



Response to FRC Consultation: Enhancing Confidence in Audit

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INTRODUCTION

ICAS welcomes the opportunity to comment on the FRC's Consultation – *Enhancing Confidence in Audit*.

Our CA qualification is internationally recognised and respected. We are a professional body for over 20,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's and the world's great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Any enquiries should be addressed to James E Barbour, Director, Technical Policy.

Key Comments

FRC Ethical Standard

We broadly welcome the FRC's proposed approach to consolidate all of its existing ethical standards for auditors and reporting accountants into one standard (FRC ES) and for this to also apply to public interest assurance engagements as defined. We believe that this does help to reduce the likelihood of a situation where the current Ethical Standards 2-5 may be considered in isolation without regard to the overarching principles which are currently contained in Ethical Standard 1. However, we do have a concern that the inclusion of the ESRA provisions unnecessarily complicates the proposed standard.

Public Interest Entities (PIEs)

We welcome the FRC's decision that the EU Audit Regulation requirements are not being extended beyond PIEs.

However, we are not supportive of the FRC's proposal to extend, to non-listed PIE audits, the more stringent requirements that are not subject to the FRC's intended relief. We note that these additional requirements principally relate to reporting to those charged with governance and to circumstances when a firm's fee income from an entity is expected to exceed 5%, 10% or 15% of the firm's total fee income. We believe that the FRC's rationale for so doing is weak i.e. *"on the grounds that this will enable consistency of focus on these matters by auditors and audit committees for such entities, without requiring any additional work by the auditor beyond reporting"*. This of course also means unnecessarily making such entities the subject of the FRC's more stringent requirements relating to the rotation of the audit engagement partner, the engagement quality control reviewer and other key audit partners. We believe that the FRC's more restrictive requirements should only apply to those entities which are currently caught by the scope of the FRC's definition of a 'Listed entity'. These more restrictive requirements should not be applied to other PIEs.

Definition of Listed Entity

We are supportive of the FRC's proposal that it will continue to define a listed entity consistent with the definition used in the international standards issued by the IAASB and the international ethical code issued by the IESBA: *"An entity whose shares, stock or debt are quoted or listed on a recognised stock exchange or are marketed under the regulations of a recognised stock exchange or other equivalent body"*.

We welcome that the FRC is proposing to:

- (i) amend the definition to clarify that an entity whose securities are technically listed, but which are not in substance freely transferrable or tradeable, are not listed entities for the purposes of the Ethical Standard (ES); and
- (ii) remove the unnecessary previous language difference between the definition in the APB ethical standards and the International Standards on Auditing (ISAs) (UK and Ireland) of listed entities, to avoid any suggestion that the definition for the FRC ES is intended to apply only in relation to UK and Ireland exchanges.

Non-audit Services

We welcome that the FRC does not propose to make any additions to the EU blacklist of prohibited non-audit services for PIEs. Additionally, we welcome the FRC's decision to introduce the list of prohibited non-audit services verbatim as per the EU Audit Regulation.

We also welcome that the FRC does not propose to utilise the Member State option to apply a more stringent (lower) fee cap relating to the provision of non-audit services. We believe there would be merit in including material to make it clear that the applicability of the cap will not kick-in immediately in June 2016.

We note that the FRC is proposing amendments, in accordance with the Regulation, to avoid resetting the three year calculation period where interruption arises from a gap year in providing NAS and to apply the cap to firms at the network level. Both of these proposed amendments could be viewed as gold-plating. We accept that the latter is probably justified to prevent the possible circumvention of the cap by the use of other network firms but we question whether it is necessary to include an amendment to avoid resetting the clock. We do not envisage that this would be an issue in practice.

We welcome the approach being adopted by the FRC in conjunction with BIS et al in relation to Article 4 (2) of the EU Audit Regulation i.e. that non-audit services which are required by law includes those which are required by a rule issued by a regulator in accordance with powers granted by legislation, and that these are exempt for the purposes of the calculation of the cap. We believe that this is a sensible and proportionate approach.

Elimination of Term "Chain of Command"

We believe that the proposed new definition "a partner in a position to influence the conduct or outcome of the engagement" will introduce much needed clarity in this respect as it no longer specifies the need for a person in a position of influence to be able to exert "direct" influence, and now includes persons "at each successive level of firm management, supervision or oversight relating to the audit or other public interest engagement, up to and including individuals who have ultimate responsibility for the management or governance of the firm".

