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29 September 2014

Dear Mr Siong

Exposure Draft – Proposed changes to certain non-assurance services provisions

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed changes to the Code of Ethics for Professional Accountants (the Code) set out in the above exposure draft. We apologise for submitting our response after the due date but hope that you find our comments helpful and take them into consideration.

We are supportive of the objective of the proposals to enhance auditor independence. However, the proposed changes are very limited compared with the provisions recently introduced in the EU Audit Regulation, which brings in a new regime which all auditors of public interest entities (PIEs) in the EU will need to comply with when implemented by Members States by June 2016. Those provisions go further than the proposed changes to the Code, particularly in prohibiting specific non-audit services by auditors, and any member of the audit firm network, to PIEs and their parent undertaking or controlled undertakings within the EU. For example, the EU Audit Regulation establishes outright prohibitions, with no derogations allowed, for a number of specific services, including:

- bookkeeping and preparing accounting records and financial statements;
- designing and implementing internal control or risk management procedures related to the preparation and/or control of financial information or designing and implementing financial information technology systems;
- services related to the audited entity's internal audit function; and
- services linked to the financing, capital structure and allocation, and investment strategy of the audited entity, (except providing assurance services in relation to the financial statements, such as the issuing of comfort letters in connection with prospectuses issued by the audited entity).

Others, such as taxation services are prohibited outright but with scope for Member State derogations in certain circumstances. Under the IESBA Code, these services could be provided if they were not material or significant to the financial statements and the auditor was not assuming a management responsibility.

Further, for non-audit services that are not prohibited, the EU Audit Regulation requires the approval of the audit committee after it has properly assessed threats to independence and the safeguards applied.

We would strongly encourage IESBA to give further consideration to aligning the Code more closely with the position introduced under the EU Audit Regulation for PIEs. Not only would it be helpful, especially for auditors of international groups, if the Code were brought more into line with the EU Audit Regulation but it would also further assist in reducing perceived threats to auditor independence arising from the provision of non-audit services.

In the Explanatory Memorandum, IESBA states that "the main results of [its] benchmarking exercise indicated that the jurisdictions surveyed are in line with the Code for most of the Code's provisions". However, the analysis of survey responses (linked from the Explanatory Memorandum) shows that a significant number of jurisdictions reported they have more restrictive provisions (typically around half or more of the respondents for each of the services discussed).

We note that IOSCO's Committee on Issuer Accounting, Audit and Disclosure stated that, in order to improve the Code, IESBA may consider the regulatory requirements of large jurisdictions as the Committee believes the Code appears to reflect a number of compromises to address perceived practical issues in some, particularly smaller, jurisdictions. We support the view of the IOSCO committee – to serve the public interest, and alleviate concerns about threats to auditor independence and objectivity, ethical principles for auditors of PIEs should not be subject to compromise.

We also provide further comments below on the specific proposed changes to the Code.

Emergency Exceptions

We agree with the proposal to withdraw the emergency exception provisions related to bookkeeping and taxation services for PIEs. This would also be consistent with the provisions of the EU Audit Regulation (which do not allow for emergency assistance) when it is implemented by Member States.

Management Responsibilities

We agree that it would be helpful to provide additional guidance in the Code regarding what constitutes management responsibilities. We support much of the proposed change to the guidance to the requirements that an audit firm shall not assume a management responsibility for an audit client and that the firm shall be satisfied that client management makes all judgments and decisions that are the responsibility of management.

However, we are concerned with the statement in the proposed guidance, in paragraph 290.164, that "providing advice and recommendations to assist management in discharging its responsibilities is not assuming a management responsibility." Whilst doing so may not, in itself, constitute the assumption of a management responsibility, it may in substance amount to that depending on the circumstances. Furthermore, the EU Audit Regulation prohibits auditors of PIEs from providing "services that involve playing any part in the management or decision-making of the audited entity" and does not therefore address this from the perspective of whether such services may constitute the assumption of a management responsibility. Some clarification may be needed as to what is meant by "playing any part", but depending on its interpretation it may have a very wide ranging impact and may in effect prohibit the auditor from "providing advice and recommendations to assist management in discharging its responsibilities". We would strongly encourage IESBA to explore this potential conflict with the EU Audit Regulation and how it might be addressed in finalising the changes to the Code.

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Administrative Services

We agree that it would be clearer if the guidance addressing administrative services were presented in a separate subsection rather than included in the guidance addressing management responsibilities. However, we do not believe that auditors should be permitted to provide such services to PIEs and, to avoid the perception of threats to their independence, we believe they should be prohibited from doing so. We therefore recommend moving this paragraph to the section for ‘audit clients that are not public interest entities’.

Services for Non-PIEs that are Routine or Mechanical in Nature

We agree that the proposed additional guidance would help clarify the meaning of the phrase “routine or mechanical” in the subsection that addresses preparing accounting records and financial statements.

Yours sincerely

Nick

Nick Land
Director of the FRC and Chairman of the FRC’s Audit & Assurance Council

Enquiries in relation to this letter should be directed to Marek Grabowski, Director of Audit Policy.
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About the FRC
The Financial Reporting Council is the UK’s independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code. We set standards for corporate reporting and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

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