



Ms Hazel O'Sullivan  
Project Director  
The Auditing Practices Board Limited  
5th Floor, Aldwych House  
71-91 Aldwych,  
London  
WC2B 4HN

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Dear Madam

### **Revised Draft Ethical Standards for Auditors**

PricewaterhouseCoopers LLP ("PwC") welcomes the opportunity to comment on the Feedback on Previous Consultations and the Consultation Paper in respect of the proposed revisions to the Ethical Standards for Auditors ("ESs") circulated by the Auditing Practices Board ("APB").

We fully support the drive to improve transparency and governance around non-audit services, and believe that the best and most appropriate forum to govern this area is the audit committee or those charged with governance. As such we commend the APB and Financial Reporting Council ("FRC") for the proposed changes to the guidance for Audit Committees. This enhanced disclosure and increased transparency can only improve the debate around auditor independence, and we believe these changes are the right response to deal with the perception concerns raised by some of the investor respondents to the previous consultations.

We are pleased that the APB has taken into account the overwhelming message from the October 2009 consultation, namely that the threats and safeguards approach to auditor independence is fit for purpose. The threats and safeguards approach has underpinned the UK approach to auditor independence and is widely used internationally.

Increasing prescription in this area risks moving the UK out of line with existing international practice, and would result in increased costs to UK companies, which potentially threatens their competitiveness. Therefore, it is essential that any changes to regulations are subject to better regulation principles, including cost-benefit analyses and impact assessments.

Notwithstanding our support for the principles behind the Consultation Paper, there are a number of substantive issues related to the proposed amendments, as outlined below.

### **Connected Parties and Conflicts of Interest**

The APB is right to consider whether, and to what extent, non-audit services provided to parties connected to an audit client may impact on an audit firm's objectivity and independence. We believe it is appropriate to include within the revised standards services to affiliates and, in some circumstances, to management of the audited entity. This will address the public interest concern identified in Para 8.1.

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*PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH  
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652, [www.pwc.co.uk](http://www.pwc.co.uk)*



However, it is not necessary to extend this any further, and the requirements of part (c) of “connected parties” together with the insertion of “other entities” proposed in paragraph 6 of ES 5 are open ended and disproportionate. This results in a level of complexity which is unnecessary as any significant threats in this area will in practice be self-evident. The proposed approach does not achieve the necessary clarity and certainty about what the issues are, and it is unclear what the resulting standards mean in practice. The scope of the proposed new wording within the standards is poorly defined and inconsistently applied, and this is likely to have unintended consequences and may well make them unworkable.

Conflicts of interests are an important issue for the accountancy profession and we agree that the Ethical Standards should address circumstances where a conflict of interests may impact upon independence. However, it is important that the standards are clearly focussed on the independence aspects of this issue and avoid the complexities of a more general discussion around conflicts of interest, for which there is already clear guidance (such as the ICAEW Code of Ethics, Sections 220).

### **Restructuring Services**

In March 2009, the APB proposed introducing a strengthened threats and safeguards approach to address the issues raised on restructuring services which gained widespread support. This is described as Option 3 in the Consultation Paper, and is a proportionate response to the concerns raised. The wording proposed by the APB in March 2009 addresses the threats that can arise in such circumstances and the safeguards that can be applied to reduce these threats to an acceptable level.

It is acknowledged that when a company is in distress, early intervention by appropriately skilled specialists can give rise to a significant increase in the chances of survival and preservation of value for investors and other stakeholders. Some respondents have significant concerns with auditors providing restructuring services, whereas others point to a number of benefits that can arise from using the auditor. We recognise both sides of the argument, but believe the interests of companies and their stakeholders are best served when management are able to seek speedy and trusted advice from restructuring specialists within the audit firm within a threats and safeguards regime.

Therefore, we recommend that the APB adopt the March 09 wording which provides clear guidance on the safeguards required to address any actual or perceived threats to independence, together with the additional disclosure in annual reports as suggested in the FRC’s current consultation on the “Guidance on Audit Committees”.

### **Approach towards contingent fees**

A general prohibition on contingent fees, as proposed in Option 1, would be against the interests of companies, as a contingent fee arrangement is primarily adopted by companies to reduce the risk of incurring professional costs when they do not achieve their commercial objective (and not, as indicated in the consultation paper, to incentivise the service provider).

