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Dear Mr Ferris

Consultation: Revised ethical standard 2019

We welcome this opportunity to set out our views on the FRC's Exposure draft on Revised Ethical Standard 2019.

We support the review of the ethical standard to further reduce the scope for firms to provide extensive non-audit services to companies they audit. The 'whitelist' represents an appropriate mechanism to allow those services that best sit with the auditor. However, there are a small number of areas where the definition of the whitelist does not sufficiently capture activities where auditor remains appropriate:

- Banking transactions where the bank's auditor is acting for a third party issuer (the customer of the bank), and where there is a syndicate of banks involved. In most such cases the audit firm in question will audit the customer and one or more of the banks in the syndicate. This also applies to the use of accounting firms to provide independent banking review work as part of debt restructuring.
- Clarifying that reports from the auditor to any government sponsored agency (whether regulator, tax authority or other) are acceptable as well as addressing the need to cover off international requests for information from the auditor.
- Capturing services that are assurance related, but not part of the annual report (such as ISAE 3402 exercises).

In addition, there needs to be clarity on transitional arrangements; the new rules apply to activities of the subsequent accounting period or which commence after the effective date. Otherwise, projects in progress would need to be stopped and restarted, which introduces significant downside cost and delay. Grandfathering avoids undue cost and effort, but still prevents the unconstrained continuation of long-term projects. We recommend that these transition arrangements only extend up to December 2020.

We would be happy to meet to discuss our comments in more detail if this was considered helpful.

Yours sincerely

Matthew Waymark
Director of Finance

Responses to questions

Question 1 *Do you agree with the revised definition of an ‘objective, reasonable and informed third party’ and with the additional guidance on the application of the test?*

Yes.

Question 2 *Do you agree with our proposed measures to enhance the authority of Ethics Partners, and do you believe this will lead to more ethical outcomes in the public interest?*

Yes.

Question 3 *Will the restructured and simplified Ethical standard help practitioners understand requirement better and deliver a higher standard of compliance? If not what further changes are required?*

There remain some matters of judgment, but generally we support the exposure draft as providing increased clarity to the consideration of independence. We do believe that there will continue to be grey areas that require the application of judgment, but this is unavoidable.

Question 4 *Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?*

Yes. The widespread public interest and the clear expectation that a firm should have limited involvement with the companies they audit makes the use of a whitelist appropriate. However, we believe that there remains a number of activities that deliver assurance and/or support a company’s public reporting that should allow for the auditor to play a role:

- We do not believe the revised standard adequately addresses the delivery of banking services which include a role for auditors. The changes set out seek to address situations where the service provider audits the borrower, but do not adequately address distressed lending situations (independent banking reviews). This is particularly relevant in lending syndicates (given the potential for a wide range of audit firms to be represented through the lenders participating). We agree that in bilateral lending situations (single lender) then greater restrictions may continue to be appropriate.
- The articulation of work required from the Group (or subsidiary) auditor to overseas regulators is not complete. Some activities, such as Sarbanes-Oxley are from the group (UK) auditor to the US regulator – but this is explicitly scoped out of the current version.
- There is a range of work relating to the provision of assurance over controls of service providers (typically ISAE 3402 or SOC1 reports) to their customers that the auditor is uniquely well-placed to provide given their work on the audit. This is not provided for – the “third party” test only relates to services required by UK law and hence does not address this category of work. We believe this paragraph needs to exist under the heading of “services subject to the non-audit services cap”.
- There are a range of competent authorities (such as tax authorities and other government mandated bodies) that could be better articulated and for which the provision of reports by the auditor should be acceptable. Such authorities typically want auditors to confirm that submissions are made in line with the information used for the Annual Report.
- The revised standard allows for work to be undertaken where it is “integrated with the audit work”. This is a difficult test. We believe a better test would be “closely related to the audit in the view of those charged with governance”. We agree that in all cases it must be performed on the same terms and conditions as the audit. We note that since auditors have unlimited liability on the audit but not other services, that this is key to demonstrating the close relationship.

Question 5 *Do you agree with the additional prohibitions we are proposing to introduce – in learning from the experience of enforcement cases like BHS, if the more stringent PIE provisions are to have a wider application to non-PIE entities, which entities should be subject to those requirements?*

There have been recent changes to the Companies Act (section 172) which addresses the similar question of certain entities that are of heightened public interest but are not PIEs. We would support the application of equivalent rules to entities that met these definitions within the Companies Act.

Question 6 *Do you agree with the removal of the reliefs for SMEs in Section 5 of the Standard, and the retention of reliefs for ‘small’ entities?*

Yes.

Question 7 *Do you agree with the proposed removal of the derogation in the 2016 Ethical standard which allowed for the provision of certain non-audit services where these have no direct or inconsequential effect on the financial statements?*

For the exercise of judgment, it does not seem possible to exclude considerations of materiality (or inconsequence), but we recognise the concern that there may have been inappropriate use of this derogation to support services that should be prohibited. We believe that this element of the standard should be addressed through the “objective, reasonable and informed third party” test. In most cases it is unlikely that a very low value service from an auditor would point to an issue of independence but agree that it is possible.

Question 8 *Do you agree with the changes we have made to Audit Regulation and Directive references within the ISAs (UK)?*

No comment.

Question 9 *Do you agree with the inclusion of FRC staff guidance within the application material of the auditing standards, and has this improved clarity of the requirements?*

We support the provision of additional application material. In a similar fashion the Application Guidance and Basis of Conclusion provided by the IASB enhances the ability to interpret accounting standards.

Therefore, we support the provision of application guidance, and would further recommend that the FRC consider whether Basis of Conclusion documents would further enhance the publication of new standards.

Question 10 *Do you agree with the changes we have made to ISAs (UK) 700, 250 A and 250 B, including the extension of the requirement for auditors to report on the extent to which their audits are capable of detecting irregularities, including fraud.*

Question 11 *Do you agree with the proposed additional auditor reporting requirements, including the description of significant judgments in respect of Key Audit Matters and increased disclosure around materiality?*

Question 12 *Do you agree with the revisions we have made to ISA (UK) 720, including the enhanced material setting out expectations of the auditor’s work effort in respect of other information?*

Yes, we agree with the above changes.

Question 13 *We are proposing changes to the standards to be effective for the audit of periods commencing on or after 15 December 2019. Do you agree this is appropriate, or would you propose another effective date, and if so, why?*

We agree with the need to move in an expedited manner to the new standard. However, we do not believe enough information has been provided to enable firm/companies to manage transition for work that may have already commenced.

As a general rule, we believe that the restrictions should apply for the first accounting period following the effective date, and relate primarily to activities that commence after the effective date. It is likely that many activities will commence prior to the effective date, and may even have started prior to the publication of the exposure draft. Where these services complete in a timely manner we do not believe it is reasonable to force firms to incur delays and costs from changing supplier.

We recommend that enhanced transition arrangements allow for those services that commenced prior to the effective date to complete, except where they are long term projects. We would propose that services commenced prior to 15 December 2019 and which are completed prior to 15 December 2020 be permitted – but that services commencing after 15 December 2019 and which are relevant to 2020 audit are not permitted.