



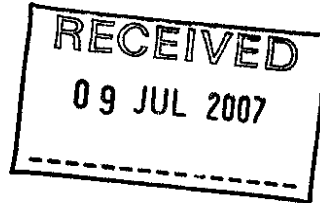
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Mr Julian Rose
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6 July 2007

Our ref: 62/JSN



Dear Sir

**Choice in the UK Audit Market
Interim Report of the Market Participants Group - April 2007**

We welcome the publication of the above Report and are pleased to respond to your request for comments.

As you will be aware, BDO Stoy Hayward LLP is the UK member firm of BDO International, the largest international accounting network outside the "Big 4". In the UK we are one of the two largest firms outside the "Big 4" and are auditors to more FTSE 350 companies than any other non "Big 4" firm. We are also the only non "Big 4" firm to have acted as auditor in recent years to a FTSE 100 company. As such we believe that we are uniquely placed to contribute to the current debate on Competition and Choice in the UK audit market.

In general, we welcome the work of the Market Participants Group and the Interim Report. We believe that it represents a further important step in the right direction to improving Competition and Choice in the UK audit market. We share the concern expressed in the report arising from the level of auditor concentration and the risks that this creates. We believe that this level of concentration not only restricts Competition and Choice but, potentially, could adversely affect audit quality. At present we do not believe there is a risk to audit quality but this relies heavily on the attitude and culture of the "Big 4" remaining committed to the continual improvement of audit quality.

Our main concern is that whilst the report has identified a number of useful measures, it does not address the issue of the underlying institutionalised prejudice that exists within the audit market place. We have increasingly noticed, as we have continued to seek opportunities to compete on a wider basis with the "Big 4" in the UK audit market, that this prejudice is deep seated and is encouraged by many market participants, including by partners and others in the "Big 4". We have also noted efforts by some partners and others in the "Big 4" to use their market position and resources to more directly target our audit

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clients and also to compete more aggressively, particularly on price. We accept that these are characteristics of a “free market” but they indicate the challenges of achieving a change in the dynamics of the market by relying solely on market-led solutions. If there is to be greater choice in the UK audit market then some of the current participants will, inevitably, lose market share. These participants need to be persuaded of the merits of a market-led solution if this approach is to be successful.

We also note that the audit market is heavily regulated and that some of the proposals will require changes in legislation or regulation. It is important that any such changes are implemented as speedily as possible.

We comment on the specific recommendations as follows:

Provisional recommendation 1

We support the objective of increasing the capability of non “Big 4” firms although, in the absence of any other changes to the characteristics of the UK audit market, do not believe that changes in ownership rules will have a significant effect. We agree, however, that this is a matter worthy of further consideration as part of a longer term plan to effect change in the dynamics and structure of the UK audit market.

In any event, we do not believe that capability (or lack thereof) is the key factor in restricting Competition and Choice. Given the significant investments we have made over the past several years it is now generally accepted that BDO Stoy Hayward LLP has the capability to act as auditors to all but the UK’s largest companies and those, such as the largest banks and insurance companies, that need a very specialist resource. The same is probably true for others as well.

Provisional recommendation 2

We believe that increased transparency is to be encouraged. However, we do not believe that lack of information about the profitability of audit work is a barrier to entry. It is possible however that additional information about the profitability of the audit market may have an impact on a wider understanding of the marketplace and thus assist in changing perceptions and attitudes.

Provisional recommendation 3

Agreed. It is vital that, if possible, auditor liability arrangements promote audit choice, subject to the overriding need to ensure audit quality. As a minimum, auditor liability arrangements must be neutral in their effect on Competition and Choice.

However, we do not believe that the absence of audit liability arrangements has had a significant effect on the willingness of a non "Big 4" firm to be appointed as auditor to a public interest entity. Certainly, BDO Stoy Hayward LLP has never declined to seek appointment as auditor due to the lack of auditor liability arrangements.

Provisional recommendation 4

Agreed. Those non "Big 4" firms that wish to engage more effectively in the UK audit market for larger public interest entities must be willing to participate in such groups.

