



APB Consultation Paper: The Provision of Non-audit Services by Auditors

Comments from ACCA
October 2010



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General comments

ACCA welcomes the opportunity to comment on the consultation on the proposed revised Ethical Standards for Auditors. We recognise that the consultation was triggered by concerns expressed by the Treasury Select Committee about the audit of certain public interest financial institutions, and this consultation is therefore concerned mainly with listed companies. This is a 'think big first' approach, and there is always a danger that practices for larger entities get cascaded down to smaller ones. ACCA prefers a 'think small first' approach and, in our comments below, we should like to draw the APB's attention to matters where smaller entities should be treated differently.

We note the consistency in the views of respondents to the October 2009 consultation, in that there should be no outright prohibition, and there should be no major change to the conceptual approach.

It is widely held to be the case (but particularly among investor stakeholders) that the provision of non-audit services is not a significant issue in addressing the external auditor's independence. Rather, the issue is one of perception – to be addressed through improved transparency. Therefore, we are pleased to have the opportunity to comment on the current consultations of the APB and the FRC together.

Much of the content of the proposed revised Ethical Standards is applicable to listed and other public interest entities. As indicated above, ACCA would prefer the Ethical Standards to address the issues from a 'think small first' point of view, with an emphasis on fundamental principles, and examples of appropriate courses of action in specific situations (including those involving public interest entities).

The importance of this approach is well illustrated when considering the provision of internal audit services. 'Internal audit' covers a wide range of activities. At one end of the spectrum, it might refer to an audit of the complete system of internal control, across an organisation, throughout the year; at the other end, particularly within smaller entities, it is likely to refer to an ad hoc project, which may have arisen as an extension of the external audit process, to address a particular aspect of business risk. For this reason, it is not appropriate for there to be a blanket prohibition on audit clients procuring internal audit services from their external auditors. For smaller entities, this

may be the only cost-effective means of obtaining the service and obtaining objective assurance concerning business risk. This highlights the need for a 'threats and safeguards' framework for resolving objectivity issues to remain paramount at all times.

While not prohibiting the provision of internal audit services by the external auditor, a threats and safeguards approach would have the effect that, for listed companies in particular, internal audit services would not be provided by the external auditor, other than in exceptional circumstances. This would come about because the same fundamental ethical principles apply to all companies, but there would be clear responsibility on audit committees to consider the justification of procuring these services from the external auditor, together with clearly identified policies and robust disclosure requirements.

In the absence of a 'think small first' approach, we believe it is essential to consider any prohibitions arising from the revised Ethical Standards from the point of view of a non-listed company audit. In such cases (where there is likely to be less public interest), a threats and safeguards approach to independence will be more relevant and more effective and, therefore, it is appropriate to make separate provisions for such engagements within the revised Ethical Standards.

Specific questions

Question 1: Do you support the approach outlined in paragraphs 2.10 to 2.18? If not, please indicate what, if any, other action should be taken. In particular, does the proposal in paragraph 2.15 present practical difficulties to auditors of small or medium sized entities?

We agree that there should not be a blanket prohibition on the provision of non-audit services by the external auditor. Neither should there be a limit on fees derived from non-audit services, as the only impact of fees on auditor independence is by way of the self-interest threat that may arise if total fees derived from a client (or group of clients) are sufficiently high.

The decision of whether or not the external auditor may provide non-audit services is primarily a matter of corporate governance and the need to ensure independence of opinion in fact and in perception. Therefore, we are in favour of enhancing the FRC Guidance on Audit Committees (with the emphasis on meaningful disclosures) with the objective of compelling audit committees to be more effective.

Generally, we support the approach set out in paragraphs 2.10 to 2.18, although we do not agree with paragraph 2.15. While we believe that the requirements would pose no significant difficulties for auditors of small and medium sized entities, we also believe that the costs would outweigh the benefits. This is because the level of non-audit fees alone does not present a threat. Rather, the level of total fees may create a threat (in the form of self-interest or intimidation), and the auditor should never lose sight of this. Otherwise, it is the *nature* of the non-audit services provided that may create a threat.

While the level of non-audit fees may be considered to be an important indicator, which should trigger a discussion with the Ethics Partner, we do not believe that the approach proposed in paragraph 2.15 is either practical or necessary in the case of the audit of a non-public interest entity.

Question 2: Are the correct services included in the list of audit related services (see ES 5 (Revised), paragraph [AD])? If not, please identify the changes that should be made and indicate whether the provision of such services gives rise to threats to auditor objectivity and independence (other than threats which are clearly insignificant).

