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6 July 2007

Our ref: GJG/mr HHG

Dear Mr Rose

## **Choice in the UK Audit Market – Interim report of the Market Participants Group**

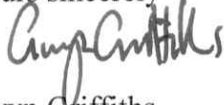
We thank you for the opportunity to comment on the provisional recommendations made in the April 2007 Interim Report of the Market Participants Group (*MPG*) (*the Interim Report*) to enhance the efficiency of the UK audit market and to mitigate the risks associated with a firm leaving the market.

The Interim Report is a useful contribution to the development of competition and choice currently going on both in the UK and Europe and, according to recent reports, recently in the United States. We welcome a market-driven response to the issue highlighted by some commentators, rather than a regulatory response.

The Appendix to this letter provides the responses to a number of the questions raised in the Interim Report.

If you have any queries on our comments, please contact me, Gwyn Griffiths, (contact details above), Martyn Jones (tel. 020 7007 0861) or Gerry Paisley (tel. 020 7007 0878).

Yours sincerely



Gwyn Griffiths  
Partner, Regulation and Public Policy

## Appendix

### **Choice in the UK Audit Market – Interim Report of the Market Participants Group: Deloitte & Touche LLP’s responses to the consultation questions raised in the Interim Report**

In this document, text from the Interim Report is reproduced in italics and our response is in normal type/font.

*Do you support the three criteria used for assessing the merits of the provisional recommendations, as shown below? If not, please propose preferred criteria.*

*Effectiveness: Whether actions would, when combined with others, contribute to achieving the intended outcomes:*

*Quality: whilst at least maintaining audit quality*

*Cost: at a cost which is proportionate to the likely benefits and which is lower than alternatives offering equivalent benefits.*

The three criteria selected by the MPG are entirely appropriate.

*For each provisional recommendation:*

- *Do you support the stated objective of the recommendation?*
- *Do you agree with the assessment of the recommendation or if not, why not?*
- *What alternative or additional recommendations could achieve the desired objective in a way that meets the assessment criteria?*

These are dealt with sequentially below.

*Objective A – increased choice of auditor for public interest entities*

*1. The FRC should promote wider understanding of the possible effects on audit choice of changes to audit firm ownership rules, subject to there being sufficient safeguards to protect auditor independence and audit quality. (A.1.1, pages 16-17)*

Agreed. We consider it is worth referring to provisional recommendation 11 in the context of safeguards.

***2. Audit firms should disclose the financial results of their work on statutory audits and directly related services on a comparable basis. (A.1.2, pages 18-19)***

We agree with the provisional recommendation and would suggest that guidance should be developed to ensure that there is comparable reporting.

***3. In developing and implementing policy on auditor liability arrangements, regulators and legislators should seek to promote audit choice, subject to the overriding need to protect audit quality. (A.1.3, pages 20-21)***

We agree with this provisional recommendation. Clearly, it will be important for the FRC's working group on Liability Limitation Agreements to take this into account.

***4. Regulatory organisations should encourage appropriate participation on standard setting bodies and committees by individuals from different sizes of audit firms. (A.1.4, pages 22-23)***

The objective of giving non-big four firms opportunities to be recognised for the skills they have is valid. The recommendation to encourage participation from different sized firms is exactly the right position to take. However, membership of these bodies should continue to be on the basis of an individual's merits and contribution to the standard-setting process, and those people who consider they have the appropriate skills should be encouraged to apply for membership.

***5. The FRC should continue its efforts to promote understanding of audit quality and should promote greater transparency of the capabilities of individual audit firms. (A.2.1, pages 26-27)***

The objective of achieving transparency on the capabilities of audit firms is one which we consider boards and investors would greatly appreciate. With better information in the marketplace, boards and investors will be able better to benchmark the alternative audit providers and make better decisions on auditor selection.

***6. The accounting profession should establish mechanisms to improve access by the incoming auditor to information relevant to the audit held by the outgoing auditor. (A.2.2, pages 28-29)***

The Statutory Audit Directive (Article 23) will require a statutory auditor that is replaced by another statutory auditor to provide the incoming statutory auditor with access to all relevant information concerning the audited entity.

The ICAEW is developing Audit Regulations and protocols to facilitate access to the relevant information by incoming auditors. We consider this will contribute to a reduction in the risk associated with first year audits.

***7. The FRC should provide independent guidance for audit committees and other market participants on considerations relevant to the use of firms from more than one audit network. (A.2.3, pages 30-31)***

We believe it is important that priority is given to quality of audits and that in implementing recommendations in this area, nothing is done that could damage audit quality.

***The next three provisional recommendations are directed at improving the accountability of boards for their auditor selection decisions.***

***8. The FRC should amend the section of the Smith Guidance dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor re-selection decision. (A.2.4, pages 32-33)***

We consider that the MPG's provisional recommendation would increase transparency of the auditor appointment process.

***9. When explaining auditor selection decisions, Boards should disclose any contractual obligations to appoint certain types of audit firms. (A.2.5, pages 34-35)***

We believe that auditors should be selected according to their capabilities and not by arbitrary requirements within contractual agreements.

***10. Investor groups, corporate representatives and the FRC should develop good practices for shareholder engagement on auditor appointment and re-appointments and should consider the option of having a shareholder vote on audit committee reports. (A.2.6, pages 36-37)***

We concur with this provisional recommendation. The interests of the company and its stakeholders are best served by the selection of the most appropriate auditors, and anything that enables boards to make the selection decision with appropriate shareholder engagement.

***11. Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse impact on auditor choice when compared to the benefits to auditor objectivity and independence. (A.3.1, pages 40-41)***

We agree with this provisional recommendation.

***12. The FRC should review the Independence section of the Smith Guidance to ensure that it is consistent with the relevant ethical standards for auditors. (A.3.2, pages 42-43)***

Agreed.

***Objective B: Reduced risk of a firm leaving the market without good reason***

***13. Regulators should develop protocols for a more consistent response to audit firm issues based on their seriousness. (B.1, pages 47-48)***

We agree with this provisional recommendation.

***14. Every firm that audits public interest entities should comply with the provisions of the Combined Code on Corporate Governance with appropriate adaptations or give a considered explanation if it departs from the Code provisions. (B.2, pages 48-49)***

We concur that corporate governance of audit firms is important to companies and their stakeholders. Further, we consider that a regime of “comply or explain” is acceptable, as for listed companies. However, there are significant differences between listed companies and audit firms and the needs and expectations of their respective stakeholders. Therefore, as suggested by the MPG, careful consideration should be given to how the Code can be adapted to audit firms.

***Objective C: Reduced uncertainty and disruption costs in the event of a firm leaving the market***

***15. Major public interest entities should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning. (C.1, pages 52-53)***

We agree with this provisional recommendation.

Deloitte & Touche LLP  
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