International Standards on Auditing (UK and Ireland)

We recognise the difficulties that the FRC has faced in this respect and are generally supportive of the approach that has been adopted. We would however request that the FRC review the proposed standards to see whether there is scope for simplifying the approach and to ensure consistency of terminology wherever possible.

Guidance on Audit Committees

We are supportive of the FRC's proposed approach to revise its 'Guidance on Audit Committees' (the Guidance), in order to align this with the new requirements for audit committees and changes to the ethical standards for auditors. However, we believe that there is a need to better inform audit committees of the non-audit services which are prohibited. This could best be achieved by replicating the content of the Ethical Standard's content in relation to the non-audit services which are prohibited in the FRC's Guidance on Audit Committees. The most appropriate place for inclusion would be in the section on 'The External Audit Process' which begins at paragraph 55 of the guidance.

Responses to the Specific Consultation Questions

Question 1: Do you agree that the overarching ethical principles and supporting ethical provisions establish an appropriate framework of ethical outcomes to provide a basis for user trust and confidence in the integrity and objectivity of the practitioner, as described in the introduction to the Ethical Standard?

We are broadly supportive of the approach adopted. We do have some finer points of detail which are included in our response to specific questions below.

Question 2: Do you support the FRC's proposals to restructure the ethical standards, as a single standard for all audit and public interest assurance engagements?

We are supportive of the overall approach i.e. to consolidate all of the five separate ethical standards for auditors into one standard and to also include the provisions relating to other public interest assurance engagement requirements. We believe this does give greater prominence to the overarching principles material that is currently located in Ethical Standard 1 for auditors and how this relates to the other more specific material currently contained in the other ethical standards and is more clearly outcome based. In particular we believe that this does help to avoid a situation where the current Ethical Standards for auditors 2-5 may be considered in isolation without regard to the overarching principles.

Our concern is whether the inclusion of the ESRA provisions unnecessarily complicates the proposed standard.

Question 3: Do you agree with the FRC's proposals for the application of the FRC ES to non-listed PIEs?

We believe that the FRC's more restrictive requirements should only apply to those entities which are currently caught by the scope of the FRC's definition of a 'Listed entity'. These more restrictive requirements should not be applied to other PIEs.

The FRC's proposed approach would appear at odds with the UK Government's view of a minimalist implementation of the EU Audit legislation although we do accept that the issue of complexity of applicability also has to be considered. On balance, we believe that the potential increased regulatory costs outweigh the reduced level of complexity and are therefore not supportive of the FRC's proposed approach.

Question 4: Do you agree with the FRC's proposal to retain the Ethical Standard – Provisions Available for Smaller Entities and to make conforming changes?

We are supportive of the FRC's proposal to retain the PASE. There was considerable pressure applied in 2004 by ICAS and the other CCAB professional bodies, and indeed by small business, for such a standard to be introduced when the APB issued its ethical standards for auditors for the first time. We welcomed the introduction of this standard at that time and believe that there is a need for it to be retained to ensure that the application of the FRC's ethical standards for auditors is proportionate.

Question 5: Do you support the FRC's proposal for the group auditor to ensure that any component auditor, whose work they propose to use in the audit and other members of the firm's network, meet the FRC ES or the IESBA Code as set out above?

We welcome that the FRC has not sought to follow the precedent set by the PCAOB and adopt an extraterritoriality approach. We agree that it is important that auditors are able to demonstrate that they are appropriately independent if their work is to be used by the group auditor. However, in contrast to the FRC, we believe that the proposed approach is flawed and would stress that a level playing field is required for component audit firms. We would prefer that the IESBA Code (subject to any additions which are required to meet the EU requirements) is adopted as the consistent standard against which the group auditor is required to carry out an evaluation of the independence of any network or third party firm whose work they propose to use in the group engagement.

Question 6: Do you support the extension of scope to other public interest assurance engagements, incorporating the requirements of the ESRA into the FRC ES, and do you agree that the restriction of scope of ethical requirements for investment circular work is sufficiently clear in the proposed text?

We agree with the FRC's view that stakeholders expect an equivalent standard of independence for firms, their partners and staff who are involved in providing other public interest assurance engagements to that required of auditors. However, we are concerned as to whether inclusion of the ESRA provisions unnecessarily overcomplicates the proposed standard.

