

Private and Confidential

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Dear Madam

APB Ethical Standards – Consultation on audit firms providing non audit services to listed companies that they audit

RSM Tenon Audit Limited welcomes the opportunity to comment on the above consultation paper as we believe that ensuring the quality of financial statements and the effectiveness of the audit process are critical to stakeholder confidence in financial reporting in the United Kingdom.

In our opinion, therefore, the question as to whether the provision of non audit services undermines that confidence should not be looked at in isolation. Consideration must also be given to the fact that where a firm provides both audit and non audit services any subsequent audit opinion given is based on a more detailed knowledge of the reporting entity's business and should therefore be a material factor in providing enhanced confidence.

We believe, therefore, that in order to reach an appropriate conclusion on audit independence the question needs to be asked as to whether limiting the ability of auditors to assist their clients in the provision of non audit services can, rather than enhancing the audit opinion, indirectly undermine investor confidence in the financial statements.

We are also of the view that when considering the proposed revisions to the Standards, consideration should be given to the range of entities that are brought within the scope of any further restrictions.

As suggested above, limiting the ability of smaller listed companies to draw on the expertise of their auditors through the provision of non audit services could have the undesirable effect of reducing the quality of financial reporting and stakeholder confidence in the financial statements. Smaller listed, AIM or Plus Market listed entities typically have much more limited internal resources and would look to third parties to supplement those resources with external outsourced expertise. Without such external support their ability to produce reliable financial information may be compromised.

We accept that the auditors are not the only source of external support available to an entity when selecting a third party to provide additional services, but we believe that the ability of the entity to draw on the expertise of their auditors has two closely related benefits for the entity:

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RSM Tenon Limited is a separate company that provides professional resources and certain services to RSM Tenon Audit Limited under the terms of a formal agreement on an arms-length basis.

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1 The knowledge the auditor derived from the audit process about the entity and its business will enhance the quality and efficiency of the additional services provided; and conversely

2 the additional knowledge gained about the business through the provision of the additional services will help in turn to improve the quality of the audit.

In our view therefore the ability to continue to provide non audit services to listed clients, especially the smaller entities, is likely to enhance the quality of financial reporting and stakeholder confidence rather than reduce it, as long as there exists an effective control within the report issuer ensuring that potential areas of conflict are properly managed. In our opinion such procedures exist in the majority of larger professional practices and have proved to be generally effective.

As regards the specific questions raised in the consultation paper we respond as follows:

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 affected audit quality?

We do not believe that the provision of non-audit services by RSM Tenon to RSM Tenon Audit clients has impacted adversely confidence in the independence of auditors. Shareholders and directors both look for strong well informed business advice from their auditors. They both expect their auditors to understand the business and to be fully up to speed with all developments.

Where services are separated between firms, there is the real risk that knowledge and understanding of the client business is diluted. Auditors may in fact become remote from critical discussions about business issues that may impact upon the financial statements. In this situation we would be concerned that there is an increased potential risk of financial statement error and the need for restatements in later years.

The current Ethical Standards have correctly in our view put safeguards into our working practices to ensure that self review threat is minimised. This has led to certain services such as valuation services being prohibited. This we accept was an important development in our profession and in making sure that shareholders have confidence in the audit services provided.

We do not see an extension of the existing Ethical Standards as necessary or beneficial. We have not seen any evidence to support the proposition that the provision of non-audit services by audit firms to their audit clients has affected audit quality. Standards of auditing are closely scrutinised through AIU, QAD and internal quality control reviews. These reviews place onerous requirements on firms to adhere to Ethical Standards and we do not believe they have shown any evidence to support the assertion that non-audit services affect 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.

In broad terms we do not consider that the provision of non audit services impacts on audit quality or independence. There are certain services such as provision of advocacy services to clients that could result in auditors becoming too closely aligned with the views and wishes of management,

but the ability of auditors to provide those services is already limited by the existing Ethical Standards.

3 In the light of your answers to questions 1 and 2, do you think that there are 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 they audit?

In our view it is not necessary to change the approach being adopted by the APB. We consider that the current practice of setting out the principles required to be followed to achieve independence and allowing effective safeguards to be used by auditors where appropriate remains the best way forward.

We do however consider that the Ethical Standards should put an obligation on auditors to communicate with the audit committee/non-executive directors the nature of safeguards that were deemed appropriate and why. This will ensure that there is greater transparency with auditors ensuring independence is maintained.

