



The Consultative Committee of Accountancy Bodies

PO Box 433
Chartered Accountants' Hall
Moorgate Place, London EC2P 2BJ
Website: <http://www.ccab.org.uk>
Email: admin@ccab.org.uk

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Hazel O'Sullivan.
The Auditing Practices Board Ltd
5th Floor
Aldwych House
71-91 Aldwych
London WC2B 4HN

The Institute of Chartered Accountants in England and Wales
The Institute of Chartered Accountants of Scotland
The Institute of Chartered Accountants in Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Chartered Institute of Public Finance and Accountancy

Dear Hazel,

APB ETHICAL STANDARD FOR REPORTING ACCOUNTANTS

I set out below the CCAB Ethics Group's response to your consultation on the draft Ethical Standard for Reporting Accountants ("ESRA").

You will be aware that we have concerns over the APB's remit in issuing the ESRA and its effect on international harmonisation:

- a) The relationship between the APB and the CCAB bodies is governed by the Letter of Understanding (LoU) signed on 30 June 2004, insofar as it has not been superseded, as regards statutory audit matters, by the Companies (AICE) Act 2004. Clearly the latter does not apply to the issue of SIRS, so the LoU should apply. We believe that Ethical Standards for SIRS fall within the remit of clause 12 of the LoU and that the matter should have been discussed with the CCAB bodies before undertaking a unilateral set of work.
- b) An aim of the European Transparency Directive is to contribute to establishing a single market throughout the European Union and improve market efficiency. This would be greatly enhanced by adhering to the IFAC Code of Ethics requirements on independence in assurance engagements, which have already been implemented in the UK and Republic of Ireland by the CCAB bodies. The issuing of a separate code which, though designed to comply with the principles of the IFAC Code, is nevertheless of quite different appearance and national application only, will detract from this process.

Nevertheless, assuming that the APB intends to continue with finalising the ESRA and recognising that it will need to be applied by those wishing to issue reports stating compliance with the SIRS, we have previously made a number of detailed observations on an earlier draft. We are pleased to see that the comments have at least been considered and in some case acted upon. Nevertheless there are a number of

instances where we remain of the view that the draft wording should be reconsidered and we have re-addressed these points in an attachment to this letter.

We understand individual CCAB bodies may be writing to you separately about additional points.

We would be pleased to discuss any of the issues raised in the letter with you,

Yours sincerely

A handwritten signature in black ink, appearing to read 'Neil Lerner', with a stylized, flowing script.

NEIL LERNER

Chairman, CCAB Ethics Group

Detailed comments on Draft ESRA

Numerical references are to paragraph numbers in the consultation draft.

1.63 Disclosure to all parties

The APB requires reporting to all parties to the engagement letter, including for example the sponsor and other parties and maybe also to the target company and its directors in a class 1. There are however a number of practical issues which make it unclear how this would operate in practice. In practice the disclosure to so many parties is likely to be onerous (particularly within the time constraints of a corporate finance transaction) and unnecessary. It should generally be sufficient for any independence issues to be reported to the audit committee of the issuer (or directors where there is no separate audit committee) with disclosure to the sponsor and other parties only where, exceptionally, any independence matters are directly relevant to them. The applicable FSA regulations require the reporting accountant (in respect of the public reporting role) to be independent of the issuer and to confirm its independence to the issuer. In practice such letters are made available to the sponsor.

1.66(ii) Disclosure of fees

It seems to be an unnecessarily onerous requirement that the total amount of fees charged should be disclosed even where this is less than 5% of relevant income. The ESRA relates to a one-off transaction. Where there is no perceived dependence threat, we do not see the benefit of such a disclosure, compared to the cost of collecting the information: unlike audit, this is not an external disclosure requirement and will predominantly impact on the smaller firms that undertake this work. Is there evidence that audit committees are unduly concerned with fee levels of less than 5%?

2.20 Business relationships

We note that the requirement not to have a business relationship applies during the 'relevant period', which is defined as covering not only the engagement period, but also the period from the date of the last set of financial statements, up to the start of the engagement period. We believe that the requirements of this paragraph should not necessarily have to apply throughout the relevant period, as we do not see that a relationship that has been completely terminated between the date of the last audited accounts and the time of appointment as reporting accountant is a threat.

