



National Audit Office

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Via email

Dear Keith,

Financial Reporting Council Consultation on implementation of the EU Audit Direction and Audit Regulation

The UK National Audit Office (NAO), on behalf of the Comptroller and Auditor General (C&AG), are pleased to respond to the Financial Reporting Council's (FRC) consultation *Implementation of the EU Audit Directive and Audit Regulations*.

The NAO audits all central government bodies and a wide range of other UK and international public bodies. The NAO applies International Standards on Auditing (UK and Ireland) issued by the FRC and also complies with the Auditing Practices Board Ethical Standards.

There are clearly key differences between the public sector entities that we audit and the private sector environment that many other professional accountants work within. It is however vitally important that all audits are conducted to the same high standard and that the applicable framework is designed to support the requirements of different sectors.

The most appropriate way for an auditor to ensure that ethical standards are maintained is by adopting a principles and safeguards based approach, and to ensure that ethical threats are considered against these principles rather than using a set of rules that can be misinterpreted or may not be entirely appropriate for the situation that arises.

With this overarching view in mind, our responses to the issues raised in the consultation are shown below. We have provided a response to the main sections relevant to the work of the NAO that are included in the consultation. Where we have referred to 'stakeholders' in our responses, this relates to all of those with an interest in the work of auditors, but with a primary focus on our key stakeholders (Parliament and the public).

With this overarching view in mind, our responses to the issues raised in the consultation are shown below. We have provided a response to each of the sections in the consultation rather than to specific question raised since not all of these are relevant to the work of the NAO. Where we have referred to 'stakeholders' in our responses, this relates to all of those with an

interest in the work of auditors, but with a primary focus on our key stakeholders (Parliament and the public).

Section 1 - Auditing Standards

The NAO is of the view that the FRC should be able to exercise provisions in the Audit Directive and Regulation to impose additional requirements in auditing standards adopted by the Commission to take account of local needs and legislation.

It is important for local needs and legislation to be reflected in auditing standards when implementing European Union requirements. This will ensure that the requirements of the standards are relevant to the UK and meet the expectations of stakeholders.

Sections 2 and 3 - Public Interest Entities

We do not believe it necessary or appropriate to make provision in the Standards for the inclusion of all public sector bodies within the definition of a Public Interest Entity (PIE).

A number of the requirements for the auditors of PIEs would not be appropriate for the bodies we audit, including enhanced audit reporting, where the C&AG already has powers to undertake additional reporting and would place added burden on smaller entities. Instead of categorising certain entities that should be subject to more stringent requirements, focus should be placed on ensuring that the audits of entities - no matter the size or business - should be subject to the highest ethical and professional standards.

The classification of a 'PIE' and a 'non-PIE' would suggest a two-tiered approach to the stringency and rigour in which the auditor would approach an engagement for each category or auditee. We do not believe this is appropriate and, indeed, within our own sector we already apply the same high level of standards to all bodies we audit, no matter what their size or business. The NAO's client base - from large government departments to smaller non-departmental public bodies - are all funded using public funds and so there are high stakeholder expectations about how these are audited. Accordingly, the NAO already adopts an audit approach that encompasses many of the more stringent requirements for listed entities and the EU Directive and Regulation for PIEs for all of our client base.

Sections 4 and 5 - Prohibited non-audit services and fee dependency

We do not agree with the proposals for a white list of non-audit services primarily because such a list is unlikely to be exhaustive and descriptions of services can be open to interpretation. The existing approach of prohibiting certain specified NAS but allowing others subject to a threats and safeguards review is well established and understood by regulators, auditors, audit committees and investors. Our preference is for a principles

and safeguard based approach that could be applied to each situation that arises and appropriate actions taken accordingly.

Further, the additional disclosures already required in our view provide sufficient transparency for the users of the accounts and other stakeholders. Audit Committees currently have the opportunity to scrutinise proposals for non-audit services provided by the statutory auditor.

If public sector entities are classified as PIEs, and a black or white list of non-audit services were adopted, then consideration should be given to the public sector environment and, in particular, the statutory requirements to undertake examinations

into the economy, efficiency and effectiveness with which departments have used their resources in discharging their functions (value for money assessments).

Under the National Audit Office Act 1983, the NAO, on behalf of the C&AG, produces approximately 60 value-for-money reports, along with other outputs, each year examining the economy, efficiency and effectiveness of government spending. Although primarily designed for the UK Parliament, many government entities make use of the recommendations raised in the value-for-money reports. Therefore, audited bodies may benefit indirectly from the work performed and this could be considered a 'non-audit service'. This work is statutory and is a vital element in enabling Parliament to hold government to account.

Fee dependency safeguards should be considered from a public sector perspective and from a principles based approach

The statutory basis for the NAO's work means that, in many cases, no cash fee is charged but instead we are funded directly by Parliament. However, in some instances the C&AG is appointed by statute and the NAO is required to charge a fee for the audit work performed. Where appointed by statute and a fee is charged, the C&AG is unable to resign due to the legal basis of his appointment. Accordingly, the safeguard of resignation set out in the consultation document is not an option for the NAO in some cases, and this should be considered by the FRC in responding to the EU Directive and Regulation.

Section 6 - Record keeping

The NAO fully supports a minimum retention period for audit documentation, including that specified in the Audit Regulation.

The NAO already exceeds these requirements by complying with guidance for record retention issued by the National Archives. Our audit files and working papers are destroyed 6 years after the year of account to which they relate. This point is included in ISQC (UK and Ireland) 1 however we would be supportive of including a minimum retention period for audit documentation.

Section 7 - Audit firm and key partner rotation

We support the view that there should be clear responsibility for auditors and audit firms to rotate. However, clarity should be provided to take account of the statutory nature of the appointment of the C&AG, should public sector entities be classified as PIEs.

As stated in our response to sections 5 and 6, the C&AG is appointed under statute and as such cannot resign or be dismissed. The C&AG, under the Budget Responsibility and National Audit Act, holds the position for a period of up to 10 years as an individual. This time period would fall within the EU Audit Directive and Regulation proposals.

We believe it is right to place the onus on audit firms to demonstrate their compliance with ES3 as well as the other Ethical Standards.

The Ethical Standards form the cornerstone of the auditing profession's reputation and as such, it is in our view right that it falls to the audit profession to demonstrate compliance, and not for clients of the profession.

I trust these observations will be of use. If you have any questions relating to this, please contact Lewis Knights, Head of Audit Methodology at the National Audit Office, at lewis.knights@nao.gsi.gov.uk.

Yours sincerely,

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