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Mrs H O'Sullivan
Project Director
The Auditing Practices Board Limited
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

Severn Trent Plc
2297 Coventry Road
Birmingham B26 3PU
Tel 0121 722 4000
Fax 0121 722 4800
www.severntrent.com

Direct Line 0121 722 4267
Direct Fax 0121 722 4183
Our Ref MM/sm

Dear Mrs 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 Severn Trent Plc Audit Committee in response to the Auditing Practices Board's (APB) consultation on audit firms providing non-audit services to listed companies that they audit.

Severn Trent plc is a FTSE 100 listed company. We do not have a listing on the NYSE.

We welcome the opportunity to respond to the APB's consultation and our responses to the specific questions and proposals 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?

No.

In our view, the procedures that we and our auditors have established to identify and prevent conflicts of interest and to safeguard audit independence are effective.

We do not therefore consider that the independence of our auditors is impacted by the non-audit services they carry out.

(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?

No.

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

Severn Trent has in place two controls under its governance framework to address this concern:

- An agreed procedure to consider and, if thought fit, approve the use of the auditors for the provision of non-audit services.
- An annual formal review of the effectiveness of the audit.

Both controls have been approved by, and are regularly reviewed by, the Audit Committee. We believe that these procedures are effective in maintaining audit quality and the independence of the auditors.

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?**

No.

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 confidence and the safeguards that can be adopted to eliminate such threat work well in practice.

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;**

We would strongly argue against any statutory prohibition on the provision of non-audit services by accounting firms to their audit clients.

We consider that the current approach, which sets out principles to be applied by companies and auditors in determining whether non-audit services may be provided, is the most appropriate approach. Any extension of these restrictions would require a shift away from this principles based approach towards a more prescriptive rules based approach.

We would not support such a change as, in our view, a rules based approach would be difficult to design and interpret in practice.

- **the imposition of other requirements through the Ethical Standards for Auditors (and if so which);**

We consider that the current approach provides an appropriate framework to safeguard against the threats to auditor independence and hence we do not believe that there should be any imposition of further 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; and**

Severn Trent’s governance framework already requires that non-audit service arrangements are pre-approved by the Audit Committee, as described in 1(b) above. We believe that this is good practice and would support a requirement for all listed companies to comply with such a requirement.

- **better (and more extensive) disclosure in financial statements.**

If there is a demand from investors and other relevant users of accounts for further information to be included in the annual report and accounts, the APB might wish to consider the following.

Narrative disclosures could be improved by introducing requirements on companies to:

- disclose their policy on the engagement of the external auditor to supply non-audit services;
- describe the nature of the services provided; and
- explain the reasons for engaging their auditors for each engagement or category of service.

Numerical disclosures could be improved by broadening the definition of audit fees to include the audit of the company’s subsidiaries and by more clearly distinguishing between assurance services provided under legislation or regulation and advisory services.

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?**

Yes.

We believe that there are instances when the use of its auditors for non-audit services is positively advantageous to the company and its shareholders. The Audit Committee of the company is however the responsible and accountable body that is in the best place to make such judgements.

With the auditors’ detailed knowledge of the company’s business, non-audit service can in certain instances be provided more effectively by the auditors. Further, we believe that there are instances where appointing another accounting firm could be inefficient and might expose the company to greater risks as that accounting firm would lack the detailed knowledge of the business which the auditors have. Again the Audit Committee is best placed to make such judgements.

In many circumstances, appointing the auditors to provide non-audit services can result in lower costs and faster delivery while safeguarding their and the company’s independence.

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

In summary:

- we believe the existing arrangements are well understood and managed by the Audit Committee and Board of Directors;
- the current governance framework is effective and gives companies the flexibility and choice required while safeguarding the independence of auditors;
- further restrictions are neither necessary nor required; and
- we consider changes to disclosure requirements may enhance investor and public perception of the effectiveness of current arrangements.

We do not have any further views.

Yours sincerely



Mike McKeon
Group Finance Director
For and on behalf of the Audit Committee of Severn Trent plc