We have underlying concerns regarding the assumption that services can be identified where the threats to objectivity and independence are 'clearly insignificant'. This must always depend on the specific circumstances. Therefore, whilst we agree with the list of audit related services in paragraph [AD], we should like to see a requirement that the auditor nevertheless considers the specific threats and the possible need for safeguards.

Paragraph [AF] appears to permit the auditor to completely disregard any threats in respect of the items in the list in paragraph [AD], and this undermines the threats and safeguards approach.

Nevertheless, we understand the rationale for setting out a list of activities in paragraph [AD]. However, the list must remain narrowly defined. We accept that this approach will allow the audit committee to be aware of those services provided by the auditor that are not considered to give rise to threats to independence (other than those that are clearly insignificant), while focusing on other non-audit services provided.

We believe these draft provisions of Ethical Standard 5 (Revised) are generally only relevant to listed entities. For a non-listed entity, the list in paragraph [AD] may be less relevant, and the auditor would simply be required to discuss all non-audit services with those charged with governance.

Question 3: Will disclosure of additional information about non-audit services in the form of a template (such as that included as an appendix to ES 1 (Revised)) reduce the perceived threats to objectivity and independence arising out of the provision of non-audit services? Do you have any suggestions to improve the template?

The template in the appendix is somewhat complex. While we believe it to be comprehensive and a useful means of communicating information to the audit committee, there may be a need for further guidance for audit committees in order to assist the presentation of meaningful information in annual reports (eg

showing remuneration for 'audit' and 'audit related services' as totals, and only analysing the remuneration from 'non-audit services').

Question 4: Will the proposed changes to the FRC's Guidance on Audit Committees reinforce audit committees' responsibility for:

- **determining whether a company's auditor should be permitted to provide particular non-audit services? If not, what further guidance should be given, and**
- **providing information about the non-audit services provided by a company's auditor**

and therefore reduce the perceived threats to auditor objectivity and independence arising from the provision of non-audit services?

ACCA believes that, in time, the proposed changes to the FRC's Guidance on Audit Committees will serve to reinforce the responsibilities of audit committees, leading to increased transparency and a reduction in the perceived threats to auditor objectivity and independence. We believe that an important element of this is the audit committee being in possession of the analysis of the auditor's remuneration in an informative and meaningful format.

However, we are concerned about the guidance regarding the pre-approval of certain non-audit services that are 'audit related'. We suggest that there might be a requirement for the audit committee to revisit the policy each year in the light of those pre-approved services actually performed, and any threats to objectivity subsequently recognised.

ACCA has provided a separate response to the FRC in respect of its consultation on the revisions to the Guidance on Audit Committees.

Question 5: Do you support:

- the approach taken to the provision of ‘extended audit services’ in ES 5 (Revised), paragraphs [AH] and [AI]?
- the additional guidance on the threats and safeguards approach in ES 5 (Revised), paragraphs [AH] and [AI]?
- the strengthening of the role of the Ethics Partner in ES 1 (Revised), paragraphs 21 to 24 and ES 5 (Revised), paragraph [AA]?
- the amended definition of ‘affiliate’ and ‘significant affiliate’?
- the application of the remuneration and evaluation policies to all members of the engagement team in ES 4 (Revised), paragraph 38?
- the other amendments referred to in Section 5?

If not, please explain your reasons and the approach that you think the APB should take.

Approach taken to the provision of ‘extended audit services’ in ES 5 (Revised), paragraphs [AH] and [AI]

Draft paragraph [T] explains why certain audit related services may only give rise to threats to auditor independence that are considered to be clearly insignificant. These services are those described in draft paragraph [AH]. However, we believe that the expression ‘performed on the same principal terms and conditions as the audit’ appears imprecise, and clarification is required within the Standard.

We agree with the approach set out in paragraph [AI], although we would prefer to see a reference to the ‘conceptual framework’ approach to the review of threats and safeguards.

Additional guidance on the threats and safeguards approach in ES 5 (Revised), paragraphs [AH] and [AI]

Although paragraph [AI] states that a threats and safeguards approach will be applied, it does not provide guidance on that mechanism. In our opinion, paragraphs [AH] and [AI] are incomplete without a reference to the different types of threat set out in Ethical Standard 1 (Revised) and the available safeguards. Therefore, we suggest that paragraph [AI] should include a cross-reference to Ethical Standard 1 (Revised) in this respect.

