

Appendix 2: Audit firm governance code: review of implementation and operation – views of our INEs

This addendum to the PwC response is submitted on behalf of PwC's independent non-executives and reflects their views on the FRC's proposals. References to "we" and "our" in the text below refer to the PwC independent non-executives ("INEs").

The purpose of the Code

The purpose of the Code as articulated in the 2010 document is unclear. A multiplicity of aims are referred to in the introductory section, which create the risk of complexity and confusion. We support the FRC's efforts to reconsider this area.

Because of this complexity, it is difficult for respondents to this consultation to answer the question on whether the Code has achieved its purpose. We believe that the most important element of the Code is the appointment of INEs by audit firms; their overall purpose in our view (and hence the overall purpose of the Code) is to strengthen the governance of an audit firm and through doing this to ensure that the public interest is taken into consideration when decisions are made.

As acknowledged in the consultation paper, the concept of the 'public interest' is extremely difficult to define. We support the comments made by PwC, in its covering letter to the response, regarding a framework for definition of the public interest. In our view, "ensuring that the public interest is taken into consideration when decisions are made" is an outcome which is achieved when the INEs carry out their function effectively. This is encapsulated in the purpose set out in PwC's covering letter to the response.

In the ongoing debate on the definition of the public interest, it is important that the FRC should not act alone. The ICAEW is also working on this area and we encourage collaboration between the regulator and the profession as a clearer articulation of the concept and its associated responsibilities is explored.

The consultation document (paragraph 16) proposes that the purpose of the Code should be "the promotion of high quality statutory audit in the interests of shareholders". We think that the outcomes achieved by the Code should not be restricted to shareholders of listed companies, but should benefit all users of audited published accounts. Many constituents of this wider stakeholder community have much at stake if high quality audit is not maintained. Shareholders have the ability to sell their shares and to diversify their holdings to minimise risk. Those such as suppliers, customers and employees, who have dependencies linking their livelihoods to audited entities, are not in this privileged position. The Code should explicitly recognise the needs of such stakeholders. However, the challenges in effective engagement with such a broad range of stakeholders should not be underestimated and the FRC should be mindful of that issue when considering the changes to the Code in the area of dialogue.

Accountability and appointment of the INEs

We support the comments made by PwC, in its covering letter and Appendix 1 to the response, concerning the accountability and appointment of INEs.

Governance structures

We do not regard the potential application of the Code's provisions throughout the international networks of audit firms as a necessary consideration for the FRC. As the trends towards globalisation and regionalisation continue, it will become even more important for UK INEs to focus on the risks to UK audit firms and to the UK public interest. This is reflected in the FRC's words in paragraph 40 of the consultation document regarding the importance of national governance structures. We agree, however, that the concept of including independent representation within audit firms' governance structures is valuable; it could be helpful for the FRC to discuss the model with peer regulators in other territories, to encourage their own consideration of similar arrangements.

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The consultation document suggests that specific governance structures could be introduced for the audit businesses of audit firms, in addition to arrangements overseeing the entire audit firms. We agree with the views expressed on this area in PwC's covering letter to the response and we do not believe that this measure is necessary. As PwC comments, further focus on audit quality could be introduced into the agendas of the existing governance bodies of firms.

Comparison with the UK Corporate Governance Code

We support the comments made in this area by PwC in its covering letter to the response. As noted above, the key element of the Code is the introduction of INEs into the governance of audit firms. We believe the FRC should carefully evaluate the benefits of future additions to the Code and consider reducing the length of the Code where this is possible.

We agree with the comments made by PwC, in its covering letter to the response, concerning the degree of prescription in some of the proposals for changes to the Code. The Code should always comprise a set of recommendations that those firms who adopt it voluntarily follow, rather than a set of mandatory requirements.

Interaction with the FRC

We agree with the proposal set out at paragraph 41 of the consultation document that there ought to be regular interaction by the FRC with INEs and/or the senior partners of the firms, on a bilateral basis rather than grouping all the firms together. The focus of these meetings should be to identify the elements of the Code that are working well, and those that are not.

Other matters

We note the inclusion in paragraph 77 of the consultation document of two areas where careful interpretation of the Code was required. One of these was a situation that PwC dealt with appropriately and on a timely basis, in order to ensure that any actual or perceived threat to independence was avoided.

In our view the Code does not need to be amended in respect of either of these two examples. In the PwC case, we were clearly able to interpret the Code and act accordingly. In the other example cited we believe there was a clear breach of the Code principles. However, recognising the increase in tendering activity inherent in the market, and the fact that many INEs may also sit on corporate boards, if the FRC wanted to indicate that the way in which PwC dealt with the situation was an exemplar of good practice, we would not object.

We hope you find these observations of assistance as you consider future changes to the Code. We would be delighted to discuss any of these points in further detail.