Ernst & Young LLP
1 More London Place
London
SE1 2AF

Tel: + 44 20 7951 2000
Fax: + 44 20 7951 1345
ey.com

Keith Billing
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

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By post & email: k.billing@frc.org.uk

Dear Keith

Auditing and ethical standards: Implementation of the EU Audit Directive and Audit Regulation

We welcome the opportunity to comment on the Financial Reporting Council's (FRC's) consultation paper: *Auditing and ethical standards: Implementation of the EU Audit Directive and Audit Regulation*. We set out in Annex I to this letter, our responses to the questions raised in the consultation paper. We are also responding to the Department for Business Innovation & Skills (BIS) discussion document: *Auditor regulation: Discussion document on the implications of the EU and wider reforms.* A copy of our response to BIS is included for ease of reference.

EY supports the FRC's aims for audit and the audit profession, including that audit and auditors serve the public interest. The EU Audit Reform Directive and Regulation will, however, affect other stakeholders (namely companies and investors) not just in relation to the statutory audit but in relation to how companies procure other strategically important professional services. In our view, it is vital that the full impact (both in terms of costs and benefits) of every option/proposal is considered in detail for each type of stakeholder, and with a view to the efficient operation of the UK capital markets.

We believe that audit committees should be empowered, so far as is permissible under EU and UK legislation, to exercise balanced judgment on behalf of shareholders. Placing external restrictions or conditions upon an audit committee, over and above those required by law, would risk diluting their authority and the principles of good governance.

We recognise that the UK is in a fairly unique position among EU Member States in that it has to bring together EU and UK reforms - the latter including both the FRC reforms and requirements in the Competition and Markets Authority (CMA) Order - to develop a new auditor regulatory regime. Given the complexity and lack of clarity as regards some of the EU requirements e.g. interpretation of the prohibited list of non-audit services in the EU Audit Regulation, we believe that the focus should be on implementing the EU regime for the EU definition of public interest entities (given that BIS does not propose to extend the definition). We believe that the EU and UK regimes should be separate and distinct and that changes to the latter should be the subject of further consultations with relevant stakeholders.

As a general comment, and as we highlight in our response to BIS, in developing the best possible regime for the UK we believe that the overarching principles should include:

- Seeking to ensure that requirements are as clear and simple to understand as possible for all stakeholders (including investors, companies and auditors). This should help to:
    - facilitate efficient adoption and consistent application by audit committees and auditors who carry out their duties on behalf of shareholders; and
    - enable shareholders to understand more easily what is required of companies and their auditors. This will help maintain confidence in the regime and empower shareholders to hold directors and auditors to account if they do not believe these agents are properly applying the regime.

  Achieving this is challenging in light of the complexity which already exists in the EU legislation, but it is within the UK Government's power to avoid further increasing complexity as it implements the EU requirements. Consistency of implementation where possible across the EU member states is another way to reduce complexity.

  However, pursuit of such simplicity comes with a note of caution. UK policymakers also need to be careful to avoid bringing in a swathe of previously uncovered companies and firms just to keep the audit regulatory framework uniform and simple. Careful consideration is needed to ensure that any extension of scope is proportionate to the risks posed by such entities to shareholders and the public interest. Such consideration should include ensuring there is broad support for any broadening from across the investor community *as a whole;* for it is the owners who ultimately bear the additional costs of increased regulation.

- Consistent with the UK Government's policy on implementing EU legislation, UK-specific additions should be exceptional, proportionate and justified by a cost benefit analysis that considers the public interest and any effects on the competitiveness of UK companies and groups.

- The UK should continue to allow an auditor to provide a non-audit service(s) (NAS) to the company it audits if, as FRC suggests, an objective, reasonable and informed third party would not conclude that the auditor's independence is compromised by providing that service, and that service is not prohibited by the Regulation.

We hope that our comments are helpful. We would be happy to provide further particulars on any of the points raised or discuss our responses in more detail. Please do not hesitate to contact me.

Yours sincerely

Andrew Hobbs
Partner
Regulatory & Public Policy

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Annex I: Responses to consultation questions

AUDITING STANDARDS (SECTION 1)

Q1. Do you agree that the FRC should, subject to continuing to have the power do so after the Audit Directive and Regulation have been implemented, exercise the provisions in the Audit Directive and Audit Regulation to impose additional requirements in auditing standards adopted by the Commission (where necessary to address national law and, where agreed as appropriate by stakeholders, to add to the credibility and quality of financial statements)?