Experience shows that the current threats and safeguards approach to contingent fees effectively addresses any perceived or actual threat to independence. This includes the recognition that a contingent fee arrangement can create an insurmountable threat if it is dependent on an audit judgement on a material matter in the financial statements or is material in practice to the audit partner’s profit share. We recommend that this approach is extended to apply to all non-audit services rather than limited to tax, corporate finance and transaction services as at present.



We recommend that the APB apply Option 2 in the Consultation Paper, as this ensures that directors or, in the case of listed entities, audit committees would be free to determine when it is in the best interests of the company to appoint the auditor under a contingent fee arrangement, subject to clear guidance on when such an arrangement can give rise to an insurmountable threat to auditor independence.

**Tax Services**

We comment in Appendix 2 on changes made to paragraph 78 of Ethical Standards 5, which have not been raised in the Consultation Paper. As drafted, the intent of the change is unclear, and could be interpreted as requiring a reduction in the circumstances under which companies can use their auditor to assist with tax calculations to support them in meeting their tax compliance obligations. We presume this is not the intent, and therefore we recommend that the APB should clarify their intention, and ensure that any change is subject to proper due process.

**Conclusion**

We would be happy to discuss any of the points contained in this letter and the attached appendices with you. Appendix 1 provides our responses to the specific questions raised in the Consultation Paper, while Appendix 2 provides additional comments on the proposed drafting.

Should you wish to discuss any of the matters in this letter please do not hesitate to contact Bill Morgan, Ethics Partner.

Yours sincerely

A handwritten signature in blue ink that reads 'Bill Morgan'.

Bill Morgan  
[bill.j.morgan@uk.pwc.com](mailto:bill.j.morgan@uk.pwc.com)  
T: 020 7213 1052

## Appendix 1 - Answers to specific questions raised by the APB



**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?*

Overall, we support the approach outlined, and believe strongly that the best way to deal with the issues of perception is through increased disclosure of fee levels and governance procedures.

We agree with the APB that there is no need for a quantitative limit on the ratio of non-audit fees to audit fees. We also agree that audit committees are best placed to monitor, and form a view on, the appropriate level of fees paid for non-audit services and to select the best qualified provider of any non-audit service.

The requirement to consider and then disclose high non-audit to audit fee ratios should only apply to public interest entities. Furthermore, for the ratio to be meaningful, it should be a comparison of fees for non-audit services with the total of audit and audit related fees

The proposal in paragraph 2.15 of amending paragraph 18 of ES 5 to require the involvement of the Ethics Partner in a judgement which the audit partner and audit committee are well-qualified to make is unnecessary. Ethical Standard 1 already contains guidance which requires an audit partner to consult with the Ethics Partner on difficult judgements, so there is no need to introduce specific examples which require consultation.

However, if the APB choose to adopt this revised drafting, it is important that this requirement should only apply to public interest entities, and the relevant ratio should be audit related and audit fees together compared to non-audit fees).

**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 believe that the services included in the list of “audit related” services are the correct services, provided that the aim of “audit related” is to identify only those services where the threats are so clearly insignificant that no safeguards need to be applied.

However, in order to avoid confusion and uncertainty in the minds of audit committees and those charged with governance, we recommend that the APB includes within Ethical Standard 5 a clear statement that there are other services which are customarily provided by the auditor, where the threat to auditor independence is routinely addressed by safeguards, such that the end-result is that the provision of these services gives rise to an overall threat which is clearly insignificant.

This is necessary because the proposed changes to the Ethical Standards introduce a requirement for the audit committee to disclose further details about any non-audit services being provided by the auditor, and to justify why they used their auditors. As such, it is important to aid investor’s understanding of this disclosure that the APB is clear that there is no presumption that services which are not audit related should not be provided by the auditor. A statement that makes this clear is included in the Consultation Paper at paragraph 4.11 and we recommend this statement is repeated within Ethical Standard 5.

One specific example of a service that would meet the above description is investment circular reporting, which under the APB’s proposals would be categorised as a non-audit service.

