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Our ref: ICAEW Rep 60/11

Paul Smith  
Audit and Accounting Policy  
Department for Business, Innovation and Skills  
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London  
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Dear Paul

**Draft Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011**

ICAEW is pleased to respond to your request for comments on the Draft Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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DRAFT COMPANIES (DISCLOSURE OF AUDITOR REMUNERATION AND LIABILITY LIMITATION AGREEMENTS) (AMENDMENT) REGULATIONS 2011

**Memorandum of comment submitted in June 2011 by ICAEW, in response to the Draft Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011**

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## **INTRODUCTION**

1. ICAEW welcomes the opportunity to comment on the Draft Companies (Disclosure of Auditor Remuneration and Liability Limitation Agreements) (Amendment) Regulations 2011 ('the draft regulations') as published by the BIS.

## **WHO WE ARE**

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance, which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure that these skills are constantly developed, recognised and valued.

## **OUR COMMENTS**

### **Welcome for the draft regulations**

4. We welcome the publication of the draft regulations and believe that they are an improvement on the current legislation which can sometimes be difficult to apply in practice. Transparent and consistent disclosure of fees paid for non-audit services will clearly be of benefit to many stakeholders.
5. However, while we regard these proposals as a step in right direction we believe that more needs to be done.

### **The needs of users of the financial statements**

6. In our opinion changes in the legislation should be driven by the needs of users of the financial statements and we would encourage BIS to undertake additional outreach work to establish what disclosures investors and other stakeholders would value when evaluating any threat to auditor independence. Meeting the needs of users should be the primary focus of this legislation, though at the same time we would not want to see any unnecessary burden being imposed on companies.
7. Some may argue that requiring disclosure of nine categories of non-audit services in the UK when the Audit Directive calls for only three categories amounts to unnecessary 'gold plating' of EU legislation. We do not agree with this view. However, as noted in paragraph 6 above, we can only support the inclusion of additional categories of non-audit services beyond those required by the Audit Directive if doing so meets a genuine need of users of the financial statements. If BIS is satisfied that this is the case, we would suggest that this is made clear in the explanatory notes to the final regulations.

### **Linkages**

8. The explanatory text accompanying the draft regulations states that the intention is that the proposed financial statement disclosures will 'link more clearly' to the classification of non-audit services under Article 49 of the Audit Directive. We agree with this sentiment. However, we are not convinced that the draft regulations achieve this aim. We have tried to map the categories in the draft regulations onto those in the Audit Directive and found that the links between them were not immediately obvious.

9. The explanatory text goes on to say that ‘it makes sense’ to further link the proposed financial statement disclosures into the Ethical Standards issued by the Auditing Practices Board (APB). Again we agree with this sentiment. However, to make this possible it will be necessary to update the illustrative template that accompanies Ethical Standard 1 to bring it in line with the amended regulations and we would suggest that BIS works with the APB so that this new guidance can be issued by the APB at the same time as the Statutory Instrument is finalised.

#### **Audit services**

10. As explained in paragraphs 11 to 13 below, we believe that the amounts disclosed as auditor’s remuneration for audit services should include amounts receivable by associates of the auditors and should include fees in relation to the audits of subsidiaries. These changes would bring the disclosure requirement into line with what most users would understand to be the cost of auditing the accounts in question.

#### **Non-audit services**

##### Category 1

11. Describing fees in relation to ‘the auditing of accounts of any associate of the company’ as fees for non-audit services is, in our view, misleading and does not provide users of the financial statements with useful information. While this category is largely similar to that under the existing regulations, we believe that BIS should take this opportunity to correct what we consider to be a fundamental flaw.
12. Under the regulations ‘associate’ is defined as ‘any subsidiary of that company, other than a subsidiary in respect of which severe long-term restrictions substantially hinder the exercise of the rights of the company over the assets or management of that subsidiary and any scheme which is an associated pension scheme in relation to that company’. In practice the allocation of audit fees between those relating to the consolidated accounts and those relating to individual subsidiaries frequently causes problems despite the guidance provided by TECH 06/06 (revised). Ultimately the split will often be done on a judgemental basis or will be driven by the legal structure of the group. Moreover, many users of financial statements fail to appreciate the distinction. In our view, as explained in paragraph 11 above, the audit fees disclosed should include not only those of the parent and those relating to the consolidated accounts, but also those relating to ‘associates’ as defined in the regulations. If necessary audit fees relating to associates of the company could be disclosed as a sub-category of the overall total but we believe it is the overall total audit fees that are of most interest to users.
13. Additionally, we feel that the exclusion of fees earned by associates of auditors from audit fees is not appropriate. In a marketplace in which global networks of accountancy firms operate it seems odd to us that, for example, fees earned by an associate of the auditor auditing an overseas branch or a consolidation return of an overseas subsidiary should not be classified as audit fees.

