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Keith Billing Esq.
Financial Reporting Council
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Our Ref: CCW/SJG

Dear Mr Billing

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

We are pleased to provide the views of Crowe Clark Whitehill LLP on the questions set out in the consultation document.

Crowe Clark Whitehill is a mid-tier accountancy firm with eight offices and approximately 650 people. It is one of the nine 'major audit firms' and is a member of Crowe Horwath International, the ninth largest global accounting network

We fully support the need for a strong audit profession within the UK that provides appropriate assurance to the capital markets and other users of financial statements. That includes having a strong mid-tier of audit firms that provide competition with Big 4 firms and choice for the audit committees of companies. It is imperative that the UK maintains its reputation for high quality financial reporting and auditing and remains attractive to investors and the capital markets.

The adoption of the EU Audit Directive and Audit Regulation into UK law and practice is an opportunity to ensure there is clarity and consistency in the application of audit requirements across the EU which will benefit the wider investor community and companies as they make strategic decisions for their business.

Although we support the need for the UK to be able to make changes where required through UK law and national interest, we believe that these variations should only be made where there is a justifiable reason for doing so that is backed up evidentially.

At the current time in the UK there is no clear and consistent definition of a public interest entity in the context of financial reporting and auditing and this is also an opportunity to address that. Companies listed on AIM and ISDX are within the definition of 'listed' for ethical purposes but they fall outside the requirements for enhanced audit reporting (for example) within the auditing standards. The FRC's definition of 'major audit' which determines the scope of audits within the inspection remit of the Audit Quality Review team then brings in other entities , such as large private companies and LLPs, large charities and large pensions scheme, which are based on subjective criteria and where there is no clear rationale that identifies these as being of 'public interest'.

On the following pages we set out our responses to the individual questions set out in the consultation paper.

We have contributed and are signatories to the combined submission on this consultation from the Group A accounting firms and members of the Association of Practicing Accountants. We have also provided a submission to the Department of Business, Innovation and Skills on its discussion paper 'Auditor regulation - Discussion document on the implications of the EU and wider reforms'. Accordingly, the comments we provide in this paper should also be read in conjunction with those submissions.

Yours sincerely

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Consultation questions	Crowe Clark Whitehill response
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, we agree that the FRC should continue to have the power to impose additional requirements but we believe that where such additional requirements are imposed then these should be made only where: (a) It is necessary for compliance with national law or other regulation or (b) There is sound evidence based on appropriate research and experience to demonstrate such additional requirements are necessary to add to the credibility and quality of financial statements. There are a number of areas where current UK auditing standards and ethical standards go beyond what would be required after the implementation of the EU Directive and Regulation and we do not accept that this situation should continue into the future without a full justification of why this is appropriate. At the FRC Stakeholder event on 11 March, there was much discussion of whether the FRC should 'turn the clock back'. We do not accept that this is the issue and do not believe this is the appropriate mindset with which to approach the consultation.
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.	Yes, on the whole we believe that the auditing standards and ethical standards can be applied proportionately to the scale and complexity of small entities.
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	We believe the requirements of Articles 22b, 24a and 24b should be applied to all audits and audit firms except the requirements under Article 24a in respect of remuneration policies and performance policies. In an environment where auditors to smaller companies provide significant non-audit services then we do not believe it either workable or desirable for such a restriction.
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	There is currently no single, clear definition of what constitutes a public interest entity for the purpose of financial reporting and auditing. Indeed, within the FRC's own auditing and ethical standards there are a number of different interpretations: • From a company law perspective 'quoted' means

Consultation questions	Crowe Clark Whitehill response
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?	only those companies listed on the main market of the London Stock Exchange • Within ethical standards 'listed' encompasses both AIM and ISDX companies. • Auditing standards refer to entities that are required to apply the UK Corporate Governance Code (or voluntarily chose to do so – which can mean entities other than listed companies) • 'Major audits' that are within the scope of the Audit Quality Review team includes all companies listed on the main market plus AIM companies with a market capitalization of greater than £100m as well as a number of other types of entity. The current position is confused and lacks clarity. We suggest that the FRC should take the opportunity presented with the implementation of the EU Audit Directive and Regulation to remedy the position. BIS has indicated that it does not intend to apply the provision available to Member States to identify any other entities as PIEs beyond the minimum required. We believe that the FRC's approach should be consistent with that of BIS and, accordingly, there should be changes made to the auditing standards and the ethical standards to achieve this. The most significant of those changes would be to the ethical standards where companies listed on AIM and ISDX would be taken out of the scope of 'listed companies'. In terms of the definition of 'major audits' which is used as a basis for the scope for the work of the FRC's Audit Quality Review team, we believe this should also be reviewed and aligned with a single definition of 'public interest entity'. In this regard, it is our view that the fundamental issue to consider is not whether an entity (or class of entity) is of interest to the public but whether the public interest can be protected by having enhanced audit arrangements. Large private companies and AIM companies do not, ordinarily, carry the same level of public interest as companies listed on the Stock Exchange and they are not subject to the same regulatory environment. Although AIM listed companies have external investors, those investors should be aware of the higher risk associated with those investments. AIM companies are often relatively small companies who need a market to achieve their growth aims but that is not a reason for being classified as public interest. Arguably the same could be said for a number of companies at the lower end of the main London Stock