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The APB has acknowledged that the provision of such services is generally uncontroversial and that the risk to auditor independence is low and already dealt with in the ESRA. Furthermore, a large number of London market transactions are now global in nature and typically have a US and International comfort letter. Under US auditing standards these letters can only be given by the auditor, and therefore fall firmly into audit related. The same is true of debt offerings where the audited accounts are used for the prospectus and the comfort letter is based on the firm being the auditor.

Consequently a strict application of the APB's definition of 'audit related' services would split investment circular reporting between two categories. We recognise this would be confusing, so we recommend that investment circular reporting fees should be included in a subtotal in the suggested template within fees for non-audit services (i.e. an aggregation of public and private reporting).

**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?*

We believe that additional disclosure to audit committees about the nature of the non-audit services will help to reduce the perceived threats to objectivity and independence. As such, we consider the template to be helpful guidance on the level of information to be provided by the auditor to audit committees.

We agree with the APB that the provision of this information to the audit committee may influence the detail provided in the financial statements. However, we do not believe the use of such a template in public disclosure should be mandatory for audit committees, and we commend the APB and the FRC for not seeking to make the use of this mandatory within the FRC's revised guidance.

We suggest the template would provide more useful information to the audit committee and to investors through the introduction of two sub-totals:

- A sub-total of audit plus audit related. This would show the total of fees paid to the auditor for services which do not need safeguards to be applied, and would link to our proposal that the meaningful fee ratio for investors is the total of audit plus audit related fees compared to all other non-audit services .
- A sub-total after investment circular reporting and other services pursuant to legislation. This would act to distinguish them from the other 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?*

We believe the proposals set out in the FRC's Guidance on Audit Committees will reinforce the audit committees' responsibility, and believe the recommendations around improved disclosure and transparency are key to addressing the perception issues raised by respondents to the previous consultation.

We have separately replied to the FRC, and in that letter we comment on aspects of the drafting.

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**Question 5:** Do you support:

the approach taken to the provision of 'extended audit services' in ES 5 (Revised), paragraphs [AH] and [AI]?

We support the approach taken in paragraphs [AH] and [AI], and believe that the application of a threats and safeguards approach to any work that is performed outside of the overall audit is the correct response.

In Appendix 2 we comment on concerns we have in relation to the proposed amendments to paragraph 45 of ES 5, relating to internal audit work.

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

We have assumed that this is an incorrect reference, as paragraphs [AH] and [AI] refer to extended audit. We presume that the question intended to refer to the proposed amendments in paragraphs 46 to 50 in ES1 and paragraphs [V] to [X] and paragraph [Z] of ES5.

Further guidance on how to apply the threats and safeguards approach is helpful, and will give greater confidence to audit committees and investors that independence is being safeguarded. Therefore, we support the approach, but have concerns over the detailed drafting in paragraphs [V] and [Z], which we have outlined in Appendix 2.

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

We agree with the APB that the role of an Ethics Partner is a key role within the audit firm. However, we question the need for any significant tightening of the rules, as we believe that under the current guidance the Ethics Partner role is working effectively.

We do not share the concerns expressed in paragraph 5.14 of the Consultation Paper that other senior Risk Management or Compliance roles can be in conflict with the public interest perspective that the Ethics Partner role was intended to address. In fact, we believe that combining the Ethics Partner role with other senior Risk or Compliance roles means that the Ethics Partner is likely to have more influence and authority within the audit firm, and will often lead to a higher calibre individual being the Ethics Partner.

Whilst it is clearly important that the responsibilities of the Ethics Partner should not be impeded by any other responsibilities, we do not believe it is necessary to state that the Ethics Partner's responsibilities need to take precedence.

We also have some specific comments on the drafting in paragraphs 21 and [B], which we outline in Appendix 2.

the amended definition of 'affiliate' and 'significant affiliate'?

We believe that there are significant unnecessary costs to companies and their auditors in the APB not adopting a definition for affiliates which is identical to IESBA, particularly where there is not any substantive difference. In this case, materiality is already generally understood to be both qualitative and quantitative (indeed materiality is defined in accounting literature as being qualitative and quantitative), and therefore the additional words are unnecessary. Furthermore, this



description of factors that are relevant to materiality will not be readily understood, and is therefore not helpful

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

It is widely accepted that the use of specialists as part of the audit improves audit quality, and therefore we would caution against doing anything that could make this harder to achieve.

