



LONDON SOCIETY
OF CHARTERED
ACCOUNTANTS

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Regulation and Ethics Review Panel

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Dear Keith,

CONSULTATION: AUDITING AND ETHICAL STANDARDS RE IMPLEMENTATION OF THE EU AUDIT DIRECTIVE AND AUDIT REGULATION

I am writing as Chairman of the Regulation and Ethics Review Panel (RERP) of the London Society of Chartered Accountants (LSCA). The LSCA is by far the largest of the 22 district societies affiliated to the Institute of Chartered Accountants in England and Wales (ICAEW). It has a membership of 34,000, representing nearly one quarter of all ICAEW members, and also provides services to other ICAEW members who live or work in London. London members, like those of the Institute as a whole, comprise a mixture of those working in all sizes of practice and those working in businesses, both large and small, or otherwise not in practice. They also include many of the ablest and most senior Chartered Accountants, together with a wide range of specialists.

RERP welcomes the opportunity to comment briefly on this discussion document. We have seen a draft of the ICAEW representation and endorse this in full. The focus of RERP is on the ethical and regulatory aspects of proposals as they affect auditors rather than on more technical issues and this is reflected in our comments below.

GENERAL COMMENTS

We agree with the ICAEW view that the FRC should pick up the audit and ethical standards requirements for audits, which arise from the European Union Audit Regulation and Directive, and have stated this in our response to the BIS discussion paper.

We also agree that it is important not to lose sight of why the European Commission initiated the review of auditor regulation in the first place as a response to perceived shortcomings in the audit process in the wake of the 2008 financial crisis.

Its main purpose was to address the audit of banks and the largest and most complex Public Interest Entities (PIEs) that could pose systemic risks to financial stability and market confidence. This focus should be reflected in the FRC's approach to implementation of the Regulation and the Directive.

We support the view that there should not be change for the sake of change nor unwarranted extension of regulation beyond the minimum required by the Regulation and the Directive.

We accept that it is reasonable for the FRC to retain powers to go beyond international standards and requirements where needed, to support an overall aim of maintaining audit quality as part of a contribution to strong capital markets. We would, however, expect the FRC to justify its use of such powers based upon clear evidence of a need, supported by robust impact analysis.

Were the Government to be implementing the requirements of the Regulation and the Directive, we would expect it to adhere to its stated principles of regulation and to seek to avoid going beyond the minimum requirements of the measures being transposed into the UK regulatory framework. It follows that we would expect the FRC to take a similar approach.

We consider that additional requirements for PIEs should be restricted to the narrowest scope of audits possible and have concerns that the approach to restrictions on the provision of non-audit services (NAS) to such entities could prove to be overly prescriptive and represent an unwelcome and unjustified move away from principles-based regulation.

Particular regard should be had to not placing unwarranted additional burdens on small enterprises and their auditors.

SPECIFIC COMMENTS

Question 1: We agree that the FRC should exercise the provisions in the Audit Directive and 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). We would, however, expect such powers to be exercised only in exceptional situations. Such divergences would need to be justified and supported by a high-quality impact assessment.

Question 2: We believe in principle that it is possible for the FRC's current audit and ethical standards to be applied in a manner that is proportionate to the scale and complexity of the activities of small undertakings but would welcome more practical guidance as to how this can be achieved. The ES PASE is particularly useful in this regard and we support its retention. We support the ICAEW view that simplification can go further in particular as regards small non-PIE audits.

Question 3: See response to question 2.

Question 4: We support the ICAEW view that the definition of PIEs should not go beyond that specified in the Directive.

Question 5: We do not believe that the additional requirements for PIE audits should be applied to entities not defined as PIEs in the Directive.

Question 6: See response to question 5.

Question 7: We welcome the fact that the general prohibition on the provision of NAS has been replaced in the Regulation and Directive by the more familiar threats and safeguards approach, supplemented by a 'black list' of specific prohibitions. We consider this preferable to taking the approach that everything that is not included in a 'white list' is not permissible.

Question 8: See response to question 7. We have not considered in detail the listed of allowed services set out in paragraph 4.13 of the consultation.

Question 9: We do not believe that there are NAS in addition to those prohibited by the Audit Regulation that should be specifically prohibited.

Question 10: We support the taking up of the derogations to allow the provision of certain prohibited NAS if they have no direct or have immaterial effect on the audited financial statements.

Question 11: We believe that 'immaterial' is a sufficient explanation of the criteria for allowing the waiving of the prohibition in particular cases.

Question 12: We believe it is sufficient to require the audit committee to approve the provision of non-prohibited NAS.

Question 13: We believe that the current requirement for auditors outside the UK to apply the IESBA code in conducting part of a group audit remains appropriate and would resist an attempt to impose FRC requirements worldwide. There would be a need to deal with the situation where another EU firm is involved, if the FRC were to go beyond the list of prohibitions set out in the Regulation.

Question 14: See response to question 13.

Question 15: We support the ICAEW view that the 70% overall cap on fees for NAS is unjustified and would favour minimum implementation. We do not believe that there would then be a need to implement a lower cap for some or all types of permitted NAS.

Question 16: We support the proposal that the FRC be allowed to grant exemptions from the cap, on an exceptional basis, for a period not exceeding two years. Such exemptions would require disclosure.

Question 17: We do not believe it appropriate to extend the cap to include network firms.

Question 18: Not applicable in view of our answer to question 17.

Question 19: We would not support extending the requirement for calculating the cap beyond that specified in the Regulation – see our response to question 15.

Question 20: We believe that the requirements in ES 4 should be maintained re disclosure of total fees for audit and non-audit services in respect of PIE audits. They do go beyond those required in the Regulation and the Directive but are familiar and change is not warranted.

Question 21: We support the application of the ES 4 requirements to all PIEs but see our response to question 4.

Question 22: We agree that it is reasonable 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.

Question 23: We do not believe it is necessary for the FRC to specify a minimum retention period for audit documentation, since this is dealt with satisfactorily in current auditing standards

Question 24: We 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. We would point out, however, that the appointment of auditors rests with the shareholders and do not expect that in practice there will be many instances of non-compliance.

Question 25: We agree that the partner rotation requirements in ES 3 should be retained.

Question 26: We believe that the more restrictive requirements of ES 3 should apply to all PIEs but would welcome transitional arrangements for new PIEs and would also refer you to our response to question 5.

Question 27: We have identified no additional impacts that the FRC needs to take into account. We would, however, urge the FRC to ensure that the impact analysis is of high quality and considers both qualitative and quantitative issues.

Please do not hesitate to contact me, if you have any queries or wish to discuss any of these matters further.

Yours sincerely

Bruce Picking