



**Association of Accounting Technicians
response to the Financial Reporting
Council's consultation on Enhancing
Confidence in Audit: Proposed
Revisions to the Ethical Standard,
Auditing Standards, UK Corporate
Governance Code and Guidance on
Audit Committees**

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the above named consultation document and associated documents published on 29 September 2015 (condoc).
- 1.2. AAT is submitting this response on behalf of our membership and from a wider public benefit perspective.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposed changes would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our operationally skilled members in practice.
- 1.6. AAT is not offering comments on the detailed proposals set out in the consultation document and its annexes but wishes to draw attention to some overarching general principles in the following response.

2. Executive summary

- 2.1. AAT recognises that to enhance public confidence in audits in the UK it is essential to establish the highest ethical practices as well as procedures for ensuring audits are carried out effectively and efficiently. While appropriate auditing procedures can be codified within Auditing Standards, the practice of high ethical standards by auditors is dependent upon an attitude of mind and is therefore difficult to fully codify. Similarly corruption is reflected by an attitude of mind and while the extremes of the spectrum of ethical practices are easy to identify, it is the grey area in the middle which gives rise to problems in practice and proves difficult to set out in an effective Ethical Standard.
- 2.2. AAT has concluded that the proposed revisions to the Ethical Standard, Audit Standards, UK Corporate Governance Code and Guidance on Audit Committees focuses on enhancing public perceptions as a basis for enhancing public confidence of auditor independence. This may not reflect actual independence and brings with it significant disadvantages as regards optimising value from auditors, as well as failing to ensure the actual independence of auditors.
- 2.3. In the drafting of the following response, AAT has considered the achievement of the objectives as set out in the introduction to the main condoc, optimising value from auditors (3.6 below), public interest entities ("PIE's") (3.7 below), small entities (3.8 below) and the impact assessment (3.9 below).

3. AAT response to the consultation paper Enhancing Confidence in Audit: Proposed Revisions to the Ethical Standard, Auditing Standards, UK Corporate Governance Code and Guidance on Audit Committees

- 3.1. AAT is concerned that the proposed revised Ethical and Auditing Standards fall short of achieving the overall objectives to maintain market confidence in the independence of auditors (so that investors remain confident in the quality of financial statements) and to “serve the public interest” due to an excessive reliance on perceived independence rather than practical solutions to meet the needs of users of audited financial statements with regard to those aspects which can weaken public confidence.
- 3.2. It is possible for an audit firm to adopt and illustrate compliance with the principles set out in the Ethical and Auditing Standards but still fail to act in an independent manner in the conduct of an audit.
- 3.3. It is accepted that perceptions of independence are important in respect of PIE’s, however other entities, where the public interest is not an issue, have different needs as stakeholders are looking primarily for reliability in the financial statements. Whatever the size of the audited entity, more stringent audit regulations do not necessarily result in improved public confidence or in the integrity and independence of auditors. Such could be engendered by more informative audit reporting and appropriate disciplinary action taken by RSB’s against offending auditors.
- 3.4. AAT considers that confidence in the integrity and independence of auditors can best be achieved by requiring more information in auditors’ reports as regards the significant elements of the financial statements which are based on subjectivity, uncertainty, judgement or bias contained in financial statements, which is of greater benefit to users than the statement that the financial statements represent “a true and fair view” and who can then understand the degree of any uncertainties as well as the margins of subjectivity inherent in the financial statements and form their own opinions as to the degree of prudence reflected in the financial statements. FRS 102 and IFRS 7 require disclosures of similar information in financial statements as regards financial instruments to be applied by directors of entities in situations where there are material liquidity risks. However such disclosures will only arise on an exceptional basis and it is AAT’s view that those who rely on audited accounts require the auditors to give their independent view in respect of all such significant elements of financial statements to assist them in understanding the potential impact of uncertainties.
- 3.5. **Optimising Value from Auditors**
 - 3.5.1. In order to optimise value from auditors there needs to be a relaxation of compulsory rotation, tendering periods and the removal of capping of non-audit services, with the facility to appoint auditors for a period longer than one year, with reliance on the disciplinary procedures of RSB’s as regards non-compliance with ethical standards.
 - 3.5.2. It is inevitable that the current trend for ever more stringent regulation of auditors (particularly as regards non-audit services) and a reduction in the number of entities required to have audits will result in a reduction of choice in the market place and, as a direct consequence, an increase in audit costs. While such is justifiable as regards PIE’s, other entities will not achieve any benefits from the tougher Ethical and Auditing Standards, AAT believes that substantial audit cost benefits could arise by reducing the constraints placed on the provision of non-audit services by auditors of entities other than PIE’s and removing the need for the periodic retirement of audit firms and rotation of lead auditors.

- 3.5.3. An auditor's detailed working knowledge of an entity that is subject to their audit accumulated over a number of years clearly has several potential advantages to both the entity and the auditor, particularly as regards acting as tax advisers or providing tax compliance services, as well as other business advisory and compliance services.

