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Dear Madam

Draft Revised Ethical Standards for Auditors

We welcome the opportunity to comment on the consultation paper circulated by the Auditing Practices Board ("APB") in respect of the proposed revisions to the Ethical Standards for Auditors ("ESs").

We broadly support the proposed revisions and have substantive comments in just three areas, partner rotation, the all partner rule and alignment with the IFAC Code. Appendix 1 provides our responses to the specific questions raised in the consultation paper. There are number of areas where we consider the drafting may not have achieved its desired effect and we comment on these in Appendix 2.

Amendment to audit rotation period

We fully support the fundamental objective behind the rotation of audit engagement partners but believe that the success of any rotation system is ultimately a question of finding the right balance. If the rotation period is too long there is an increased risk of familiarity threats. If, however, the period is too short then the relatively quick turnover of senior staff can be detrimental to audit quality.

We believe the current five year period creates unnecessary risks to audit quality and that extending the period to seven years would not increase the familiarity threat.

Increased audit quality

We believe that a two year extension to the existing rotation period would have a significant impact on the levels of audit quality. In our experience, audit quality improves significantly as the engagement partner's knowledge of the audit client and its business grows and they are better able to identify and assess risks associated with that audit. They are also more readily able to adapt and change the audit approach to respond to changes in the audit client and its risk environment.

Further, we believe that obtaining this knowledge and understanding increases the rigour with which the auditor is able to review the appropriateness of management's decisions and policies. It also assists in improving the quality and effectiveness of discussions and communications with those charged with governance and ensures consistency of management explanations over time. This is particularly the case with large and complex businesses where the current period of five years can act as a barrier to gaining and effectively implementing such knowledge.

It should be recognised that if extending the period seven years increases audit quality because audit partners continue to learn in this period it is unlikely that such partners will be becoming complacent or lacking in scepticism at the same time. For this reason we do not believe there would be a decline in the objectivity of an audit partner in the sixth and seventh years.

Amended definition of Key Audit Partner ("KAP")

We note that it is proposed to amend the existing definition of KAP to include those members of the audit engagement who are responsible for the audit of material subsidiaries or divisions. As a consequence of this extension, the number of people who would be subjected to rotation requirements will significantly increase.

This expansion to the numbers of staff affected by rotation means the task of managing resources, particularly in light of the differing Ethical Standard time limits for audit engagement partner and KAP, will continue to be substantial, particularly for the largest firms. Accordingly, an extension to seven years for the audit engagement partner would not only align the two time limits, it would also assist in mitigating some of the impact on the management of resources and therefore assist in ensuring compliance with the regulations.

Alignment with Statutory Audit Directive

In addition, we also note that the SAD requires a maximum seven year rotation period in respect of listed company engagement partners. We understand that all, or substantially all, of the rest of Europe is likely to implement this requirement at seven years within their own domestic legislation. We believe, therefore, that the ES should be aligned with the SAD requirement to avoid the added complexity that arises where the UK position on rotation is inconsistent with that elsewhere in Europe.

The all partner rule

We welcome the proposal to relax ES 2, paragraph 7 in respect of shares held by an immediate family member. However, we question whether it is appropriate to limit the proposed exceptions to the two specific circumstances identified.

With changes in family circumstances it is increasingly common that a partner's spouse is financially independent and has a separate career. For the larger audit firms, such careers will often be with an audit client and, where the spouse works in the investment management industry, will inevitably involve investing in a firm's audit clients.

The ESs are to our knowledge unique in the world in having an "all partner" restriction on holding financial interests. Both IFAC and the SEC have a "restricted person" restriction, which prevents partners and their immediate family members who have an involvement with an audit client from holding financial interests but permits all other partners to do so. It is true that the Big 4 have each adopted an all partner rule internationally, but this is largely for operational reasons and because of a desire to avoid any risk of the perception that might be created if large numbers of partners were invested in audit clients. The important point, however, is that a firm may grant a dispensation to a firm imposed rule in specific circumstances but cannot do so when it is imposed by external regulation.

