

Auditing and ethical standards

The AIC's response to the Financial Reporting Council

The Association of Investment Companies (AIC) is a trade body for the closed-ended investment company sector. We represent 359 investment companies, holding assets of over £184 billion. The AIC's members are predominantly listed on the Main Market of the London Stock Exchange. Some have shares admitted to trading on the Specialist Fund Segment; others are quoted on AIM.

The AIC's members include investment trusts, Venture Capital Trusts, UK REITs and non-EU companies. Our non-EU members are usually domiciled in Guernsey and Jersey.

The AIC has considered the [consultation on revisions to ethical and auditing standards 2019](#), published by the Financial Reporting Council (FRC).

The AIC does not have any comments on the proposed revisions to the auditing standards.

The AIC broadly supports the proposed amendments to the ethical standards. However, we have some specific comments which we have addressed below.

Question 4: Do you agree with the introduction of a permitted list of services which the auditors of PIE audits can provide?

The AIC supports the FRC's approach to apply principles rather than rules in order to maintain good governance.

Article 5 of the EU Audit Regulation sets out a number of prohibited non-audit services for public interest entities (PIEs). The FRC's current ethical standards incorporate this list of prohibited non-audit services. This approach allows audit firms to provide other non-audit services, subject to companies and audit firms evaluating the threats and safeguards to the auditor's independence.

This allows companies to maintain as high a level of commercial flexibility as possible, given the prohibitions required by the Audit Regulation.

The AIC does not support the FRC's proposed change in approach to move, from a list of prohibited services, to a shorter list of permitted non-audit/additional services for auditors of PIEs. This is not in line with the UK's principles based approach to regulation, or the UK's regulatory approach not to gold-plate EU legislation.

The danger of introducing a permitted list is that certain services might be omitted which could sensibly have been undertaken. Additionally, in some circumstances, this may lead to unforeseen consequences and limit the choice of auditor or non-audit service providers available to the company.

Question 5: Do you agree with the additional prohibitions we are proposing to introduce – in learning from the experience of enforcement cases like BHS, if the more stringent PIE provisions are to have a wider application to non-PIE entities, which entities should be subject to those requirements?

The AIC agrees with bringing other large non-PIE companies into scope. However, the AIC **recommends** the market capitalisation threshold be increased to £500m for AIM or NEX Exchange quoted companies incorporated in the UK. Using this threshold would ensure that companies with equivalent market capitalisations to FTSE 350 companies would be included, but smaller companies would not. This is a proportionate approach.

Question 6: Do you agree with the removal of the reliefs for SMEs in Section 5 of the Standard, and the retention of reliefs for ‘small’ entities (in Section 6 of the Standard)?

No. The AIC **recommends** these reliefs remain in place. Where companies are able to take advantages of SME listed company reliefs, they should continue to be able to. Removing these reliefs is not in line with the UK’s principles based approach to regulation, or the UK’s regulatory approach not to gold-plate EU legislation.

Assessing which services the auditor should provide, and who should provide them, is the responsibility of the audit committee which makes recommendations to the board. Further restrictions would reduce the ability of the audit committee to act in the best interest of the company.

The choice available to audit committees to select service providers to provide audit and non-audit services must remain as extensive as possible. To introduce any restrictions that go beyond those outlined in the Statutory Audit Amending Directive and Regulation may reduce the number of audit firms willing or able to tender for particular audit or non-audit work and therefore would serve to restrict further the choice of provider available to companies.

For our member companies that comply with the AIC Corporate Governance Code (as endorsed by the FRC), and for those companies complying with the UK Code, the audit committee is responsible for “*developing and implementing a policy on the engagement of the external auditor to supply non-audit services, ensuring there is prior approval of non-audit services, considering the impact this may have on independence, taking into account the relevant regulations and ethical guidance in this regard, and reporting to the board on any improvement or action required.*” (UK Code Provision 25)

If the external auditor provides non-audit services, the audit committee must also provide an explanation of how auditor objectivity and independence are safeguarded. Therefore, there is a clear explanation in the accounts with regard to the provision of non-audit services. The requirement for listed entities to disclose details of audit and non-audit fees in the annual accounts provides the investor with relevant information.

The AIC **recommends** that no further restrictions are placed on providing non-audit services.

Question 7: Do you agree with the proposed removal of the derogation in the 2016 Ethical standard which allowed for the provision of certain non-audit services where these have no direct or inconsequential effect on the financial statements?

No. The AIC **recommends** the derogation remains in place. This derogation only relates to certain defined non-audit services. In addition, where auditors do provide those services, they must *“have no direct or have an immaterial effect, separately or in the aggregate on the audited financial statements”*.

Removing this derogation is not in line with the UK’s principles based approach to regulation, or the UK’s regulatory approach not to gold-plate EU legislation.

Certain non-audit services that are not material to the financial statements, such as tax services relating to the preparation of tax forms, should continue to be allowed to be undertaken by the company’s auditor.

Removing this derogation would be a disproportionate response. It will increase the costs to companies without providing a significant benefit to shareholders.

September 2019

To discuss the issues raised in this paper please contact:

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