



## Auditing and ethical standards

### The ABI's response to the FRC's consultation on the implementation of the EU Audit Directive and Audit Regulation

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1. The ABI is the voice of insurance, representing the general insurance, protection, investment and long-term savings industry. It was formed in 1985 to represent the whole of the industry and today has over 300 members, accounting for some 90% of premiums in the UK.

#### ABI comments

2. We welcome the opportunity to comment on the Financial Reporting Council's *Consultation: Audit and ethical standards – Implementation of the EU Audit Directive and Audit Regulation*.
3. In our view, the audit framework in the UK works reasonably well. We support the FRC adopting an approach that, consistent with the BIS's commitment to this, avoids the gold-plating of European requirements and also minimises inconsistencies with other European countries and so does not penalise multinational companies.
4. We therefore, for example, support a black-list approach to non-audit services that limits prohibitions to the minimum specified at the European level, and we would not support an increase in the 70% cap on non-audit fees. Likewise, we do not agree with extensions of the European requirements to group entities outside of Europe or to non-group auditors.
5. Further, we think that the company, and its Audit Committee, should continue to have as central role a role as possible in assessing auditor independence and distinguishing risks that are material from those that are not.
6. We consider the distinction between listed and unlisted companies to be crucial. To extend the FRC's more stringent requirements to other PIEs would place disproportionate burdens on mutuals and other unlisted insurers. Very many of these are relatively small, have limited resources, and lack finance other than from their policyholders - the protection of whose interests is already at the very heart of increasingly extensive and substantial regulation and supervision by the Prudential Regulation Authority. Every effort should be made to avoid adding another layer to this.

7. Likewise, it would not be appropriate to extend the FRC's more stringent requirements to PIEs that are subsidiaries of listed companies, given group governance structures and the FRC's existing requirements at group level.
8. Our answers to the FRC's questions are given in the appendix.

Association of British Insurers  
March 2015

**ABI response to the Financial Reporting Council's Consultation: Audit and ethical standards – Implementation of the EU Audit Directive and Audit Regulation**

***Section 1 – Auditing Standards***

***Question 1 (see pages 11 – 13)***

*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)?*

1. We agree.

***Section 2 – Proportionate Application and Simplified Requirements***

***Question 2 (see pages 14 – 15)***

*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.*

2. We have no comments.

***Question 3 (see pages 15 – 17)***

*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.*

3. We have no comments.

***Section 3 - Extending the More Stringent Requirements for Public Interest Entities to Other Entities***

***Question 4 (see pages 18 – 25)***

*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?*
4. Re (a), no. In our view, the distinction between listed and unlisted companies is primary. To extend the FRC's more stringent requirements to other PIEs is gold-plating, quite unnecessary, and onerous – whether it be to PIE subsidiaries of

listed companies or to other non-listed PIEs such as unlisted mutual insurers. Re (b), we are not convinced of the cost/benefit of distinguishing between different types of listed entities.

**Question 5** (see pages 18 – 25)

*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?*

5. We are not convinced of the cost/benefit of distinguishing between different types of listed entities.

**Question 6** (see pages 18 – 25)

*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?*

6. No. In our view, the distinction between listed and unlisted companies remains the key one. To extend the FRC's more stringent requirements to other PIEs – whether PIE subsidiaries of listed companies or other unlisted PIEs such as mutual insurers – is gold-plating, quite unnecessary, and onerous.

**Section 4 – Prohibited Non-audit services**

**Prohibition of additional non-audit services** (see pages 29 – 35)

**Question 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?*

7. We strongly support the black-list approach, rather than a white-list. We support the Audit Committee having the responsibility of evaluating independence risks as much as possible, and that only specific activities that are widely accepted as compromising independence should be prohibited. A 'white list' approach is unnecessarily constraining, and it gold-plates European legislation. It might introduce inconsistencies with requirements in other European countries and so be especially onerous for multinational companies.

**Question 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?*
8. We do not support a 'white-list' approach. (a) We do not consider that any of the services set out in paragraph 4.13 should be excluded. We consider that

applying the independence principle might well result in other services being included. (b) We assume that full and detailed consultation would be necessary, both initially and periodically.

**Question 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?*

9. No. We do not support such gold-plating of European legislation, not the introduction of inconsistencies with other European countries.

***Derogations in respect of certain prohibited non-audit services (see pages 35 – 36)***

**Question 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?*

10. Yes. We support the Audit Committee being able to evaluate independence risks as immaterial and the entity's ability exercise freedom of choice.

**Question 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?*

11. Yes.

***Audit Committee's role in connection with allowed non-audit services (see page 36)***

**Question 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?*

12. Yes. In our view such Audit Committee approval is sufficient. No other conditions are needed. Our answer would not be different.

***Geographical scope of the prohibitions of non-audit services, by the audit firm and all members of its network, to components of the audited entity based outside the EU (see pages 37 – 39)***

**Question 13**

*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 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?*

13. No. We see no need to gold-plate the European requirements in this way. It is for the entity, its Audit Committee, and the auditor, all at the group level in the EU to decide on these independence risks.

***Applying restrictions to other group auditors that are not part of the group auditor's network (see pages 39 – 40)***

***Question 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?*

14. No. We see no need to gold-plate the European requirements in this way. It is for the entity, its Audit Committee, and the auditor, all at the group level in the EU to decide on these independence risks.

***Section 5 – Audit and Non-audit Services Fees  
Fees for non-audit services (see pages 42 – 46)***

***Question 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?*

15. Yes, we consider it to be sufficient. We see no reason to gold-plate the European legislation.

***Question 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?*

16. We agree in principle with this flexibility being available.

***Question 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,?*

17. Yes, we consider that the cap should apply only as required by the Audit Regulation - we see no reason to gold-plate this.

***Question 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?

18. N/A. As above, we not consider that a modified cap is needed.

**Question 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)?*

19. Yes. Yes, we consider that the basis should apply only as required by the Audit Regulation - we see no reason to gold-plate this.

**Total fees for audit and non-audit services** (see pages 46 - 48)

**Question 20**

*Do you believe that the requirements in ES 4 should be maintained?*

20. We support the continuation of the requirements in ES 4.

**Question 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?*

21. In our view, the distinction between listed and unlisted companies remains the key one. To extend the FRC’s more restrictive requirements to other PIEs is gold-plating, quite unnecessary, and onerous.

**Question 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”.*

22. We have no comments.

**Section 6 – Record Keeping**

**Question 23** (see page 49)

*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?*

23. We have no comments.

**Section 7 – Audit Firm and Key Audit Partner Rotation**

**Audit firms** (see page 50)

**Question 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?*

24. We have no comments.

***Key audit partners*** (see pages 50 - 51)

***Question 25***

*Do you believe that the requirements in ES 3 should be maintained?*

25. We support the continuation of the requirements in ES 3.

***Question 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?*

26. In our view, the distinction between listed and unlisted companies remains the key one. To extend the FRS's more restrictive requirements to other PIEs is gold-plating, quite unnecessary, and onerous.

***Consultation Stage Impact Assessment***

***Question 27*** (see pages 52 – 60)

*Are there any other possible significant impacts that the FRC should take into consideration?*

27. The requirements will place disproportionate burdens on mutuals and other unlisted insurers. Very many of these are small, have limited resources, and lack finance other than from their policyholders - the protection of whose interests is already at the very heart of extensive and substantial regulation and supervision by the Prudential Regulation Authority. Every effort should be made to reduce the effects.