As a result of the ESs, there are circumstances where it is not possible for a person to be, or become, a partner in any major audit firm if their spouse is involved in normal investment management activities. This does not appear to be either necessary or in the interests of furthering the attractiveness of the auditing profession. Although we have not investigated this, we also wonder if this position could give rise to a challenge under human rights legislation.

We believe that the ESs should permit an immediate family member of a partner who is not in a position to influence the conduct and outcome of the audit to hold a financial interest in an audit



client if the reason for the holding is directly related to the person's employment, subject to implementation of any safeguards to reduce any threat to an acceptable level. The additional requirements in the proposed revision are not necessary to ensure objectivity.

Alignment with the IFAC Code

Many of the proposed revisions to the ESs are driven by the need to implement the provisions of SAD and also to try and ensure continued adherence with the minimum requirements of the revised IFAC Code.

We fully support the amendments necessary to effect the implementation of the SAD regulations. Unlike these, however, elements of the revised IFAC Code remain under debate and it is unlikely that the revised Code will be finalised prior to the adoption of the revised ESs in April 2008.

As a result, it is possible that the ESs, if adopted in their current form, may be out of line with the requirements ultimately contained in the final version of the IFAC Code. In light of this we believe that the revisions designed to align the ESs with the IFAC code should not be finalised and implemented until the IFAC Code has been settled. This would ensure that the key changes necessary to implement SAD are implemented immediately and allow further limited revisions to be undertaken as and when the IFAC Code has been finalised.

Conclusion

We would be happy to discuss any of the points contained in this letter and the attached appendix with you in more detail if this would be of assistance. Should you wish to do so, or require clarification on any matter, please do not hesitate to contact Bill Morgan, Ethics Partner.

Yours faithfully

A handwritten signature in cursive script that reads "PricewaterhouseCoopers".

PricewaterhouseCoopers LLP

Appendix 1

Answers to specific questions raised by the APB

Q1: Do you have any concerns about the nature of the services currently being provided to listed companies by their auditors such that the APB needs to develop further standards and guidance for inclusion in the ESs?

No, we believe that the existing ESs provide sufficient guidance and control regarding the provision of services to listed audit clients.

Q2: Do you agree with the APB's view that there is no need to make major changes to the ESs?

Yes.

Q3: Do you believe that any of the proposed changes to the ESs will add to audit costs

It is inevitable with any regulatory change that its implementation will lead to additional costs. We do not, however, believe that the likely additional costs will be significant or disproportionate. Furthermore, provided the increased costs that will arise from the increase in the number of KAPs are offset by extending the partner rotation period to seven years, we do not believe that the changes will increase costs in the long term.

Q4: Given that the revised ESs will be effective for audits of financial statements for periods commencing on or after 6 April 2008, are there any changes to the ESs proposed by the APB which will be difficult to implement? If so, are transitional arrangements necessary?

It is likely with the change to the KAP definition that a significant number of partners not currently impacted by the existing rotational requirements will become subject to the new provisions with effect from 6 April 2008.

Any partner who becomes designated a KAP on 8 April 2008 and has already served nine years or more would, under the proposed arrangements, not be able to continue to act in the next accounting period. We believe there should be a one year extension for such persons.

Q5: The arguments outlined above appear evenly balanced and therefore the APB would appreciate commentator's views on whether to retain the existing requirement for audit engagement partners on listed companies to rotate after five years or move to seven years. What are your reasons for this view?

As explained in the main body of this letter, we believe that the rotation period for audit engagement partners should be extended to seven years.

Q6: Do you believe that the APB should retain the existing requirement for audit engagement partners on listed companies to have a "cooling off" period of five years? What are your reasons for this view?

We believe that any "cooling-off period" should be set at the minimum period necessary to ensure that the familiarity threat is minimised. We believe that the five year period currently contained in ES3 is unnecessarily long and should be reduced to two years in line with both the existing IFAC Code and the requirements of the Statutory Auditors and Third Country Auditors Regulations 2007.

The pace of business change, particularly in listed entities, is such that a partner returning to an audit client after two years is faced with an enterprise that is different in many ways, whether internally or in the market environment that it operates. We believe that the challenges to master this "new" client's circumstances will always be such that there is no significant threat of familiarity through complacency or lack of an enquiring attitude.