We consider the proposed change to be unnecessary and disproportionate to the potential threats to auditor independence. The current application of the policy within ES 4 covers all people who will have a significant impact on the audit. By definition, the other members of the engagement team will not be making key audit judgements. Therefore, we believe that adequate protection is provided through the current rules, which rely on the normal mechanism of threats and safeguards including the need to avoid a significant self review or self interest threat.

The practical effect of the proposed change would be to prevent a relevant expert who has selling objectives related to a particular audit client from providing input on the audit. This is likely to result in separate teams for audit and non-audit work, with a consequent danger of a drop in the quality of resources available to support the audit engagement team.

the other amendments referred to in Section 5?

We support the other amendments.

**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?

We have significant concerns that the proposed implementation date of 15 December 2010 is not achievable in practice, and that seeking to rush these proposals through will result in an unnecessary burden and incremental costs for companies and their auditors. We believe the implementation date should be extended.

Given the scale of this consultation, and the complexity of the issues raised in Sections 2, 4 and 5, it is essential that companies and their auditors are able to work through the issues and implications of these changes in an ordered manner, and have the time to make the necessary changes to systems, and procedures, guidance and training before the new regulations become effective.

We would also highlight that the current drafting means that the proposed effective date also appears to apply to the proposed changes related to restructuring services, contingent fees, and connected parties which are described in Sections 6-8 of the Consultation Paper. The consultation on these issues is currently at the stage of considering options and alternative approaches, and it is important that there is sufficient time allocated to complete the appropriate cost-benefit analysis or impact assessments to support whatever changes (if any) the APB concludes are necessary.

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**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?*

We strongly support Option 3, which provides for the adoption of the threats and safeguards approach. This should be applied to all entities.

Please refer to the main letter for more information.

If, following this consultation, the APB were to decide to adopt Option 1 or 2 for listed companies we would have drafting comments of a significant nature and would wish to provide these to the APB.

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

As with the definition of affiliate, PwC believes that there are unnecessary costs to companies and their auditors that arise when regulators adopt different definitions with no substantive difference. Therefore, PwC believes that, wherever possible, the APB should look to adopt definitions that are consistent with those used by IESBA. This removes confusion, avoids scope for inadvertent errors, and ensures that UK companies are subject to the same regulatory framework as their international competitors.

We acknowledge that the current definition, and explicitly the exclusion of differential fees, can give rise to questions, and therefore we support the introduction of a revised definition that is more closely aligned with IESBA.

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

We recommend the APB should adopt Option 2, which would take the current guidance and apply this to all non-audit services.

We believe that experience shows that the current threats and safeguards approach to contingent fees effectively addresses any perceived or actual threat to independence when applied in conjunction with the recognition that a contingent fee arrangement can create an insurmountable threat if it is dependent on an audit judgement on a material matter in the financial statements or is material in practice to the audit partner's profit share.

**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?

In our main letter we comment on several issues related to the APB's proposed approach to conflicts of interest and the use of the term "connected parties". We expand on several of these statements below.

- i. The requirements of part (c) of "connected parties" are open ended and disproportionate

The first two parts of the definition of connected parties (affiliates and management) are both clear and appropriate to be applied when considering independence in ES 5 (indeed PwC has historically assumed that any assessment of independence needed to include relationships with these groups). However, part (c) of the definition is inappropriately broad as there are a

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wide range of entities that have the ability to influence management which would have no impact on auditors' independence.

Replacing part (c) with "related parties" would not solve this problem, as there are also many people who might be considered a "related party" who would have no impact on auditors independence.

- ii. The requirements of part (c) of "connected parties" and the insertion of "other entities" proposed in paragraph 6 of ES 5 is unnecessary and results in a level of complexity which is unnecessary as any significant threats in this area are in practice self-evident

Including part (c) of "connected parties" and "other parties" in the definition of "non-audit services" would result in companies and their auditors needing to establish systems and processes to identify and consider the impact of relationships with significantly more entities than at present. This is unnecessary for the purposes of safeguarding independence, as those relationships that could impact independence will in practice be self-evident.

