



1 October 2019

FAO: James Ferris
Financial Reporting Council
8th Floor, 125 London Wall
London, EC2Y 5AS

Via email: AAT@frc.org.uk

Dear James,

Consultation: Proposed revisions to the 2016 UK Auditing and Ethical standards

The Corporate Reporting Users' Forum ("CRUF") welcomes the opportunity to comment on the consultation on revisions to the Ethical and Auditing Standards. It is supportive in principle of the intentions to enhance the rules in response to findings from recent audit enforcement cases and from audit inspections, regarding the quality and content of the auditor's reports in order to improve transparency about what is found in the course of an audit.

The CRUF's comments will be at a high level as the CRUF participants in this response will not necessarily have a highly technical and detailed knowledge of auditing. The views expressed herein will be driven by the outcomes looked for by users in regards to good corporate reporting and the assurance provided by audit in respect of good corporate reporting.

The CRUF's comments also recognise that other consultations or the implementation of their results, such as the Kingman and Brydon reviews, are occurring at the same time as this consultation and its conclusion. This may impact some of the results of some of your questions, such as question 5 if the definition of PIE changes. We have therefore answered your consultation on the basis that the FRC are trying not to anticipate the outcomes of the other consultations in this consultation's proposed changes to the Ethical and Auditing Standards.

The CRUF does not accept that recent corporate failures show that standards need to be strengthened. It is more inclined to believe that improved and/or increased transparency is likely to increase the chances of potential corporate failures being appropriately flagged in advance so that they are either prevented or better managed to protect value to shareholders and other key stakeholders.

The CRUF will also have a range of views on whether audit quality has actually declined as supposedly indicated by recent corporate failures, or by the audit firms' public inspection reports; whether confidence in the quality of audit has declined; and whether the expectations, especially of corporate reporting users, on auditors have continued to grow. At one end of the spectrum, participants will believe that audit quality is fine and at the other end that serious enhancements need to be introduced. However, it will be difficult for non-practitioners to describe what these enhancements should be beyond improved and/or increased transparency in reporting. Empirical evidence of the thousands of UK statutory audits that meet their standards, sought outcomes and are therefore fine, compared to the few corporate failures where management are probably more

to blame than auditors, suggests audit quality has not necessarily declined. Also audits and their quality should not be a solution to prevent corporate management failure. They should be a second line of defence in flagging potential corporate failures where management are not providing the information themselves.

Responses to the questions raised in your consultation document dated July 2019 that relate to the issues that concern investors are set out below.

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, we agree with the revised definition: such a person is informed about the respective roles and responsibilities of an auditor and those charged with governance and management of an entity, and is not another practitioner. The perspective offered by an informed investor, shareholder or other public interest stakeholder best supports an effective evaluation required by the third-party test, with diversity of thought being an important consideration. Other public interest stakeholders include such parties considered to be the stakeholders of a company for the purposes of meeting directors' obligations under s172 of the Companies Act 2006.

However, the definition should recognise the primacy of equity investors or shareholders or members as a whole in a company as stakeholders, as auditing under UK company law is for them only and they will be the primary users of audited financial statements. This is not to negate the public interest of other key stakeholders in an audit but tries to include a sense of proportionality to the determination of the application of the ethical principles. If there is too wide a body of stakeholders then there is likely to be too wide a view on such application of those principles.

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, we agree with the proposed measures to enhance the authority of Ethics Partners ("EPs"):

- If, in the context of a consultation with the EP, the firm decides not to follow the EP's advice in relation to a PIE engagement then the matter must be reported to INE's/Competent Authority/those charged with governance within the firm.
This external reporting requirement is critical to enhancing the visibility and authority of the EP.
- Quarterly reporting of all breaches to the Competent Authority (FRC/ARGA).
- Clarification that the EP should have at their disposal 'appropriately skilled and experienced staff'.