Provisional recommendation 5

Agreed. We strongly support the publication of reports on audit inspections carried out by the Audit Inspection Unit. Care is needed to ensure the public reports are prepared on a consistent and comparable basis. We believe that there are cost implications of this proposal but believe that the benefits will outweigh these costs.

Provisional recommendation 6

Agreed. We support the work currently being carried out in this area by the ICAEW and supported by others, including this firm. Whilst this is a useful measure we do not believe that it will have a significant effect.

Provisional recommendation 7

There may be circumstances in which it is appropriate to use firms from more than one network and thus independent guidance would be useful.

Provisional recommendation 8

We agree that greater transparency about audit selection would be useful. We believe it would be useful for audit committees to explain how they have assessed the effectiveness of their audit arrangements, and their perception of the quality of the audit.

Provisional recommendation 9

We believe that the existence of covenants and other obligations to appoint a certain type of audit firm, invariably a "Big 4" firm, is a major barrier to entry and reinforces the institutionalised prejudice that exists within the audit market place. Whilst we accept that in almost every case banks are willing to revise their position the mere existence of such an obligation in a draft agreement acts as a barrier to some companies even being prepared to consider the appointment of an audit firm other than a "Big 4" firm.

Thus, whilst we welcome this proposal we believe that the transparency needs to include reference to influences that arise before the contractual stage. As noted above, it is often the inclusion of a clause in a draft agreement (which may subsequently be removed), or a reference in a letter or a conversation, that influences an entity not to appoint a non "Big 4" firm.

Whilst we accept there may be circumstances where it is appropriate for a banking, investment or other such agreement to include a clause specifying the use of a "Big 4" audit firm we do not believe that such clauses should be a routine feature of these agreements and should only be included where there are reasons to do so rather than being regarded as "standard form" and only being removed following an appropriate discussion.

Provisional recommendation 10

Agreed. It has become evident during the course of the current debate on Competition and Choice that directors, particularly non executive directors and members of audit committees, believe that investors have a more restrictive view on the appropriateness of audit firms than is the case.

Provisional recommendation 11

Agreed. We believe that a review of these rules would be sensible but note the importance of audit independence as a contributor to perceptions of audit quality. Given the current market concentration it is possible that a relaxation in certain regulations might reduce the pressure for the continual improvement of audit quality.

We would support the suggestion that a five-year rotation period for the lead audit partner in stricter than necessary and would support its relaxation to seven years. We believe that this would potentially increase the capability of non "Big 4" firms to audit larger public interest entities as many of these entities have expressed concern about the need to assess not only the audit partner but her/his potential successor given the short time period for which someone can be lead audit partner. We do not believe this would have an adverse effect on audit quality, indeed it is more likely that it will increase audit quality.

Provisional recommendation 12

Agreed. As noted above, we believe that a review would be sensible but note the importance of audit independence as a contributor to perceptions of audit quality. Given the current market concentration it is possible that a relaxation in certain regulations might reduce the pressure for the continual improvement of audit quality.

Provisional recommendation 13

We do not believe that any audit firm can be regarded as “too large to fail” but agree that it would be useful to understand the likely regulatory response in certain circumstances.

Provisional recommendation 14

As noted above, we support all measures to improve transparency and would welcome the introduction of an appropriate governance code for audit firms. However, the existing Combined Code was designed for listed corporate entities where, in particular, there is a separation of ownership and management. We believe it might be difficult to adapt the existing Code and support the creation of a group to develop an appropriate governance code for larger LLPs and other partnerships where there is a public interest responsibility.

Provisional recommendation 15

Agreed. We think this is a sensible precaution and would provide an opportunity for audit committees, and others, to ensure they have a wider understanding of the capabilities of audit firms other than the audit firm that acts for them.

We trust the above comments and observations are self explanatory but would be happy to discuss them further. If you wish to do so, or have any queries or concerns about the above please contact our Managing Partner, Jeremy Newman.

Yours faithfully



BDO Stoy Hayward LLP