THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

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By email: desmond.wright@icaew.com

Dear Des

VOLUNTARY CODE OF PRACTICE ON DISCLOSURE OF AUDIT PROFITABILITY

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the paper Voluntary Code of Practice on Disclosure of Audit Profitability published in September 2008.

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

ICAEW REP 143/08

VOLUNTARY CODE OF PRACTICE ON DISCLOSURE OF AUDIT PROFITABILITY

Memorandum of comment submitted in December 2008 by the Institute of Chartered Accountants in England and Wales, in response to the Consultative Committee of Accountancy Bodies consultation paper *Voluntary Code of Practice on Disclosure of Audit Profitability* published in September 2008.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute' or the 'ICAEW') welcomes the opportunity to comment on the Consultative Committee of Accountancy Bodies (CCAB) consultation paper: Voluntary Code of Practice on Disclosure of Audit Profitability, published in September 2008.

WHO WE ARE

2. The Institute 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, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 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. The ICAEW ensures these skills are constantly developed, recognised and valued.

OVERALL COMMENTS

4. We appreciate the work of the CCAB drafting group in following up the recommendation of the Financial Reporting Council (FRC) Market Participants Group (MPG) on disclosure of audit profitability. This has been inevitably raised questions which the proposed guidance seeks to address.

5. We set out below our responses to the questions posed and a number of other minor observations. Our principal concern relating to the proposed scope. We believe the MPG's focus was on the very large end of the audit market and believe the scope should be limited accordingly. Therefore we draw particular attention to our response to question 1.

COMMENTS ON SPECIFIC QUESTIONS

Question 1: Do you agree that the proposed scope captures the appropriate firms to report in compliance with the [draft] Code?

6. We believe that the guidance should have a narrower scope. The recommendation that led to this guidance derives from the FRC's MPG report. In our view the competition concerns addressed by the MPG report are focused on the larger end of the audit market, not on the auditors of all public interest entities.

7. The guidance should target firms with a relatively large market share (although obviously others should not be precluded should they wish to comply). It could, for example be targeted at the firms covered by the Audit Inspection Unit's Public Reporting arrangements.

Question 2: Do you agree with the overall definition of the reportable segment?

8. It is unclear why only audit work 'required by UK statute' should be included. It is likely that in many cases, the same personnel carry out non-statutory audit work as statutory audit work. Accordingly this aspect of the definition adds unnecessary complexity to firms' calculations.

9. It would be useful to include part of the last sentence of paragraph BC5 in paragraph 6, as this explains the intent well.

Question 3: Do you agree that the examples in paragraph 5 of audits to be included in the reportable segment are appropriate? Should any examples be omitted, or are there other examples that should be included?

10. The examples in paragraph 5 are reasonable, but unnecessary.

Question 4: Do you agree that the examples in paragraphs 7 and 8 of directly related services to be included in or excluded from the reportable segment are appropriate? Should any examples be omitted, or are there other examples that should be included?

11. We agree that these are useful examples, adding clarity to the intent behind paragraph 6.

Question 5: Do you agree that this is the appropriate basis for recognising and measuring revenue? If not, why not, and what other basis would you suggest?

12. We agree.

Question 6: Do you agree that direct costs should not normally be allocated by methods such as applying a gross margin from another business segment?

13. We agree.

Question 7: Do you agree that overheads should be allocated to the reportable segment?

14. On balance we agree. It would probably produce more consistent results not to allocate such costs but given the significance of audit to most firms, it would be inappropriate to regard these overheads as unrelated to the audit segment.

Question 8: Do you agree that the proposed guidance on allocating overheads achieves an appropriate balance between minimising prescription for preparers while achieving comparability between firms?

15. The potential variability in allocation of overheads is one of the key aspects behind the need for this guidance. The examples in paragraph 15 are a useful illustration of the intent behind the allocation of overheads in terms of type: a similar set of examples would give a useful illustration of the intent behind the 'more general methods of allocation' statement in paragraph 12.

Question 9: Do you agree that reporting firms should disclose the impact of material non-recurring or 'lumpy' costs, in order to highlight their effect on profitability? Will the current guidance achieve sufficient comparability between firms, or is further guidance needed on the identification and disclosure of such costs?

16. We agree.

Question 10: Do you agree that the basis of accounting for members' or partners' remuneration should be consistent with the firm's legal structure, with disclosure of the basis and the extent of allocation to the reportable segment?

17. We agree.

Question 11: Do you agree with the option to disclose in either the Annual Report or the Transparency Report?

18. We agree.

Question 12: Do you agree with the proposals for the timing of implementation of the [draft] Code?

19. If our suggestion that the proposals apply only to a smaller number of firms (see Q1) is accepted, then the timeline may be achievable. However, many of the firms have year ends in the late spring / summer and this does not leave much time for any necessary system changes between publication of the finalised code in March and starting to collect data on this basis.

20. If, however, the code continues to apply as drafted to all 'transparency firms' then we do not believe that all of the smaller firms included in this scope may be ready to comply within one year. In particular, not all such firms are limited liability entities and therefore not all of them currently publish financial statements. We would suggest applying the Code from 2010 to those firms within the scope suggested in question 1 and from 2011 to other transparency firms in order to provide those smaller firms with more time to prepare.

OTHER COMMENTS

21. Paragraph 7, final bullet: we assume this relates to 'work….i<u>n relation </u>to the audit <u>of</u> a branch or …..'

22. Paragraph 15: would this not flow better after paragraph 12?

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