



Response to FRC Consultation: Audit Firm Governance Code – A review of its implementation and operation

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INTRODUCTION

ICAS welcomes the opportunity to comment on the FRC's Consultation – *Audit Firm Governance Code – A review of its implementation and operation*.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Any enquiries should be addressed to James E Barbour, Director, Technical Policy.

General Observations on Implementation of the Code

Lack of visibility

There would appear to be a lack of visibility of the Code's application to external parties. For example, we have received comments from those who make use of the services of audit firms that the firms do not appear to be referring to the Audit Firm Governance Code (AFGC) in their respective audit tenders.

Other than regulatory bodies, we are not convinced that any other users are making reference to the firms' respective transparency reports. Despite this, we also believe that the firms need to be able to articulate clearly what they are doing i.e. tell their story. Their reports should already be fair, balanced and understandable, so requiring this should not be an issue to the firms.

Pace of Evolution

Whilst we accept that times move on and revision of the AFGC is required, we have concerns that some of the proposed changes may be too radical in nature.

Responses to the Specific Consultation Questions

1 Firstly, and most importantly, is the stated purpose of the Code still valid?

We believe that the stated purpose of the Code is still valid. We understand that the inclusion of one of the original objectives, namely:

"Benefit capital markets by enhancing choice and helping to reduce the risk of a firm exiting the market",

was to ensure that the linkage to the Market Participants Group's recommendations was maintained. We were always doubtful on the extent to which the Code would help to enhance the level of competition and choice. That said, the firms, as noted above, could do more to promote their adherence to the Code, even if just to better market themselves.

1a Do you agree that the Code's purpose should be redefined in this way?

The FRC should not seek to define the public interest in this context more than has already been done. The role of the Independent Non-Executives (INEs) is relatively clear under the existing code, therefore, we are not convinced that there is a need to better define their role. There was always going to be a learning curve in the early years of the Code as the INEs got used to the different entity structures of the larger firms in comparison to those of corporate entities. As this was a new type of role it is only natural that it would evolve over time. There is also a need to allow for the INEs to be flexible and to exercise their own judgement.

2 Should there be separate governance arrangements for audit? What might such arrangements look like?

We do not believe that there should be separate governance arrangements for audit. We firmly believe that the Code should apply firm wide. There are other services being provided by the firm that could have a serious impact on the firm's reputation. Indeed, audit as a service line is continuing to decrease in overall firm revenue terms.

3 Should the Code include more detail and impose more requirements on tone at the top and professionalism more generally?

No, enough has already been done within the firms to emphasise the importance of the 'Tone at the top' and indeed the firms are continuing to do so.

4 Do you agree that the concept of the Code should be spread elsewhere in the world? How might this be achieved?

Whilst it has been good to note the Code being applied in certain cases beyond UK firms, it does not naturally have extraterritorial reach. Conceptually, it would be good for this to happen, however, due to differences in how the firms are structured globally, there would be a number of practical challenges that would need to be overcome. Additionally, as well as the UK firms having a responsibility to spread the word and promote good governance on a global basis, the FRC also has a responsibility via IFIAR to do likewise.

5 How might the independence of INEs be protected and demonstrated?

We believe that independence of mind is absolutely crucial but that appearance of independence is also important. Ultimately, it is the integrity and objectivity of the particular individuals that is of paramount importance.

That said, an evolutionary development of the Code might be to introduce specified terms of service akin to provision B.2.3 of the UK Corporate Governance Code.

"B.2.3. Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director. Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board."

6 Should the firms follow a standard process in appointing INEs, including all such positions being publicly advertised? What engagement, if any, should investors in audited entities have into an audit firm's appointment of INEs?

Firms should not be required to follow a standard process and there is no need for all such positions to be publicly advertised. Head-hunters would be the normal means of identifying and approaching suitable candidates.

We are not persuaded that there is a need for investors of audited entities to have any engagement in this regard and we are not convinced that they would want to in any case.

7 Should the FRC or any other regulator have a role in the appointment of INEs; perhaps a right of veto?

We do not believe that any regulator should have a role in the appointment of INEs. There will be opportunities for informal feedback to be given to the firms regarding their respective appointments.

8 Which of these (see below), if any, should be incorporated into the Code? Are there any other aspects of the Corporate Governance Code which should also be considered?

- **The inclusion in firms' transparency reports of a viability statement providing an assessment of long term solvency and liquidity**
- **Term limits on INEs' appointment**
- **Transparency around the remuneration of INEs**
- **A minimum number of INEs per firm**
- **A requirement for at least one INE to have recent and relevant financial experience**
- **An independent Chairman**
- **Greater consideration of diversity**
- **A formal role for INEs on remuneration, nomination, risk and/or audit committees**

It is our view that each of the above could be introduced. The first of these would be of particular value as it would give an indication of the financial health of a firm, however, there would undoubtedly be practical issues in implementing such a provision e.g. how do you define the firm in this context and could it be applied solely to the UK firm etc?

9 To who should the boards, INEs and public interest committees be accountable? How should this accountability be discharged, including to the FRC?

Practically speaking, the INE's accountability/duty of care can only be to the firm. However, the INE themselves would be expected to adopt an attitude of recognising the importance for the firm to maintain its reputation and standing in the business community.

10 Should the Code include specific provisions on the firms' Boards and Public Interest bodies engaging with and disclosing certain matters to regulators?

It is not clear what exactly paragraph 41 of the FRC document is seeking to do. There would be merit in arranging general meetings of INEs from all firms to share their experiences and best practices akin to what the FRC facilitates for audit committee chairs. If however, it is individual meetings with the Boards of specific firms that is being proposed then this might not be the best environment for INEs to express their views. Additionally, we are not convinced that the FRC would have sufficient resource to adopt such a policy.

There should be the right for INEs to disclose matters to a regulator, but it is hoped that any such issues would be considered internally in the first instance. The option to report to a regulator would of course be the final recourse for the individual.

11 Is greater transparency sufficient? What else can be done?

Greater transparency is sufficient. As per the content of paragraphs 86 to 88 of the document INEs should be asked to report specifically on what they have done during the year to discharge their public interest responsibilities. The firm's management should also be asked to confirm that the Transparency Report is "fair, balanced and understandable". We do question however whether there is a need to require the disclosure of key performance indicators.

12 Should the Code be applied to a wider group of firms?

No. We believe that the current scope requirement is proportionate. Firms not caught within its scope have the opportunity to voluntarily adopt the Code.

13 Do you have any comments on the role of the FRC in this context?

The Code should now be owned by the FRC.

14 Do you have any further comments on any of the issues raised in this report?

As mentioned at the outset, there is a need to increase the visibility of the application of the Code by the firms.

We recognise the complexity involved in this area but believe that INEs can, when the need arises, also be advocates for their respective firms.