

CONSULTATION

FINANCIAL REPORTING COUNCIL: AUDITING AND ETHICAL STANDARDS IMPLEMENTATION OF THE EU AUDIT DIRECTIVE AND AUDIT REGULATION

ABOUT AIA

The Association of International Accountants (AIA) was founded in the UK in 1928 as a professional accountancy body and from conception has promoted the concept of 'international accounting' to create a global network of accountants in over 85 countries worldwide.

AIA is recognised by the UK government as a recognised qualifying body for statutory auditors under the companies act 2006, across the European Union under the mutual recognition of professional qualifications directive and as a prescribed body under the companies (auditing and accounting) act 2003 in the Republic of Ireland. AIA also has supervisory status for its members in the UK under the money laundering regulations 2007.

AIA promotes and supports the advancement of the accountancy profession both in the UK and internationally. The AIA exams are based on international financial reporting and international auditing standards and are complimented by a range of variant papers applicable to local tax and company law in key jurisdictions together with an optional paper in Islamic accounting.

AIA members are fully professionally qualified to undertake accountancy employment in the public and private sectors.

AIA RESPONSE

INTRODUCTION

We are pleased to have the opportunity to take part in the FRC's consultation process with respect to Member State options, included in the EU Audit Directive and Audit Regulation. We respond as follows to each of the questions posed in the FRC's consultation document.

1. 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)?

It is logical that auditing standards should be developed on an international basis and appropriate that the FRC should continue to be the UK authority empowered to impose these additional requirements on an as needed basis. We support the view that the FRC should have such power, on the basis that it would be used to make only warranted changes. Given the focus on audit processes by ISAs, and the consequent extra burdens these have placed on smaller firms, it is important that there is full continuing provision for their concerns to be properly taken onto account when introducing new regulation.

2. 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 - we do not believe such application is of particular concern. There is always going to be vigorous debate on this point, particularly amongst very small audit firms. Overall, we believe the current balance is about right.

3. 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 support the view that the same requirements should apply to all audits, however the FRC should provide guidance on the application of these to small entity audits. Differing requirements may confuse stakeholders and perhaps imply that auditors have different 'drivers' depending on size of the entity being audited.

4. 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 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?

On the basis that they will augment audit outcomes, to engender confidence in the audit function, all of the more stringent requirements should apply to all PIEs as defined by the audit directive and to all other Listed entities as currently defined by the FRC.

5. 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?

Our response is the same as to that at question 4 above. We see these as additional safeguards in the interest of stakeholders.

6. 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?

Again, in the interest of augmenting audit quality, we are of the view that all of the more stringent requirements should extend to all the other 'entities whose audits fall with the scope of the AQR for 2014/15'.

7. 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 are sympathetic to the view that there should be stringent restrictions on the level of non-audit services provided by the auditors of PIEs. However the reality is that there are significant cost/efficiency benefits to be derived from using in situ knowledgeable firms, to carry out certain specific additional services. In terms of engendering confidence in the audit function, a perennial issue with the 'black list' approach will continue to be the inherent subjectivity in allowing other services to be provided "subject to evaluation of threats and safeguards by the auditor". In light of this we believe that it is vital for the audit committee to carry out such evaluation. Of perhaps equal significance, is that PIEs may well be desirous of properly using their auditors to provide additional services, not included on a white list. In the interest of perceived auditor's independence, we would favour a 'white list' approach - along the lines of that referred to in paragraph 4.13 - but can see this would impinge on the ability of audit committees' choice of providers of services - to the detriment of audit clients. We therefore believe that a 'black list' approach is the only viable option.

Referring to paragraph 4.21, we do not believe that “staff development” issues provide any justification for the provision of non–audit services to audit clients.

8. 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?

(A) Inclusion of the services as set out in paragraph 4.13, including the ES5 ‘audit related services’ appear appropriate. With a ‘white list’ approach it is difficult to justify adding more without detailed clarification.