Question 7: To provide additional clarity in respect of auditor independence, do you support the FRC's proposal to replace the 'chain of command' definition with the revised wording of the definition of a person in a position to influence the conduct or outcome of an engagement?

We are supportive of a change in this area as the current approach has caused considerable difficulties in interpreting in practice and therefore led to lack of consistency in application.

We believe that the proposed new definition "a partner in a position to influence the conduct or outcome of the engagement" will introduce much needed clarity in this respect as it no longer specifies the need for a person in a position of influence to be able to exert "direct" influence, and now includes persons "at each successive level of firm management, supervision or oversight relating to the audit or other public interest engagement, up to and including individuals who have ultimate responsibility for the management or governance of the firm".

Question 8: Do you support the FRC's proposal regarding accepting an engagement for an entity employing a former partner or other restricted person, to comply with the requirement set out in the Directive?

We are supportive of this approach.

Question 9: Do you agree with the FRC's proposal to mitigate the risk of an auditor's independence being compromised, by clarifying requirements relating to the provision of non-audit services provided before taking up appointment as auditor?

We are supportive of the FRC's proposal in seeking to mitigate the risk of an auditor's independence being compromised prior to taking up appointment as auditor.

Question 10: Do you support the FRC's proposal to make consistent the prohibitions over providing advocacy for an audited entity in relation to tax?

We do not believe that there is any need to change the wording of the extant provision which we believe is proportionate. We believe that it is worth bearing in mind that if there is a matter of dispute between HMRC and the audited entity, then the audit firm is already likely to have formed a view on the suitability of the tax treatment and therefore assisting the client in that regard will not necessarily unduly compromise independence. We also believe that, for smaller clients, the impact on their business of having to seek new advice/support in this area will be disproportionate to any wider benefit given that safeguards will be applied in any case.

Question 11: Do you agree with the prohibition proposed by the FRC in respect of the provision of tax services on a contingent fee basis?

We are not supportive of a complete prohibition. We believe that there are certain services, such as VAT reclaim related services, which are mechanistic in nature, and therefore acceptable for auditors to provide to their audit clients. Obviously, the provision of such services needs to be considered on a case by case basis but we see no reason for a complete prohibition.

Question 12: Do you agree with the FRC's proposals to offer targeted reliefs in respect of the audits of smaller listed/ smaller quoted entities?

In our response to the FRC's earlier discussion paper, we highlighted the need to seek to reduce the regulatory burden on smaller listed entities and to promote the UK Government's growth agenda. We therefore proposed that relief should be provided to certain smaller listed/smaller quoted entities. We therefore welcome the FRC's proposal to relieve certain listed entities from certain of the FRC's more stringent requirements. We also believe that the FRC has targeted these reliefs at the right level of entity. However, we would have liked to have seen a wider series of reliefs provided for such entities.

Question 13: Do you believe that the FRC's proposals are targeted at the right level, if not what alternative considerations for the application of reliefs would you suggest?

We believe that the FRC's proposals are targeted at the right level. The threshold being applied is that which was advocated by ICAS in our response to the FRC's earlier consultation paper.

We believe however that further consideration needs to be given to the dates on which the average calculation should be based.

Question 14: Do you agree that the reliefs should continue not to apply, to entities which exceed the threshold and then subsequently fall below the threshold, for a period of two financial years following the financial year in which the reliefs first ceased to apply?

We are not convinced that this is necessary.

Question 15: Do you agree with the FRC's proposed approach to incorporate the requirements of the Regulation and Directive into the text of the quality control and auditing standards?

We recognise the difficulties that the FRC has faced in this respect and are generally supportive of the approach that has been adopted. We would however request that the FRC review the proposed standards to see whether there is scope for simplifying the approach and to ensure consistency of terminology wherever possible.

Question 16: Do you foresee any difficulties if the effective date is for audits of financial statements for periods commencing on or after 17 June 2016?

We do not foresee any difficulties with the changes becoming effective for audits of financial statements for periods commencing on or after 17 June 2016, subject to the caveat that the finalised standards are issued in sufficient time to allow the firms to: update their respective methodologies; update their systems; and provide training to their staff.