Furthermore, whilst we would always wish for audit engagement partners to serve for their full term, a reduction in the "cooling off period" would have the benefit of allowing flexibility to meet the challenges where the audit engagement partner cannot serve their full term for whatever reason

Q7: Do you support the approach of the APB to continue relief for the auditors of smaller entities from a small number of the requirements of the ESs for a further period of time?

We are comfortable with the APB's proposed approach.

Q8: Do you support the proposed strengthening of the ESs with respect to valuations, actuarial services and litigation support services?

We agree with the proposal in principle. However, we believe that the resulting proposals have a number of deficiencies:

- There is an inconsistency between paragraph 54, which deals with "a valuation", and paragraph 59, which deals with "actuarial valuation services". It is not clear if there is a reason for this difference. Furthermore, the valuation section refers both to "a valuation" and "valuation services".
- The "Valuation Services" section begins by defining "a valuation" but not "valuation services". The "Actuarial Valuation Services" section does not have an equivalent definition paragraph, although it would appear useful to have one.
- Although we acknowledge that there is no proposed change from the existing ESs in this respect, we question whether the meaning of having a "material effect on the financial statements" is sufficiently clear. Would a valuation of £999 when the financial statements record an asset of £1,000 result in a material effect? Or is it intended to refer to the absolute amount of the valuation, such that a valuation of £999 when the gross assets are £1,000 would "have a material effect" but a valuation of £999 when the gross assets are £1 million would not?

Q9: Do you support the proposed relaxation of the ESs with respect to certain financial interests in audit clients held by immediate family members of partners where those partners are not involved in that audit?

We are fully supportive of the APB's proposed relaxation as this provides a sensible relaxation to the "all partner" rule with no loss of independence. However, we believe that the proposals should go further, as set out in the main body of this letter.

Q10: Do you support the proposed relaxation of the ESs with respect to certain business relationships with audit clients?

We believe the existing rule unnecessarily prohibits trivial arrangements and relationships which have no bearing on independence and objectivity and fully support the proposed relaxation regarding these forms of business relationships.

Appendix 2 General points

Definition of "Affiliate"

The definition of "Affiliate" in the ESs is different from the "Related Entity" definition in the IFAC Code. It is not clear whether there is any difference in substance between the two definitions. Since we and many other firms have to comply not only with the ESs but also the IFAC rules (because network firm policies inevitably adopt IFAC definitions for global consistency reasons), we believe the definition should be conformed to be the same as IFAC. If, on the other hand, it is intended to include further entities than IFAC we would question why but at the least this should be made clear.

ES1 Paragraph 28 – "Management Threat"

We believe that the addition of the reference to paragraph [A] to wording of this paragraph makes it appear that there are two separate threats, whereas there is in fact only one threat – on behalf of management the making of judgements and the taking decisions that are the responsibility of management. We do not consider the additional words aids clarity or are necessary.

We also believe that the expression "*participation in projects where management are required to make judgements and take decisions*" is too broad and thus unhelpful. In all projects management is required to make judgements and decisions. It should perhaps more appropriately refer only to projects where an auditor works closely alongside senior management in an advisory capacity.

Finally, we believe that the clause "which are their responsibility" is intended to identify which sort of judgements and decisions are being referred to. On this basis there should be no comma before the clause and it should read "... and take decisions which are their responsibility...".

ES1 Paragraph [C] – Integrity, objectivity and independence

Paragraph [C] sets out a number of factors which firm's should consider when determining whether additional safeguards should be applied to client engagements. We believe that the paragraph should be amended to read "... Such policies *shall* take into consideration the nature of the entity's business ..."

ES1 Paragraph 47 – Network Firms ... involved in the audit of group financial statements

Paragraph 47 requires that an independence confirmation is received from any network firm that participates in the audit. However, under paragraph [E] no independence confirmation is required from any network firm that does not participate in the audit on the basis that reliance can be based on compliance with network firm policies and procedures.

