

## CBI response to the FRC consultation on Auditing and Ethical Standards

March 2015

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1. The CBI welcomes the opportunity to respond to the FRC's consultation on the details of the UK implementation of the EU audit market reform. The CBI has been an active contributor to the debate throughout the process and has been working closely with the UK government to ensure that reforms seek to improve quality, independence, resilience and choice of audit.
2. We welcome the focus on high quality audits and believe that a key success factor to these reforms being introduced effectively will be to offer complete and timely clarity to companies so that their respective audit committees can begin to take the necessary steps.
3. The CBI highly values the FRC's consultative approach and the efforts that both the FRC and BIS continue to make to ensure a successful implementation of the new rules. As the FRC's role in this is now set to increase, we would welcome consistency with the government's assurances that there is no intention to gold-plate the EU reforms in the UK.
4. With these principles in mind, the CBI makes the following points in response to the proposals:
  - **A changed definition of public interest entities (PIEs) must not lead to unintended negative consequences for smaller businesses**
  - **A more stringent application of the cap on fees for non-audit services and the black list of prohibited non-audit services would risk a decline in audit quality**
  - **As a general point, requirements for audit committees should seek to avoid duplicative outcomes in cases where similar requirements and arrangements are already in place**

We also annex our response to the connected BIS consultation in order to provide a full picture of our views.

### **A changed definition of public interest entities (PIEs) must not lead to unintended negative consequences for smaller businesses**

5. We understand that the decisions made at EU level mean that it will no longer be possible for the UK to exclude certain entities from the PIE definition, in effect broadening the scope. Given that the EU has clearly set out that all listed entities qualify as a PIE, and the FRC's current stance on 'listed companies' spans those quoted on Aim, ISDX and other smaller exchanges, this means that a significant proportion of smaller firms will now be captured by the requirements.
6. We are concerned that the inability of smaller quoted companies to seek assistance from their auditors when preparing their reports and accounts in the future could result in a decline in quality of documents published by smaller companies. These firms often do not tend to publish any additional information for finance providers and investors, so the quality of their annual reports and accounts is highly important.
7. Therefore, we would support simplification of the rules for smaller firms where possible in order to avoid a decline in quality in smaller firms accounts and reports. Importantly, the FRC should seek to avoid



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placing disproportionate burdens on smaller companies that do not offer any benefits to their investors – the ultimate users of the audit.

8. Furthermore, we would propose that guidance is offered to those businesses who are required to have a statutory audit, but who are not classified as a PIE. It is important that these businesses have clarity on what is considered best practice for non-PIEs, so that a box-tick voluntary compliance with the new requirements for PIEs can be avoided as these may not necessarily be suitable for smaller private businesses.

**A more stringent application of the cap on fees for non-audit services and the black list of prohibited non-audit services would risk a decline in audit quality**

9. We believe that the EU cap of 70% on audit fees for non-audit services is appropriate and should not be lowered further. We would welcome consistency with the UK government's policy to not engage in gold-plating and to only go beyond EU legislation in exceptional circumstances and based on a full cost benefit analysis. While it is unclear what the benefits of lowering the cap would be, there are clear downsides to this.
10. Creating an even greater divide between an audit firm's audit and non-audit function would encourage a split between pure audit firms and non-audit firms, with the risk that the top talent will be more compelled to join the non-audit firms as these would offer a broader range of career opportunities. As a result, the pure audit firms would suffer from a talent drain that would ultimately result in a decline of audit quality.
11. This argument also applies to the proposal to prohibit further non-audit services that are not currently on the EU's black list. Therefore, we support the introduction of the EU black list in its current form and would be opposed to extending this list. Investors share the view that there are sufficient safeguards in place in the UK to protect auditor independence, and agree that an extended list is not necessary.
12. This view has been echoed by the Parliamentary Under-Secretary of State for Business, Innovation and Skills, Jo Swinson, who has stated that with regards to the black list Government is 'reassured by the proposal on the table, because the list now mirrors existing ethical standards'<sup>1</sup>.
13. With this in mind, a top priority for business remains to be the need for full clarity around this, especially around critical issues such as the appropriateness of tax advice.
14. In respect of the tax advice point in particular, we would support it if the Member State options for derogations in this area were to be taken up by the FRC. We believe that if certain tax and valuation services do not have a direct effect or are immaterial to the audited financial statements, then it would be a sensible approach to allow the audit committee in question to exercise balanced judgement on these cases.
15. In addition, we note that there is no specific question in the Consultation Document on the exclusion of non-audit services which are "required by law" from consideration in testing compliance with the cap. While we note that the discussion on the "reporting accountant" services provided on pages 57 and 58 of the Consultation Document is useful, we believe that further clarification by the FRC on the other non-audit services that could be defined as "required by law" would be helpful, in particular those services that are audit-related assurance by nature, such as interim reviews.

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<sup>1</sup> Evidence given by Jo Swinson MP to the European Standing Committee C - Financial Audits on 30 October 2013.

**As a general point, requirements for audit committees should seek to avoid duplicative outcomes in cases where similar requirements and arrangements are already in place**

16. As a general and final point we would ask BIS and the FRC to take care in their joint implementation efforts to avoid outcomes that would pose duplicate requirements on certain entities that are already subject to regulations regarding auditor independence. For example, we support the audit committee exemption available for UCITS and AIFs as these funds are subject to a well-established regulatory regime and additional specific governance requirements such as the appointment of an independent depositary.
17. In addition, we would support the audit committee exemption where the group audit committee is discharging the requirements that would be imposed on a PIE's own audit committee as this exemption avoids any duplication that would otherwise occur where a PIE would have to create an audit committee in addition to one that already exists at the group level.