(B) We are of the view that this will be difficult to mitigate in practice, but close liaison with the audit committee about possible services including those as suggested in paragraph 4.13 would be one part of a risk mitigation strategy. It also occurs that liaison with the FRC to obtain guidance on ‘an as and when basis’ would also be helpful in this respect.

9. 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?

No the prohibited non–audit services are broad ranging and this prohibition should achieve the desired effect.

10. 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?

Yes (subject to answer 11, below) - but only in exceptional situations as per paragraph 4.36 - for groups that may have components in locations for which the auditor of that component is identified as the only practicable provider of a particular non–audit service. With this exception, in our view the self–interest threat highlighted in paragraph 4.37, is in itself sufficient justification for not taking up the derogations.

11. 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?

Our concern is that the term ‘immaterial’ in this context is so subjective that there are likely to be inconsistencies in its interpretation, making way for inconsistencies in the types and levels of such services being provided by audit firms.

12. 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?

It is sufficient. As to whether or not a white list approach was adopted is not relevant.

13. 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, ideally to ensure consistency of approach. However, for the reasons explained in paragraph 4.49, we doubt that this will be practicable. The pragmatic way forward seems to be to continue as current with the International Code.

14. 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?

Ideally, yes, however again this may not be logistically practicable.

15. 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?

Whilst we understand the arguments to leave the cap undisturbed, there are always going to be elements of 'doubt' about auditor objectivity, when such a relatively high threshold is reached – especially if there is an audit failure. For this reason we believe that the cap should be lower than 70%, notwithstanding that this in itself may be low as compared to previous levels, for some firms.

16. 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. Certain exceptional non-routine services may be required from time-to-time and provision should be made to allow for these, subject to independence safeguards.

17. 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?

In order to help dispel doubts with regard to auditor independence, a modified cap should be calculated and applied to network firms. Not to have such modification appears to be at odds with the self-interest reasons for introducing a cap in the first place.

18. 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?

We believe that both the audit fees and the non-audit fees for the group as a whole should be taken into account. There should be no exceptions.

19. 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)?

It is not ideal because of the exclusions for certain circumstances as detailed, particularly in instances where there is an interruption in the provision of services. However, we appreciate the inherent difficulties involved in identifying a practicable acceptable modified cap, and on balance do not see a three year basis as being of concern.

20. DO YOU BELIEVE THAT THE REQUIREMENTS IN ES 4 SHOULD BE MAINTAINED?

On the basis that the more restrictive benchmark percentages are not causing concern in the UK, we believe the current ES4 requirements should be maintained.

21. 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?

We believe that the more restrictive requirements in ES4 should apply with respect to all entities whose audits fall 'with the scope of the FRC's AQR team for 2014/15'.

22. 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".

Yes. Whilst there is an argument that exceeding the specified percentages for a period longer than three (or more) consecutive years, better fits the dictionary definition of "regularly" - on balance, in the context of the subject matter and the sensitivity of the issue, at least three consecutive years seems appropriate.

23. 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?

Taking account of the provisions of the Limitation Act 1980, setting out time limits for claims against firms, we would suggest a retention period of at least seven years.

24. 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, although some may see this inclusion as overkill given the legal requirements.

25. DO YOU BELIEVE THAT THE REQUIREMENTS IN ES 3 SHOULD BE MAINTAINED?

Yes – we do not believe there is need for change. As the ES was revised a relatively short time ago, following extensive debate, and we have no evidence of particular concerns of stakeholders in this respect, we believe that the existing requirements are appropriate.

26. 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?

Yes to all 'entities whose audits fall with the scope of the FRC's AQR team for 2014/15'.

27. ARE THERE ANY OTHER POSSIBLE SIGNIFICANT IMPACTS THAT THE FRC SHOULD TAKE INTO CONSIDERATION?

None noted.

FURTHER THER INFORMATION

The above replies represent our comments upon this consultation document. We hope that our comments will be helpful and seen as constructive. AIA will be pleased to learn of feedback, and to assist further in this discussion process if requested.

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