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18th March 2015

FRC Consultation: Auditing and Ethical Standards – Implementation of the EU Audit Directive and Audit Regulation ('the Consultation')

Dear Keith

Chartered Accountants Ireland and the Chartered Accountants Regulatory Board ('the Institute') are pleased to respond to the above consultation. We have responded to individual questions in the Appendix to this letter.

As Ireland's largest Recognised Accountancy Body for statutory audit and a Recognised Supervisory Body in the United Kingdom ('UK'), the Institute has contributed to the debate on reform of statutory audit both in Ireland and the UK and also to the EU process from publication of the EU Green Paper on statutory audit in 2010. The Institute has also been an active participant in Irish and UK government processes which have considered various issues regarding transposition of the 2013 EU Audit Directive ('the Directive') and the EU Audit Regulation ('the Regulation'). We remain supportive of initiatives aimed at continuing to drive audit quality and which underpin confidence in statutory audit.

Most recently, the Institute has responded to a similar consultation by Ireland's Department of Jobs, Enterprise, and Innovation ('DJEI') on the same subject. We are supportive of the EU intention of achieving a harmonised market for statutory audit services and harmonised regulatory regimes. However, given that Regulation 537/2014 contains, unusually, a series of Member State Options, it is unlikely that such regimes governing statutory audit throughout the EU will be identical. Public Interest Entities ('PIEs') will be subject to the Member State Options adopted in

their country of registration, so application issues may arise in cases where there are several PIEs in the same group but registered in different Member States. There will be similar implications when a PIE is part of a group with a non-EU parent. Undoubtedly, therefore, implementing the requirements of the EU reforms alone, and in particular, the Regulation, will impose additional costs and regulatory requirements on PIEs themselves and their auditors. On the other hand, in many places throughout its consultation document the FRC is adopting an approach which adds significantly to the scope and requirements of the EU reforms.

The optimal approach for achieving a harmonised application of the EU reforms throughout the EU is for Member States to implement those measures that are requirements of the Regulation and Directive without any additional 'gold plating'. We believe that this view is shared by the Department for Business, Innovation and Skills and its stated intention of not wishing to make 'unwarranted changes' in transposing the EU measures.

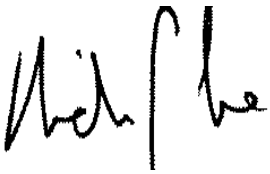
We consider that the EU reforms represent a comprehensive, transparent, and robust series of measures aimed at achieving its stated intentions without requiring additional measures by individual Member States unless such can be demonstrated as adding to improved audit quality.

Over many years the current arrangements between the FRC and Ireland as regards financial reporting and auditing standards have been positive for Irish business. Indeed, in our recent response to DJEI we have emphasised these arrangements which have also been beneficial to companies operating in both jurisdictions and have also been particularly important for accountancy bodies recognised in Ireland and the UK. However, the capital market in Ireland, differs significantly in terms of scale and complexity to the UK markets. We note that in paragraph 3.20 of the Consultation the FRC acknowledges that the UK capital markets are relatively more complex and sophisticated compared with other EU jurisdictions.

Given that the EU reforms are aimed in particular at capital markets, we have some concern that those proposals being considered by the FRC which go beyond the requirements of the Regulation and Directive may not be entirely appropriate for the Irish market. This could arise where the Irish government decides to apply the EU requirements in a manner which is different to the UK but which it considers to be more appropriate to Ireland's own circumstances. The potential consequences of this will need to be discussed and considered by relevant authorities, including the FRC, DJEI, IAASA, and indeed business and the audit profession.

We look forward to continuing to engage in the transposition process and to the next phase of FRC consultation.

Yours sincerely



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Appendix

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)?

We are supportive of the FRC retaining the ability to impose additional requirements where there is a consensus among stakeholders that such are necessary and result from specific legal or regulatory obligations. We do note, however, the comments of the Department for Business, Innovation, and Skills in its own consultation on the transposition of the Regulation and Directive that it does 'not want to make unwarranted changes'. So while we continue to support the principle espoused in the above question, such powers should only be exercised when there is clear evidence for so doing and where other routes of achieving the same purpose (such as through the International Auditing and Assurance Standards Board ('IAASB')) have been exhausted.

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.

We have always believed that current audit and ethical standards are capable of proportionate application. Indeed, the Institute publishes an audit product 'Procedures for Quality Audit' which is aimed specifically at audits of smaller audits and which, we believe, complies with the requirements of ISAs (UK & Ireland) and is widely used by member firms. Similarly the ES PASE appears to continue to work well.

