

28 January 2010

Ms H O'Sullivan  
Project Director  
The Auditing Practices Board Limited  
5th Floor  
Aldwych House  
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Dear Ms O'Sullivan

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

We are pleased to have had the opportunity to respond to the consultation paper issued by the Auditing Practices Board on 6 October 2009.

### *Who we are*

Wolseley Plc is the world's largest specialist trade distributor of plumbing and heating products to professional contractors and a leading supplier of building materials to the professional market. In the year ended 31 July 2009 the Group recorded revenue of £14.4 billion from operations in 27 countries. The Group is listed on the London Stock Exchange and is a component of the FTSE100 index.

### *Response to consultation*

Our responses to the specific questions asked in the consultation paper are set out in the Appendix to this letter. We would summarise our response as follows:

- As the consultation paper notes, a number of audit failures in the US around 2001 were partly attributable to firms providing non-audit services that compromised their independence and objectivity as auditors. Although there had been no comparable failures in the UK, extensive changes in UK governance requirements for both audit firms and audit committees were made and started to come into effect from 2004. The UK has thus significantly strengthened its governance regime, at the same time as the potential cost of audit failure to the international accounting firms has given them strong commercial incentives to maintain stringent controls over the quality of their work. While some market participants may still think that the provision of non-audit services risks a conflict of interest, it is not clear to us how they would currently justify this perception.
- For Audit Committees, ensuring the objectivity and independence of the external audit will always be paramount. However, Audit Committees also have an obligation to shareholders to make a sensible use of the resources at their disposal. A company's auditors have a deep and detailed knowledge, not just of its business but of its legal structure and how it is financed and taxed. The company has already paid for this knowledge base through the audit fee, and there are clear benefits to using the audit firm for advisory work whenever this can be done without a conflict. The benefits are not just in the form of reduced advisory fees, but in the speed with which advisors can be briefed, reducing the demands on corporate management and allowing transactions to be done more quickly and efficiently, and in the increased likelihood that all implications of a transaction for the rest of the company's activities are identified and managed appropriately.

- Our impression is that those representatives of the shareholders of listed companies who directly make investment decisions are discriminating in their attention to corporate governance. On rare, well-publicised occasions they will challenge a Board's proposals for its composition or remuneration, and they make a continuous but generally unpublicised assessment of executive performance. We are not aware of such investment managers or analysts expressing any concerns about current practice in using auditors for non-audit work, either ours or that of other listed companies.
- Most of the time shareholders delegate the monitoring of corporate governance to compliance departments or independent consultants, which tend to assess governance through a checklist, in terms of strict compliance with the most detailed and prescriptive guidance available. In such circumstances there may be a tendency for Boards to prefer the "easy option" of compliance with the letter of the guidance, even in circumstances where they privately consider that doing so will impose unnecessary costs on shareholders, as they may not be given credit even for a considered explanation of their reason for non-compliance. If this is a risk even under current arrangements, then it will only be exacerbated by making that guidance even more restrictive.
- In our opinion the current standards for auditors and corporate governance requirements reach an appropriate balance between preserving the objectivity and independence of the audit function, and allowing businesses to make judgments about when it is cost-effective to use audit firms as advisors without compromising their role as auditors. We consider that it would help dispel the perception of a potential conflict if the annual report of the Audit Committee identified the nature and cost of all material non-audit engagements undertaken by the auditors, explained why management considered it more efficient or effective for the audit firm to fulfil these engagements, and stated explicitly that the Audit Committee was satisfied that the nature of these engagements did not compromise the independence and objectivity of the external audit.
- We consider it vital that any potential changes to current arrangements are assessed with a view to the international competitiveness of the UK capital markets. British law, by comparison to some other jurisdictions, gives shareholders extensive powers to direct the activities of a company, and starts from the presumption that it is their responsibility as well as their right to hold the directors accountable. The directors, correspondingly, should be primarily concerned about justifying their actions and decisions to the company's owners, and its other stakeholders, rather than to regulators. The resulting corporate governance framework – based on principles such as "comply or explain" and "threats and safeguards", rather than on a prescriptive and inflexible rulebook – has historically proved attractive to investors, and has worked as well as any competing model in the market turmoil of the last couple of years. Increasing the length of the rulebook in response to a perceived rather than actual risk will increase the internal and external cost of compliance for little or no benefit. Unless any potential changes are adopted internationally by all significant regulatory regimes at the same time, the further result will be to reduce the competitiveness of our capital markets.

Please do not hesitate to contact me if I can provide any further assistance with the Board's consultation.

Yours sincerely

Steve Webster  
**Chief Financial Officer**

**APPENDIX**

- 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?*

The Treasury Select Committee Report published in May 2009 stated that certain representatives of the investor community remained sceptical that audit independence can be maintained when non-audit services are provided, and that particular commentators argued that audit firms face strong incentives to temper critical opinions of accounts prepared by executive boards, if there is a perceived risk that fees from non-audit work could be jeopardised.

Given this testimony, it is difficult to dispute that the provision of such services has an impact on confidence, though it is not indicated how numerous these sceptical investors are, or who the commentators are if they are not members of the investor community.

