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Dear Ms O'Sullivan

Auditing Practices Board Ethical standards: Consultation on audit firms providing non-audit services to listed companies that they audit

I write on behalf of the GC100 in response to the Auditing Practices Board's (APB) consultation on audit firms providing non-audit services to listed companies that they audit. As you may be aware, the GC100 is the association for the general counsel and company secretaries in the FTSE 100. There are currently over 120 members of the group, representing some 90 companies.

The GC100 welcomes the opportunity to respond to the APB's consultation and our responses to the specific questions and proposals set out in the consultation are set out below.

1. (a) Do you think that the provision of non-audit services by accounting firms to their audit clients currently impacts confidence in the independence of auditors?

We do not believe that the provision of non-audit services by accounting firms to their audit clients currently impacts on confidence in the independence of auditors. Provided a company's audit committee applies, or explains its reason for not applying, the Combined Code and develops and implements a policy on the engagement of the external auditor to supply non-audit services, which follows the FRC's Guidance on Audit Committees, the provision of non-audit services should not impact on the independence of the auditor employed by that company.

In fact, we believe that there are instances when the use of its auditor for non-audit services is positively advantageous to the company and its shareholders, and does not compromise auditor independence. With the auditor's detailed knowledge of the company's business, the non-audit service can be provided more effectively. Further, we believe that in many instances, appointing another accounting firm would be very inefficient and may expose the company to

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greater risks as the accounting firm lacks the detailed knowledge of the business which the auditor has.

In addition, engaging an auditor who has detailed knowledge of the company's business is beneficial to management as (depending on the nature of the non-audit work in question) it prevents them from needing to spend time briefing a firm unfamiliar with the business before it can commence the non-audit work, provided there are suitable provisions in place to ensure that the auditor's independence is maintained. As a consequence of engaging the auditor, the company saves fees and the non-audit work can be undertaken sooner, which is advantageous to both the company and its shareholders.

We would, however, suggest that the APB and FRC could take steps to address the perception that the provision of non-audit services by the auditor impacts his independence (an issue we feel is not borne out in practice), by publicising and raising awareness of their Ethical Standards and the threats and safeguards approach currently in use.

(b) Are you aware of any instances where the provision of non-audit services by accounting firms to their audit clients has or may have adversely affected audit quality?

We are not aware of any instances where the provision of non-audit services by accounting firms to their audit client has, or may have, adversely affected audit quality and we consider that the current safeguards in place are sufficient to protect auditor independence.

- 2. If you do consider that the provision of non-audit services has adversely affected audit quality or currently impacts confidence in the independence of auditors please identify which non-audit services are of concern.**

Not applicable, see response above.

- 3. In the light of your answers to questions 1 and 2, do you think that there needs to be a change in the approach taken by APB to the setting of standards relating to the provision of non-audit services by auditors to the entities that they audit?**

We do not believe that there needs to be any change in the approach taken by the APB to the setting of standards relating to the provision of non-audit services. We believe that the APB's Ethical Standard on non-audit services comprehensively covers the ethical issues of maintaining the auditor's independence when providing such services. The principles set out in the Standard which serve as a basis for determining the areas of non-audit work which could create a threat to the auditor's objectivity or perceived loss of independence and the safeguards that can be adopted to eliminate such threat work well in practice.

However, we would suggest that there may be some scope for reviewing the Ethical Standards to make them clearer and easier to understand.

4. **If you think that there should be a change in the current arrangements, would you advocate:**
- **Complete or more extensive prohibitions on the provision of non-audit services by accounting firms to their audit clients within the Ethical Standards for Auditors;**
 - **The imposition of other requirements through the Ethical Standards for Auditors (and if so which);**
 - **More active corporate governance – e.g. so that non-audit service engagements were required to be pre-approved by the company’s board of directors or audit committee;**
 - **Better (and more extensive) disclosure in financial statements.**

We do not think there should be a change in the current arrangements. In particular, we do not advocate more extensive prohibitions on the provision of non-audit services as we perceive no benefit in doing so.

Many large multinationals are often limited to the “big four” audit firms for their audit and non-audit services due to the complexity of their operations and specific subject matters in question. Prohibiting a company’s audit firm from providing non-audit services would significantly limit choice and could have a detrimental impact. In some instances, companies have minimal choice on the accountancy firm they could appoint to carry out a particular piece of work, as the level of expertise required may only be available at the same firm as the auditor.

We do not believe it is necessary or desirable that every single engagement of an audit firm should be pre-approved by the board or audit committee, as that may be wholly impracticable in a large multi-national which makes extensive use of external advisors. However, any engagement of an audit firm should clearly be undertaken in accordance with policies approved by the audit committee, and should be subject to periodic review in terms of assuring compliance with that policy.

