

Auditing Practices Board

Consultation on amendments to the APB Ethical Standards for Auditors

November 2011

Invitation to comment

1. Following an extensive consultation on the provision of non-audit services by auditors, revisions to the APB Ethical Standards for Auditors were published in December 2010. Since that date two issues have arisen which the APB proposes to resolve through further amendment to the standards.
2. The APB invites responses to the two questions set out below.
 - a. Is it appropriate to extend the end date for the transitional arrangements in respect of the provisions set out in ES5, paragraph 95 from 31 December 2011 to 31 December 2014?
 - b. Is the proposed revised Appendix to ES 1 appropriate?
3. As this consultation is focused upon just two specific proposals, a shorter consultation period than normal has been set and letters of comment should be sent, so as to be received no later than **7 December 2011**. The APB would prefer to receive letters of comment in electronic form. These may be sent by e-mail to h.osullivan@frc-apb.org.uk. If this is not possible, please send letters of comment to:

Hazel O'Sullivan
Project Director
The Auditing Practices Board
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

All comments will be regarded as being on the public record and will be published on the APB's website within seven days of receipt, unless you specifically request that your response be treated as confidential.

Tax services provided on a contingency fee basis

4. Some tax advisory engagements relate to situations where the tax law is uncertain and can only be determined at a date some time in the future, for example, after tax or judicial proceedings have been determined. As those proceedings often take a number of years to resolve, companies may be advised to protect their position by making tax claims (which will remain outstanding until the proceedings are concluded and the tax treatment is determined). Often the substantial majority, but not all of the work, in preparing the claim is undertaken early on.
5. In some situations, perhaps because the client regards the claim as somewhat speculative, the engagement is undertaken on a contingent fee basis – i.e. any eventual fee is tied to the outcome of the tax claim. As a result, any such fee cannot be determined until the outcome of the judicial process is known and any consequential work (in particular in agreeing the effect of the judicial decision upon the claim made) has been completed.
6. One of the amendments to the Ethical Standards that became effective in December 2010 prohibited firms from undertaking any tax services on a contingent fee basis for companies that they audit where the outcome is dependent on uncertain tax law. Recognising that firms were likely to have a number of uncompleted engagements of the nature described above, the revised Ethical Standards contained a transitional provision permitting firms to continue with such engagements until the earlier of the completion of the engagement or 31 December 2011.
7. Subsequent to the publication of the revised Ethical Standards, the APB was advised that a substantial number of such engagements are likely to remain unresolved for a number of years after 31 December 2011 (because of the time it will take for legal proceedings to be completed). From enquiries made by the APB, it is clear that a substantial number of such engagements will not be completed by 31 December 2011, that the majority of the outstanding issues relate to whether, and if so how, VAT should be levied, and that any tax that may be saved as a result of such claims has not been, and will not be, recognised in a company's financial statements until the claims are finalised.
8. Unless the transitional period is extended, audit firms will be prohibited from completing such contracts. When establishing the length of the transitional period, the APB was not aware that so many existing contracts would be affected.
9. The APB has considered in principle the fairness of retroactive changes to its Ethical Standards. As it did not intend its revision to the relevant Ethical Standard to have such a significant retroactive effect on contracts entered into prior to 31 December 2010, the APB has concluded that it would be appropriate for the transitional period to be extended from 31 December 2011 to 31 December 2014.
10. In reaching this decision, the APB noted that:
 - ES 4, paragraph 22 requires all contingent fee arrangements relating to the provision of non-audit services to listed companies to be disclosed in writing to those charged with governance; and
 - The amounts of any contingency fees under such contracts will be disclosed in the company's annual report in the year of payment^{1, 2}.

¹ The Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements)(Amendment) Regulations 2011.

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For the avoidance of doubt, the proposed transitional arrangement would only relate to contracts entered into before 31 December 2010 (as before) and that no relief would be given for any contingency fee contracts entered into after 31 December 2010.

11. The extension to the transitional period would be achieved by the addition of words to the transitional arrangement in paragraph 171 of ES 5, as indicated below:

Where compliance with the requirements of ES 5 would result in a service not being supplied, services contracted before 31 December 2010 may continue to be provided until the earlier of either:

- (a) the completion of the specific task or the end of the contract term, where this is set out in the contract; or
- (b) 31 December 2011 (or, in the case of services prohibited under paragraph 95, 31 December 2014)~~where a task or term is not defined~~, as long as the following apply:
 - the engagement was permitted by existing ethical standards (including transitional provisions);
 - any safeguards required by existing ethical standards continue to be applied; and
 - the need for additional safeguards is assessed, including where possible any additional safeguards specified by ES 5, and if considered necessary, those additional safeguards are applied.

² It is also appropriate to note that the UK Corporate Governance Code requires audit committees to explain to shareholders in the annual report how, if the auditor provides non-audit services, auditor objectivity and independence is safeguarded. Guidance in paragraph 4.38 of the FRC Guidance on Audit Committees provides that the explanation should include for each significant engagement, or category of engagements, what the services are, why the audit committee concluded that it was in the interests of the company to purchase them from the external auditor (rather than another supplier) and how auditor objectivity and independence has been safeguarded.

Disclosure of auditor remuneration regulations

12. Disclosure of information relating to the provision of non-audit services by auditors is the responsibility of companies when publishing full financial statements. New regulations associated with this disclosure have recently been published by the Department for Business, Innovation and Skills, the effect of which will be to better align the statutory disclosure categories with those in the Ethical Standards. Revised categorisations of audit and non-audit services in these regulations mean that the illustrative template for communicating information on audit and non-audit services in the case of listed companies which is contained in ES 1 can be simplified.
13. The new regulations apply to disclosures in financial statements covering periods beginning on or after 1 October 2011 but may be adopted earlier. As these are closer to the categorisations used in ES 5, the APB wishes to encourage auditors to use the new template with immediate effect rather than the old one so that more companies can use these new categorisations in their financial statements under the early adoption provisions. It is therefore proposed that the new template, which is set out below, will replace the current Appendix to ES 1 with immediate effect.
14. The proposed revised Appendix to ES 1 is shown on the following page:

APPENDIX: Illustrative template for communicating information on audit and non-audit services provided to the group

	Current year £m	Prior year £m
Audit of company	X	X
Audit of subsidiaries	X	X
Total audit	X	X
Audit related assurance services³	X	X
Other assurance services^{4 5}	X	X
Total assurance services	X	X
Tax compliance services (i.e. related to assistance with corporate tax returns)	X	X
Tax advisory services	X	X
Services relating to taxation	X	X
Internal audit services	X	X
Corporate finance services not covered above	X	X
Other non-audit services not covered above	X	X
Total non-audit services	X	X
Total fees	X	X
Occupational pension scheme audits	X	X
Non-audit services in respect of the audited entity provided to a third party ⁶ .	X	X

Disclosure of contingent fee arrangements under paragraph 22 of ES 4 can also be facilitated through the use of a footnote to this template.

Disclosures required under UK company legislation are indicated by those categories in bold type above. Fuller information can be provided by companies if desired.

³ This will, and will only, include those services which are identified as audit related services in paragraph 55 of ES 5.

⁴ This will not include any tax or internal audit services, all of which should be disclosed under those headings.

⁵ This will include assurance engagements such as those which involve reporting on historical financial information which are included in an investment circular in accordance with the Standards for Investment Reporting 2000 (Revised): Investment reporting standards applicable to public reporting engagements on historical financial information.

⁶ For example, where the audit firm provides transaction related services, in respect of an audited entity's financial information, to a prospective acquirer of the audited entity (see paragraph 12 of ES 5).