##### Categories 2-5

14. We are supportive of splitting ‘assurance services’ into categories 2 & 3 and ‘tax advisory services’ into categories 4 & 5.

##### Category 6

15. Category 6 refers to fees in relation to ‘internal audit services’. Although this category exists under the current regulations we have always believed, and continue to believe, that this is not worthy of a separate category. The term ‘internal audit’ is in practice used to encompass a wide range of services and we feel that grouping these together under a single heading does not necessarily provide users of the financial statements with the most useful information and may in fact be misleading. We believe that such services should be categorised as part of either ‘all other assurance services’ or ‘all other non-audit services’ depending on their exact nature.

## Categories 7-8

16. In this instance we fail to see the logic in splitting 'corporate finance transactions' into two separate categories. We would urge BIS to either combine these services into a single category or to provide further rationale for the distinction.
17. We are unclear as to whether category 7 is designed to include only services the auditor must do pursuant to legislation or just things that are conventionally done by the auditor and whether this implies that category 8 is designed to include services where the entity has more discretion about who it appoints. More clarity is needed.
18. If a decision is made to retain the split between these two categories, we feel that the wording in category 8 should be clarified to make it clear that it is referring to corporate finance transactions not included in category 7.
19. Also, as a small drafting point, we suggest that 'or any of its associates' should be added on the end of category 8.

## Category 9

20. Category 9 refers to 'all other non-audit services not identified in paragraphs 6 to 8'. As this is clearly a residual category we would suggest clearer drafting would be to refer to this category simply as 'all other non-audit services' or 'all other non-audit services not identified above'.

## **Phoenix Venture Holdings Limited and MG Rover Group Limited**

21. While we fully appreciate the concerns raised in the wake of the affairs of Phoenix Venture Holdings Limited and MG Rover Group Limited, we are pleased to note that the proposals do not extend the disclosure of fees for non-audit services to 'connected' parties as we feel doing so would impose a disproportionate burden on large private companies.

## **Other related concerns not covered by draft regulations**

22. We are concerned that the complexity of the regulations, particularly the inclusion of confusing terminology, means that they are prone to being misunderstood.
23. We have referred already to the confusing use of terms such as 'associate of the company' and 'associates of the auditor' in the regulations. We would encourage BIS to consider ways to make the legislation more user-friendly and the terminology more consistent with, for example, that used in financial reporting standards.
24. We would also encourage BIS to consider removing the criterion in Regulation 6(3)(b) which currently must be met before the disclosure exemption can be taken and which does not appear to be included in the Audit Directive. This results in most parent companies and subsidiaries making boilerplate disclosures in their accounts and is therefore, in our view, of no real value.

## **Small and medium-sized companies**

25. To be consistent with our comments above, we believe that for small and medium-sized companies the disclosure of auditor's remuneration for auditing the accounts should include fees paid to associates of the auditor for auditing those accounts. It should also include fees for auditing the accounts of subsidiaries when group accounts are presented. These changes would bring the disclosure requirement into line with what users would understand to be the cost of auditing the accounts in question.

### Adoption date

26. The draft regulations state that they will come into force on 1 October 2011. We are unclear if this means from that date ie, for any financial statements approved thereafter, or for periods beginning on or after that date. We believe it should be the latter. Critically, we are unclear as to whether the draft regulations would apply to 31 December 2011 year-ends. This needs clarifying.
27. Given the deregulatory nature of the proposed changes, we would encourage BIS to allow early adoption on a voluntary basis so that those companies that wanted to apply them to 31 December 2011 year-ends would be able to do so.

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