Yes. That said, we are supportive of EU-wide adoption of International Auditing Standards (ISAs) to promote consistency within the EU and consistency internationally and mitigate the risks posed by having a patchwork of rules. Differences in implementation create added complexity for companies, their auditors and shareholders.

PROPORTIONATE APPLICATION AND SIMPLIFIED REQUIREMENTS (SECTION 2)

Q2. Do you believe that the FRC's current audit and ethical standards can be applied in a manner that is proportionate to the scale and complexity of the activities of small undertakings? If not, please explain why and what action you believe the FRC could take to address this and your views as to the impact of such actions on the actuality and perception of audit quality.

Other stakeholders are better placed to answer this question.

However, as a general comment, we support the Government's approach to small and micro-sized companies in the Better Regulation Framework Manual i.e.: "Regulatory measures should only extend to small and micro-businesses where any disproportionate burden is fully mitigated".

We believe, therefore, that it is appropriate for the FRC to consider whether its audit and ethical standards can be applied in a manner that is proportionate to the scale and complexity of small undertakings.

Q3. When implementing the requirements of Articles 22b, 24a and 24b, should the FRC simplify them, where allowed, or should the same requirements apply to all audits and audit firms regardless of the size of the audited entity? If you believe the requirements in Articles 22b, 24a and 24b should be simplified, please explain what simplifications would be appropriate, including any that are currently addressed in the Ethical Standard 'Provisions Available for Small Entities', and your views as to the impact of such actions on the actuality and perception of audit quality.

Other stakeholders are better placed to answer this question.

EXTENDING THE MORE STRINGENT REQUIREMENTS FOR PUBLIC INTEREST ENTITIES TO OTHER ENTITIES (SECTION 3)

Q4 With respect to the more stringent requirements currently in the FRC's audit and ethical standards (those that are currently applied to 'Listed entities' as defined by the FRC) that go beyond the Audit Directive and Regulation:

(a) should they apply to PIEs as defined in the Audit Directive?

(b) should they continue to apply to some or all other Listed entities as currently defined by the FRC? If so, which of those requirements should apply to which types of other Listed entities?

This is a complex question which, without further information, is difficult to answer. So that all respondent stakeholders, not least investors, may answer these questions on a more informed basis, it would be helpful if the FRC could set out in more detail the pros and cons of the various policy options, together with an impact assessment, for each of the entity categories that would be effected.

While this is being done, we believe that the focus needs to be on implementing the EU requirements for PIEs and on making those requirements as clear and simple as possible for companies and auditors to follow.

As we stated in our response to BIS, we strongly support the Government's minimum implementation principle i.e., "that (save in exceptional circumstances) the UK does not go beyond the minimum requirements of the measure which is being transposed." This Principle applies to retaining stricter UK requirements and introducing new requirements (including taking up Member State options) that go beyond the minimum EU requirements.

We believe that time should be taken to review the UK domestic regime - which for clarity should be kept distinct from the EU PIE regime - and consider the risk that any extensions of scope could dilute the FRC's public interest focus. In particular, non-PIE companies covered by the FRC's Ethical Standards (ES) should be consulted as a separate exercise - perhaps dovetailed with the FRC's smaller listed company project - as they will have issues that merit spending time on and debating separately.

Q5. Should some or all of the more stringent new requirements to be introduced to reflect the provisions of the Audit Regulation apply to some or all other Listed entities as currently

defined by the FRC? If so, which of those requirements should apply to which types of other Listed entities?

See our response to Q4 above.

Q6. Should some or all of the more stringent requirements in the FRC's audit and ethical standards and/or the Audit Regulation apply to other types of entity i.e. other than Listed entities as defined by the FRC, credit institutions and insurance undertakings)? If yes, which requirements should apply to which other types of entity?

See our response to Q4 above.

In addition, unlisted entities, such as pension schemes, may currently use their auditor to provide a range of services under the IESBA provisions. However, these entities may not be aware that the FRC is proposing to extend the more onerous EU requirements. These entities would, therefore need to be consulted separately.

PROHIBITED NAS (SECTION 4)

Q7. What approaches do you believe would best reduce perceptions of threats to the auditor's independence arising from the provision of NAS to a PIE (or other entity that may be deemed of sufficient public interest)? Do you have views on the effectiveness of (a) a 'black list' of prohibited NAS with other services allowed subject to evaluation of threats and safeguards by the auditor and/or audit committee, and (b) a 'white list' of allowed services with all others prohibited?