2.30 Loan staff

The requirement for a two year non-involvement of any loan staff taking on any role could be more onerous than the equivalent requirement in ES2,36. Given the nature of the engagement, this should be restricted to any role that has a significant impact on the engagement report: if the role does not have a significant influence on the engagement, the threat is unlikely to be significant too.

2.37 Cooling off period

There are a number of potential threats associated with partners joining their clients: intimidation of auditors as a result of being used to following the orders of the individual in question; familiarity as a result of excessive auditor /client links; and a

potential self interest threat in being offered a lucrative position while still with the firm. The first two threats are more perceived than real and the third would not apply if the partner had joined the business before any engagement was envisaged. We appreciate that the requirement is consistent with ES2 but we do not believe consistency to be a justification. This is more of an onerous requirement in a non-recurring engagement environment and we do not believe the cost-benefit analysis equation is the same. Accordingly in these circumstances, we believe a threats and safeguards approach should be applied rather than an absolute prohibition.

2.77 Objectives of staff

We note that the requirements relate to objectives, etc re selling non-audit services “to the engagement client” . It is unclear whether this means that objectives for selling other service to non-audit clients in general are outside the scope of the prohibition. Given that the engagement is non-recurring and potentially to a non-audit client, it is quite likely that staff / partners will be involved whose objectives would normally include selling other service to non-audit clients in general. We believe these could create a threat. However, it should be clarified that where this is the case, a safeguard could be to override the general objectives with an engagement-specific clause (perhaps written into the firm’s remuneration arrangements with relevant staff) that the objective does not include selling other services to the particular reporting client.

3.5 Networks

The obligation on the accountant to trawl through its global network in order to identify situations where others within the firm have accepted an engagement or are considering accepting an engagement in relation to the client or to its significant affiliates seems disproportionate and inconsistent with the confidentiality principle outlined earlier in the document. For non-recurring relationships, a reactive approach, as included in the IFAC code, should be sufficient, with the accountant effectively being required to assess known or likely threats, rather than to seek them out. This would also render the dispensation in 3.11 unnecessary as regards network firms.

3.7 Other services

The logic of the ‘relevant period’ is that an independent review / audit is acceptable to remove the threat. Therefore, it should be offered as a potential safeguard here.

3.17 Internal audit

It is not clear why the situations outlined in this paragraph should result in the accountant always being prohibited from reporting on the target financial information even if the accountant has in effect acted in a management role for the acquirer, particularly if that role related to an affiliate of the acquirer rather than to the acquiring company itself. We accept that this position is consistent with that of ES5 but we do not believe that consistency is an acceptable reason when the circumstances are different, as they would be in the type of engagement outlined above. In such circumstances, it would seem particularly important to apply the threats and safeguards approach rather than absolute prohibitions.

There is also a lack of clarity as to what the position is if the service has been undertaken if it was not reasonably foreseeable that the conditions in (a) and (b) would apply. Is the implication that the engagement should not be undertaken or that threats and safeguards could apply?

3.25 IT implementation

As point on 3.17 above

3.46 Tax services

You will be aware of our concerns over ES5, 73, which is the equivalent of this requirement. Given the non-recurring nature of the assignment, these concerns are heightened and 3.46 (a)(b) at least should have 'and' between them rather than 'or'. There is not an ongoing advocacy issue here.

3.55 Appointment of employees

As point on 3.17 above

Additionally, we have a similar concern to that noted in 3.46 above. While this paragraph is the equivalent of ES5,83, the inclusion of any employee in any position seem to be particularly onerous in a non-recurring scenario. There will be no threat if the employee's position does not result in any involvement with the subject matter being reported on.

3.60 Remuneration services

It is not clear that this would always be relevant in a reporting accountant situation. There may be circumstance where there is a direct threat in terms of what is being reported on, but equally, there may not. The threat here is familiarity which by its nature is heightened through long term connection. In the circumstances of engagements covered by the ESRA a threats and safeguards approach should apply.

3.81 (b) Contingent fees

The point considered in 2.20 above also applies here: if the service has already been provided, at a point when the investment circular engagement was not in contemplation, we do not see that there is a threat.

3.87 Accounting services

It is unclear why the performance of accounting services to the acquirer and its significant subsidiaries should lead to a prohibition on an accountant reporting on target financial information. This should be limited to accounting services that create a self review threat, given the particular engagement.

See note under 3.17 above re consistency.