



Our ref: ICAEW Rep 77/12

30 May 2012

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Dear John

Consultation paper on monitoring the work of third country auditors

ICAEW is pleased to respond to your request for comments on the consultation document monitoring the work of third country auditors issued in March 2012.

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

Yours sincerely

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ICAEW REPRESENTATION

Monitoring the Work of Third Country Auditors

Memorandum of comment submitted in May 2012 by ICAEW, in response to the Professional Oversight Board's consultation document Monitoring the Work of Third Country Auditors published in March 2012

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation document Monitoring the Work of Third Country Auditors published by the Professional Oversight Board on 7 March 2012, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

MAJOR POINTS

Support for the initiative

5. The consultation document seeks to set out the POB's approach to monitoring third country auditors where there are not adequate recognised inspection arrangements. These auditors, referred to as "Article 45" auditors (by reference to the relevant article in the statutory Audit Directive) number some 31 covering 43 relevant audits.
6. We understand the POB's difficulties in this area, and support the general approach of applying a proportionate and balanced response where the costs do not outweigh the benefits. We agree that the single template approach is not appropriate and a flexible response is necessary, though in various parts of the consultation document we still think that some unnecessary constraints have been applied.
7. In particular we think that the approach may have been more enlightened had it been made from the viewpoint of overall risk to public interest in the UK rather than simply trying to meet the obligations of the Directive on a minimal basis. Rotation over longer periods than 3 years and the use of technology such as video conferencing to effect reviews are examples where some more imaginative solutions may be applied in developing a suitable inspection programme.
8. On the other hand we consider the leverage of audit networks' own quality assurance inspection procedures a progressive idea though one that needs careful crafting. In our paper to the EC on 5 March 2007 concerning the implementation of Articles 45-47 of the Directive we suggested that the global networks' own global procedures could have a key role to play in achieving audit quality, and this is a natural development from that concept.

9. We also suggest that there may be some benefit in POB working with other national regulators through EGAOB and IFIAR to establish a common framework and methodology for dealing with the oversight of smaller countries, which would reduce the administrative burden whilst extending coverage. The progress of transitional states (which are a weakness in the current regulatory cover) and appropriateness of reciprocity rules could be challenged effectively through these organisations.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Do you agree with the overall approach set out in paragraph 3.2 ?

10. We believe that the rationale set out in paragraph 3.2 is a reasonable approach to this difficult area. "Proportionate" however is a subjective term, and perhaps the paper should be set out more clearly what the key elements are that would determine proportionality. We also believe that consideration should be given widening the context of "significance" to one of major interest such as is defined in Schedule 10 to the Companies Act 2006 rather than limiting it purely to investor interest, though we recognise that in the majority of cases that may be the only element of public interest.

Q2: Do you agree with the proposals on "Article 45" auditors set out in paragraph 3.3? If not, what alternative(s) would you propose?

11. With regard to the first bullet step in 3.3, we consider there has to be some assessment of the competence of the independent audit regulator if they look to rely on that work and it is high significance.
12. However we think this process could be developed further by looking to EGAOB or indeed IFIAR to provide some regulatory lead and provide a common coordinated inspection programme for small countries that the larger regulated countries could place reliance on. This would reduce cost and duplication whilst retaining the integral objectives of the inspection programme envisaged by the Statutory Audit Directive.
13. The fifth bullet suggests drawing down on other external information including quality reviews carried out by international networks for low or very low significant audits. Whilst we cautiously welcome the innovative approach, we would caution the options available to the networks themselves to be able to supply such information on a voluntary basis and the contractual and legal consequences would need to be carefully considered.
14. In the case of the final bullet we are not convinced it is appropriate to apply an arbitrary cut off of 5 audits to decide whether the AIU need to conduct reviews on site. This is imposing a degree of rigidity in what is intended to be a flexible option. For example by way of contrast, the crown dependency monitoring work at one Crown Dependency based firm with more than 10 relevant audits will in 2012 be undertaken from the separate UK network firm's offices in London.
15. We similarly would challenge in the final bullet why 5 is considered as the benchmark for the purpose of conducting firm wide work. This would have the effect that a firm with one fewer client saves itself 20 review days, and could lead to unhelpful market behaviours. We would suggest the approach to such whole firm work needs to be much more flexible at the lower levels, for example by only exploring potential whole firm problems identified through the file review process.