As an overarching comment, we would suggest alternative terms to the concept of a "black list" and "white list" as these references could be regarded as pejorative. We suggest, and will use in our response, the terms "prohibited list" and "permitted list."

Of the two options, EY supports a prohibited list approach, which is based on clear principles that allow informed decisions to be taken should additional services, not currently contemplated, be developed.

To ensure consistency and a level EU playing field for UK companies, however, it is important that the UK does not over-implement the EU requirements and the Guiding Principles for Transposition[1] in relation to minimum implementation are applied to both the legislative and the non-legislative requirements.

As a general principle, if an objective, reasonable and informed third party would not conclude that an auditor's independence is compromised by providing a NAS, it is difficult to see where the public interest lies in the NAS being prohibited. Instead an audit committee should be able to evaluate and provide independent oversight over the procurement of permissible NAS. It is

[1] HM Government – Transposition Guidance: How to implement European Directives effectively

noteworthy that the audit committee's interests, in ensuring auditor independence is not compromised (thereby threatening audit quality), are entirely aligned with the interests of the shareholders the committee represents.

Arguments against a permitted list approach include that it:

- is too prescriptive and limiting (and could be inadvertently more limiting than intended);
- may restrict a PIE's ability to use its auditor urgently to perform NAS that have been omitted in error;
- is not future-proof;
- may inadvertently reduce the ability to innovate (e.g., for an auditor to provide services in relation to solvency and liquidity) potentially affecting projects looking at the future of audit; and
- may limit flexibility for the PRA, FCA and other regulators (including non-EU regulators such as the SEC), if they determine that the auditor should perform certain services; and
- is inconsistent with the approach of UK law and regulation which traditionally spells out what one cannot do, rather than says what one might do.

Particular interpretational challenges with the Article 5 prohibited list are set out in our response to BIS (see answer to Q23).

Q8. If a 'white list' approach is deemed appropriate to consider further:

(a) do you believe that the illustrative list of allowed services set out in paragraph 4.13 would be appropriate or are there services in that list that should be excluded, or other services that should be added?

(b) how might the risk that the auditor is inappropriately prevented from providing a service that is not on the white list be mitigated?

See our response to Q7 above for our comments on a permitted list approach.

If, however, the balance of stakeholder views support a permitted list over a prohibited list, and the FRC determines the benefits of a permitted list approach outweigh the costs/disadvantages, we would ask the FRC to take the following views into consideration.

As an overarching comment, the key question for any permitted list would be whether an objective, reasonable and informed third party would conclude that an auditor's independence is compromised by providing a NAS. If there is no risk to independence, we do not believe there is any reason to not allow a service. The list should, therefore, be reviewed and consulted on periodically, to identify any services that have either been omitted in error or have been included but have subsequently given rise to concerns.

Permitted services

In our view, it would not be in the interest of companies, their shareholders or the capital markets - both in terms of efficiency and expediency - if a company could not use its auditor to perform

certain services that do not impair independence. Moreover, shareholders may also take comfort from an auditor's involvement in the provision of some services. These include capital markets transactions particularly where:

- *A working capital report is issued* - there may be substantial overlap with the consideration of going concern in the context of the audit of the financial statements, and third parties such as investors may take comfort if the service is provided by the audit firm;

- *Auditor comfort letters* – whilst not required by regulations, they are typically requested on just about every capital market transaction. There are also certain comfort letters that cannot be issued without having an "audit base". Theoretically another firm could obtain an audit base just to issue a comfort letter, but it is unlikely that many firms would wish to take on this work because of the risk issues. Even if they did, the cost to the company – and ultimately the shareholders – would be significantly increased and on some transactions there would not be the time for another firm to obtain knowledge equivalent to an audit base;

- *Reporting on pro forma financial information in a circular/prospectus* – it is much more difficult for a non-auditor to do this work (assuming another firm is prepared to do so if they are not the auditor). As the auditors already understand what is in the accounts and what the accounting policies are, there would be efficiencies to the company – and ultimately the shareholders - if the audit firm was to provide this service;