In our view it should be permissible to place reliance on compliance with network firm policies and procedures of a network firm both when they are involved in the audit and when they are not. Obtaining confirmations is a burdensome administrative process which does nothing to improve compliance with independence rules. Effort is more effectively put by networks into overall monitoring of compliance with network policies and procedures.

ES2 Paragraph 17 – Financial Relationships

Paragraph 7 has been amended to prohibit the holding of financial interests save where paragraph [A] applies. However, paragraph 17 provides for further circumstances when a financial interest

may be held. For consistency the exception of paragraph 17 should also be referred to in paragraph 7 such that it would read:

" 7 The audit firm, any partner in the audit firm, a person in a position to influence the conduct and outcome of the audit or, save where the circumstances contemplated in paragraph [A] or paragraph 17 apply ..."

ES2 Paragraph [C] – Business Relationships

We have two concerns about the explanation of what is "inconsequential" in paragraph [C].

- The paragraph contains a two part test, which is confusing. We believe the first leg is unnecessary and the paragraph should begin:

"[C] Where there are doubts about whether a reasonable and informed third party would conclude that the consequences ..."

- Every business relationship, no matter how inconsequential, would "have an influence on the auditor's relationship with the audited entity". The definition is therefore unhelpful as it is too broad. Wording that might more closely capture the intent might be

"...the business relationship may, in the context of independence, have an influence of some consequence on the auditor's relationship ..."

ES3 Paragraph 12[A] – Additional provisions related to audits of listed companies

Paragraph 12[A] allows a former audit engagement partner or engagement quality control reviewer to continue to be involved with an audited entity in a non-audit capacity. However, such individuals should not "exert any influence on the audit engagement". We believe this wording is intended to permit a former engagement partner to be a person in the chain of command for that audit client provided that, although he or she is "in a position to influence the conduct and outcome of the audit", he or she does not in fact exert such influence. We believe this is appropriate.

In paragraph 12, we believe that clause (c) should be amended as follows:

"... or hold any position of responsibility in relation to the audit of the audited entity..."

otherwise it implies some sort of management role in relation to the audit client and could be considered to prohibit non-audit responsibilities.

ES5 Paragraph [B] – Identification and assessment of threats and safeguards

Paragraph [B] states that threats to the auditor's objectivity may arise when a non-audit service is provided to an entity which is not audited by the firm, but "*which is connected in some way*" to an audited entity. This phrase is capable of extremely wide interpretation, far wider than is intended or justified. For example, an entity can be "connected in some way" to another merely by being a supplier or customer. The phrase needs to be narrowed to make clear that only connections relevant to independence need to be considered.

ES5 Paragraph [K] – Tax Services

Paragraph [K], in seeking to align the ES with the proposed IFAC Code, introduces a prohibition on tax accounting services for listed companies where the resulting accounting entries or deferred tax calculations are material to the client's financial statements.

We note, however, that Paragraph 117 of ES5 – Accounting Services contains a general prohibition on all accounting services for listed companies, whether material or not. In light of this apparent inconsistency, we believe that the wording of Paragraph [K] should be amended to clarify that the provision of tax accounting services, where the numbers are not material, is a specific relaxation to the otherwise overarching prohibition the preparation of accounting entries.

ES5 Paragraph 99 – Corporate Finance Services

We believe that the wording in Paragraph 99 is too widely drawn in seeking to prohibit the provision of corporate finance services “*relating to an audited entity*”. Such services could, under the current definition, prohibit the sale of a business that is not an audit client to an audit client where such services were to be undertaken on a contingent fee basis. We believe that such a restriction is inappropriate and, accordingly, recommend that the phrase “*relating to an audited entity*” is changed to “in respect of an audited entity”.

ES5 Paragraph 109 – Transaction Related Services

Paragraph 109(a) has the potential to be read as requiring the transaction related services team to contact the audit engagement partner. If an audit firm has been engaged by a non-audit client to provide transaction related services in relation to the potential acquisition of an audit client of that firm any communication between teams would, unless explicitly agreed by both clients, be a breach of the ethical wall required to exist between the teams. Accordingly, we believe that the paragraph should be amended to avoid any implication that there should be such communication.