We have considered the proposed amendments to paragraphs 46 to 50 of Ethical Standard 1 (Revised) and paragraphs [V] to [X] and 32 to [Z] of Ethical

Standard 5 (Revised). We support the additional guidance proposed, but we are concerned that draft paragraph [Z] does not include a note that other safeguards may be more appropriate (and that the examples given are not exhaustive). We note that the examples provided only refer to the self-review threat.

Strengthening of the role of the Ethics Partner in ES 1 (Revised), paragraphs 21 to 24 and ES 5 (Revised), paragraph [AA]

The proposed amendments appear reasonable, although it is not obvious that there is a significant problem to be resolved.

In our opinion, the addition to paragraph 24 does not enhance clarity, and we suggest that it should simply state that the role of supporting the Ethics Partner should take priority over other support roles. Alternatively, one might conclude that this does not need to be stated, as the point is made clear in respect of the Ethics Partner himself. Therefore, it could be argued that the addition to paragraph 24, in fact, detracts from the clarity of the Standard.

We note that the term 'ethics partner' has not been changed to have leading capitals consistently throughout Ethical Standards 1, 4 and 5.

Amended definition of 'affiliate' and 'significant affiliate'

Although the proposed amended definition represents a move closer to the International Ethics Standards Board for Accountants (IESBA) definition, we note that the two definitions would still not be completely aligned. Therefore, we propose that the IESBA wording be adopted in its entirety, and that further clarity be sought through the efforts of the APB and the professional bodies to influence the development of the IESBA Code of Ethics for Professional Accountants.

Application of the remuneration and evaluation policies to all members of the engagement team in ES 4 (Revised), paragraph 38

The rationale for extending the requirements to all members of the engagement team has not been stated in the consultation document, and the proposal would appear to be contrary to the beliefs of the majority of respondents to the previous consultation.

ACCA is not in favour of Ethical Standard 4 (Revised) prescribing to which staff the remuneration and evaluation policies should relate. We believe that, if the Ethical Standards were to emphasise a principles-based approach in this area, the requirements relating to remuneration and evaluation policies would automatically extend to key partners and others in a position to influence the significant judgements made during the engagement.

Other amendments referred to in Section 5

Generally, we support the other amendments referred to in Section 5 of the consultation document. In particular, the proposed strengthening of Ethical Standard 2 (Revised) in respect of governance roles with an audited entity is based on the IESBA Code, and ACCA is in favour of this further alignment with the Code.

With regard to the relaxation in respect of the financial interests of new partners, we note that this is a very specific situation, and specific provisions in this respect might lead to a need to consider a full list of similar situations that should result in the relaxation of the current rules. Other examples that might need to be addressed are where a partner inherits a financial interest or where the spouse of a partner acquires an interest. Therefore, we would, instead, advocate a principles-based approach.

Specifically, proposed paragraph [G] of Ethical Standard 2 (Revised) states 'The audit firm ensures that: such financial interests are approved by the Ethics Partner.' What form should this approval take? Surely, the financial interest should be *considered* by the Ethics Partner, but the Ethics Partner is in no position to approve such financial interests, as they are undesirable and exceptional.

Question 6: Are there any reasons why the revisions to the Ethical Standards proposed by the APB in Sections 2, 4 and 5 will be difficult to implement for audits of financial statements for periods commencing on or after 15 December 2010? If so, what further transitional arrangements might be necessary?

The APB's perceived need to introduce the proposals so soon has not been fully explained. There is a risk of confusion and error if auditors are not well

prepared for the changes. This may be heightened in the case of short accounting periods.

Currently, many auditors are focusing on the implementation of the Clarity ISAs and, therefore, it would be preferable to defer the implementation of the revised standards until, say, periods commencing on or after 15 March 2011. In addition, to implement the changes with reference to accounting periods *ending* on or after a certain date would reduce the risk of confusion during the transition process, as such an approach would be consistent with the Clarity ISAs.

Question 7: Which of the options (to address the self review threat arising from the provision of restructuring services) set out in paragraph 6.14 should the APB adopt? Should the option that you have chosen apply to all entities, or only to listed entities?

Our response to this question assumes that auditor independence issues often arise out of the provision of restructuring services – an assumption that we have not seen evidenced. While we acknowledge that public perception is important, and this should be a factor in the case of listed entities, a threats and safeguards approach is always going to be relevant in order to encompass the various types of services that might be described as ‘restructuring services’. However, we would prefer any guidance beyond that included in the March 2009 consultation to be in a separate document, so as not to play down the importance of the threats and safeguards approach.