Accordingly, we recommend that the definition of non-audit services should be focussed solely on services provided to the audited entity and its affiliates.

- iii. The scope of the proposed new wording within the standards is poorly defined and inconsistently applied;

The current drafting is inconsistent in the entity or entities that are referred to. The references to "audited entity", "affiliates" "significant affiliate" and others are not consistent and logical throughout the standards. Furthermore, there are then several other additional groupings of entities or services identified that the auditor needs to consider. These include "connected parties", "a third party who is connected (through a relationship)" [Para D, ES1], "parties whose interests may be contrary to the audit client" [para 12, ES1], together with "services in connection with the audit client".

This level of inconsistency will lead to differences in interpretation, inadvertent errors, and general confusion amongst audit committees and auditors about the entities that need to be considered. Therefore, a comprehensive review of this area is necessary before the revised standards are formalised

- iv. It is important that the standards are clearly focussed on the independence aspects of this issue and avoid the complexities of a more general discussion around conflicts of interest

Whilst conflicts of interest are important, and can, in certain circumstances, have an effect on actual or perceived independence, they are a separate issue. Furthermore, there are already various sources of regulatory guidance that addresses this more general topic, including the ICAEW Code of Ethics, Section 220. In the interests of clarity the ESs should focus solely on the independence aspects of conflicts of interest.

The issues of conflicts of interest are perfectly capable of being addressed separately through the wording we suggest in Appendix 2 for paragraph 12 of ES 1, together with the wording that already exists in paragraph 31 of ES 5.

We have included in Appendix 2 comments on some of the paragraphs referred to in order to highlight some of the issues that the drafting raises. This is not an exhaustive list, and we have not included every reference to connected parties in Appendix 2.



**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.*

It is inevitable with any regulatory change that its implementation will lead to additional costs. However, several of the options suggested as possible approaches in Section 6, 7, and 8 could give rise to costs to both companies and their auditors which significantly outweigh any benefit.



PwC would be willing to meet with the APB staff to discuss any of the comments set out below.

### **Connected parties and conflicts of interest**

As described in our answer to Q10, we believe significant improvements should be made to the drafting in connection with the proposed approach to connected parties and conflicts of interest.

If the APB decides to continue with the concept of “connected parties” it will be important in the interests of clarity that the additional category (those with an ability to influence) is identified on a consistent basis, and we recommend the APB will need to consult further on this issue prior to any implementation of this aspect of the standards.

### **Contingent fees - definition**

PwC believes that the APB should adopt the IESBA definition of contingent fees, which would remove the exception for differential fees. As currently drafted, the proposed definition is not exactly the same as that used by IESBA, but it is not clear if these differences are intended to be substantive or are simply due to drafting preferences. PwC believes there are benefits to be gained from having consistent definitions, and that any variations can lead to confusion and inconsistent interpretations by auditors and their audit clients. Therefore, we propose that paragraph 11 of ES 4, and the definition of contingent fees in the Glossary, should be made consistent with the IESBA definition.

### **Contingent fees - approach**

PwC believes that the best approach to contingent fees is to make the existing guidance apply to all services, and to emphasise the factors and safeguards that the auditor should evaluate in forming a view on the appropriateness of any contingent fee arrangement.

We recommend, for simplicity, bringing all references to contingent fees together into one place in Ethical Standard 4, and then just cross-referring to this within Ethical Standards 5.

### **Need for clearer and more concise guidance**

There are several instances within the ESs where there is guidance that could be interpreted differently by different users. This potential for confusion is dangerous, and can lead to companies and auditors feeling like they have to second guess what the real intent of the drafting is.

The standards are becoming ever longer, which makes them harder to read and interpret consistently. Furthermore the suggested redrafting includes additional guidance that can easily be interpreted as setting an expectation of best practice behaviour, when we do not believe that is either the APB's intention nor is it appropriate. Examples of this include the last sentence in paragraph [V] in ES5, and the last sentence of [AJ]

### **Directors, management, key management positions**

Throughout the Ethical Standards there are different references to “management”, “directors”, “those charged with governance”, and “persons in key management positions”. In some instances management is defined as including directors and those charged with governance, whereas in others the drafting makes it clear that the auditor should consider management AND directors AND those charged with governance.