- *Reporting on profit forecasts* – it is possible for a firm, other than the auditor, to provide this service but an alternative provider would need to take on much more risk than the auditor because they are unlikely to have the same knowledge of the company as the auditor. To manage this risk, the provider would need to acquire knowledge of the company quickly or face significant risk issues and increase its fees as a consequence. From a company perspective it would take longer to engage another firm (and there might not be time to do so in a takeover situation) and therefore cost more. Users may also take more comfort if the report is provided by the auditor. Also, in Takeover Code transactions the timetable may mean it is wholly impractical to use someone other than the auditor;

- *Investment circulars, for example, Class 1 disposal circulars* - all information in the shareholder circular is likely to be derived from the accounting records of the company and the services will involve working capital report and pro-forma reporting and a comfort letter (see above). Again, it is theoretically possible for firms other than the auditor to provide these services, but as the work requires an understanding of what is in the financial statements, the accounting policies and the business in general, it would be very inefficient for the company and ultimately the shareholders.

As an example, in October 2013 the Takeover Panel introduced a new requirement that a cost saving statement in a defence document had to be reported on by a reporting accountant. Given the significant time constraints, relevant knowledge of the existing audit firm and other potential reporting accountants being conflicted (as it would be a non-recommended bid), it could severely prejudice the shareholders' interest if the company was not able to use its auditor.

It will also be important to ensure that the PRA and FCA have flexibility to ask the auditor of a regulated firm to provide any NAS they consider necessary. We assume that services required by regulators - including non-EU regulators - would fall under Article 4.13 but it is important to ensure that other regulators' powers are not fettered by a lack of clarity and/or flexibility. An auditor of a financial services firm will also have a direct relationship with, and be under a duty to report to, the Prudential Regulation Authority or Financial Conduct Authority.

As regards the FRC's illustrative list of permitted services set out in paragraph 4.13, we agree with this list subject to the comments set out in this letter, including the following specific comments:

- *Reporting required by law or regulation to be provided by the auditor* should (if the FRC goes ahead with its proposals to extend the NAS restrictions outside the EU) be read as including non-EU legislation/regulation and non-EU regulators of EU firms or groups including EU firms. For example, under SOX, the SEC requires firms to have an integrated audit engagement letter in place and the auditor to perform control testing. It should also include auditing standards.

- *Reporting on regulatory returns* should include Corep, Finrep, CCAR and BSC239, which are typically driven from the same processes and information as the financial statement audit.

- *Reporting on government grants* should include R&D tax credits, as Government may take comfort from the auditor doing this work

- *Reports required by the competent authorities / regulators supervising the audited entity, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider.* We strongly support the inclusion of this category of NAS. In particular, it would include skilled persons reviews (s166 and s165 reports) where the provider is required to be objective. Often the choice of providers is limited due to conflicts with providers who are supporting the business or the need to secure a skilled person with appropriate skills. We believe that it is, therefore, important for use of the auditor to remain an option for such benchmarking and independent assessments. We would suggest that the wording is, however, changed to "agreed with the entity" rather than "identified to the entity" as an entity might identify issues, for example with the limited choice of provider.

- *Audit and other services provided as auditor of an entity, or as 'reporting accountant', in relation to information of the audited entity for which a reasonable and informed third party would conclude that the understanding of the entity obtained by the auditor for the audit of the financial statements is relevant to the service, and the nature of the services would not compromise the auditor's independence and objectivity.* We strongly support the inclusion of this category in a permitted list and believe that it which should include the capital market NAS discussed previously, for example, reporting accountant engagements for stock exchange listings and transactions, (effectively financial accounting and going concern due diligence) and performance track record and assurance opinions on model reviews.

  We also believe that this category should include:

- Assurance work (e.g. process assurance) relating to country-by-country reporting requirements;

- Work performed by the audit team that enhances the quality of the audit, e.g. review of non-financial controls or risk which feed into statements / reporting that fall under the auditor's responsibility, e.g., the company's viability statement.

There are other examples of services typically provided by the auditor which provide benefits to a broad group of stakeholders. For example, an ISAE3402 review or similar over the control environment at a service provider, which is then utilised both by the service provider and the clients of the service provider and their auditors. There are also a series of other reporting requirements that are similarly used, such as SOC 1&2 and ISO certifications, which should also be considered.

Mitigation of risks

We believe the risks identified by FRC as being associated with a permitted list should be mitigated by either:

- allowing, as a ring-fenced category, independent assurance services to those charged with governance or third parties and services that are required by law; or.
- incorporating "hallmarks" in the list to enable it to expand expediently to incorporate appropriate new or omitted services.

