

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

### **Comments from Professor John Arnold, Non-Executive Director and Chair of the Audit Committee, PZ Cussons PLC**

From the (auditee) company's point of view, non-audit services should be provided by the most appropriate and effective supplier. If that supplier is the company's audit firm, it is the responsibility of the audit committee to ensure that there is no impact on the independence of the audit. Current provisions provide guidance to ensure that auditor independence is maintained. Replacing the judgement of the audit committee with a rules-based regulatory framework would harm the company's ability to choose the supplier able to provide best value and hence damage the company's competitiveness.

The above conclusion depends on:

1. The audit committee having appropriate procedures in place to evaluate potential conflicts of interest;
2. The company having appropriate reporting procedures in place to enable shareholders to reassure themselves that no conflicts of interest exist.

Provided the above conditions are met, it is possible furthermore that audit quality itself will be improved by the audit firm's deeper understanding of the company's business.

The academic evidence summarised in the consultation paper provides little clear evidence that there is a problem, especially post-2004. If there is an issue, it seems to be primarily with the perception of investors that the quality of the audit may be reduced if the audit firm provides other services. If this is an issue, it should be addressed by improved reporting disclosure rather than by prohibiting the provision of non-audit services by the audit firm.

In response to the specific questions posed:

#### **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?** Not within auditee companies provided their audit committees have appropriate procedures in place to assure the independence of the audit. Shareholders and other users of company reports may have reservations about the independence of the audit if non-audit services are provided by the auditing firm unless adequate and appropriate disclosure is made in the company's annual report.

**(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?** No.

**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.** If external users lack confidence in the auditor's independence because they perceive a conflict of interest that is not addressed adequately in the annual report, it is likely that the provision of any non-audit services would be cause for concern.

**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?** Possibly – see the last two bullet points below.

**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 nonaudit services by accounting firms to their audit clients within the Ethical Standards for Auditors;** No.
- o **The imposition of other requirements through the Ethical Standards for Auditors (and if so which);** No.
- 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;** Audit committee or board approval should be required where any possibility exists of the auditor's independence being compromised, ie in most situations where non-audit services are provided by the audit firm.
- o **Better (and more extensive) disclosure in financial statements.** This is an important area to explore further in order to address the issue of a perceived lack of auditor independence. I understand that a working group of the Institute of Chartered Accountants of Scotland is currently developing proposals for enhanced disclosure in this area.

**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 benefits should at least be recognized:

- More choice in being able to identify the best supplier for the service.
- Better quality audit resulting from the audit firm's greater understanding of the company's business.

The benefits are less about cost savings and more about the increased quality of audit and other services.

**6 Are there any other views that you would like the APB to take into account?** As noted earlier, any further restrictions on a company's ability to choose the best supplier of non-audit services would inevitably adversely affect the company's competitiveness.

John Arnold  
18 January 2010