Extensive changes in UK governance requirements for both audit firms and audit committees have been made since 2004. The UK has thus significantly strengthened its governance regime in recent years, at the same time as the potential cost of audit failure to the international accounting firms has given them strong commercial incentives to maintain stringent controls over the quality of their work. While some market participants may still think that the provision of non-audit services risks a conflict of interest, it is not clear to us how they would currently justify this perception.

*(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? Please give the reasons for your views.*

As the consultation paper notes, a number of audit failures in the US around 2001 were partly attributable to firms providing non-audit services that compromised their independence and objectivity as auditors. We are not aware of any instances in recent years in the UK.

- 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. Please give the reasons for your view.*

For large listed companies audited by the large international firms, we do not consider that the “self-interest,” “management” and “advocacy” threats to audit independence are significant. No single client represents a significant proportion of the overall fees of the large audit firms, and these firms have considerable market strength with respect to their clients. The management teams of listed companies are strong enough, and the external resources on which they call sufficiently wide, that we consider it very unlikely they would be unduly influenced by the views, or dependent on the advocacy, of any one advisor.

The past cases in which the provision of non-audit services gave rise to concern about audit independence appear to have related to “self-review”, where an audit opinion is dependent on non-audit work performed by the same firm. In our view, the current standards applying to audit firms, and guidance for audit committees, provide sensible arrangements for ensuring that non-audit work performed by the audit firm does not compromise the independence and objectivity of the audit opinion.

- 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? Please give reasons for your view.*

Our impression is that those representatives of the shareholders of listed companies who directly make investment decisions are discriminating in their attention to corporate governance. On rare, well-publicised occasions they will challenge a Board's proposals for its composition or remuneration, and they make a continuous but generally unpublicised assessment of executive performance. We are not aware of such investment managers or analysts expressing any concerns about current practice in using auditors for non-audit work, either ours or that of other listed companies.

Most of the time shareholders delegate the monitoring of corporate governance to compliance departments or independent consultants, which tend to assess governance through a checklist, in terms of strict compliance with the most detailed and prescriptive guidance available. In such circumstances there may be a tendency for Boards to prefer the "easy option" of compliance with the letter of the guidance, even in circumstances where they privately consider that doing so will impose unnecessary costs on shareholders, as they may not be given credit even for a considered explanation of their reason for non-compliance. If this is a risk even under current arrangements, then it will only be exacerbated by making that guidance even more restrictive.

In our opinion the current standards for auditors and corporate governance requirements reach an appropriate balance between preserving the objectivity and independence of the audit function, and allowing businesses to make judgments about when it is cost-effective to use audit firms as advisors without compromising their role as auditors.

- 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 nonaudit 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.*

*Please provide reasons for your views and any suggested solutions.*

As noted in our response to question 1, we recognise that there is a perception in some quarters that there is a potential conflict between auditor independence and the provision of non-audit services under current arrangements. We do not consider this perception to be well-founded, and consider that better disclosure should help to dispel it. We consider that the annual report of the Audit Committee should identify the nature and cost of all material non-audit engagements undertaken by the auditors, explain why management considered it more efficient or effective for the audit firm to fulfil these engagements, and state explicitly that the Audit Committee was satisfied that the nature of these engagements did not compromise the independence and objectivity of the external audit

- 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? If your answer is yes, please provide specific examples of these benefits and indicate the magnitude of any cost savings that arise.*

For Audit Committees, ensuring the objectivity and independence of the external audit will always be the paramount principle. However, Audit Committees also have an obligation to shareholders to make a sensible use of the resources at their disposal. A company's auditors have a deep and detailed knowledge, not just of its business but of its legal structure and how it is financed and taxed. The company has already paid for this knowledge base through the audit fee, and there are clear benefits to using the audit firm for advisory work whenever this can be done without a conflict. The benefits are not just in the form of reduced advisory fees, but in the speed with which advisors can be briefed, reducing the demands on corporate management and allowing transactions to be done more quickly, and in the increased likelihood that all implications of a transaction for the rest of the company's activities are understood and managed appropriately.

Unfortunately we do not consider it possible to quantify these benefits. It is not feasible to estimate what additional fees would be incurred in bringing an advisor "up to speed" with all the background knowledge about our business and organisation that our auditors already possess, nor to cost the inefficiency of dedicating a lot of senior management time to briefing advisors rather than executing the transaction.

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

We consider it vital that any potential changes to current arrangements are assessed with a view to the international competitiveness of the UK capital markets. British law, by comparison to some other jurisdictions, gives shareholders extensive powers to direct the activities of a company, and starts from the presumption that it is their responsibility as well as their right to hold the directors accountable. The directors, correspondingly, should be primarily concerned about justifying their actions and decisions to the company's owners, and its other stakeholders, rather than to regulators. The resulting corporate governance framework – based on principles such as "comply or explain" and "threats and safeguards", rather than on a prescriptive and inflexible rulebook – has historically proved attractive to investors, and has worked as well as any competing model in the market turmoil of the last couple of years. Increasing the length of the rulebook in response to a perceived rather than actual risk will increase the internal and external cost of compliance for little or no benefit. Unless any potential changes are adopted internationally by all significant regulatory regimes at the same time, the further result will be to reduce the competitiveness of our capital markets.