We also consider that various publications previously issued by the Auditing Practices Board (Practice Note 26, for example) continue to be a valuable reference source for auditors of smaller entities.

Anecdotally, there do appear to be differences in interpretation of proportionate application, in particular, between practitioners and quality assurance inspectors. There may be merit in exploring this issue further by engaging in further debate on what proportionality means to these respective parties and how this can be demonstrated.

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.

As with our answer to Question 2 we do believe that such requirements should apply to all audits and are capable of proportionate application. Indeed much of what is required by Articles 22b, 24a, and 24b is already included in professional standards. The critical issue, as with our answer to Question 2, is arriving at a common understanding on what is appropriate for smaller audits. Some additional research on this issue may be helpful.

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?

Consistent with our response to the DJEI consultation in Ireland, we are not supportive of 'gold plating' any of the measures in the Regulation and Directive. These new requirements will represent a significant challenge to PIEs, and their auditors, involving new complexities and costs. Gold plating such measures by applying additional requirements in extant FRC auditing and ethical standards will undoubtedly add additional burdens to entities newly classified as PIEs. We are not convinced that the costs of this proposal will outweigh any identified benefits.

Implementation of the EU reforms provides the FRC with an opportunity to consider whether it remains appropriate to impose on UK listed entities requirements beyond those contained in the Regulation and Directive. To the extent that such additional obligations do not contribute positively to audit quality and represent significant additional burdens, then requirements should be harmonised with those mandated by the EU.

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?

Consistent with our response to Question 4 above we are supportive of the EU aims of achieving a harmonised market and regulatory regime for PIEs and their statutory auditors. The only way of achieving this is for all EU Member States to avoid further gold plating of the requirements in the Regulation and Directive. We are therefore not supportive of the suggestion contained in Question 5.

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?

No. See our response to Question 5.

Q7. What approaches do you believe would best reduce perceptions of threats to the auditor's independence arising from the provision of non-audit services 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 non-audit services 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?

The FRC suggestion of the introduction of a so called 'white list' represents a significant departure from the EU Regulation and is perhaps the most obvious example of 'gold plating' contained in the FRC consultation.

There is already ample evidence of companies reducing the use of their statutory auditors to provide non-audit services as audit committees, in particular, pay particular attention to the imperative of demonstrating auditor independence.

A 'white list' approach was not considered by DJEI during its recent consultation, nor are we aware of such being considered in any other jurisdiction. We do not support the concept of a 'white list'.

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?

We are not supportive of a 'white list' approach. Indeed, we believe that the provision of permitted services (with appropriate safeguards) to audit clients does enhance audit quality through permitting a deeper understanding by audit firms of client businesses.

Q9. Are there non-audit services 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?

The Regulation contains a comprehensive set of measures aimed at achieving the EU's stated objectives for audits of PIEs. For individual Member States to add additional prohibitions to an already comprehensive and restrictive list will cause further regulatory divergence and fragmentation, resulting in more regulatory complexity across the Single Market. The burden of such divergence will be most heavy on those PIEs operating in various Member States with different restrictions on the provision of non-audit services ('NAS').

The most efficient way of achieving consistency and a level playing field is to respect the comprehensiveness of the list of prohibited NAS as established by the Regulation. Not least of the measures in the Regulation is the importance attached to the role of the audit committee in policing what an entity buys from its auditor by way of NAS. We are not supportive, therefore, of this list being added to.

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

Consistent with our responses above, we believe that it is appropriate for Irish companies to be afforded the maximum flexibilities available in Article 5.3 in accordance with the safeguards detailed in that Article.

While there may be some interpretational issues to be addressed in availing of this Option, the provision of such NAS will be subject to approval by the audit committee – an appropriate and proportionate safeguard.

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. This has already been deemed appropriate within the EU Regulation. We are not aware of any compelling reason for an alternative approach nor what such an approach might be.

Q12. For an auditor to provide non-audit services that are not prohibited, is it sufficient to require the audit committee to approve such non-audit services, 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?

The package of measures contained in the Regulation as a whole is a sufficient and appropriate response to strengthening auditor independence and transparency on the awarding of NAS to the statutory audit firm. Article 5.4 of the Regulation regarding the role of the audit committee is an important component of these safeguards

Should a compelling reason arise in the future suggesting that a more strict approach be adopted, then additional safeguards can always be considered.