This should be standardised across the Ethical Standards, and we would encourage the APB to adopt the same language used in other regulatory frameworks when describing management.

### Drafting comments on specific paragraphs

ES1 Para [A] Introducing conflicts of interest under the heading of Integrity is inappropriate. Integrity is necessary to deal appropriately with conflicts of interest but freedom from conflicts or the appearance of conflicts is not necessary for a person to have integrity. This paragraph should be deleted (the point is dealt with in paragraph 12).

ES1, Paragraph 12 - amend to read as follows:

*Independence is freedom from situations and relationships which make it probable that a reasonable and informed third party would conclude that objectivity either is impaired or could be impaired. Independence is related to and underpins objectivity. However, whereas objectivity is a personal behavioural characteristic concerning the auditor's state of mind, independence relates to the circumstances surrounding the audit, including the financial, employment, business and personal relationships between the auditor and the audited entity ~~and its connected parties~~ and its affiliates. ~~Relationships with parties whose interests may be contrary to the interests of the audited entity may also be relevant to the appearance of the auditor's independence.~~ Independence can also be affected by relationships between the auditor and a third party.*

ES1, Paragraph 21(b) – replace the reference to a “consistent” approach with a “compliant” approach. Consistency of approach is not the important issue; it is ensuring that a firm is always compliant with the standards.

ES1, Paragraph [B] – Following the “spirit of the principles” is tautologous. It should be “spirit of the rules” or just “principles”.

Para 32 Management threat – the inclusion of “or its connected parties” is incorrect based logically on the prohibition in Para 30

ES1, Paragraph [D] – It is unclear who is meant by “parties connected (through a relationship) to an audited entity” – is it “connected parties” or something wider? We do not believe this paragraph adds anything to what is said before.

ES1, Paragraph [D], second bullet – it is difficult to understand how the auditor having additional information about the views of the finance provider would not be a positive thing that would help the audit judgement. The issue being referred to here is really one of confidentiality, but this is very different from any potential impairment of independence. This error is also repeated in paragraph 31 of ES5.

ES1, Paragraph 63 (wrongly numbered) –This paragraph can be read to create a requirement for discussion with and approval by those charged with governance in advance of non-audit services being provided and needs to be clarified. It should be up to audit committees to determine the extent of formality they require around this area, including whether to “pre-approve” services meeting certain criteria. Furthermore, this paragraph was previously only applicable to audits of listed companies. If it is intended to impose an advance discussion and approval process on all companies this would create an unnecessary burden for non-listed companies.



ES1, Paragraph 59 – currently there is a need to disclose threats and safeguard related to relationships in clause (a), but not a need to disclose threats and safeguards related to non-audit services in clause (b). There should be a need for such disclosure in both cases.

ES1, Paragraph 61 – we presume the final sentence is intended to make it clear that there is a need to disclose three separate additional items, which are 1) contingent fees, 2) value of future contracted services, and 3) value of proposals submitted. As drafted it does not pick up all of the second category or any of the third.

ES1, Appendix 1 – See our comments on the template in response to question 3

ES4, Paragraph [H] – This paragraph indicates that a contingent fee arrangement **does** create significant self-interest threats even though the auditor only **may** have an interest in the outcome of the non-audit service. As drafted the case for there always being a significant self interest threat is not made. Furthermore, it fails to recognise that in some cases the contingency will not be dependent on the outcome of the service (for example tax reclaims, where the outcome is based on the decisions of the taxing authorities).

ES4, Paragraph [M] – It is not clear what is meant by “other” non-audit services.

ES4, Paragraph [N] - the reference to paragraph [L] appears to be incorrect, and should refer to paragraph [J]

ES4, Paragraph [N] – In ES 5 the use of the term “engagement team” to refer to the team doing the audit can lead to confusion. We therefore recommend the first bullet adopts the second option

ES4, Paragraph 16 – We presume this should be consistent with paragraph 14 and require disclosure of contingent fee arrangements for non-audit services provided to the audited entity or its affiliates.

ES4, Paragraph 38-40 – Please see our response to Q5.

ES5, Paragraph [T] – The drafting here is different from paragraph [AH], which is confusing. Furthermore, it is unnecessary to include a definition of audit related more than once. We also recommend that an explanation be given of what is meant by “integrated with the audit” to avoid significant uncertainty in interpretation.

