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Dear Mr Billing

ICSA response to consultation: auditing and ethical standards – implementation of the EU audit directive and audit regulation

We welcome the opportunity to comment on the FRC's consultation on implementation of the EU audit directive and audit regulation.

As you know, the Institute of Chartered Secretaries and Administrators (ICSA) is the professional body that qualifies Chartered Secretaries, which includes company secretaries. Company secretaries have a key role in advising companies on their governance arrangements and for governance reporting. Our members are therefore well placed to understand the issues around the proposals for implementation of the EU audit directive and regulation. However we think there are a couple of questions that would be better addressed by the accounting firms that provide audit services and are outside our expertise. We have therefore not attempted to answer those questions.

We have set out below our responses to the questions in your consultation.

Section 1: Auditing standards

Q1 Do you agree that the FRC should exercise the provisions in the Audit Directive and Audit Regulation to impose additional requirements in auditing standards?

Yes. We think the FRC is the appropriate body to do this.



Section 2: Proportional application and simplified requirements

Q2 Do you believe that the FRC's current audit and ethical standards can be applied in a manner proportional to the complexity of the activities of small undertakings?

Yes. We agree with this proposal in principle.

Q3 Should the FRC simplify the requirements of Articles 22b, 24a and 24b?

We think this question is best answered by the accounting bodies that provide audit services.

Section 3: Extending the more stringent requirements for Public Interest Entities

Q4 With respect to the more stringent requirements in the FRC's audit and ethical standards:

a) should they apply to PIEs as defined in the Audit Directive?

We think that the requirements should 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?

We think they should continue to apply to all other listed entities as currently defined by the FRC.

Q5 Should some or all of the more stringent new requirements apply to some or all other listed entities as currently defined by the FRC?

We think the more stringent new requirements should apply to listed entities as defined in the Audit Directive. We do not think the definition should be extended to automatically include smaller companies quoted on markets such as AIM.

Q6 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?

Yes. We think that the more stringent requirements should also apply to privately owned entities that are of significant public relevance because of the nature of their business, their size or the number of employees. However, the parameters for such entities should be clearly set, with proper consideration given to the risk that is being addressed by applying the more stringent requirements.



Section 4: Prohibited non-audit services

Q7 Do you have views on the effectiveness of (a) a ‘black list’ of prohibited non-audit services or (b) a ‘white list’ of allowed services?

We support (a) a ‘black list’ of prohibited non-audit services. This approach corresponds with current practice, is easily understood, and a ‘black list’ of services can be updated and supplemented as the need arises. This approach is more flexible and provides for the discretion of audit committees and/or auditors to exclude other services as they consider necessary. A ‘white list’ would be a significant change for UK companies and would probably result in a number of unforeseen circumstances. In our view a ‘white list’ would not provide the flexibility needed to deal with changes when needed or these unforeseen consequences.

Q8 If a ‘white list’ approach is deemed appropriate:

a) do you believe the illustrative list is would be appropriate?

We think the list set out in paragraph 4.13 looks appropriate but we do not think it is possible to think of all services that should be included. This is one important reason why we support the ‘black list’ approach.

b) how might the risk that the auditor is inappropriately prevented from providing a service that is not on the white be mitigated?

We think this is a major risk associated with the ‘white list’ approach and do not think it is possible to provide the necessary flexibility.

Q9 Are there additional non-audit services that should be prohibited?

No. We do not think there are any additional services that should be prohibited at this time.

Q10 Should the derogations member states may adopt under the Audit Regulation if the prohibited non-audit services have no direct or have immaterial effect on the audited financial statement be taken up?

Yes. We agree the derogations should be taken up and think the FRC is the appropriate competent body to make decisions on this matter.

Q11 If the derogations are taken up, is an ‘immaterial’ effect sufficient?

Yes. We agree that ‘immaterial’ is appropriate.



Q12 Is it sufficient to require the audit committee to approve non-audit services, after assessment of threats to independence and application of safeguards?

