

10 April 2006

ICAEW Rep 23/06

Hazel O'Sullivan.
The Auditing Practices Board Ltd
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Aldwych House
71-91 Aldwych
London WC2B 4HN

Dear Hazel,

APB ETHICAL STANDARD FOR REPORTING ACCOUNTANTS

The Institute of Chartered Accountants in England & Wales ('The Institute') is pleased to respond to your request for comments on the draft Ethical Standard for Reporting Accountants.

Please contact me or Tony Bromell (tony.bromell@icaew.co.uk) should you wish to discuss any of the points raised in the attached response.

Yours sincerely/faithfully



Neil Lerner
Chairman, Ethics Standards Committee



ICAEW REP 23/06

APB ETHICAL STANDARD FOR REPORTING ACCOUNTANTS

Memorandum of comment submitted in April 2006 by the Institute of Chartered Accountants in England and Wales, in response to the Auditing Practices Board consultation paper 'Draft Ethical Standard for Reporting Accountants' published in January 2006

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute') welcomes the opportunity to comment on the consultation paper *Draft Ethical Standard for Reporting Accountants* published by the Auditing Practices Board (APB).

WHO WE ARE

2. The Institute of Chartered Accountants in England and Wales is the largest professional accountancy body in Europe, with more than 127,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

GENERAL POINTS

Need for the ESRA

4. We accept that the APB does have a role in setting standards for accountants undertaking public reporting engagements in principle. However, as the number of bodies issuing ethical guidance in non-audit areas increases, so does the potential for conflict between ethical standards. We do not see what this draft Ethical Standard for Reporting Accountants (ESRA) achieves that is not already covered by Institute's own standards derived from the IFAC Code of Ethics. Accordingly we do not see that there is any public interest benefit from introducing this UK-specific measure.
5. We note that the APB has not undertaken a formal regulatory impact assessment (RIA) but has noted that it believes additional costs to reporting accountants who are not auditors to be minimal. We believe that there is a need for a formal RIA (relevant to your Question 14) as there are a number of additional costs that need to be considered. These include:
 - the potential consequences of a leak of price sensitive information as a result of the need to perform a widespread search for independence threats (see comments in paragraph 12 below on the key issue of confidentiality);
 - the potential damage to London as a financial market place from a perception that the UK is becoming a high regulation environment. As noted above, we do not believe that there is a need for this additional set of requirements.

6. We assume that the APB will be arranging for the issue of the ESRA to be cleared by the Financial Services Authority and the Treasury as it relates work undertaken in respect of business in markets that they are regulating.

Response of the CCAB Ethics Group

7. The CCAB Ethics Group, in which the Institute participates, has written to you separately on a number of points relating to previous comments on an earlier draft. We have not repeated those points here but endorse the comments made in that letter.

Implementation

8. We trust that when finalising the implementation date for the ESRA, the APB will have regard to the need for transitional arrangements as some changes to existing procedures and arrangements cannot be readily made without damaging quality or implementing complex systems. Transitional arrangements were included in the Ethical Standards on auditor independence and we believe it would be appropriate to include similar provisions.

COMMENTS ON SPECIFIC POINTS

9. Our comments below relate to particular paragraphs or sections of the ESRA and do not specifically address the questions raised in the consultation paper unless we have a particular comment to make. In such circumstances the comments draw attention in the heading to the relevance to a particular question.

Paragraphs 1.1 to 1.3: Scope of the ESRA (relevant to Question 2)

10. We have received a number of observations that it is not entirely clear when the ESRA should be applied and when the ethical code of the professional bodies should apply. The ESRA's application will be by way of the requirement in the Statements of Investment Reporting Standards (SIRS) to comply with the ESRA: that is to say, any engagement that issues a report that states compliance with the SIRS will have to comply with the ESRA. We believe the position could be made clearer through a couple of measures set out below.
11. First, we note that SIR1000 includes in paragraph 1 thereof a brief discussion of some of the key terms (e.g. reporting accountant). This may be helpful in the ESRA.
12. Second, 1.2 refers to the ethical guidance issued by the professional accountancy bodies. Clearly, compliance with the ESRA does not remove the need for compliance with such professional guidance but it would be useful if the provisions in the ESRA were such that compliance with the ESRA resulted in compliance with the assurance independence requirements in the professional bodies' codes. As regards the Institute's Code, the assurance independence requirements are derived from section 290 of the IFAC Code of Ethics. We have

compared the two and believe that compliance with the ESRA would result in compliance with our assurance independence requirements except in one respect related to 3.11 of the ESRA. We address this issue in paragraph [20] below.

Paragraph 1.16: Confidentiality

13. This paragraph recognises the difficulties in applying aspects of the ESRA due to the confidential nature of many investment circular reporting engagements for long periods: indeed sometimes until the investment circular is issued, which is likely to be after completion of the reporting accountant's work. The paragraph limits the requirements of the ESRA to apply only to those within the engagement team and those with a direct supervisory or management or other oversight responsibility for the engagement team who have actual knowledge of the investment circular reporting engagement. However, it is not clear to what extent 1.16 interacts with requirements and guidance contained elsewhere in the document. For example, it is not clear how this limits the extent of requirements to gather and disclose interests and relationships. A particular concern is that in order to gather the information and clarify potential issues from information generated from operational systems with individuals in order to disclose the details required by 1.66, it would be necessary either to disclose the details of the transaction to people outside the immediate engagement team who may not be aware of the transaction, or at a minimum raise a suspicion that an investment circular reporting engagement is being undertaken. The proposed ESRA does not provide any guidance on how this should be achieved. Notification of other relationships to all parties to the engagement may breach duties of confidentiality to other clients. It would be helpful if further guidance were provided in the ESRA on the extent to which the provisions in 1.16 recognising the confidentiality requirements, limit the requirements to gather and disclose interests and relationships set out elsewhere.

