



Grant Thornton

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Dear Mr Hodge

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

We welcome the Financial Reporting Council's (FRC) progress report and further consultation. We share the FRC's commitment to improve competition and choice in the UK public company audit market and we remain ready, willing, and able to perform more public company audit work. However for a variety of reasons many large companies remain reluctant to purchase audits other than from the largest four audit firms, and it is this lack of change in buying patterns which largely underpins the limited choice in the public company audit market.

We address specific issues raised by the paper in appendices to this letter.

Actions taken by Grant Thornton

We remain enthusiastic and willing suppliers of assurance services to the public company audit market. We set out below actions taken by Grant Thornton. These actions include building on our leading position in the AIM audit market which has given us a strong base of clients and experience, providing significantly enhanced share of public company audit work. In time we believe that our strategy of building market share from a strong base will lead to a sustainable and significant presence in the larger corporate audit market.

The following facts demonstrate the benefits to date of our policy to provide professional services to more public companies on a sustainable basis over an extended period of time.

The 2007 transaction with Robson Rhodes further enhanced the firm's critical mass and was the single biggest development in the structure of the UK audit profession for a number of years.

In the April 2006 Oxera report, prepared for the DTI and the FRC, Grant Thornton were identified as the only firm other than PricewaterhouseCoopers to hold a leadership position, and we have since sought to enhance this leadership position on AIM. The FRC's progress report shows we have increased our position as the leading adviser on AIM from 13.8% in November 2006 to 16.0% in February 2008.

In addition to improving our leadership position on AIM, we have significantly increased our market share in FTSE Small Cap and FTSE Fledgling companies, up from 2.6% to 8.2%. In the period since November 2006 we have increased the number of our FTSE 250 audit

Chartered Accountants

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clients from one to six. Last year we provided non-audit services to one in six of the FTSE 100. The combination of AIM leadership and increasing Main Market share provide a solid base from which to build our presence in the larger corporate market.

Grant Thornton is also one of the largest providers of audit services to the Audit Commission, Audit Scotland, and the Wales Audit Office and therefore is at the forefront of government auditing in the UK.

Actions taken by member firms of Grant Thornton International

The Oxera report identified that the most common barrier to appointing a firm such as Grant Thornton was a perceived lack of geographical reach and depth. Member firms of Grant Thornton International Ltd (Grant Thornton International) employ 27,000 people in more than 90 countries. In common with the UK, other member firms of Grant Thornton International have made progress in the public company audit market. The following facts serve to demonstrate Grant Thornton International's global capability:

- in total, member firms of Grant Thornton International achieved 25% fee growth to \$3.5b in 2007, making it by a significant margin the fastest growing international network
- the number of large public companies in G8 economies audited by member firms of Grant Thornton International grew by 30% in 2007
- the US member firm of Grant Thornton International audits nearly 400 SEC companies, and in the second quarter 2008 was the first firm outside the largest four (five prior to the demise of Andersen) audit firms to top the Public Accounting Report's quarterly audit rankings (determined by weighing net audit wins, net gains in revenue audited, net gains in assets audited, and net gains in audit fees)
- member firms of Grant Thornton International experienced significant expansion in BRIC economies via organic growth and acquisition, for example the member firm in Brazil experienced 65% organic growth
- significant transactions enhancing resources available to member firms of Grant Thornton International were completed in Hong Kong, China, Ireland, Australia as well as in the UK
- in China, five firms merged into a single national practice and the first of a planned series of mergers was completed with a substantial regional firm, resulting in a combined firm which can draw on the talents of more than 1,000 staff, and a platform for making further mergers
- specialist services, such as business risk, corporate finance, recovery and reorganisation, and public sector advisory, increased fee income by 33% in 2007.

As the UK member firm of Grant Thornton International we have made substantial investment in strengthening of the global brand and the development of a new global strategy. A small example of our international capability is that Grant Thornton has acted on every corporate listing in the UK by an Indian company.

Public company audit buying patterns have not changed

We agree that regulators should explore all avenues in seeking to remove inequalities in the public company audit market. However we observe that the FRC, and some regulators elsewhere in Europe, appear to hold the view that firms such as Grant Thornton have not moved forward into the public company audit market as quickly or as forcibly as some regulators would have liked. Consequently some regulators give the impression that they are seeking a quicker solution to the issue of concentration than had previously been envisaged.

Grant Thornton has made real progress in expanding its share of the public company audit market but we believe that greater impact on the public company audit market by firms such as Grant Thornton has been hindered by lingering misconceptions in part of the market place about capabilities, and by private contractual or unofficial restrictions on auditor appointment imposed on public companies by some banks and intermediaries. It is evident that there are still issues to address before firms like Grant Thornton can be said to be competing with the four largest firms on a level playing field where audit firms compete primarily on the grounds of audit quality. However there are circumstances outside our control or influence, but within the influence of regulators, which continue to restrict our progress.