Under a "hallmarks" approach, a service that has some or all of the following characteristics could be automatically included on the permitted list:

- An objective, reasonable and informed third party would not conclude that an auditor's independence is compromised by providing the NAS (no self-review threat, management threat or advocacy threat)
- Legal/auditing standard requirement - e.g. a SOX404 opinion
- Based on standards issued by an independent third party e.g., professional bodies
- Objective is to provide assurance/comfort/opinion to third parties/those charged with governance;
- Certain level of independence/objectivity needed by service providers such as independence, legal / auditing standard requirements.

A hallmarks approach would be preferable to a grey area between the EU prohibited list and the FRC's permitted list, as we believe it will be more helpful in empowering audit committees to make balanced judgments on behalf of shareholders.

We do not believe that the permitted list should extend beyond the requirements of the prohibited list (i.e. it should extend to the PIE, its EU controlled undertakings and its EU parent undertakings, but not to all group entities within and outside the EU).

Unless the permitted list includes sufficient "hallmarks", there may also need to be a process to enable companies/audit committees to request the FRC to allow/include another specific NAS or

hallmark. Requests would need to be determined by the FRC within a set time period e.g., the FRC could reach a decision on an exception basis, based on the individual facts and circumstances, within a short time frame e.g., five working days and then decide on whether to add the service on a permanent basis, based on consultation, within six months.

Q9. Are there NAS in addition to those prohibited by the Audit Regulation that you believe should be specifically prohibited (whether or not a 'white list' approach is adopted)? If so, which additional services should be prohibited?

Other stakeholders are better placed to answer this question.

We would note, however, that the prohibited list of NAS in Article 5 of the Regulation, which was heavily debated by both the EU Council and Parliament, is more stringent than the equivalent requirements at international level (the IESBA Code of Ethics) as well as those of our major trading partners outside of the EU, including the SEC/PCAOB.

As the FRC notes, "there may be relatively few services currently provided, other than audit related services, that would be permitted under the Audit Regulation." We do not, therefore, believe that any extension to the list is necessary to safeguard the public interest. The prohibition of additional services in the UK would also create inconsistency and added complexity for EU groups.

The audit committee will continue to provide independent oversight over the procurement of permissible NAS. The existing checks and balances in the system (pre-approval, disclosure, and financial limits) provide strong ex-ante safeguards. In addition to audit firms' policies and procedures to comply with professional standards, independent inspections of statutory audits by the competent authorities include ex-post assurance on auditor independence and the appropriateness of any NAS supplied.

If new service offerings are developed in the future and these are seen as creating threats to independence which are not sufficiently covered by UK Ethical Standards, then the option could be applied.

Q10 Should the derogations that Member States may adopt under the Audit Regulation – to allow the provision of certain prohibited NAS if they have no direct or have immaterial effect on the audited financial statements, either separately or in the aggregate - be taken up?

Yes. This option, which was debated and approved by the EU, will create the flexibility for companies to ask their auditors to provide immaterial - and in some cases very small pieces of work - in certain circumstances, without the costs and potential inefficiencies created by asking another firm to provide.

We believe that the option should be exercised in full to allow all the services listed. An objective, reasonable and informed third party is unlikely to conclude that an auditor's independence is

compromised by providing the range of taxation and valuation services set out in points (a) (i), (a) (iv) to (vii) and (f) and these services provide value to companies and their shareholders. The measures agreed by the EU are sufficient to safeguard auditor independence and provide oversight over the provision of such services. See also our response to Q11 below.

Q11 If the derogations are taken up, is the condition that, where there is an effect on the financial statements, it must be 'immaterial' sufficient? If not, is there another condition that would be appropriate?

Yes, immateriality is the best test we can think of and it is also consistent with existing independence rules in the UK and under IESBA. It is important to have a common approach across the EU to avoid creating unnecessary complexity for EU groups.

However, we believe that audit committees will welcome clarity on what is meant by services that "have no direct or have immaterial effect…on the audited financial statements" in the Article 5(3) derogation.

Q12. For an auditor to provide NAS that are not prohibited, is it sufficient to require the audit committee to approve such NAS, after it has properly assessed threats to independence and the safeguards applied, or should other conditions be established? Would your answer be different depending on whether or not a white list approach was adopted?

Permissible NAS are already subject to audit committee oversight, approval and public disclosure. They will now also be capped at 70% of the audit fee. We believe that these safeguards are sufficient but see also our answer to Q19 in our response to BIS.