3.6. Public Interest Entities

- 3.6.1. AAT agrees that there is a need for a more stringent approach to the regulation of the audit of PIE's, but at the same time there is a need to extend the definition of PIE's to include all entities which are substantially dependent upon public monies.
- 3.6.2. A revised definition should include all entities whose activities have a significant impact on the public at large, including providers of public utilities and public services, entities funded by public monies (both by grants and commercial contracts) and charitable entities in all forms.
- 3.6.3. In addition commercial entities which are dependent upon publicly funded contracts or grants should fall within the definition of a PIE as well as "listed entities". The oversight of such audits needs to be open and transparent to the public at large, whereas the oversight of other entities needs to focus on the needs of their stakeholders.
- 3.6.4. With regard to enhancing confidence in the audit of PIE's, specifically, greater emphasis should be placed on the role of Audit Committees as it is they who can provide the answers required by the public at large in situations where the auditor may not appear to be independent but is acting in the best interests of the entity. The focus of Audit Committees for PIE's should be on their responsibility for stakeholders interests and reporting but not being answerable to governing bodies boards, and where such reports are not dealt with satisfactorily, to report this to stakeholders.
- 3.6.5. Currently in the UK, charities with a turnover below £500,000 per annum are exempt from statutory audit requirements and such a threshold appears to be a reasonable level to set for all PIE's. Due to the nature of PIE's, it is essential that such entities need to be subjected to a more burdensome level of audit regulation in order to illustrate transparency in their duty for public accountability.

3.7. Small Entities

- 3.7.1. Small entities exempt from audit are, by definition, not subject to the requirements of Auditing Standards. Nevertheless there is a great need for the public to have confidence in the proper presentation of financial statements as much as with those entities subject to audit.
- 3.7.2. There is a need to address the credibility and usefulness of financial statements of entities which are exempt from audit, particularly as some may be of a substantial size with relatively sophisticated management structures and the facility to prepare statutory financial statements in-house, possibly without any need for ethical considerations to be reflected on those financial statements. Users of statutory financial statements not subject to audit, particularly suppliers and lenders, need to have assurances as to the reliability of those financial statements.
- 3.7.3. However, AAT believes that there is a significant issue as regards the credibility of financial statements which are exempt from audit. At present, exemption from audit is available to "small" entities which can be of a substantial size leaving users of their financial statements, with uncertainties as to whether the

financial statements reflect any bias or imprudent subjectivity in their preparation, or whether they have been subjected to any independent scrutiny. The regulatory requirements required of auditors are so demanding as to require the application of administration and technical procedures, together with experience levels, which necessitate both dedicated specialisms of audit staff and a minimum cost of audit irrespective of size of the entity subject to audit.

- 3.7.4. AAT considers that the confidence of users of financial statements of small entities could be enhanced by requiring a new approach to the method of preparation. Entities which are currently exempt from audits on the basis of being below the size thresholds should be required to have their financial statements prepared by an independent firm of accountants holding a recognised professional qualification and being regulated by a professional body. The basis of preparation and limitations as regards reliance on the reported results and financial position (similar to the additional information suggested for inclusion in auditors reports on audited financial statements referred to in 3.3 (above) would be confirmed in an attached report. In this way the independent firm will be responsible for making judgement as regards the application of prudence in particular and for providing users with sufficient information to understand the risks attaching to the financial entitlements. All financial statements prepared internally by the entity itself or by other unregulated persons should be subject to audit whatever the size (but perhaps subject to a de minimus turnover limit of £500,000 per annum in line with the exemption for charities).

3.8. Impact Assessment

3.8.1. The Impact Assessment document does provide an extremely comprehensive, practical and usable executive summary of the revisions contained in all of the relevant condocs. However, AAT is not convinced that the Impact Assessment brings to light any real cost benefits. It would seem that the assumptions made on the basis of the costs of implementation in respect of the revisions are generally arbitrary and unverifiable. In practice, AAT considers that they will be implemented by audit firms as part of their ongoing costs of training and systems development, and do not require any separate discrete costs to be incurred.

- 3.8.2. On the other hand, the implementation of the revisions does not generate any cost benefits and the degrees of achievement of the objective of “enhancing confidence in audit” cannot be identified or evaluated.

4. Conclusion

- 4.1. The concept of establishing confidence in financial statements by reference to confidence in the auditors is not one where the public’s expectations can be met. With auditors’ reports only containing adverse comments on an exceptional basis, the users of financial statements can never know when their confidence has been well placed but will know only when an unexpected disaster arises, that it is misplaced. There are rarely examples where a disaster is preceded by an auditors’ report containing appropriate warnings due primarily to an expectation that an auditors’ report is expected to be “clean” except in the most extreme situations.
- 4.2. AAT’s concerns are that an excessive focus on perceived integrity, objectivity and independence of auditors is not helpful to audit firms, audited entities or users of audited financial statements. To enhance public confidence more effectively, auditors’ reports should not only reflect the auditors’ opinion as to acceptance of a “true and fair view” but should be informative as to the impact of significant matters of subjective or judgemental evaluation or significant risks attaching to the ultimate realisation of assets and liabilities (as referred to in 3.3 above). These considerations are equally important to users of

financial statements of smaller entities which are not required to be subject to audits but still require independent assurances as to the basis of preparation of the financial statements.

- 4.3. AAT believes that confidence in the integrity and independence of auditors is best achieved by requiring more informative audit reporting as regards the significant subjective aspects, uncertainties, judgement, and bias contained in financial statements. This will be of greater benefit to users than the statement that the financial statements represent “a true and fair view” who can then understand the degree of any uncertainties as well as the margins of subjectivity inherent in the financial statements.
- 4.4. AAT would suggest that it would be more helpful to users of the Ethical and Auditing Standards if the contents were presented in a different format by creating sections as appropriate to different classes of user. As presently formatted, there is a degree of repetition throughout the documents when referring to requirements for PIE’s. It would be more user friendly and easier for reference purposes if the main body of the Standards comprised requirements for all audits and that it is followed by a section of additional requirements relevant to PIE’s only. As audits of “small” entities are more of a rarity, it would then be helpful to have a third section setting out the reliefs and requirements for such.

5. About AAT

- 5.1. AAT is a professional accountancy body with over 49,500 full and fellow members¹ and 82,400 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 members in practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

6. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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¹ Figures correct as at 30 September 2015