Key messages

- There are some services which are clearly a threat to auditor independence. To ensure clarity and consistency, there should be a globally consistent list of services that are prohibited based on a set of common principles. These should be reviewed periodically.

- The provision of many non-audit services to audit clients can improve the quality of audit and reduce costs and complexity for businesses – without compromising independence.

- Audit committees (or their equivalent), as representatives of shareholders and those responsible for governance, are best placed to decide what services their auditors can provide beyond the prohibited list.

- Attempts to regulate the provision of non-audit services through lists of permitted services or price caps would prove arbitrary, difficult to implement and could damage audit quality.
Auditors’ scope of services

What’s the challenge?
Some people say that allowing auditors to carry out any non-audit services for their audit clients weakens their independence, objectivity and professional scepticism. We disagree.

Certain activities are without doubt in conflict with the independence of the audit and should be prohibited. For all other services, we believe the audit committee, as the shareholders’ representative charged with governance, is in the best position to decide whether they are consistent with the company’s own governance, and are in its stakeholders best interests in relation to the quality, price and efficiency of the non-audit service proposed.

Why is this important?
Independence is the bedrock of the auditing profession and audit quality, and fundamental to fulfilling our public interest role in the capital markets. Regulators and legislators, particularly in the European Union (EU), appear to believe that prohibiting some of the services auditors provide, under existing principles and frameworks, to the companies they audit will increase their independence.

Only some of the wide range of services that a multi-disciplinary professional services firm provides are recognised to be in conflict with independence and objectivity. We agree that we should be prohibited from providing those services to the organisations we audit. This is already the case in many parts of the world.

The involvement of our people and our network with a broad range of clients across industries and geographies has helped us develop world class skills that, together with an independent and objective perspective, are in demand across the entire marketplace. We believe that those charged with governance should not be constrained in their choice of provider where there are no conflicts with independence and objectivity. They should be able to choose the provider they believe will do the best job - otherwise their oversight accountability and responsibility will be undermined, competition reduced and the costs and complexity to both companies and, in the end, consumers and investors could increase. Unnecessary prohibitions or limitations may deprive the company of the very best skills when it needs them most.

All those involved in financial reporting should have clarity and a globally consistent way to identify any services that compromise independence. There are already a number of frameworks in place that are widely accepted and have proved to be effective so it makes sense to adopt one of these frameworks globally. There needs to be flexibility to so the list remains relevant. This is important because as business models, technology and accounting standards change, the auditor’s skills and their service offerings must change to reflect the evolving market. The audit committee can then exercise its judgment about what, if any, other services may be provided.

Where are we now?
Our network has clear, detailed and comprehensive policies and processes to evaluate the potential impact of a proposed service on our independence; they give us comfort that we are independent at all times. We need to help increase transparency about the current safeguards and why we believe they are effective.

An auditors’ independence would be called into question if they also delivered a service that contravened four core principles underlying independence frameworks. Auditors generally should not:
• function in the role of management,
• audit their own work,
• perform work that creates a mutual or conflicting interest with a client, or
• act as an advocate for a client.

From a regulatory perspective there are variations in the way different countries apply these principles. Most follow the International Ethics Standards Board for Accountants ‘Code of Ethics for Professional Accountants’ (the Code). This is built around a principles-based framework for assessing threats and safeguards in relation to services that can be provided. In addition the Code provides greater clarity by explicitly prohibiting a number of services that are deemed to compromise independence.

In the US, independence standards are consistent with the four principles above. They do not identify permissible services but do prohibit nine specific types of services.
for audit clients. As an extra safeguard, the Sarbanes-Oxley Act says audit committees have to pre-approve all auditor services. And, like international standards, it also prohibits audit firms from compensating audit partners for selling non-audit services to their audit clients.

In the EU, proposals have been put forward to significantly restrict the services audit firms can provide to their audit clients. The proposals specifically define the services that would be prohibited, and those that would be ‘permissible’ so long as they remain within a defined, so-called, fee cap. These proposals are being made against the backdrop of the detailed and complex rules already in place to safeguard independence.

What does PwC believe?

More international consistency would be helpful and, based on the important lessons learned from the current financial crisis and existing models, certain additional and meaningful safeguards make sense to further promote audit quality and demonstrate independence. We believe:

- Audit committees should be responsible for overseeing auditor independence, including reviewing and approving services provided by their auditor. Many audit committees already do this and do it well.
- A globally consistent list of services should be developed, evaluated against the four core principles, which reflect an agreed view of those that compromise independence. There is already much alignment between, for example, the US and much of Europe.

A global set of prohibited services would provide a basis for consistency around the world and clarity to the marketplace that independence threats have been eliminated.

- A prescribed list of permissible services is inappropriate. By limiting the auditor to providing services based on only a small subset of its expertise, a company is potentially deprived of access to certain expertise when it’s needed. The audit committee should decide whether permissible non-audit services may be provided by the auditor.
- A cap on non-audit fees does not make sense. Independence is not determined by an arbitrary monetary amount. When an audit committee is deciding whether the auditor should provide a particular service, it will undoubtedly consider many factors, including the overall quantum of services. The audit committee is closest to the facts and circumstances and is in the best position to decide what is in the stakeholders’ interests.

In conclusion

There are some services which are clearly a threat to independence. These should be agreed and prohibited worldwide. For all other services, the audit committee is in the best position to decide who should provide them. Taking away or limiting its ability to choose its best provider does not enhance objectivity or scepticism nor would a defined list of permitted services or an artificial cap on services promote audit quality, independence or governance. It is bad for those charged with governance, bad for investors and not in the public interest.

There are already significant safeguards and frameworks in place at both the regulatory, audit committee and audit firm level to ensure that only services that do not conflict with independence are provided to audit clients. We follow the Code worldwide, in many cases applying stricter safeguards, and have detailed policies and processes so that only appropriate services are provided. We believe these are effective, but that their effectiveness is improved through audit committee oversight and transparency (including additional reporting) about what those safeguards are and how they work.