Audit committees should be empowered to monitor and approve NAS without additional regulatory restrictions, as they are best placed to exercise judgment on behalf of shareholders. Placing external restrictions or conditions upon an audit committee would risk diluting their authority and the principle of good governance. The approach remains appropriate regardless of whether or not a permitted list is adopted by the FRC and seems to work well in the US.

Q13. When implementing the provisions of the Audit Regulation in the Ethical Standards, should the FRC require the group auditors of PIEs to ensure the principles of independence set out in the FRC's standards (including the provisions relating to the provision of NAS) are complied with by all members of the network whose work they decide to use in performing the audit of the group, with respect to all components of the group based wherever based? If not, what other standards should apply in which other circumstances?

Before answering this question, it is important to point out that network members outside the EU already have to apply the IESBA Professional Standards which cover prohibitions on providing NAS. Nothing in the Regulation changes this position.

Given the extensive debate on the application of the Audit Regulation at an EU level and the Government's Guiding Principles for Transposition[2] in relation to minimum implementation, we believe that UK implementation should be kept as simple and close as possible to the EU requirements.

Q14 When implementing the provisions of the Audit Regulation in the Ethical Standards, should the FRC require the group auditors of PIEs to ensure the principles of independence set out in the FRC's standards (including the provisions relating to the provision of NAS) are complied with by all other auditors whose work they decide to use in performing the audit of the group? If not, what other standards should apply in those circumstances?

See response to Q13 above.

AUDIT AND NON-AUDIT SERVICES FEES (SECTION 5)

Q15 Is the 70% cap on fees for NAS required by the Audit Regulation sufficient, or should a lower cap be implemented for some or all types of permitted non-audit service, including the illustrative 'white list' services set out in Section 4?

See the answer to Q19 in our response to the BIS discussion document, for our views on issues arising from the application of the provisions on the cap on NAS.

The 70% cap was agreed on after considerable debate in the EU Parliament and Council. Particularly given the nature of the NAS that the FRC proposes to permit (e.g. where an objective, reasonable and informed third party would not conclude that the auditor's independence is compromised by providing the NAS), we do not see any need to reduce the cap further.

Q16 If the FRC is made the relevant competent authority, should it grant exemptions from the cap, on an exceptional basis, for a period not exceeding two years? If yes, what criteria should apply for an exemption to be granted?

Yes. As noted above, it is important that there is sufficient flexibility for the FRC to provide exemptions from the cap. For example, companies with one-off major transactions may require urgent NAS that could exceed the fee cap in their own right. It would not be in the best interest of the company, its shareholders nor the market as whole, if the company did not have the ability to use its auditor to provide these NAS, provided an objective, reasonable and informed third party would not conclude that the auditor's independence would be compromised.

Whilst the impact will depend on the size of the audit fee, the transactions that could cause issues are complex class 1 acquisitions – especially where they result in a reverse takeover.

[2] HM Government – Transposition Guidance: How to implement European Directives effectively

For example, if a company needs to issue urgently, under the Takeover Code, a profit forecast in defence of a bid, the work may be subject to very tight timescales that might preclude the engagement of an independent firm of advisers. Where public reports are required, which is normally the case, such work is already subject to independence standards (Ethical Standards for Reporting Accountants).

Many exemption requests are likely to arise from unpredictable capital market events (e.g. takeovers) and be subject to tight deadlines. The FRC will, therefore, need a suitably proportionate and expedient application process that provides companies with certainty as quickly as possible. The FRC could, for example, have a fast-track process for any NAS that are likely to breach the cap but which are required by regulation (including the Takeover Code).

We believe that the FRC's existing criteria for granting exemptions from the 1:1 rule should apply to applications for exemptions from the cap (e.g. not frequent or part of a trend). However, it is important that the FRC does not overly fetter its ability to make a common sense decision if an exemption requested does not quite fit the criteria.

Q17 Is it appropriate that the cap should apply only to NAS provided by the auditor of the audited PIE as required by the Audit Regulation or should a modified cap be calculated, that also applies to NAS provided by network firms,?

No, given the extensive debate on the application of the Audit Regulation at an EU level and the Government's Guiding Principles for Transposition[3] in relation to minimum implementation, we believe that UK implementation should be kept as close as possible to the EU requirements. In particular, we do not believe that the calculation or scope of the cap on NAS should be amended by the UK to further restrict permitted NAS.