ES5, Paragraph 8 – The deletion of “to an audited entity or any of its affiliates” without any replacement descriptor is very unhelpful. Is APB’s intention that it should cover non-audit services to “connected parties”?

ES5, Paragraph 11 – This is an example demonstrating the need for consistency throughout ES5. This firm has always interpreted this paragraph as covering non-audit services to “an audited entity and its affiliates”, even though it refers only to “an audited entity”.

ES5 Footnote 7 – This does not appear to be a good example. An audit team (or persons advising it) will always need to have sufficient expertise. This is no different if the non-audit service is done by the audit firm or another party.

ES5, Paragraph Y – The phrase “consider the implications of such perceived loss of independence and” is confusing and unnecessary and should be deleted.



ES5, Paragraph 31 – this is a repetition of the wording in ES1, Paragraph [D]. We are unclear how the additional knowledge gained by the auditor would lead to any loss of independence. The issue is one of confidentiality, which is not relevant to the ESs.

ES5, Paragraph [Z] – we believe that segregation of information between a non-audit team and an audit team will rarely be relevant in safeguarding a self review threat. Both teams will have access to the same client information, and the audit team will have access through management to all the deliverables of the non-audit service.

ES5, Paragraph [Z] – the final sentence of b. is unclear, and could be interpreted to mean that the Ethics Partner has to be involved in every instance where a review partner is considered appropriate. This seems disproportionate.

ES5, Paragraph [AA] - the important point should be that the firms approach is “compliant” with the standards rather than being “consistent” with other decisions within the firm.

ES5, Paragraph 41 – The inclusion of the word “advisory” in the last sentence is potentially misleading as the main point is that “assisting” is more of a threat than “providing assurance”. The point is clearer if “advisory” is deleted.

ES5, Paragraph 45 – the reference to where “substantially all of the internal audit activity is outsourced” works if there is a substantial internal audit function, but it is not clear how this should be applied if the company only has a very small (insignificant) internal audit team, and it requests its auditors to provide additional internal audit services. We presume that this would not be an issue as long as the auditor was not going to place significant reliance on the internal audit work performed.

ES 5 Paragraph 78 – There are drafting changes proposed to paragraph 78 which are not referred to in the detail of the consultation proposals in the document. In particular, it is proposed that an “expectation” test replaces a “purpose” test when evaluating whether engagements to prepare current or deferred tax calculations can be used when preparing accounting entries that are material to the financial statements. This would mean that auditors will have to consider carefully how their work product might be used by the client rather than just the purpose for which it is intended.

In our view this drafting change may have significant unintended consequences as there are many situations where tax services include the provision of tax calculations which are not provided for the purpose of preparing accounting entries, but which clients will naturally expect to use when preparing their financial statements. For example, the following might reasonably be expected to be relied on by management when preparing possibly material accounting entries:

- tax computations prepared after an audit is completed for the purpose of submission to the Revenue authorities (a permitted service) – i.e. for adjusting accounting entries in respect of the subsequent financial year, or alternatively simply used in deciding that no adjustments are required;
- tax payments advice based on completed tax computations which will flow through into the accounts;



- tax advice including an evaluation or calculation of prospective tax liabilities arising from a transaction or series of transactions which may give rise to a tax charge in the accounts and therefore flow through to them.

It is our view that these circumstances should be permissible on the basis that the intervention of management in the accounts preparation process, the use on the audit of people who were not involved in the provision of the tax services and the oversight of the Revenue authorities, can be regarded as acceptable safeguards.

We note that the new IESBA code has a "purpose" test (290.185) similar to the current APB Clause 78, (which also mirrors the US PCAOB's approach), so it is not clear why the APB wishes to move away from this.

ES5, Paragraph 95, and 99 – Further to our comment above on the need to be consistent and clear on the meaning of "management" and related terms, it is important to be clear on what is meant by a "key management position".

ES5, Restructuring services – Refer to proposed drafting above. As mentioned in our letter, we have only provided drafting comments on Option 3. If, following this consultation, the APB is minded to adopt either Option 1 or 2 for listed companies we would have significant drafting comments and would welcome the opportunity to provide these to you.