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For attention of Susan Currie
Financial Reporting Council
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28 August 2015

Dear Ms Currie

As the only audit firm outside the six largest which is covered by the Audit Firm Governance Code on a mandatory basis, Baker Tilly UK Audit LLP submits the following response to *Audit Firm Governance Code – a review of its implementation and operation*.

Executive Summary:

Our principal submissions are:-

- high-quality audit needs to be encouraged, not mandated, and care should be taken not to damage the economics of the product's delivery;
- the Code needs to serve proportionate objectives and avoid arbitrary gold-plating of obligations for which no empirical need is shown – better to try to bring the rest of the world up to the UK standard before fine-tuning current norms further;
- the public interest role of INEs is vague, ill-defined, arbitrary, and needs elucidation, and the FRC's suggestions for its expansion (and indeed for many of the possible changes to the Code) cannot be safely risk assessed and assessed for unintended consequences till a workable and comprehensible definition is arrived at;
- although, as a means of stimulating competition, innovation, and addressing market concentration (which carries with it, of course, a risk of exit from the market and a concomitant existential threat to statutory audit itself), the Code has not worked optimally, the original Market Participants Group concluded that addressing competition issues was an important objective for the Code and it should remain so;
- the degree of recent and prospective change in the overall regulatory framework of audit is such that we think this is not the time to introduce more, and in particular more radical change; and
- Our firm represents clients drawn from every part of the SME sector. Our duty to those clients is to provide a high-quality service at a cost which they can bear. Any change in the Code's strictures will have a concomitant cost that would inevitably have to be referred on to those clients. We would counsel against the additional financial burdens that might accrue to those companies, as being counter-intuitive to the Growth initiative.



Responses to the Specific Consultation Questions

Q1 Do you agree that the Code's purpose should be redefined in this way [that the public interest, for Code purposes, should be – to foster audit quality; preserve the reputation of the non-audit parts of the audit firm's business; and prevent the firm's failure]?

We believe that the purpose of the Code, as originally stated, should not be amended. So much work on the meaning and application of the public interest is ongoing (the implementation of the EU Audit Directive and Regulation is a substantial piece of work that is predicated on public interest considerations, for example), and there are so many references to the term in the Code, that amendments would be premature.

The role of INEs is already clear under the code as presently expressed and our experience is that they have grown into the role, a process which is ongoing. Further cementation, without additional change or commitment, would be the best way to proceed.

Q2 Should there be separate governance arrangements for audit? What might such arrangements look like?

This is an *Audit Firm* Governance Code and so we do not believe that the Code should try to replicate audit firm governance arrangements across firms' other professional activities: the public interest does not mean the same thing in most non-audit services.

Though other services being provided by the firm could have a serious impact on the firm's reputation, the Code already requires INEs to have regard to such matters and we see no need to refine that obligation.

Q3 Should the Code include more detail and impose more requirements on tone at the top and professionalism more generally?

No, we do not believe so: enough has already been done within the firms to emphasise the importance of 'tone at the top', and firms' leaderships are responding to the Code obligation already.

Q4 Do you agree that the concept of the Code should be spread elsewhere in the world? How might this be achieved?

We believe that any obligation to replicate the Code across other jurisdictions is a matter for IFIAR, not firms' international networks – securing uniformity of application of the Code across jurisdictions would be very difficult: witness the problems the European Commission has faced in securing application of the Audit Directives in some Member States, for example.



Q5 How might the independence of INEs be protected and demonstrated?

Our own experience is that INEs are already currently demonstrating both independence-of-mind and of-fact. When they were brought into the firm, they invited to have an open mind on how it delivers audit quality, and to challenge it at Board level. The integrity and objectivity they have brought to their work is clear to our Board and their contribution valued.

That contribution is virtually bound to grow as the years go by and as their contribution comes to be better understood. Adding further obligations or tinkering with existing ones might threaten the pleasing progress we have witnessed.

Q6 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 standardised process and there is no need for all such positions to be publicly advertised: audit firms (certainly our own) are not public bodies and should not be treated as such.

Similarly, we are not persuaded that there is a need for investors of audited entities to have any appointment-engagement in this regard - we do not imagine they would want it in any case.

Q7 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 – the FRC is an oversight body and in our opinion it should not, so far as possible, be involved in the carrying out of any aspect of firms' operational work.

Q8 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?

It is our view that none of the options given should be introduced: they seem to us, individually and collectively, to be grossly disproportionate to the size and nature of our audit clientele.

Q9 To who should the boards, INEs and public interest committees be accountable? How should this accountability be discharged, including to the FRC?

INEs' accountability and duty of care can only rationally be to the firm, modified by the conclusions of the debate about the nature and scope of the public interest that is ongoing currently.

The Code is explicit already on INEs' rights and obligations and we counsel against introducing obligations of accountability to the FRC.



Similarly, we do not support either an obligation to include KPIs for INEs in Transparency Reports against KPIs or to have to include in the Transparency Report confirmation that the Report is 'fair, balanced and reasonable': this is an importation from governance reporting by listed companies and we reiterate the point we made earlier – the extent to which we are involved in PIE audit activity is so limited as to make a disclosure of this kind valueless.

Q10 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 end paragraph 41 of the consultation document is seeking to serve and the justification for change is not made out. A lack of proportionality would attend any obligation around disclosure of this kind.

Q11 Is greater transparency sufficient? What else can be done?

Current levels of transparency are sufficient. Any temptation to prescribe further content around the Transparency Report should be resisted as an unwarranted and unnecessary gold-plating of the Code.

Q12 Should the Code be applied to a wider group of firms?

No - there is neither need nor justification.

Q13 Do you have any comments on the role of the FRC in this context?

The Code should continue in the joint ownership of the FRC and ICAEW.

Q14 Do you have any further comments on any of the issues raised in this report?

Our firm represents clients drawn from every point on the SME scale, a commercial sector that is vital to UK productivity. Some of the audit entities in that sector are not truly 'public interest' ones, in that they are not of any systemic importance and often do not have the in-house financial reporting capability that larger ones do.

Regulators have to be mindful of the cost of regulation to them and avoid a one-size-fits-all regulatory mentality, or one that forgets this: any additional costs of compliance with the Code would almost inevitably be borne by audit entities and it may be disproportionate to do so.

contd.



We hope these submissions are helpful and we will be happy to supplement any of our answers, if you wish.

Yours sincerely

T M McMorrow
Director of Policy, Regulation and Ethics