An outright prohibition on the provision of restructuring services (Option 1) would not be in the interests of either the company or the economy. In many situations, speed to react will be crucial, and the company will often look to the auditor for help. However, guidance issued by the APB must emphasise the increased threat to auditor independence, and perceived auditor independence, in the case of a listed entity, stating that restructuring services may only be provided in exceptional circumstances, in which adequate safeguards are available. In this respect, we note that listed companies will often be able to use the services of specialist restructuring companies.

ACCA would prefer to focus on a principles-based approach to assessing the threats to objectivity brought about by the provision of restructuring services to an audit client (Option 3). However, we are content that specific non-audit

services may be noted, within APB guidance, as examples where the threats to the fundamental principles may not be adequately reduced by appropriate safeguards.

Question 8: Does the revised definition of a 'contingent fee basis' give rise to any practical issues?

We perceive no practical issues arising from the revised definition, and we welcome the closer alignment with the IESBA definition of 'contingent fee'.

Question 9: Which approach do you consider that the APB should adopt in relation to contingent fees and why?

ACCA is not in favour of extending the prohibitions at all in this respect. We are in favour of placing emphasis on a threats and safeguards approach, which will lead to improved competence in its application. Moreover, it is important to safeguard opportunities for companies (particularly SMEs) to share commercial risk with their auditors by entering into contingent fee arrangements in some circumstances.

However, there is an argument for guidance that explains why a contingent fee arrangement for non-audit services may give rise to a familiarity threat (as the interests of the auditor become so closely aligned with those of the audited entity), or a self-interest threat (because the outcome of the non-audit engagement may be influenced by a material audit judgement).

We suggest that paragraph 11 of Ethical Standard 4 (Revised) should clarify that the definition of a 'contingent fee basis' includes percentage fees, ie not only those situations where the fee may be payable in full or not at all.

Question 10: Does the definition of a ‘connected party’ give rise to any practical issues? If so, how could those practical issues be addressed? What are the relative advantages and disadvantages of the alternative approach suggested in paragraph 8.6?

We have no significant concerns regarding the definition of a ‘connected party’.

However, we are concerned that seeking to expand on the principle of integrity by relating it to conflicts of interest is, in itself, a move away from fundamental principles, changing the understanding of the reader and complicating the concepts of both integrity and conflicts of interest. If there is a conflict between the interests of the audited entity and any other party, this may impact on the interests of the auditor, and therefore the auditor will recognise the conflict and deal with it in accordance with a threats and safeguards approach.

In paragraph [D] of Ethical Standard 1 (Revised), in the second example given, it is not the *outcome* of the non-audit service that has an impact on the financial statements of the audited entity, but the knowledge gained by the auditor that would have an impact on the audit report if the management’s assumption about going concern is inconsistent with the auditor’s knowledge. There is a confidentiality issue here, and a possible conflict between the interests of the two clients. We agree that this gives rise to a threat to objectivity, but the example is somewhat contrived, and involves a number of different ethical principles. We suggest removing this second example.

Paragraph [E] of Ethical Standard 1 (Revised) refers to the work performed in the course of the non-audit service engagement being ‘properly and effectively’ assessed. It is noticeable that the word ‘independently’ is not used. We are concerned that, if two teams within a firm cannot be independent of each other, the quality control reviewer is also unlikely to be independent of the audit engagement team.

Question 11: Would the adoption of any of the approaches discussed in Sections 6, 7 and 8 give rise to any significant costs that would not be outweighed by the benefits of the relevant proposal? If so, please describe and, to the extent possible, quantify the costs that you think would be incurred and why the benefits would not outweigh the costs.

Many of the proposals contained within these sections of the consultation document should be achieved through good practice, and so it could be argued that significant costs should not be incurred by firms' implementation of the proposals. However, the proposals within Section 8, on conflicts of interest, appear unnecessarily complex, although the principles concerned are easily understood. Therefore, we would advocate compliance by way of a threats and safeguards approach with regard to fundamental principles.

The APB should be aware that auditors will incur costs (either directly or through providers of audit methodology) in changing their systems and procedures, without any obvious need or substantial benefit to stakeholders. Additionally, where there is considered to be a need for change in the interest of perception, the benefits would be minimal in the case of non-listed company audits, in which there are fewer stakeholders.

