The 100 Group

Investor Relations and Markets Committee

Mr Keith Billing
Financial Reporting Council
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By email: k.billing@frc.org.uk

19 March 2015

Dear Mr Billing

Auditing and ethical standards: Implementation of the EU Audit Directive and Audit Regulation

I am writing in my capacity as Chairman of The 100 Group Investor Relations and Markets Committee to share with you our views on the FRC's consultation document on the above topic.

Who we are

The 100 Group represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent around 90% of the market capitalisation of the FTSE 100, collectively employing over 7% of the UK workforce and in 2014, paid, or generated, taxes equivalent to over 14% of total UK Government receipts. Our overall aim is to promote the competitiveness of the UK for UK businesses, particularly in the areas of tax, reporting, pensions, regulation, capital markets and corporate governance.

Our views

We have provided input into a number of UK and European consultation processes in the past few years on proposals for reforms in the audit market. We look forward to the completion of the process of reform and the re-establishment of certainty over the rules and future rules in this area.

We have noted the Department of Business Innovation and Skills' (BIS') discussion document on this topic, including the proposals that the FRC should have responsibility for implementing aspects of the EU Directive and Regulation ('the EU rules') including the ability to decide on member state options in these areas. Our response assumes that the FRC is granted such delegated powers.

We have two main concerns about the FRC's consultation on this topic:

1) That the proposals go beyond the EU rules in some areas, proposing additional rules or requirements and extending the scope of the EU rules.
2) That the approach to certain member-state options proposes potentially more onerous rules than could be applied by other member states.

We agree with aim of BIS's Guiding Principles for EU Legislation of "ending the gold-plating of EU legislation in the UK", and we note that BIS's Better Regulation Framework Manual explains that for the implementation of EU legislation "Ministers are particularly keen to

ensure that there is no gold-plating, and that any costs to business are kept to a minimum".[1]

Given the long process of discussion and finalisation of the EU rules we question whether that process really omitted consideration of risks of such significance to require additional UK rules that go beyond the EU rules.

The appendix to this letter indicates some areas where we have identified potential gold-plating or other measures that indicate more restriction for the UK than other member states.

We would like to reiterate our belief in the importance of a robust, independent audit with clear ethical regulations, but we do not believe that the situation is 'broken' in the UK to the extent suggested in some of these proposals.

Please feel free to contact me if you wish to discuss the views contained within this letter.

Yours sincerely

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[1] BIS: Guiding Principles for EU Legislation, April 2013; BIS: Better Regulation Framework Manual, Practical Guidance for UK Government Officials, July 2013.

Appendix

We have not responded to the specific questions posed in the consultation as our main concern is outlined in the body of our letter. However, we outline in this appendix some areas where we have identified proposals for gold-plating or other measures that indicate more restriction for the UK than other EU member states.

We have focussed on the factors that affect large listed companies. We have not focussed on the structure of the regulation of audit or on the proposed extension of the requirements to non-'PIE' companies as these have less direct implications for our member companies.

References to sections of the consultation and relevant questions are provided for your convenience.

Prohibited Non-audit services (Section 4 of the Consultation)

Question 7: What approaches do you believe would best reduce perceptions of threats to the auditor's independence arising from the provision of non-audit services to a PIE (or another entity that may be deemed of sufficient public interest)? Do you have views on the effectiveness of (a) a 'black list' of prohibited non-audit services with other services allowed subject to the evaluation of threats and safeguards by the auditor and/or audit committee, and (b) a 'white list' of allowed services with all others prohibited?

The proposed 'white list' of permitted non-audit services, instead of the 'blacklist' approach in the EU rules would be a clear example of gold-plating. We do not believe that a case has been made that such a strict rules-based approach is necessary, particularly as:

- There are, and will be, other rules on the provision of non-audit services by auditors which require consideration of independence, safeguards and risks, which include the approval of services by the audit committee and which will include the EU black list rules and fee cap. In our view these rules appear to address this matter. We are not aware of any compelling arguments for going beyond these in the UK whilst such an approach is considered sufficient in other EU countries.
- The proposed white list approach also goes significantly beyond the approach to regulation of non-audit services by auditors taken by the FRC to date which we believe has worked in practice.
- The white list approach appears to indicate a lack of trust in the ability of audit committees to exercise judgement within a framework of extensive existing rules and guidance.
- The consultation itself notes that "for many companies, the supplemental impact of such further prohibition on audit committee choice and commercial flexibility for auditors may not be extensive…The FRC believes that there may be relatively few services currently provided other than audit related services, that would be permitted under the Audit Regulation." The argument seems to be that there may be no real difference between the black list and white list approaches in practice. If that were the case then there could be no significant argument for adopting an approach that increases the prescriptive rules.
- We do not agree that it would, in fact, be the case that a white list approach would have no difference in practice to a black list approach. We believe that the white list approach would reduce the ability for audit committees to exercise judgement, and would reduce the choices available to audit committees.
- The white list approach also has a great deal of potential for additional administrative burden on both companies and regulators. Fundamentally,

creating a workable white list is much more burdensome than a black list as rapid processes will need to be put in place to deal with unforeseen, but perfectly reasonable services that will almost inevitably arise. The black list approach would have more flexibility in this regard.

We are also concerned that even though there has been a long process in the UK and in Europe of considering rules around the audit market, the FRC's consultation document (which will be followed by another consultation document later in the year) is still consulting on questions on how rules for auditors should be changed to 'reduce perceptions of threats'. The question of the approach to non-audit service provision by auditors was considered in the setting of the EU rules. We question whether more consultation and discussion on the same question is appropriate and necessary.

Question 8: If a 'white list' approach is deemed appropriate to consider further: (a) do you believe that the illustrative list of allowed services set out in paragraph 4.13 would be appropriate or are there services in that list that should be excluded, or other services that should be added? (b) how might the risk that the auditor is inappropriately prevented from providing a service that is not on the white list be mitigated?

Our main views on the white list are covered in our response to Question 7. We note that the considerations in Question 8 would be unnecessary if the white list approach is not taken.

Question 10: Should the derogations that Member States may adopt under the Audit Regulation – to allow the provision of certain prohibited non-audit services if they have no direct or have immaterial effect on the audited financial statements, either separately or in the aggregate – be taken up?
Question 11: If the derogations are taken up, is the condition that, where there is an effect on the financial statements, it must be 'immaterial' sufficient? If not, is there another condition that would be appropriate?

In line with our view that UK regulations should not, without good reason, be any more restrictive than those for any other EU member state, we would support taking up these derogations.

Audit and non-audit services fees (Section 5 of the Consultation)

(Questions 15 to 19)

The consultation discusses the calculation of the cap on non-audit fees. We understand that if the white list approach were not taken up then the FRC would consider further the approach to the calculation of the cap. We re-iterate our overriding point in this regard: that UK companies should not be disadvantaged, but would consider any significant proposals in this area once they have been set out more clearly by the FRC.

We note that the consultation considered potential exemptions from this cap. We believe that the FRC should have the flexibility to grant exemptions. This could assist in situations where the auditors are the appropriate provider of services related to significant transactions such as in the role of 'reporting accountant', for example.