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 non-audit services) 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?

We are not convinced of how extraterritorial application of FRC Ethical Standards can be achieved. Such a measure, would, in our view, be counterproductive to achieving a harmonised regime both within the EU and beyond. Even if achievable, it would introduce unwarranted complexity.

We do not therefore support the proposal in this question.

The IESBA Code remains the appropriate basis for achieving harmonised ethical requirements for auditors.

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 non-audit services) 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?

As at Question 13 above, we believe the IESBA Code offers the best prospect of achieving uniform and consistent independence requirements for auditors.

We are not supportive, therefore, of the proposal in Question 14.

Q15. Is the 70% cap on fees for non-audit services 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?

Regulation 537/2014 constitutes a comprehensive package of measures aimed at underpinning auditor independence, providing greater transparency on the role of audit, and strengthening the regulation of auditors of PIEs through State delivery of regulation and supervision.

Taken as whole, we believe the measures in the Regulation of themselves (caps on fees for non-audit services ('NAS'), restrictions on the nature of NAS that may be provided by auditors, mandatory audit firm rotation) provide a sufficient and appropriate framework to achieve the above objectives without the need to for additional 'gold plating' by Member States.

Those most impacted by these measures, PIEs themselves, will look to implementation of these measures in a manner which keeps associated costs to a minimum and provide the necessary competitive environment to conduct business efficiently.

It is our position that the cap of 70% should not be reduced further.

The combination of the cap, new restrictions on non-audit services, and the strengthened role of audit committees will provide sufficient safeguards in respect of auditor independence.

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?

It makes sense to permit exemptions from the '70% requirement' subject to the agreement of the competent authority. It is not unusual for the auditor to be required to carry out additional work of a non-audit and non-routine nature – which may result in fees exceeding the cap – eg unanticipated due diligence, special investigations, responding to requests from regulators, mergers, and IPOs. The fact that this temporary exemption is subject to competent authority approval provides the appropriate safeguard. Measures elsewhere in the Regulation provide the necessary transparency.

Q17. Is it appropriate that the cap should apply only to non-audit services 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 non-audit services provided by network firms?

We are not supportive of such a proposal which serves to introduce additional complexity to an already complex Regulation. Consistent with our general opinions on transposition of the Regulation and Directive, the FRC/BIS should seek to align transposition with the EU requirements, avoiding any gold plating.

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 non-audit services, including the illustrative 'white list' services set out in Section 4, be excluded when calculating the modified cap?

We have answered 'No' to Question 17.

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

Consistent with our answers to related questions on this issue, we do not believe there is a need for the FRC/BIS to go beyond the requirements in the Regulation.

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

We have no evidence suggesting that the existing requirements in ES 4 which go beyond the EU requirements are causing any particular difficulties in practice. We have no particular objection to these thresholds remaining as is.

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?

Applying these criteria to all PIEs does go beyond the EU requirements. This may cause particular difficulties for smaller audit firms. Evidence based research would help assess the impact on such firms before deciding whether to apply the more restrictive ES 4 thresholds.

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. Our understanding is that 'three consecutive years' is established practice and, in our view, remains appropriate.

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?

We see no need to depart from the current practice where such requirements are specified in the Regulations of the Recognised Professional Bodies – currently 6 years.

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?

It is unclear why this issue has been singled out from any other issues regarding compliance with the law by statutory auditors. We believe auditors will be more than aware of the legal requirements with regard to the duration of audit appointments. Having a single point of reference (ie legislation) avoids the potential for confusion and inconsistent application or interpretation. PIEs themselves will also have a responsibility to ensure that the appointment of the statutory auditor is in accordance with legal requirements.

We are therefore not supportive of this proposal.

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

The current ES 3 requirement is more restrictive than the EU requirement of 7 years and also than the IESBA requirement of the same period. Given that the definition of PIEs may include entities (unlisteds) previously not subjected to the ES 3, five year requirement, this more restrictive rule may impact disproportionately on smaller audit firms. While we have no evidence in this regard, transposition of the EU Regulation affords the FRC an opportunity to revisit ES 3.

While the overriding priorities must remain audit quality and auditor independence, unless there is compelling evidence to the contrary, FRC should reconsider aligning partner rotation requirements with the EU Regulation and the IESBA Code.

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?

We do not support extending the measures of the EU Regulation and Directive beyond the minimum scope of these Instruments.

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

See our covering letter.