Furthermore we believe that the issue of audit effectiveness is more closely aligned with the ability to demonstrate specialist knowledge of the industry of the reporting enterprise. We believe that the auditors of highly complex businesses, perhaps especially those in the financial services industry, should be required to formally demonstrate this knowledge.

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 as noted earlier.

However, we note that current disclosure requirements provide information on the amount of fees paid to auditors for non audit work but gives limited information on the nature of the services to be disclosed. There is therefore a lack of clarity and potential inconsistency in the way fees are disclosed and stakeholders may perceive additional concern over auditor independence as a result.

We would therefore welcome improved clarity over the reporting disclosures to be made in financial statements of the nature of the services provided.

We would also recommend that there is a greater involvement by the non executive directors/members of audit committees in the decision as to whether auditors be appointed to provide non audit services above a specified fee threshold. We also consider that where additional services are provided, the auditor should report not only to executive management on the results of

that work but report directly to the non executive directors to enable them to assess the quality and value of the work provided.

5 In setting the standards relating to auditor independence, do you believe regard should be had to the perceived benefits that are derived 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.

Yes we do consider that the provision of non audit services can and do provide benefits to companies, especially the smaller listed and AIM clients. There are a number of areas where the provision of services could be considered to be beneficial including:

- provision of advice and assistance in the preparation of financial records and the annual statutory financial statements. The increasingly complex rules on financial reporting mean that in many cases the in house staff do not have the experience to effectively understand and implement the new financial reporting requirements. Their auditors will have wider experience of dealing with these issues and have a deeper knowledge of the business than other third parties. This knowledge will enable them to ensure the accounting procedures and disclosures in financial statements are of the highest quality.

We would estimate that a small AIM listed client will be facing additional costs in the order of £10,000 each year for the full annual statutory accounts and £5,000 for the interim report. Our fees have not reduced by this level as the review process for financial statements prepared by a third party has become more onerous.

- provision of tax services. Whilst the provision of taxation services is largely independent of the audit process the knowledge developed by the audit firm will help ensure that tax legislation is applied most effectively for the client, and reported accurately. Clients will need to hold tax and audit planning meetings with two firms, resulting in largely the same discussions being held twice. Communication becomes more complicated and disjointed and scheduling of work critical. We would estimate that this will lead to wasted management time as well as additional costs from professional firms on smaller listed companies in the region of £10,000 per client.

- provision of corporate finance and due diligence support in potential acquisitions and flotations. The knowledge built up by the auditing firm places the firm in a unique position to understand strategy and the business. Following the acquisition the auditor is in the position of understanding the acquired business and its impact on the group audit strategy. An independent firm will not have access to the historical knowledge and understanding and will have to spend more time with management to be able to effectively advise. The cost to the business is hard to quantify as getting an acquisition wrong can be very costly.

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

A key concern we have over the potential limitation of providing non audit services to listed companies is the range of entities to which limitations might apply. As set out in our opening comments we believe that the provision of non audit services by auditors can, especially for the smaller listed and AIM companies with limited resources, enhance the quality of financial reporting

and help improve the overall confidence that stakeholders may have in the financial reporting and audit process.

We would therefore advocate that any restrictions being considered are not applied to all listed companies but to a specific range of larger and more complex companies.

We suggest that the target companies for any further restrictions should certainly be those companies in the FTSE 250, with preferably a further qualification based upon complexity and public interest. These businesses should have the scale of resources necessary to provide the services which could otherwise be outsourced to third parties. Regulated entities, such as banks and insurance companies, who in order to comply with their obligations to regulators would be required to have effective internal reporting systems and controls that operate on a daily basis, would similarly be expected to be less reliant on external input.

We are also concerned about ensuring there is adequate choice of dual source service providers. At present the largest companies are often restricted to working with the big four firms when in fact the mid-tier firms are able to provide credible alternatives to the big four. The APB needs to encourage opportunity for all and not to restrict further the ability of the mid-tier to compete and add value to certain sectors of corporate Britain.

If you wish to discuss any of the comments that we have made please do not hesitate to contact Patrick Wright at this office (Tel: 01256 370367 Email: patrick.wright@rsmtenon.com).

Yours faithfully



RSM Tenon Audit Limited