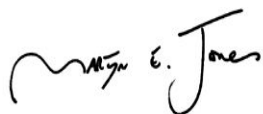
This should also be borne in mind should the APB be considering extending any potential changes to unlisted entities. In any case, there is a much greater connection between shareholders and managers in such entities so there are unlikely to be relevant stakeholders for whom perception issues referred to above could arise.

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

Although set out in different manners, the absolute requirements within the Ethical Standards are not dissimilar to those of the International Federation of Accountants or even those of the SEC in most areas related to the provision of NAS by auditors. A move further away from these recognised international positions would make the provision and receipt of services to and by international companies more complicated and be against the general thrust of convergence advocated by, amongst others, the G20 and the European Commission. The Commission has backed up its stance by referring the French authorities to the European Court of Justice on the grounds that the latter's sweeping NAS prohibitions unduly restrict the freedom to provide services.

If you have any queries please do not hesitate to contact us,

Yours sincerely

A handwritten signature in black ink that reads "Martyn E. Jones". The signature is written in a cursive style with a large initial 'M' and 'J'.

MARTYN JONES
Chairman, CCAB Ethics Group