

28 January 2010

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Our Ref: SJJ

Dear Ms O'Sullivan

### **Consultation on audit firms providing non-audit services to listed companies they audit**

I write with my firm's comments on the above consultation paper. Prior to addressing the questions on which the paper requests specific views, we would like to comment on the definition of "listed company" within the APB's Ethical Standards.

At the present time there is a degree of inconsistency within European law, UK company law and the auditing environment as to what constitutes a listed company.

European law is driven by the definition of companies whose shares are listed on a recognised exchange and, indeed, it is this definition that flows through to the Companies Act 2006 albeit reworded as "quoted company". Accordingly, within the UK, only companies listed on the London Stock Exchange (LSE) are quoted. Within the auditing environment, however, the definition of listed company has a wider definition such that it includes companies whose shares are "marketed under the regulations of a UK or Irish recognised stock exchange or other equivalent body". Accordingly, within the UK, companies whose shares are traded on the Alternative Investment Market (AIM) and the PLUS Market are included in the definition of listed companies for audit purposes.

There can be a significant difference in the size and scale of the companies within these areas and the need they have of services from their auditors and accountants can be similarly diverse. The different natures of those markets is such that the shareholder groups of the companies within them are also different and may express differing views when it comes to confidence in the audit process and how, indeed, they might view the appropriateness of non-audit services provided by the auditors.

The AIM and PLUS Markets are often used by private companies wishing to take their first steps into the public arena. Although these companies will have a degree of public interest, we contend that this is likely to be less for a company listed on the LSE. The cost of compliance for these generally smaller companies can be significant and to apply the same rules to them for the provision of non-audit services by their auditors we believe only adds greater cost that outweighs any public benefit. .By necessity, many of those companies have relatively small and inexperienced management teams, particularly in the finance function, who require

professional assistance. In these circumstances, the auditors can bring their experience to bear in a number of areas including financial reporting and governance structures. To use the same rules for these companies as those in the top echelons of the FTSE100 when it comes to looking at provision of non-audit services seems to us to be inappropriate and, in fact, to the detriment of enhancing shareholder value at the smaller scale.

Our view, therefore, is that the 'one size fits all' approach in Ethical Standards for listed companies is not appropriate and should be reconsidered.

**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?**

**(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 do not believe it is possible to give a general answer to part (a). The degree to which the provision of non-audit services impacts confidence in the independence of auditors can only be assessed on a case by case basis taking account of the services that are provided to the particular company and the stakeholders involved. We do note that certain parts of the investor community has been more vociferous than others in raising questions about non-audit services but it is important to consider the needs of all stakeholders.

The Ethical Standards set out a framework that has provided reasonably clear guidance as to what is and is not acceptable in the provision of non-audit services. Audit Committees are also charged with assessing the independence of the auditors and the suitability of the services provided by them. Together, we believe this gives an effective framework.

We are not aware of any specific instances where the provision of non-audit services has or may have adversely affected audit quality.

**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.**

There has, of course, been much press discussion about 'extended assurance services' that might be offered to companies.

As a general rule, we would regard it as inappropriate to offer external audit clients any internal audit services although we do believe it important to understand fully the nature of the service being offered. Classically with internal audit, it would be the Audit Committee that sets and reviews the scope of the internal audit work to be undertaken and the internal auditor reports to them. If this were to be the case with the 'extended assurance services' then we would consider this an inappropriate service to be offered by the external auditor.

If, however, the nature and scope of the work was designed by the external auditor, with a reporting function to the Audit Committee, then this may not be inconsistent with the external auditor's role. If the auditor were to make recommendations for improvements in a client's accounting systems and controls then, provided that the final decision on the appropriateness of the changes was taken by management, we believe there may not be a significant threat to the auditor's independence. The external auditor does report to the shareholders and, accordingly, it is important to ensure that the shareholders' view of independence is understood. This may be another area where the differing types of listed companies and their shareholders may have different needs and views.

**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 the 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 there needs to be a wholesale change in approach to the setting of Ethical Standards relating to the provision of non-audit services except that, as outlined at the start of our submission, we believe the approach as far as listed companies is concerned should be reviewed.

We do believe there is, still, a degree of confusion surrounding the provision of tax compliance services.

**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;**
- **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 believe that if there are to be further changes to the Ethical Standards in respect of non-audit services then there should be a greater consideration of the nature of the service provided to the size and nature of the entity involved.

We certainly do not advocate more extensive prohibition on non-audit services to certain of the companies on AIM and PLUS Markets for the reasons detailed earlier in this letter. We would advocate quoted companies (i.e. those listed on the LSE) being treated differently from those on AIM and PLUS Markets and indeed there may even be scope to deal with companies outside the FTSE350 differently to those within it.

The Professional Oversight Board's current way of determining how the quality of audit firms is monitored is made by reference to whether the firm has audit clients listed on the LSE and those above a certain market capitalisation where listed on AIM or PLUS Markets. We would support this as an approach for determining thresholds at which the provision of non-audit services may need to be assessed differently. We would support more active corporate governance participation and more extensive disclosure in the financial statements of entities in the 'top tier'.

**5. In setting the standards relating to auditor independence, do you believe regard should be had to the potential benefits that are derived by companies from the provision of non-audit services by their auditors? If your answer is yes, please provide specific examples of these benefits and indicate the magnitude of any cost savings that arise.**

As set out above, many of the companies listed on the AIM and PLUS Markets are relatively small and have relatively scarce resources, for example the Finance Director. Those companies need to balance the use of those resources and it may not be economically viable for them to retain the in-house expertise in financial reporting and taxation matters that might be expected at a much larger company, even say in the FTSE 250. The assistance that the audit firm can bring in these areas can be significant. Of course, these services could be provided by another accountant independent of the auditor but this does provide inefficiencies and duplication of costs in needing two sets of professionals to become familiar with the company and its business. This does not, we contend, enhance shareholder value and bring greater confidence in the audit.

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

Whilst broadly supporting the Ethical Standards and acknowledging that they have brought a framework that is relatively clear and understood, we do believe that there should be a greater role for those charged with governance to assess the suitability or otherwise of the non-audit services that can be provided by the audit firm. We believe the Audit Committee is in the best position to judge whether there is or could be a perceived conflict of interest and whether safeguards that might be put in place by the audit firm to manage those conflicts are effective.

Yours sincerely



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