Question 3: Do you agree with the proposals for "equivalent" registered TCAs, particularly for US audit firms set out in in paras 3.5 to 3.7? If not, what alternative(s) would you propose?

16. Based on the exercise of the current reciprocity arrangements we agree with the proposals.

17. However we would query the continued political expediency of the reciprocity arrangements with regards to the US, which means the approach (and expense) applied is not focused on the risk factors underpinning the paper but the political conduct of third countries. The approach appears even more out of balance when it is considered that “transitional status” countries like Indonesia are outside the scope of monitoring arrangements. Given the movements that the US authorities have made in recent years and the political statement having been made, we believe consideration should be made now to accepting US equivalency as far as possible irrespective of their continued inspection programme in the UK. This of course is subject to the legal obligations imposed in this area.

Question 4: Do you agree that the results of external monitoring should be reported to a regulatory committee of the FRC? (para 3.8)

18. We concur with the proposed arrangements.

Question 5: What charging structure do you consider provides a sensible and fair basis for recovering the costs of external monitoring? (paras 3.9 to 3.11)

19. We recognise that given the small and widely variable population this is not an easy decision to make. There are arguments for and against both approaches.
20. The review specific approach has the merit of being fairer, recovers the fixed cost up front, avoids timing disputes and is easily understood. However countering that is the need to consult annually on its composition, recovery of costs has to be done in arrears, the pattern of billing is irregular and there are complex billing arrangements needed.
21. The general approach has the merit of being simple for collection, recovers the costs in full irrespective of activity undertaken, provides a consistent predictable charge to the firms and once accepted is not subject to much further challenge. On the other hand the model is vulnerable to single changes in circumstance that could lead to under-recovery, flexing in the model for member changes could lead to long arguments, some firms might see high charges for apparent little activity and there could be some gamesmanship by firms as they seek to avoid the higher tariffs.
22. In preparing this response as a representative of our members, we would tend to lean towards the first option. However based on our own experience as a regulator we would tend to the second. A third approach that could be considered is a combination of both with a fixed cost payable by all supplemented by a variable cost depending on visits.
23. Detailed numbers under either approach might inform the decision further and influence the acceptability of the preferred formula to the relevant firms. However, based on the above assessments, if asked to choose between the two, we consider the lower risk option and the one that is administratively more straight forward would be the general approach outlined in the second bullet.

Question 6: Do you consider that the information we are proposing to publish, as set out in paras 3.12 and 3.13, is adequate for the needs of investors? If not, what do you propose?

24. We support principle of transparency which is clearly key to ensuring investors have the “comfort” they need. In terms of the approach we wondered if there was any evidence of issues for firms from countries currently without any oversight or inspection process or with zero transparency for any inspections that are done, as this might influence how this question might be responded to.
25. We noted above that in the outline approach set out in paragraph 3.3 reference is made to relying on the reviews of network firms. As noted in paragraph 11 above there may be some sensitivities around the use of that information and other sources, and the AIU may need to balance the principle of transparency with the confidentiality needs to secure process.

26. Whilst we agree with the proposal to disclose where access to conduct inspections is denied, a distinction should be drawn between those firms where the laws or regulations of their country forbid such access as against the firm itself making such refusal.

Question 7: Overall, do you consider that these proposals for external monitoring provide the basis for a proportionate and practicable way of meeting the SAD requirements on quality assurance? (After para 3.13)

27. On balance we believe the proposals are an acceptable basis upon which to proceed.

Question 8 Do you have any comments on the assessment of costs and benefits in Section 4? We should welcome in particular the assessment of UK investors on the value of benefits that might flow from the two options for external monitoring reviews.

28. We agree with the conclusions around the options, but we are not sure how accurate the cost assessments are. The costs can for example be influenced by the degree of outsourcing applied in the reviews and the procurement rules applied around travel.

29. On the investors point, if representations are received from this stakeholder group, it will need to be judged whether these are representative of the investor community as a whole. We would however refer back to the point made in paragraph 8 above that public interest in this area is not always confined to that of the investor community and there may be other relevant stakeholders whose views need equally to be taken into account..

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