However, we do not expect this to lead to more ethical outcomes in the public interest as we generally believe that most, if not all, professionally qualified auditors will try to be ethical in their audit work. The measures will be supportive of ethical outcomes as they will increase an EP's authority. The effectiveness of an EP will depend more on their personal qualities and qualifications and those of the staff they have in their team.

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?

This question is better answered by practitioners and not by CRUF participants.

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

Yes, we agree that a list of permitted services will be helpful by providing additional clarity.

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?

Yes, we agree with the additional prohibitions:

- Internal audit services – previously allowable for non-PIEs where the firm did not expect to place reliance on the work done, and where the firm was not performing a management role.
- Recruitment services – previously limited to key management personnel.

The CRUF has no current suggestions on which non-PIE entities should be subject to the more stringent PIE provisions. However, we would suggest that you wait to see how the revised Ethical Standard is implemented over the next three to five years before deciding to extend it to certain non-PIEs as we expect audit firms to extend the requirements themselves in the interests of having consistent standards for all their audits.

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 (in Section 6 of the Standard)?

Yes, we agree as we expect firms to implement consistent ethical requirements for all their audits in due course.

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?

Yes, we agree as this is clearer due to no longer requiring a subjective judgement.

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

This is too technical for CRUF participants to have a view on.

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?

Like question 8, this is too technical for CRUF participants to have a view on and should be answered by audit practitioners. For both these questions, if practitioners indicate the revisions make the requirements clearer, we would support the changes.

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.

Yes, we agree with the changes and are awaiting the Brydon Review to consider broader questions about what the expectations of auditors are, or should be, in respect of fraud, and the legal and regulatory framework which is required to deliver on those expectations.

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

Yes, we agree with the additional auditor reporting requirements as this should improve and/or increase the transparency as mentioned at the beginning of our response that CRUF participants would look for.

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?

Our understanding of the revisions is that they should improve the auditor's work effort in respect of and reporting on other information in order to try and reduce the expectation gap between some corporate reporting users and auditors. If the revisions do this, we will support them. However, we also think that how auditors implement the revisions and report based on them will do more in reducing the expectation gap on work carried out by auditors on other information.

Like question 10, we agree that wider questions on the expectations of auditors in respect of other information should await the results of the Brydon Review.

Whether the simplifications of the Standard are beneficial will be best answered by practitioners.

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?

The CRUF has no issues with the proposed effective date of 15 December 2019.



About the Corporate Reporting Users' Forum (CRUF)

The CRUF was set up in 2005 by users of financial reports to be an open forum for learning about and responding to the many accounting and regulatory changes that affect corporate reporting. In particular, participants are keen to have a fuller input into the deliberations of accounting standard setters and regulators. CRUF participants include buy and sell-side analysts, credit ratings analysts, fund managers and corporate governance professionals. Participants focus on equity and fixed income markets. The Forum includes individuals with global or regional responsibilities and from around the world, including Australia, Canada, France, Germany, Hong Kong, India, Japan, New Zealand, South Africa, UK and USA.

The CRUF is a discussion forum. Different individuals take leadership in discussions on different topics and in the initial drafting of representations. In our meetings around the world, we seek to explore and understand the differences in opinions of participants. The CRUF does not seek to achieve consensus views, but instead we focus on why reasonable participants can have different positions. Furthermore, it would not be correct to assume that those individuals who do not participate in a given initiative disagree with that initiative. This response is a summary of the range of opinions discussed at the CRUF meetings held globally. Local country differences of opinion are noted where applicable.

Participants take part in CRUF discussions and joint representations as individuals, not as representatives of their employer organisations. Accordingly, we sign this letter in our individual capacity as participants of the Corporate Reporting Users' Forum and not as representatives of our respective organisations. The participants in the Forum that have specifically endorsed this response are listed below.

(Signatures)

Charles Henderson

Rupert de Borchgrave

Marietta Miemietz
Primavenue

Peter Parry
UK Shareholders Association