Finally, we do not believe that there is a need for the imposition of other requirements through the Ethical Standards for Auditors. Listed companies are already subject to voting recommendations from voting research organisations, such as RREV (Research Recommendations Electronic Voting), IVIS (Institutional Voting Information Service) and PIRC, who clearly review the level of non-audit service fees when recommending the vote on the re-appointment of the auditor and we believe their corporate governance guidelines have influence. Further, we would suggest that it is clear from the data in your consultation document, in particular paragraphs 5.4 and 5.8, that the trend is for increased scrutiny which has resulted in a reduction in the level of fees for non-audit services over the last 10 years. Therefore, we do not believe that there is any need for further guidelines from the APB.

We do, however, suggest the following three measures that could enhance the current corporate governance arrangements:

1. There could be a requirement on companies to disclose their policy on the engagement of the external auditor to supply non-audit services and explain their rationale for engaging their auditors.
2. There could be a requirement that the audit committee should review annually the amount spent by the company on non-audit services and the categories and fee limits set out in its non-audit services policy, to ensure they remain at appropriate levels.
3. Companies could also be required to disclose the level of non-audit services that arise directly from an audit and the level of non-audit services that are required to be provided by the auditor by law or regulation (for example under the Sarbanes-Oxley Act 2002). This would give investors an understanding of the “true” level of non-audit services provided by the auditor.

We note that in its current consultation on the revised UK Corporate Governance Code, the FRC has stated that it may wish to review the audit committee provisions or supporting guidance depending on the outcome of the APB’s consultation. We would propose that the disclosure recommendation and the annual review of non-audit service fees and categories could be included in the revised UK Corporate Governance Code. Although the National Association of Pension Funds already recommends in their Corporate Governance Policy and Voting Guidelines that a company’s policy on non-audit work should form part of the audit committee’s report to shareholders, we believe that including the recommendation in the UK Corporate Governance Code would give it more universal application to all listed companies.

We believe that these requirements would help to provide greater transparency to investors and regulators on the steps taken by companies to ensure that where non-audit services are provided by the auditor, their independence is maintained.

5. In setting the standards relating to auditor independence, do you believe regard should be had to the perceived benefits that are derived by companies from the provision of non-audit services by their auditors?

In setting the standards relating to auditor independence, we believe that regard should be had to the perceived benefits that are derived by companies from the provision of non-audit services by their auditor. Cost, quality, risk management and consistency benefits are derived, for example, from the following non-audit services:

- The involvement of a company’s auditor in a due diligence exercise is often clearly preferable as their detailed knowledge of the business enables them to aggregate the risks, and also enables them to plan more effectively and efficiently for subsequent audits of the new business which may be acquired.

- Regulators around the world specifically appoint a company's auditor to audit or review certain certifications, for example, confirmation of total or elements of revenue on which certain levies are calculated, audit of regulatory fees paid, confirmation of capex spending and cost accounting reviews.
- Comfort letters provided to banks or underwriters confirming that the information provided in a prospectus is consistent with the audited accounts.
- The review of interim reports, a significant non-audit service.

The above services would not be possible for anyone other than the auditor to perform without incurring great expense.

For those companies listed in the US and subject to SEC regulations, they are required by section 404 of the Sarbanes-Oxley Act 2002 to include in their annual report a management report on the company's internal controls over financial reporting and an accompanying auditor's report on management's assessment. As this work for the auditor is not included within the UK definition of audit fees, any changes to the rules over non-audit work would need to align to the requirements of section 404.

We also support the following arguments advanced by companies, set out in paragraph 3.3 of your consultation paper, as to the benefits derived in engaging the auditor to provide non-audit services:

- the provision of non-audit services provides a valuable means of a company benefiting from external expertise, so enabling management to focus on key business activities;
- auditors have the confidence of management and already know the company well and so do not need the same degree of briefing and oversight as would be required by firms unfamiliar with the company. This can result in cost, quality and consistency benefits, which in turn benefits shareholders;
- the corporate governance regime ensures that non-audit services are purchased without jeopardising auditor independence; and
- it is incorrect to assert that investor's interests are not properly considered and protected when auditors provide non-audit services as management act as an agent for investors.

6. Are there any other views that you would like the APB to take into account?

We do not have any further views.

Please note that the views expressed in this letter do not necessarily reflect those of each and every individual member of the GC100 or their employing companies.

If you have any queries at all please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Mary Mullally', with a stylized flourish at the end.

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