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	Exchange but there is not scope for UK legislation to deregulate beyond the EU minimum requirements. We do not believe large pension schemes should be PIEs as membership of each scheme is restricted to employees of the participating employers and so there is not a wide public interest in each scheme in its own right. The security of promises given to members is backed by the investment funds and in the case of defined benefit (DB) schemes the employer and where the employer fails the Pensions Protection Fund (PPF). The PPF is funded by employers that offer DB schemes and not the public purse. Large charities should also not be regarded as PIEs. There is no record of systemic risk of failure within large charities and although charities should be reporting their activities through annual reports, the risk of failure of a charity is not, we contend, linked to the truth and fairness of historical financial reports.
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?	No. Please see our response to question 4 above. We believe it appropriate to deal with the issue of defining PIEs first and then applying the provisions of the Audit Regulation proportionately.
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 question 4 above. We do not believe this is the appropriate question to consider as it implies that the FRC's approach of applying 'more stringent' requirements should continue and we contend that this should be the case only after an appropriate exercise to consider whether this is justifiable.
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?	We support the views expressed in the Group A/APA response. Overall, we believe the 'black list' approach is preferable to the 'white list' as we believe this provides greater clarity both auditors and audit committees on what non-audit services are or are not permissible.

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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?	As noted in question 7 above, we believe the 'black list' approach is more appropriate.
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?	There are no further non-audit services that we believe should be prohibited.
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?	Although we can see in principle that it may be attractive to adopt those derogations in the circumstances specified we foresee potential difficulties in applying those principles in practice.
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?	We believe the subjectivity involved in the non-audit service performed should be considered as well as materiality. Where services provided are more mechanical in nature (i.e. the degree of subjectivity is reduced) then there is less of a threat to the independence of the audit firm.
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?	Yes, we believe the audit committee (or board in the absence of an audit committee) to be the appropriate body to approve such services.

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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?	Yes. In order to preserve confidence in the objectivity and independence of the auditor we believe the principles should be applied consistently no matter where the component auditor is based.
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?	The way the question is phrased implies that the group auditor is somehow able to enforce compliance on another firm of auditors that is not within its own network. We do not believe that such an approach is either desirable or practicable. We do, however, believe the group auditor will need to satisfy themselves that the component auditors whose work they chose to use is appropriately independent for the assignment in question.
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?	Yes, we believe the 70% cap proposed to be both sufficient and appropriate.
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, we believe this is appropriate but note that the Regulation provides that the request for the exemption should come from the auditor. We believe that any such request should come only after appropriate consideration and approval from the audit committee. We recommend that the FRC should consult on what conditions would be regarded as 'exceptional'.
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 foresee practical difficulties in applying a modified cap that includes non-audit services provided by network firms. On balance we believe the cap should only apply to non-audit services provided by the group auditor.

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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?	Please see our response to question 17 above
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)?	Yes, we believe this approach is appropriate.
Q20. Do you believe that the requirements in ES 4 should be maintained?	No, we do not believe the requirements of ES4 should be maintained unless the FRC can provide evidential justification to demonstrate that to change the requirements would lead to a diminution in audit quality and/or a significant decrease in investor and market confidence.
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?	No, please see our response to question 20 above.
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".	We are not convinced that three consecutive years is the appropriate measure as the timing of work could be planned to ensure that the thresholds were not breached in a particular year. We would support an assessment of an average over a three-year period.
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 believe that the FRC should stipulate a retention period of 5 years as set out in Article 15

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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, we believe this to be appropriate.
Q25 Do you believe that the requirements in ES 3 should be maintained?	No. We believe that the requirements of Article 17 should be applied. Although the ES3 currently requires rotation of the audit partner after five years we are not aware of any empirical evidence that this rotation period enhances audit quality or has led to greater investor and market confidence when compared to the seven year rotation period. We would not regard any change as being a retrograde step and if the FRC wished to retain the five year rotation period then that should be after an appropriate impact assessment and full justification based on sound empirical evidence.
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?	Please see our answer to question 25 above. The question is promulgated on the assumption that the more stringent requirements of ES3 will remain, which we do not believe to be an appropriate starting point.
Q27. Are there any other possible significant impacts that the FRC should take into consideration?	No, but we believe that the FRC should ensure its focus is on proportionality in the application of the Audit Directive and Regulation.