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FAO Chris Hodge
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Dear Sirs

Choice in the UK Audit Market: Progress report and Further Consultation

Thank you for asking for comment on the paper entitled 'Choice in the UK Audit Market: Progress report and Further Consultation'. Deloitte welcomes the opportunity to contribute to the consultation process and we set out below our comments on this consultation paper.

Section 3: Changes to audit firm ownership rules

We support a relaxation of the restrictions in this area as we consider that they are onerous and unnecessary protectionism. A carefully managed change in the audit firm ownership rules may provide the necessary impetus for smaller firms to develop and compete effectively with the Big Four in the audit market for listed companies.

We support a market led solution to this issue. However, we do have some remarks as outlined below:

- In its study for the European Commission, Oxera notes that firms outside the Big Four could struggle to raise debt finance, particularly in raising funding in excess of tangible assets; the cost of capital in such a scenario may be prohibitively expensive. Given that it would take smaller firms a number of years of sustained investment to break into the larger client market then perhaps a series of smaller fundraisings over the period of envisaged growth would deliver a more affordable method.
- As the effect of the credit crunch may last a number of years there is a potential risk to funding lines should smaller firms adopt debt funding in the future. Such firms may be at greater risk of a collapse if the accessibility of such credit lines was withdrawn.

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- With the potential that smaller firms may want to expand aggressively and investors may seek quick returns, there must be sufficient and robust safeguards in place to avoid an excessive focus on short term shareholder return at the expense of audit quality or the long term stability of the audit firm.
- There may be an undesirable change of culture within an audit firm if external investors (especially those with little or no audit experience) provide finance.
- Independence issues will also have to overcome.
- There is also the potential for competition issues if a group of institutional shareholders only supported the appointments as auditors of listed companies of firms which they own.

The Consultation Paper states “The concern that outside owners may drive down audit quality assumes that these owners are unaware that the value of their investment could be damaged or destroyed if the firm loses its reputation for quality and independence.” We agree that rational, long term value investors will undoubtedly support and seek to enhance the reputation and value of the entity in which they have invested. However, the actions and effects of speculative investors pose a significant risk to any firm that raises capital. Such risks must be fully explored and appreciated before any change is made to the rules or legal requirements.

Section 4: Draft guidance on use of firms from more than one network

There are three main areas that will need concerted action to address over a period of time.

1. Regulatory Developments

There have been a number of recent regulatory developments that hinder progress towards use of firms from more than one network. For example, the Statutory Audit Directive by making the group auditor solely responsible for the audit opinion; International Standard on Auditing 600 (Revised) generally introduces more impediments. These need to be considered further.

2. The perceptions of audit committees

Ultimately, the decision on which auditor to appoint resides with the audit committee. Audit committees require a degree of security when it comes to selecting their auditor and this results in the larger listed companies opting for Big Four auditors. Whilst a commonly used method in France, the use of joint auditors is not something that the UK market (i.e. audit committees of large listed clients) appear to be content with.

3. Risk of fraud

If there is more than one audit firm auditing a large, complex group then there will be an increased risk that fraud may go undetected as there will be no one person with a view of all the facets of the group. A salient example of this is BCCI, where audit responsibility was split between two different firms.

In summary we believe that this is an area that will need further widespread consultation so that all stakeholders are fully aware of the issues that need to be addressed. Ultimately, the decision on which auditor or auditors to appoint resides with the audit committees and unless and until they can confidently appoint joint auditors or auditors from more than one network it is unlikely any regulatory response can propel the market in this direction.

Deloitte.

If you have any specific questions relating to our response to this consultation paper please do not hesitate to contact Gwyn Griffiths on the number above or Martyn Jones on 020 7007 0861.

Yours faithfully

A handwritten signature in cursive script that reads "Deloitte & Touche LLP".

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