Yes. We think it is appropriate that the audit committee provides approval for non-audit services. It is important to note that audit committee chairmen and members are available to shareholders to be held to account. The audit committee report, including details of monitoring non-audit services, is included in companies' annual reports and the reappointment of directors, including members of the audit committee, is at the discretion of shareholders.

Q13 Should the FRC require the group auditors of PIEs to ensure the principles of independence are complied with by all members of the network?

Yes.

Q14 Should the FRC require the group auditors of PIEs to ensure the principles of independence are complied with by all other auditors whose work they use?

Yes.

Section 5: Audit and non-audit services fees

Q15 Is the 70% cap on fees for non-audit services sufficient or should a lower cap be implemented for some or all types of permitted non-audit services?

We think the 70% cap is sufficient for all types of permitted non-audit services. We are strongly of the view that the cap should not be any lower.

Q16 Should the FRC (as competent authority) grant any exemptions from the cap, on an exceptional basis, for a period not exceeding two years?

Yes. We think the FRC should be empowered to grant exemptions as it considers appropriate. This would be particularly relevant to times of corporate actions or transaction where services such as those set out in paragraph 5.8 of the consultation document are provided by the auditor. These services include an opinion on information in circulars and prospectuses, and to support confirmations provided by the sponsor to the FCA. Because of their understanding of the company, the auditor is best placed to provide these services.

Q17 Is it appropriate that the cap should apply only to non-audit services provided by the auditor, or should a modified cap also apply to non-audit services provided by network firms?

We think it is appropriate that the cap should apply only to non-audit services provided by the auditor. We do not think it would be appropriate to go beyond the EU requirements and to also apply a modified cap to network firms.



Q18 Should the audit and non-audit fees for the group as a whole be taken into consideration in calculating a modified alternative cap?

We do not support a modified alternative cap.

Q19 Is the basis of calculating the cap by reference to three or more preceding consecutive years appropriate?

Yes. We think three years is appropriate and also agree that the circumstances when this would not apply, as set out 5.3, are appropriate.

Q20 Do you believe that the requirements in ES 4 should be maintained?

Yes. We support these Ethical Standards.

Q21 Do you believe the more restrictive requirements in ES 4 should apply to all PIEs and should they apply to some or all other entities deemed to be of sufficient public interest?

Yes. We would support these Ethical Standards being applied to certain PIEs such as large unlisted banks and insurance companies.

Q22 Do you believe that an expectation that fees will exceed the specified percentages for a least three years should be considered as “regularly” exceeding those limits?

We do not have a view as to whether this should be considered as “regularly” exceeding the limits.

Q23 Should the FRC stipulate a minimum retention period for audit documentation?

Yes. We think there should be a minimum retention period for audit documentation and that this should be six years. Six years is the standard period for document retention.

Section 7: Audit firm and key audit partner rotation

Q24 Do you believe that the FRC’s audit and/or ethical standards should establish a clear responsibility for auditors to ensure they do not act as auditor when they are effectively time barred?

Yes. We think it would be appropriate for this responsibility to be placed on auditors.



Q25 In relation to audit partners, do you believe that the requirements of ES 3 should be maintained?

Yes. We think the more restrictive requirements in ES 3 should be maintained. The current requirement that the 'key audit partner' may serve no more than five years causes no practical difficulties and we think it is appropriate. We see no need to extend this to seven years.

Q26 Do you believe that the requirements of ES 3 should be maintained in relation to all PIEs and some other entities?

Yes. We think it would be appropriate that the requirements of ES 3 should apply to other entities and those set out in paragraph 3.22 of the consultation document appear appropriate. However, we think that the inclusion of 'other entities' of significant public relevance because of the nature of their business, their size or number of employees, should include the setting of clear parameters, with proper consideration given to the risks being addressed.

Q27 Are there any other considerations the FRC should take into account?

We think that it would be appropriate for the FRC to consider personal sanctions against an audit partner if serious accounting irregularities come to light within a company after the financial statements have been approved and published, and these were not identified during the audit.

We hope you find our comments helpful and would be happy to expand on any of these points should you wish to discuss them further.

Yours sincerely



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