

Comments on the FRC Feedback Statement and impact assessment relating to its review of 2016 Auditing and Ethical Standards

Comments on Exposure Draft: Ethical Standard

Paragraph Reference	Comment
<p><u>Paragraph 2.4</u></p> <p>For each <i>engagement</i>, the <i>firm</i> and the <i>engagement partner</i> (in the case of the <i>engagement partner</i> insofar as they are able to do so) shall ensure that the <i>firm's</i> independence is not compromised as a result of conditions or relationships that would compromise the independence of a <i>network firm</i> (whether or not its work is used in the conduct of the <i>engagement</i>) or an other <i>firm</i> whose work is used in the conduct of the <i>engagement</i>, having regard to the ethical requirements in this Ethical Standard that are relevant to the <i>engagement</i>.</p>	<p>We note that the FRC is proposing to amend paragraph 2.4 of the supporting ethical provisions to remove the existing provision that permits other firms involved in the audit of an entity to apply the IESBA Code in assessing permissibility of non-audit services and we note that additionally the previous extension of the requirement to apply the Ethical Standard to network firms where the audited entity was a PIE have been removed such that the Ethical Standard would apply to all firms involved in the audit and in network firms to all audit clients. We would note that this extra territorial provision already gives rise to significant difficulties in its current format but that to propose an extension to all audit clients is unworkable. We support a principle of the international harmonisation of standards as such we don't support the principle of extra territorial application of national standards.</p>
<p><u>Paragraph 2.36 Loan Staff Assignments</u></p> <p>A firm shall not enter into an agreement with an entity relevant to an engagement, or with the affiliates of such an entity, to provide any partner or employee to work for a temporary period as if that individual were an employee of any such entity or its affiliates.</p>	<p>While we recognise the threats that the provision of loan staff give rise to in the context of Public Interest Entity audit clients which are usually large organisations with structures that enable them to readily source skills in the marketplace, the application of the prohibition to all audit clients will create difficulties for audited entities that are not PIES and that from time to time need to access support on a short term basis, often in situations where there is no local market for temporary staff with the required skills. Accordingly we would ask the FRC to consider the application of this prohibition in this context.</p>
<p><u>Paragraph 3.21 Other Partners and Staff Involved in the Engagement in Senior Positions</u></p> <p>In the case of public interest entities and other listed entities, the engagement partner shall review the safeguards put in place to address the threats to the objectivity and independence of the person or persons conducting the engagement arising where partners and</p>	<p>The inclusion of "periods prior to the firm's appointment as auditor" in paragraph 3.21 will give rise to significant challenges both in determining what constitutes a relationship and what period to consider. Accordingly we would ask the FRC to clarify what is intended so that it may be identified and managed by the firms for example, a team is usually identified during the period of the audit tender. If this requirement is intended to apply to everybody</p>

