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By e-mail to: h.osullivan@frc-apb.org.uk

Dear Ms O'Sullivan

The Auditing Practices Board (APB) consultation on audit firms providing non-audit services to listed companies that they audit

I am delighted to respond to the invitation of the APB to comment on their consultation on audit firms providing non-audit services to listed companies that they audit. I am currently the chairman of the audit committee of Ricardo plc and also of Clyde Process Solutions plc. I am a former audit partner of Ernst & Young LLP and a former convener of the audit and assurance committee of the Institute of Chartered Accountants of Scotland.

I am not in agreement with the recommendation of the Treasury Select Committee that there should be a prohibition on audit firms conducting non-audit work for the same company. I am not convinced that this would enhance investor confidence and trust in audit, as suggested by the Select Committee.

In my view, the APB's ethical standards for auditors, and particularly ES 5, "Non-audit services provided to audited entities", set out general principles which should inform the auditor's approach to different situations where non-audit work is contemplated, and thereby identify any threats to their independence and objectivity, and apply appropriate safeguards to mitigate such threats or avoid the situation giving rise to the threats. I consider that such a principles-based approach, focusing on threats and safeguards, is more effective and efficient in dealing with such threats rather than detailed rules which will not be appropriate to all situations.

In my view, investors should be protected in this regard by suitable strong governance arrangements set up by company boards, not by detailed rules for the auditors. Audit committees have a key role in monitoring the application of the principles of threats and safeguards in practice. They are best placed to make decisions in the best interests of their shareholders in considering independence risks and mitigating safeguards on a case-by-case basis.

Audit committees should consider all relationships between the auditors and the company, to ensure that they do not compromise the auditors' judgement or

independence particularly with the provision of non-audit services, where a company policy relating to these should be agreed with the board.

Such a non-audit services policy should require that the auditors are excluded from carrying out any non-audit work which puts them in a position of auditing their own work, making management decisions for the company or acting as an advocate of the company. For services that arise directly from the audit and services which are currently required to be provided by the auditor by law or regulation, the auditors are generally best placed to undertake such work from their knowledge of the company. Other services provided by the auditors because of their familiarity with the company, such as tax compliance and reporting on prospectuses, can be most effectively carried out by the auditors, as long as their work does not conflict with their independence, as discussed above. For consulting and other services where the auditors have appropriate financial skills, there may be occasions when the auditors are best placed to undertake such work, but only where appropriate safeguards are in place and with suitable pre-approval by the audit committee.

The audit committee should also consider setting a pre-approval limit for the quantum of aggregate non-audit fees in relation to audit fees, to ensure that the value of such fees does not impair the independence of the audit partner.

In my view, it is a critical part of the audit committee's governance role to ensure that there are policies in place to cover non-audit services and that these policies are complied with. In both listed companies where I am chairman of the audit committee, we have such policies in place, and they are actively complied with. Indeed the Smith guidance should result in listed company audit committees having such policies in place.

If there were to be a total prohibition of non-audit services from auditors, it might make it more difficult for international groups to change their auditor to another firm with the international spread required, as this would require changing existing arrangements for non-audit services provided by the other major firms, with subsequent disruption.

Investors should have full disclosure of the policies in place and the quantum of non-audit and audit fees, to give them assurance that effective governance arrangements are in place and being applied. Enhanced disclosure of the nature of non-audit services carried out would help investors in this regard.

In response to the specific questions raised by the APB in their consultation paper, I respond as follows. The reasons for my views are generally developed above:-

1. I consider that where the auditor of a listed company follows the ethical standards and the audit committee has effective policies for approving non-audit services combined with appropriate disclosure of these policies and the quantum of audit and non-audit fees, then the confidence of investors should not be impacted. I am not aware

of any instances where the provision of non-audit services has adversely affected audit quality or currently impacts confidence in the independence of auditors.

2. Not applicable, due to answer at question 1.
3. I consider that the current approach taken by the APB to the setting of ethical standards is sound. In particular, I support the APB's philosophy of setting out principles rather than detailed rules, as these should be more effective in dealing with different circumstances.
4. Not applicable, due to answer at question 3.
5. I consider that the perceived benefits derived from the provision of non-audit services by auditors should not be covered by ethical standards for auditors. These ethical standards should clearly address any risks to independence and suitable safeguards, without taking account of any benefits to the company. The benefit to the company should be more appropriately considered by audit committees and boards, in determining whether it is appropriate to use the auditors for non-audit services, balanced against any perceived threats to independence and objectivity.

Thank you for giving me the opportunity to comment on the APB consultation paper.

Yours sincerely

Ian M Lee