Q18 If your answer to question 17 is yes, for a group audit where the parent company is a PIE, should the audit and non-audit fees for the group as a whole be taken into consideration in calculating a modified alternative cap? If so, should there be an exception for any NAS, including the illustrative 'white list' services set out in Section 4, be excluded when calculating the modified cap?

N/A

Q19 Is the basis of calculating the cap by reference to three or more preceding consecutive years when audit and NAS have been provided by the auditor appropriate, given that it would not apply in certain circumstances (see paragraphs 5.3 and 5.15)?

[3] HM Government – Transposition Guidance: How to implement European Directives effectively

Given the extensive debate on the application of the Audit Regulation at an EU level and the Government's Guiding Principles for Transposition[4] in relation to minimum implementation, we believe that UK implementation should be kept as close as possible to the EU requirements.

Q20 Do you believe that the requirements in ES 4 should be maintained?

Yes, this is a tried and tested approach which is understood by users.

Q21 When the standards are revised to implement the Audit Directive and Regulation, do you believe that these more restrictive requirements in ES 4 should apply with respect to all PIEs and should they apply to some or all other entities that may be deemed to be of sufficient public interest as discussed in Section 3? If yes, to which other entities should they apply?

See our response to Q4 above.

We believe that the distinction between PIEs and non-PIEs should be kept as clear as possible and the domestic and EU regimes kept simple, separate and distinct.

Q22 Do you believe that an expectation that fees will exceed the specified percentages for at least three consecutive years should be considered to constitute an expectation of "regularly" exceeding those limits? If not, please explain what you think would constitute "regular".

Yes, we support the interpretation of "regularly" i.e. it is a pattern and not a spike caused by a one-off major transaction. However, it is important that the FRC does not unduly fetter its ability to make common sense decisions in exceptional circumstances.

RECORD KEEPING (SECTION 6)

Q23 Should the FRC stipulate a minimum retention period for audit documentation, including that specified by the Audit Regulation, by auditors (e.g. by introducing it in ISQC (UK and Ireland) 1)? If yes, what should that period be?

The RSB rules cover record keeping now and under the ICAEW Audit Regulations we are currently required to keep our audit records for at least six years.

If the FRC is minded to introduce additional requirements, we regard six years as an appropriate period of time.

[4] HM Government – Transposition Guidance: How to implement European Directives effectively

AUDIT FIRM AND KEY PARTNER ROTATION (SECTION 7)

Q24 Do you believe that the FRC's audit and/or ethical standards should establish a clear responsibility for auditors to ensure that they do not act as auditor when they are effectively time barred by law from doing so under the statutory requirements imposed on audited PIEs for rotation of audit firms?

Yes. The EU reforms (and also the CMA's Order plus the UK Corporate Governance Code) are all predicated on the affected companies having responsibility for monitoring the audit appointments they make. This is a logical approach. Provided the obligation continues, we would have no objection to there also being a similar responsibility for auditors.

If responsibility is also placed on auditors then any sanctions for a breach need to be proportionate.

Q25 Do you believe that the requirements in ES 3 should be maintained?

We believe that, to ensure consistency and a level playing field, the requirements for UK PIEs should be consistent with the EU requirements.

Q26 When the standards are revised to implement the Audit Directive and Regulation, do you believe that these more restrictive requirements in ES 3 should apply with respect to all PIEs and should they apply to other entities that may be deemed to be of sufficient public interest as discussed in Section 3? If yes, to which other entities should they apply?

EY has always supported a 7 year audit partner rotation period as we believe that this strikes an appropriate balance between knowledge and independence in ensuring audit quality for shareholders. This period is also consistent with International Standards.

The mobility of the signing audit partner will also become an increasing challenge for all PIE auditors, given rotation and the significantly increased tendering activity. Assuming the UK opts for 10-year plus 10-year (i.e. 20 years maximum) tendering, one could argue that it is better to have seven year partner rotation (i.e. 7+7+6 year rotations) rather than five-year rotation (i.e. 5+5+5+5 year rotations) because there will be one less rotation to manage in that event.

We note that ES 3 (para 16) provides a degree of flexibility for audit partner tenures, in circumstances where a change in partner at a particular time would be detrimental to the interests of the company and its shareholders. This is a welcome compromise if FRC, on the back of stakeholder support, decides not to increase the current UK model of 5 year audit partner rotation.

CONSULTATION STAGE IMPACT ASSESSMENT

Q27 Are there any other possible significant impacts that the FRC should take into consideration?

We have no additional comments at this time.