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<p>staff have been involved in the engagement, or been responsible for the relationship between the audit firm and the entity, including periods prior to the firm's appointment as auditor, in senior positions for a continuous period longer than seven years and shall discuss those situations with the Ethics Function / Partner.</p>	<p>participating in an audit tender it would make managing a gradual rotation mechanism more difficult.</p>
<p><u>Paragraph 4.10</u></p> <p>The <i>firm</i> and any of its network firms shall not provide any <i>non-audit /additional services</i>, in respect of an <i>entity relevant to an engagement, wholly or partly on a contingent fee basis</i>. Providing non-audit/ additional services on a contingent fee basis, can give rise to a perception that the <i>firm's</i> interests are so closely aligned with the entity that the integrity, objectivity and independence of the <i>firm</i> and <i>covered persons</i> could be, or seen to be compromised.</p>	<p>We note that the FRC is proposing to restrict the provision of non-audit services on a contingent fee basis to all audit clients both by the firm and its network. We would note that contingent fees are viewed by audit clients as a useful way of accessing services without incurring costs and thereby ensuring value for money. While we accept that there are self-interest threats, our view is that those threats are manageable, particularly for non-PIEs. We would also ask the FRC to consider the difficulties that applying this restriction poses for network firms where a group has operations in many jurisdictions and where a patchwork of different rules apply. This is particularly the case for audited entities that are subsidiaries of entities in other jurisdictions that permit contingent fees or where the group retains different audit firms in different jurisdictions.</p>
<p><u>Paragraph 4.19</u></p> <p>Where the <i>firm</i> and/or members of its network provide services to a group, the requirement in paragraph 4.18 shall apply on a group basis for all services provided by the <i>firm</i> and its <i>network firms</i> to all entities in the group and to their <i>connected parties</i>.</p>	<p>In the context of paragraph 4.18 and 4.19, we would note that while the FRC are not currently proposing to amend this paragraph it would be helpful if the paragraph was clarified to make it clear that the requirement to assess the ratio of fees for non-audit services applies when the firm is issuing an audit report on a group's consolidated financial statements i.e. that the requirement does not mean that the auditor of a subsidiary must consider the non-audit services provided by the network to affiliates.</p>
<p><u>Paragraph 4.43</u></p> <p>The <i>firm</i> shall establish policies on the nature and value of gifts, favours and hospitality that may be accepted from and offered to other entities, which are likely to subsequently become an entity relevant to an engagement and issue</p>	<p>We note that the FRC has extended the restrictions on hospitality to include "entities which may in due course become an entity relevant to an engagement". In line with our comments on paragraph 3.21 on rotation, the proposed inclusion of entities which may</p>

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<p>guidance to assist partners and staff to comply with such policies. Offering or accepting gifts, favours or hospitality to entities which may in due course become <i>an entity relevant to an engagement</i> may create a perception that the <i>firm</i> is not objective and independent from the perspective of an objective, reasonable and informed third party.</p>	<p>become audit clients would give rise to considerable and significant difficulties for firms, particularly in at a time when rotations are not always flagged in advance. We would ask the FRC to clarify that the intention is that this requirement would only apply to PIEs and only during the audit tender period.</p>
<p><u>Paragraph 5.40</u></p>	<p>This paragraph includes the heading “Services required by UK law or regulation and exempt from the non-audit services cap”. The subsequent bullet points clarify that the fee cap does not apply to third countries but would suggest that the heading is amended to state services required by law and not “UK” law.</p>
<p><u>Paragraph 5.42</u></p> <p>An audit firm undertaking the statutory audit of an entity relevant to an engagement, which is not a public interest entity, but meets the definition for <i>an other entity of public interest</i> shall follow the requirements in paragraphs 5.40-5.42.</p>	<p>We note that the FRC intends to extend the scope of the application of the fee cap on non-audit services to include audited entities within the scope of the FRC’s Audit Quality Review (i.e. AIM listed entities) and would ask the FRC to clarify the basis for extending the fee cap to entities that are not listed on regulated markets.</p>
<p><u>Paragraph 5.83</u></p> <p>The <i>firm</i> shall not provide litigation support services to:</p> <p>(a) a <i>listed entity relevant to an engagement, or a significant affiliate</i> of such an entity, where this would involve the estimation by the <i>firm</i> of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the <i>listed entity’s</i> financial statements, or in other <i>subject matter information</i> or <i>subject matter of the engagement</i>, either separately or in aggregate with other estimates and valuations</p>	<p>With respect to 5.83 b) we would ask the FRC to clarify the difference in the proposed paragraph for non-PIE entities versus the provisions applying to listed entities.</p>

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<p>provided; or</p> <p>(b) any other <i>entity relevant to an engagement</i>, where this would involve the estimation by the <i>firm</i> of the likely outcome of a pending legal matter that could be material to the amounts to be included or the disclosures to be made in the entity's financial statements, or in other <i>subject matter information</i> or <i>subject matter</i> of the <i>engagement</i>, either separately or in aggregate with other estimates and valuations provided.</p>	