Paragraphs 1.41 to 1.45: Scope of persons from whom independence is required (relevant to Question 3)

14. The ESRA extends the requirement to consider independence beyond the engagement client, its directors and senior management and its affiliates to the sponsor and other parties from whom the reporting accountant "takes instructions" and any other entities directly involved in the transaction which is the subject of the investment circular. The IFAC Code of Ethics, section 290, focuses on the requirement for the accountant to be independent from the party which is responsible for the subject matter. IFAC's approach recognises that the fundamental issue is to ensure that the firm is independent from the responsible party for the subject matter, with a threats and safeguards approach being adopted in respect of other parties, taking into account the materiality of the subject matter /subject matter information for which the other parties are responsible. The ESRA should follow the principles set out by IFAC and focus on the core issue of independence of the firm from the party on whose financial information the firm is reporting in relation to an investment circular reporting engagement. A threats and safeguards approach, following the discussion in IFAC 290.20, should be applied to other parties.

15. The argument for applying the provisions of ESRA directly only to the particular responsible party on whose financial information the firm is reporting in relation to an investment circular reporting engagement, is further strengthened by the concessions which have been included in 3.11. This concession to some degree recognises that in this situation (which is quite typical of a Class 1 circular) what is fundamentally important is that the reporting accountant is independent of the audit client on whose financial information the reporting accountant is undertaking work rather than the entity which is publishing the investment circular. However, as drafted, 3.11 may not achieve the planned objectives because in practice the entity publishing the investment circular is likely to, or be advised by its advisers to, require normal disclosure in line with ESRA to play safe. Adoption of an approach similar to that in IFAC 290.20 would allow the ESRA to be consistently applied where needed rather than blanket application with a dispensation, and will avoid the ESRA becoming a cause of a time delay in some investment circular reporting engagements.

Paragraph 2.13: Firm pension schemes

16. The paragraph gives an example of a pension scheme holding shares in the reporting entity in circumstances which might not give rise to an unacceptable threat. Increasingly, pension schemes invest through segregated portfolios managed en-bloc by investment managers who make the day to day decisions and where the Trustees and the sponsoring employer only make decisions on the percentage allocation between investment categories. We believe such schemes would be in a similar position to that illustrated and an additional example might be helpful.

Paragraph 2.27: Loaning staff to clients

17. How is the accountant necessarily to know a year beforehand that the investment circular reporting project will arise?

Paragraphs 2.64 to 2.65: Contingent fees (relevant to Question 8)

18. The distinction between contingent fees (which are prohibited) and negotiating fees after completion of the engagement (which is allowed) appears to be a very fine one and open to abuse as currently drafted. The discussion should clarify that if these arrangements (or differential fees) are to be applied, the basis on which the determination is to be made must be clear in advance.

19. It would also be useful to clarify that taking fees in a format that provides a link to the outcome (e.g. being remunerated in shares) would be construed to be a contingency fee basis.

Paragraph 3.5: Definition of relevant period

20. We do not believe that the relevant period should include within its definition, the period between the date of the last financial statements and the start of the reporting engagement. This effectively entrenches that period in the detailed provisions following this paragraph. In practice the relationship / service at issue may have been completely terminated prior to the reporting engagement being

envisaged, with no ongoing consequences. We believe that a threats and safeguards approach should be applied to such relationships/services.

Paragraph 3.11: Dispensation for reports published in an investment circular issued by another entity.

21. The wording in 3.11 implies that if advantage is taken of the dispensation not to make an evaluation of other engagements provided, then no threats and safeguards analysis need be applied at all. We doubt this is what is intended and it would not be in compliance with section 290 of the IFAC Code of Ethics (and thus the Institute's own assurance engagement independence requirements). It should be clarified that there should be an assessment of any known threats, notwithstanding that a full pro-active assessment is not being undertaken, and that appropriate safeguards should be applied.

Paragraph 3.72: Sponsors (relevant to Question 4)

22. 3.70(a) and 3.71 rightly prohibit the reporting accountant from promoting the shares of the entity being reported upon. 3.72 then discusses acting as a Sponsor / Nominated Adviser. While these roles do not of course equate to promoting shares, we believe that there should be an assessment to ensure that a reasonable and informed third party would not conclude that the activities undertaken while Sponsor /Nominated Adviser would not be seen to equate to promoting the shares.

Minor drafting points

23. 1.25. As there are two subjects, the engagement partner and the ethics partner, the verbs should be in the plural.
24. 1.32. Line 2. "an other" should read "another". This also occurs in Para 3.5 (b), line 2 and Para 3.6, line 3.
25. 2.26. Line 4. Should it read "..any person who is also.."?
26. 2.45. Line 5. Should it read "...any period which was materially..." ?