

MEETING SUMMARY

MEETING OF: APB Ethics sub-committee

DATE AND

TIME: Tuesday 6th April 2010 at 2.00pm

PLACE: Aldwych House - London WC2

PRESENT: Tony Bromell
Richard Fleck (Chairman)
Marek Grabowski
Jon Grant
Peter Hughes
Michael McKersie
Graham Pimlott
Minnow Powell

In attendance Tom Barrett

Staff:

APOLOGIES: Alyson Coates
Andrew Jones
Tom Troubridge

1. Introduction and minutes

Richard Fleck noted that he was due to report to the FRC Board on the results of the consultation at its 20th April meeting. He observed that he would advise that the APB was currently working through the responses and issues raised. He would be emphasising that there was overwhelming rejection of the proposition that there should be an outright prohibition on non-audit services but that there were certain areas where improvements could be made. There was a general view that audit committee disclosures of policies on non-audit services could be improved as well as the legislative requirements relating to the disclosure of categories of non-audit fees. There was also some support from investors for limited changes to the Ethical Standards with regard to restructuring and internal audit services.

The summary of the previous meeting was agreed.

2. Banding of non-audit services

There was further discussion of the possible criteria to be used to define a 'middle band' of non-audit services between 'audit' and 'other non-audit services'. There was some support for a revised definition using (i) the nature of the report and (ii) how 'closely related' the work was to an audit, and it was agreed that this would be discussed further once there was a clear list of which services would be covered in such a definition and which would not. It was also agreed that the APB would be asked specifically whether the notion of 'closely related' should involve a requirement that a significant part of the work should be performed by the audit engagement team.

It was agreed that words needed to be added to ES5 to explain the purpose of having a separate category of audit-related services and that, rather than requiring 'clearly inconsequential' threats to be documented there would be a statement to the effect that there was no presumption that threats were inconsequential and therefore the requirements of ES1 would apply.

It was agreed that the Paper on Banding would be updated to focus on the proposed approach arrived at after discussion with the Sub-committee, with additional questions on the further issues to be discussed,

3. Audit committee involvement in non-audit services

Proposed re-drafting of an excerpt from the Guidance on Audit Committees was reviewed. In discussion, it was thought that a link was needed to the banding of non-audit services and that there was a need to emphasise that the audit committee's exercise of judgement needs to be greatest in relation to other-non-audit services.

4. Magnitude of non-audit fees

Marek Grabowski described the analysis of non-audit fees of all listed companies and a sample of other public interest entities undertaken by staff. The ICC data, which was recognised to have some limitations, indicated that 17% of all listed companies had non-audit fees in excess of audit fees. It was agreed that these ratios were difficult to interpret without being sure whether Sarbanes Oxley work on internal controls had been classified as audit or non-audit. It was also noted that the ICC data also indicated that 49% of the total value of non-audit fees reported by all listed companies were reported by companies that had non-audit fees in excess of audit fees. There was a similar concentration of non-audit service fees in the sample of other public interest entities.

There was discussion about whether this information suggested that an overall cap on non-audit fees was desirable and, if so, whether it was possible to impose this on either auditors or audit committees. The latter approach was a matter for the FRC and that the FRC would be asked to consider additional guidance to audit committees along the lines suggested in paragraph 20 of Paper 3. It was agreed that an outright monetary limit on

non-audit fees would be difficult to impose on the auditor both because there would be practical difficulties in complying with one set sufficiently low to be meaningful and because this would unnecessarily restrict audit committees in making decisions in this area. However, further discussion by the APB was needed on whether the requirement in paragraph 18 of ES5 for the auditor to consider the magnitude of non-audit fees needs to be given added emphasis.

It was observed that further discussion of this issue needed to be linked to banding. There were different views in the sub-committee on whether any ratio should compare the sum of fees for audit and “audit related” services to fees for other non-audit services or whether the comparison should be between audit and other non-audit services (excluding “audit related” services fees).

5. Internal audit / extended audit services

Richard Fleck noted that APB would need to be made aware that the treatment of internal audit services in the IFAC Code was under review because some regulators and others were raising the issue that using the external auditor for internal audit services might weaken corporate governance.

Jon Grant introduced a staff paper on internal audit / extended audit services which included the results of the AIU survey into what ‘extended audit’ services had been provided to FTSE 350 companies in the last year. This indicated that while the number of ‘extended audit’ services appeared low there were a number of additional services provided which appeared to be similar to internal audit services.

There appeared to be inconsistency in the way that fees in relation to such work was classified. The paper proposed:

- (i) additional wording to ES5 to help determine what should be included in ‘audit’;
- (ii) additional guidance to be located in the Guidance on Audit Committees; and
- (iii) additional guidance for the internal audit services section of ES5 to emphasise the broad nature of the internal audit category and to distinguish between internal audit activities that involved consulting as opposed to assurance.

There was broad support for the approach adopted although it was recognised that much internal audit work involves giving advice and therefore it would be difficult to make a sharp distinction between consulting and assurance activities.

In relation to the description of what was 'audit' it was agreed that this needed to be checked against the ISA (UK and Ireland) definition of an audit to avoid any inconsistency and that further consideration was needed about how to classify fees for the statutory audits of overseas subsidiaries.

It was agreed that, although reporting responsibilities might be one indicator to consider when distinguishing between audit and non-audit services, given that many audit issues are reported to management in the first instance (encouraged by the new ISA 265) often with recommendations for improvements, it was agreed that the criteria for what was audit need not include specific reference to reporting lines.

The discussion about internal audit / extended audit services touched on the adequacy of the information provided by auditors to audit committees more generally and in particular whether ES1 para 59 should make explicit whether the nature of the threats involved needed to be communicated. It was agreed that this would be raised for consideration by the APB.

6. Restructuring services

The sub-committee discussed the latest drafting of a new section of ES5 on restructuring services and, in particular, the draft prohibition that would apply when restructuring services for listed companies involve the auditor undertaking a critical role in the restructuring plans when events or conditions exist that cast doubt on the audited entities ability to continue as a going concern. It was agreed that it should be clarified that this would not prevent the audit firm reporting in connection with a rights issue and that paragraph [Y] of the proposed draft to add in the "developing and executing" language from paragraph [X]. Further consideration should also be given to the term "executing" in these two paragraphs.

It was also noted that further information was needed from investors as to the nature of their concerns in this area, whether these justified the need for specific prohibitions and whether the proposed changes would adequately address their concerns.

7. March 2009 consultation

Jon Grant recapped on the actions that had been agreed at the 24th March sub-committee meeting. Further comments included:

- On governance roles the sub-committee was comfortable with adding 'Officer' as defined by CA 2006;

- The proposed definition of an affiliate was still unclear and impractical. It seemed desirable to adopt the definition in the IFAC Code but to clarify that both quantitative and qualitative aspects applied to the use of the word 'material' and that one of the qualitative aspects would be the nature and magnitude of the possible threats to auditor independence.

The sub-committee meeting ended at 5.45pm. It was agreed that the staff papers would be reworked and circulated to the sub-committee by the close of business on Friday, for comments before noon on Monday 12 April. They would then be circulated to the APB for further discussion at the 21 April Board meeting.