Question 17: Do you agree with the FRC's proposals to: (a) adopt the proposed ISA (UK and Ireland) 700 (Revised) and ISA (UK and Ireland) 701; and (b) extend the application of ISA 701 to (i) those entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code and (ii) PIEs?

We welcome the FRC's proposal to adopt ISA 700 (Revised) and ISA 701 for use in the UK. We also welcome the FRC's decision to maintain some of the important elements required by existing ISA (UK&I) 700, namely the inclusion of materiality and the description of audit scope.

However, we find the inclusion of three different sources of requirements in proposed ISA (UK&I) 701 (the international requirements; those relating to the EU Directive/Regulation; and the requirements of existing ISA (UK&I) 700) confusing. We are concerned that this has resulted in some repetition in the final standard. We acknowledge that the FRC is restricted in how far it is allowed to amend or interpret the international and EU Regulation requirements. However, we believe that this could be simplified by removing the reference to the requirements applicable to those who apply the UK Corporate Governance Code and augmenting the application material to incorporate details as to how application of the international requirements will result in compliance with the EU Regulation requirements.

With regard to the proposed ISA (UK&I) 700 (Revised), we believe that the guidance could be clarified by removing references to “*In the UK and Ireland*” and “*For statutory audits...*”, as these words are unnecessary. In particular we do not support drawing distinctions between statutory and non-statutory audits. We also recommend that the FRC strongly considers tailoring the examples in proposed ISA (UK&I) 700 to reflect the specific UK and EU requirements for both UK and Irish companies, as they are not helpful in their current, untailored, form.

We agree with the proposal to extend the application of ISA 701 to (i) those entities that are required, and those that choose voluntarily, to report on how they have applied the UK Corporate Governance Code and (ii) PIEs.

Question 18: Do you agree with the FRC’s proposals to: (a) adopt the proposed ISA (UK and Ireland) 720 (Revised); (b) include requirements to allow the auditor to provide the required opinions and statements under UK [and Irish] legislation; and (c) withdraw Section B of ISA (UK and Ireland) 720 (Revised)?

We support these proposals.

Question 19: Do you agree with the FRC’s proposals to enhance auditor reporting in respect of the going concern basis of accounting?

We have mixed views about these proposals. Whilst there will be some benefit re increased transparency of the respective responsibilities of management and auditors, we wonder whether the potential increased clutter in the report will outweigh the potential benefits.

Question 20: Do you agree with the proposed scope of ISA (UK and Ireland) 250 Section B being limited to PIEs, or do you believe that the requirements of ISA 250B should also apply to non-PIEs in regulated sectors?

We believe that the scope of ISA 250B should be limited to PIEs.

Question 21: Do you agree with the FRC’s proposals for the minimum retention period for audit working papers for all audit engagements?

Given current requirements we do not believe that this is strictly necessary. However the proposed minimum retention period of 6 years from the date of the auditor’s report seems sensible and is consistent with HMRC guidelines.

Question 22: Do you agree that the minimum retention period should apply to all audit documentation rather than just those documentation requirements deriving from the Regulation and Directive?

We agree that the minimum retention period should apply to all audit documentation.

Question 23: Do you agree with the FRC’s proposal to withdraw Bulletin 2008/4 and incorporate additional application material into ISA (UK and Ireland) 210 (Revised)?

We agree with the FRC’s proposal to withdraw Bulletin 2008/4 as it will be out of date. Whilst we note the additional application material incorporated into ISA 210, we believe there would be merit in issuing a new Bulletin as this helps to facilitate an appropriate level of consistency.

Question 24: Do you agree with the changes to section C.3 of the Code?

We are generally supportive of the changes to section C.3 of the Code. We do however question the value of requiring companies to disclose advance notice of their respective tendering plans.

Question 25: Is an advisory vote on the audit committee report required?

We do not believe that an advisory vote on the audit committee report is required. We do however believe that the FRC should maintain a watching brief on this issue.

Question 26: Do you agree with the changes to the Guidance?

We are generally supportive of the proposed changes. However, we believe that there is a need to better inform audit committees of the types of non-audit services which auditors are prohibited from providing to their PIE audit clients. This could best be achieved by replicating the content of the Ethical Standard's content in relation to the non-audit services which are prohibited, in the FRC's Guidance on Audit Committees. The most appropriate place for inclusion would be in the section on 'The External Audit Process' which begins at paragraph 55 of the guidance.