

Chris Hodge
Financial Reporting Council
5th Floor, Aldwych House
71-91 Aldwych
London
WC2B 4HN

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Direct line: 0207 980 0764

Email: jbabiak@uk.ey.com

By post and e-mail: auditchoice@frc.org.uk

Dear Mr Hodge

INTRODUCTION

Choice in the UK audit market

1. Ernst & Young LLP welcomes the opportunity to offer its views on the FRC's progress report and consultation (the "Consultation Paper") on choice in the UK audit market, published in May 2008.
2. This FRC consultation focused on two of the fifteen proposals first published as Market Participant Group (MPG) recommendations in April 2007, namely: *Effects of changes to audit firm ownership rules*; and *Guidance on the use of firms from more than one network* (recommendations one and seven respectively). The FRC has also invited opinion on its overall progress implementing the other MPG recommendations.

OVERALL OBSERVATION

3. We responded in detail to the original MPG recommendations on 6 July 2007, and shared our views on subsequent consultations (e.g., proposed changes to the Smith Guidance, 6 June 2008). In addition we have: commented on proposed new guidance (e.g., the Audit Quality Framework, 6 June 2008); advised on the formulation of guidance for auditor liability limitation agreements, June 2008; and are participating in the Audit Firm Governance Working Group convened by the ICAEW (launched in May 2008) to review proposals for a code on audit firm governance.
4. These are examples of our commitment to engage fully with the FRC in its consultations and reviews, on MPG and related matters. Therefore the views of Ernst & Young, on this Consultation Paper, will be familiar to the FRC. That said, we believe it is in the public interest to briefly reiterate in this letter our position on recommendations one and seven. If desired, anyone visiting the FRC's website can access our detailed responses to the original MPG report and the consultations that followed.



INVESTOR IN PEOPLE

SPECIFIC COMMENTS

Effects of changes to audit firm ownership rules

5. In principle we do not oppose extensions to audit ownership rules, as long as the changes are optional and do not extend regulations of publicly held organisations to those who elect to remain privately held. However, in our view the proposed changes would not improve the level of choice in the UK audit market, but they could inflate the cost of audits without a corresponding increase in quality for those who elect to obtain external investment.
6. For example, firms may have to divert revenues, earmarked for longer-term investment in risk and quality controls, to pay a “rate of return” to external investors. This could undermine audit quality and possibly increase the risk of audit firm failure, which in turn could deter potential new entrants or smaller firms looking to invest in the provision of audit services.
7. We are also unclear as to how a change in ownership rules could progress the development of new global networks. This is because the significant investment decisions required to achieve this tend to be multi-geographical in scope, which would make capital-raising highly problematic. Similarly, because audit firms have been unable to limit their liability by insurance or other means, any amount of capital raised would be unlikely to protect these networks against large claims. This means, in effect, that firms would have to find investors willing to take a long-term view on a high-risk investment.
8. However, even if outside investors could be persuaded to accept this risk, their ownership might inadvertently reduce choice and constrict competition for some organisations. This is because the other investments and business interests of investors might create conflicts of interest and breach independence rules.

Guidance on the use of firms from more than one network

9. In our view the proposed guidance for audit committees, on how to make use of firms from different audit networks, would probably have little impact on audit choice. This is because most companies would not, in our opinion, take this course of action.
10. Years of market experience with joint audits indicates that companies and firms would have to spend time and money dealing with the increased complexity created by using different auditors for the same audit. This would involve different firms having to work together under disparate legal and contractual arrangements. In a competitive landscape, where fees would be unlikely to provide for the cost of coordination, companies would also have to face the risk that audit teams from different networks might overlook reporting errors or irregularities, as they get distracted coordinating and assimilating each other’s policies, procedures and outputs.
11. Conversely, the complexity of multiple auditing is more vulnerable to wilful manipulation by company directors who may wish to conceal errors of judgement, incompetence or criminal activity. Playing-off one auditor against another, to impede the closer scrutiny of a particular aspect of a company’s accounts, could become more prevalent with an increase in the use of multiple auditors.

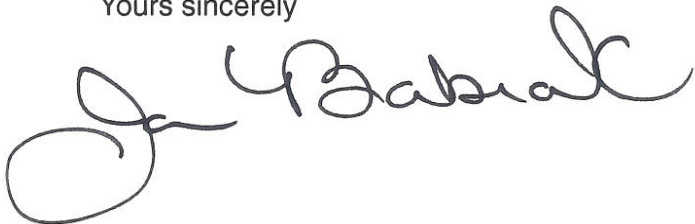
Overall progress of the FRC's implementation of MPG recommendations and related initiatives

12. In our response to the fifteen MPG recommendations, we challenged the relevance of many toward the objective of increasing choice in the market. Our concerns remain on those points.
13. On a related point we noticed there was no progress report on the cost effectiveness of new or proposed initiatives. We believe fully costed regulatory impact assessments for each specific recommendation or initiative is needed for the effectiveness of progress to be measured.

CONCLUSION

14. The case for MPG recommendations one and seven was reviewed comprehensively during the initial consultation in April 2007. Consequently, our views on these recommendations are the same now as they were over 12 months ago, and we expect others might draw the same conclusion. For this reason we question the merits of re-consulting, especially in the absence of a regulatory impact assessment.
15. We agree strongly with comments made by the FRC's CEO on various public platforms during the year, stating that more regulations do not always provide better regulation. To this end we would like to see further progress in the use of impact assessments. There should be a greater certainty of outcome following consultations, with initiatives "progressing" to delivery or terminating within defined timeframes.
16. We hope our response is helpful and respectfully ask the FRC to publish it alongside other responses shortly after the consultation closes. If the FRC would like further clarification on the points raised by Ernst & Young, please contact me at your convenience.

Yours sincerely



Jan Babiak
UK Regulatory & Public Policy Partner