The two proposals which are centred on investment look only at the supply of audit services, but from our position as a willing high quality supplier we see that the key driver for change is demand from companies. Grant Thornton would consider significant further investment if there was tangible evidence that significant numbers of UK companies were preparing to change auditor in the near future. There is no such evidence and in the absence of these signals we do not believe that significant investment in resources by an audit firm would, in itself, encourage companies to change auditor. In conclusion, significant investment in audit firms by third parties, or by firms themselves, remains an unattractive proposition in the short term while there are no clear changes to public company audit buying patterns.

We support moves to liberalise the arcane ownership rules for audit firms but we wish to clarify that Grant Thornton has not hitherto been constrained by access to funding. In fact Grant Thornton's recent growth in the public company audit market would have been no greater had we had access to greater external funding.

Regulatory options for a sustainable solution

We believe that there are easier options available to the regulators than audit firm creation or third party investment, with lower risk to audit quality and market confidence, which remain substantially unexplored.

Investors such as Hermes, the Association of British Insurers, and the National Association of Pension Funds have made important and helpful contributions to the choice debate by making it clear that they do not necessarily require their investee companies to appoint one of the largest four audit firms. The next biggest barrier to appointment by public companies of audit firms such as Grant Thornton is institutional prejudice driven by some intermediaries, such as certain investment banks, commercial banks and law firms. The Market Participants Group Recommendation 9 (disclosure by companies of contractual obligations to appoint certain types of audit firms) is a worthy attempt to overcome this barrier but is proving to be ineffective. Recommendation 9 requires disclosure after compliance by the company with the imposed restriction on auditor appointment and the benefit of the recommendation is diluted by disclosure of the restriction after an auditor's appointment.

There is an urgent need for these intermediary groups to publish their policies on auditor appointments. We respect the right of any institution to have a preference on such an important issue, but given the public interest importance of the audit role in maintaining confidence in the capital markets, such preferences should be in the public domain. That would provide the opportunity for excluded audit firms to address concerns directly with the intermediary. Greater transparency of policy would also help to alleviate the current problem of some individuals within those institutions taking unilateral action to influence audit appointments (for various reasons, other than audit quality, which might include opening up the prospect of reciprocal business).

Grant Thornton has approached certain intermediaries direct, with a degree of success, but we believe that it is also the responsibility of the FRC to engage with the relevant representative bodies to achieve this transparency. In our view the FRC has not exhausted the full benefits of regulatory engagement on issues such as institutional acceptance and restrictive practices in some banking agreements.

In our response to the May 2006 FRC discussion paper Choice in the UK Audit Market we said that one of the most important roles of the regulators was to sustain the debate on choice and competition. The fact that the FRC in the UK and other regulators elsewhere have given publicity to the issue of concentration, which is not a sustainable position for the long term well-being of UK or international capital markets, has helped the growth seen by Grant Thornton in the UK and internationally.

In conclusion we recognise that lack of choice in the public company audit market is a position that has evolved over time and for which there is no quick fix. It is clear that the UK capital market needs a sustainable solution to the problem of limited choice in the public company audit market and we welcome steps being taken by the FRC in this regard. In measuring progress towards greater choice we perceive that there is a tendency for regulators to focus on the number of auditors of FTSE 100/250 companies. However, the most sustainable solution for UK capital markets is not to look for a quick fix at the FTSE 100/250 level but to allow firms first to build market share in audits of the majority of companies on the UK's capital markets, and then to build on that base by working with the very largest companies.

Yours sincerely

A handwritten signature in black ink, appearing to read 'SM', with a horizontal line underneath.

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Appendix I Effects of changes to audit firm ownership rules

We have no comments to add to those made in the main letter.

Appendix II Draft guidance on use of firms from more than one network

We support the initiative to give guidance to audit committees on this area.

On the drivers of audit quality for group audits, we have written to the FRC under separate cover on the FRC Framework document Drivers of Audit Quality.

We believe that the draft guidance omits an important element of the audit committee's considerations, and that is non-audit services. One method of expanding the choice of auditor available to companies is to avoid conflicting certain firms from performing the audit by allotting non-audit services to firms that are not the incumbent audit firm. Another method would be to appoint a new firm to conduct non-audit services which would allow the company to understand their capabilities and to get to know their people, which may in time encourage the audit committee to consider that firm for the audit appointment.

Appendix III Other aspects of progress with the implementation of the MPG's recommendations

MPG recommendation 4 - participation on standard setting bodies and committees. Grant Thornton UK LLP representatives include:

- Forum of Firms - David Maxwell, Chairman
- Global Public Policy Committee - Steve Maslin, member
- ICAEW Joint Audit Committee - Steve Maslin, Chairman
- Audit Quality Forum - Joyce Grant, Steve Maslin, members
- ICAEW Ethics Standards Committee - Peter Rowley, Deputy Chair
- ICAEW Audit Registration Committee - Glyn Williams, member
- Urgent Issues Task Force - Brian Shearer, member

MPG recommendation 5 - transparency of capabilities of audit firms. Grant Thornton was among the first audit firms to publish audited financial statements and information about our capabilities. Our latest report titled "Our Book of Secrets" is available on our website www.grant-thornton.co.uk

We comment in the main letter on MPG recommendation 9 - contractual obligations to appoint certain types of audit firms.