



THE INSTITUTE
OF CHARTERED
ACCOUNTANTS
IN ENGLAND AND WALES

1 August 2008

Our ref: ICAEW Rep 85/08

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By email: auditchoice@frc.org.uk

Dear Chris

CHOICE IN THE UK AUDIT MARKET – PROGRESS REPORT AND FURTHER CONSULTATION

The Institute of Chartered Accountants in England and Wales is pleased to respond to your request for comments on the paper *Choice in the UK Audit Market – Progress Report and Further Consultation* published in May 2008.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW Representation

ICAEW REP 85/08

CHOICE IN THE UK AUDIT MARKET – PROGRESS REPORT AND FURTHER CONSULTATION

Memorandum of comment submitted in August 2008 by the Institute of Chartered Accountants in England and Wales, in response to the Financial Reporting Council consultation paper: Choice in the UK Audit Market – Progress Report and Further Consultation.

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INTRODUCTION

1. The Institute of Chartered Accountants in England and Wales (the 'Institute' or the 'ICAEW') welcomes the opportunity to comment on the Financial Reporting Council (FRC) consultation paper: *Choice in the UK Audit Market – Progress Report and Further Consultation*, published in May 2008.

WHO WE ARE

2. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 130,000 members in more than 140 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 700,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

COMMENTS ON DISCUSSION OF EFFECTS OF CHANGES TO AUDIT FIRM OWNERSHIP

4. The potential threat to audit quality that is addressed by the existing ownership rules is that the outcome of an audit could be unduly influenced by persons who have leverage over the auditors. In that context the key issue is, in our view, control of firms rather than ownership. Partial ownership does not necessarily result in control and control may be achieved by a number of means other than ownership.
5. We therefore believe that quality requirements should be applied to firm operations to ensure that individual audits cannot be improperly influenced from outside. With these safeguards ownership restrictions would be unnecessary as such. This would liberalise the provision of capital without compromising audit quality.
6. However, as to whether this would actually enhance competition in the market, the reaction of potential capital providers is unclear. It may be that the capital flows, if at all, principally to the existing dominant firms. It is important therefore to ensure that the proposals elsewhere to address perception issues are carried forward in advance of any action on ownership.

COMMENTS ON DRAFT GUIDANCE ON USE OF FIRMS FROM MORE THAN ONE NETWORK

7. The issues addressed in the draft guidance seem to cover the most likely circumstances for use of various arrangements and the areas suitable for audit committee questioning.
8. However the tone of the guidance as drafted seems to imply that use of more than one network would not normally be appropriate (eg "in some circumstances

it may be possible to achieve a high quality and cost-effective audit by using firms from more than one network” seems to imply that normally this is not possible). We are not aware that this has been proven to be the case. In addition there are many different types of network with different internal arrangements. It does not follow that there will be one type of answer for use of one network and another type of answer for other arrangements. The guidance should be phrased in a more neutral manner, setting out issues for directors to raise with group auditors regardless of whether audit firms being used around the group all belong to one network or not.

9. The draft guidance appears to be written to address the concept of potentially using a member or members of another network of firms, on international audits. It should also address the possibilities of using: a) a small local firm that is a single practice, particularly in considering that what may be a small component to the group auditor may be a significant client for the local auditor; b) another firm on a wholly UK audit, for example a company with a divisionalised structure.
10. As regards the matters for the audit committee to consider in relation to joint auditors and the relationship with management, it may be helpful to add a couple of further considerations:
 - The guidance focuses on keeping auditors and management at a distance and maintaining the separation of the auditor. However it should recognise that there is always the need for the auditor to be close enough to have a sound understanding of the client to be able to form a sound quality audit opinion and challenge management's view.
 - The comments on 'divide and conquer' could also address the importance of not undermining the robustness of the auditors view. In a joint audit, there may be a certain amount of competition between the joint auditors, particularly if management have indicated that they are considering moving to a single auditor. This may allow management to "opinion shop" between the two firms and apply additional pressure on both auditors to support management's view when in another circumstance an alternative treatment may be more appropriate.

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