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Keith Billing
Financial Reporting Council
125 London Wall, 8th Floor
London
EC2Y 5AS

Reference: Financial Reporting Council *Consultation: Auditing and Ethical Standards. Implementation of the EU Audit Directive and Audit Regulation*

Dear Mr. Billing;

CFA Institute,[1] appreciates the opportunity to comment on the Financial Reporting Council (FRC) *Consultation: Auditing and Ethical Standards. Implementation of the EU Audit Directive and Audit Regulation* (CD).

CFA Institute is comprised of more than 100,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that the quality of corporate financial reporting and disclosures provided to investors and other end users is of high quality.

General Comments

CFA Institute supports the Financial Reporting Council (FRC) efforts to promote high quality corporate governance and auditing standards for audits of financial statements. We have a consistent history of supporting efforts to enhance the quality, relevance and value of the independent audits. Normally, CFA Institute limits writing comment letters to the principal audit standard setters such as the International Auditing and Assurance Standards Board (IAASB) and the US Public Company Accounting Oversight Board (PCAOB).

CFA Institute does not generally expect to support differential requirements for auditing standards based on local regulatory requirements or whether an entity is a public interest entity, listed entity or non-listed entity since investors allocate capital to a wide variety of companies. Consistency and comparability of financial statements and financial statement audits is central to investor protection irrespective of the nature of the ownership (listed vs. non-listed or public interest entity). Differential standards necessitate for investors an understanding, and pricing, of such differences through risk-adjusted returns. As currently articulated, without undue effort, it is challenging for investors to discern the differences in applicability (listed vs. non-listed or public interest entity) of the EU Audit Directive or the FRC's proposed changes. Investors need to be able to readily ascertain the differences in applicability being proposed.

[1] With offices in Charlottesville, New York, Hong Kong, and London, CFA Institute is a global, not-for-profit professional association of more than 116,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 137 countries, of whom more than 108,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 138 member societies in 60 countries and territories.

Given the FRC's progressive efforts to enhance the value of the audit to the users as most recently demonstrated by its recommended addition to the UK auditor's reporting model, we believe that continued public support for the FRC efforts is warranted. To this end, we support the FRC enacting changes to existing auditing standards so long as they enhance rather than reduce existing requirements and improve audit quality and the reliability investors can place on the financial statement audit.

While the CD covers other topics, our response to the CD is limited to general comments associated the following central themes:

- Auditing Standards
- Proportionate Application and Simplified Requirements
- Extending the More Stringent Requirements for Public Interest Entities to Other Entities
- Prohibited Non-Audit Services
- Audit Partner Rotation

1. Auditing Standards

As detailed in the CD, the FRC's auditing standards are based on the corresponding international standards issued by the International Audit and Assurance Standards Board (IAASB). These international standards have been augmented with a small number of additional requirements to address specific UK and Irish legal and regulatory requirements. Article 26 of the Audit Directive presents Member State options in relation to supplemental international auditing standards adopted by the European Commission (EC). These options essentially allow Member States to impose audit procedures or requirements in addition to the international auditing standards adopted by the EC if they are necessary to meet national legal requirements and add to the credibility and quality of the financial statements. The FRC believes that it should have the ability to exercise, where necessary, these options in order to add requirements as a means to seek innovative ways to support confidence in the audit and to better contribute to the development of international standards.

CFA Institute agrees that the FRC should be able to impose additional requirements in auditing standards adopted by the EC where necessary to address national law and where they would add to the credibility and quality of the financial statements. For example, the FRC adopted a UK and Irish version of ISA 700, *Forming an Opinion and Reporting on Financial Statements,* which was largely in compliance with the IAASB standard but provided for expansive language in the auditors' report which provided investors with greater insight into the audits risks and auditor responses. The FRC model extending requirements continues to receive high marks for the quality and content of information provided to investors and has added value to the auditor's report.

We support the FRC having the power to impose additional requirements in auditing standards provided that the FRC exposes any such requirements to appropriate consultation and due process. We believe that the due process is an essential element to enacting meaningful audit reforms.

2. Proportionate Application and Simplified Requirements

The Audit Directive permits a Member State required to audit "small undertakings" to apply auditing standard proportionate to the scale and complexity of the activities of such undertakings. As mentioned in the previous section, the FRC standards are based on the IAASB's International Standards on Auditing (ISA) which have been designed in a manner proportionate with the size and complexity of an entity. Further, as mentioned in the CD the IAASB continues to recognize that, in order to achieve effective implementation globally, its standards need to be, and seen to be, capable of being proportionately applied in an audit based on size and complexity of the entity.

CFA Institute supports the FRC view that the full standards should apply to entities of all sizes. We believe that auditors should exercise due professional judgment in applying and scaling auditing standards where necessary, but specific standards for smaller entities should not be developed. A differential set of standards may have an impact on quality of the audit and therefore should be subject to complete set of requirements in accordance with the ISAs. If differential standards are to be applied, investors must be made aware of such differences such that the increased risk to their capital can be efficiently priced by market participants.

3. Extending the More Stringent Requirements for Public Interest Entities to Other Entities

We believe that the more stringent requirements for public interest entities and listed entities in the FRC's Auditing and Ethical Standards should apply to all entities. Extending more stringent requirements increases confidence in the audit and will further provide more information to the investor. Further, whether listed or unlisted, capital providers are interested in the performance of audit procedures which provide assurance on the accuracy of the financial statements. Differential audit procedures necessitate differential pricing of returns on capital. As previously mentioned, CFA Institute generally does not support differential requirements for auditing standards based on whether the entity is a public interest entity, listed entity or non-listed entity since investors allocate capital to a wide variety of companies.

4. Prohibited Non-Audit Services

We support the current FRC ethical standard of applying, as a base line, a threats and safeguards approach to non-audit services. We believe that if the FRC were to identify additional non-audit services that pose a threat to auditor independence that these be added to the list of prohibited services.

5. Audit Partner Rotation

EU Regulation limits key audit partners to seven years of service followed by three years of no involvement with the audit before they are allowed to serve again. Under the existing FRC requirements partner service is limited to five years followed by five years of cessation for the audit engagement partners, engagement quality control reviewers and other key partners. As we note above, the overlap in applicability (listed vs. non-listed and public interest entities) is not clear without undue study.

CFA Institute believes that the FRC's more restrictive ethical standard of limiting the engagement partner to five years with a five year cooling off period for subsequent participation is the more stringent and effective policy. This requirement should apply to engagement partners, engagement quality control reviewers and other key partners.

Closing Comment

Thank you for the opportunity to express our views on this important proposal. If the FRC has questions or seek furthers elaboration of our views, please contact Matthew M. Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org.

Sincerely,

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