

**National Office**

**Grant Thornton UK LLP**  
Chartered Accountants  
UK member of  
Grant Thornton International

Our Ref NJJ/SAM/0507  
Your Ref MPG INTERIM

Julian Rose  
Secretary, Market Participants Group  
Financial Reporting Council  
5th Floor  
Aldwych House  
71-91 Aldwych  
London WC2B 4HN

For the attention of Julian Rose

4 July 2007

Dear Mr Rose

**CHOICE IN THE UK AUDIT MARKET - INTERIM REPORT OF THE  
MARKET PARTICIPANTS GROUP**

We welcome the opportunity to respond on the above named report.

Grant Thornton is a large financial advisory/accountancy firm in the UK. We are the UK member of Grant Thornton International, one of the world's leading international organisations of independently owned and managed accounting and consulting firms, which operate in 113 countries and employ over 25,000 people worldwide.

We support the work of the Market Participants Group (MPG), and we support the approach taken by the MPG and the Financial Reporting Council (FRC) in seeking views from stakeholders. We believe that the 15 interim recommendations taken as a whole represent a positive step towards addressing the concerns of stakeholders, especially share owners, of excessive concentration in the public company audit market. In order to maintain momentum for change we would encourage the FRC to publish a time frame for implementation, and measures of success for its package of recommendations.

**Principles which underpin the debate on auditor choice**

In contributing to the debate on auditor choice Grant Thornton has adopted three underlying principles, namely:

- audit quality - the most important factor is that the provision of high quality audits for UK companies must be safeguarded in the short term and sustained in the long term
- share owner needs - the debate on choice in the public company audit market creates tensions between different stakeholders, but it is the needs of share owners, who are the ultimate users of audited information, which should be given primacy

Grant Thornton House  
Melton Street  
London NW1 2EP  
T +44 (0)20 7383 5100  
F +44 (0)20 7383 4715  
DX 2100 EUSTON  
www.grant-thornton.co.uk

Grant Thornton UK LLP is a limited liability partnership registered in England and Wales: No.OC307742. Registered office: Grant Thornton House, Melton Street, Euston Square, London NW1 2EP. A list of members is available from our registered office.

Grant Thornton UK LLP is authorised and regulated by the Financial Services Authority for investment business.

- market-led solutions - reliable audits depend in part upon building effective relationships between auditor and executive directors; non-executive directors; board committees with oversight responsibilities such as audit committees; and other operational management; and market solutions to improve choice are more likely to foster these effective relationships.

### **Audit firms have a vital role to play in improving choice**

While we support the FRC's work, we recognise that those audit firms, such as Grant Thornton, that have signalled their enthusiasm to increase their presence in the larger corporate audit market need to invest and be seen to invest in their audit offering so as to continue to persuade more audit committees to use their services.

The transaction to combine the firms of Grant Thornton and Robson Rhodes has been driven in part by the desire to achieve greater depth so that we can engage on a sustained basis with the larger corporate audit market. We have also invested in dedicated resource so that we can more effectively communicate with audit committees of larger corporates, which means that we are better informed of their concerns and needs and those audit committees in turn are better informed of the capabilities, breadth of services and reach of Grant Thornton and the Grant Thornton International organisation.

The Grant Thornton International organisation has also made significant investments in various key financial centres across the world to ensure that the needs of larger corporate clients are met. These investments include the appointment of a global leader of assurance, the strengthening of the secondment programme particularly into emerging markets, and measures to increase the depth of resources of member firms in countries such as China, India, Russia and Brazil.

### **We strongly support the work of the FRC to increase auditor choice over time**

Overall, we strongly support the package of measures proposed by the MPG. None of these measures in isolation is likely to have a dramatic impact upon the structure of the audit market in the short term. However, taken together over time they are likely to increase the awareness and quality of information used by those responsible for auditor appointment/re-appointment decisions to help them make effective decisions.

We believe that market solutions to the choice problem are likely to have more enduring impact than shorter term regulatory measures; however it will take time for market solutions to prove effective. The FRC runs the risk of its work being undermined by parties who criticise an apparent lack of progress. Therefore we encourage the FRC to take the initiative to promote what it believes success will look like. The FRC has already made important contributions, in particular being a catalyst for key share owners and their representatives to make clear statements about their views<sup>(1)</sup>.

We acknowledge that success measures and timescales are difficult areas. One success measure might include a survey of attitudes of Chief Financial Officers, Financial Directors and audit committees toward auditor appointments. We believe that the FRC could achieve

an early success by instituting a working group of other regulators, who are similarly seeking to improve auditor choice. Grant Thornton believes that there is an international role for the FRC in reaching out to others who are also examining auditor choice in other jurisdictions. We encourage the FRC to take the lead on this topic and, by coordinating its work with other key regulators and with important share owners, we believe the FRC can influence the achievement of effective solutions in important key markets.

### **We strongly support the FRC's view that auditor choice is a real and important problem**

While a small number of commentators question whether auditor choice is a problem, there is widespread evidence that most stakeholders would prefer listed company audits to be spread more widely between audit firms. In addition to the evidence provided from the Oxera Consulting study (2), auditor choice is being examined in the EU by the European Commission and in the US by the Paulson Committee; the recent survey of members of the International Corporate Governance Network (whose membership includes leading global institutional investors) showed that a clear majority would welcome greater auditor choice and many felt that competition in the audit market was a problem. Based on this evidence it is clear that auditor choice is a real and important problem.

### **Influence exerted by intermediaries should be transparent**

We believe the MPG has correctly identified the role played by intermediaries as having an important influence on auditor selection decisions, and we believe that it would benefit all parties if there were to be transparency in this area. Paul Boyle, FRC Chief Executive and MPG Convener, said at the MPG stakeholder meeting on 10 May that "...the practice seems to have evolved of using the expression 'Big Four' as a shorthand way of saying high quality audits, and they are not necessarily synonymous phrases...". Unfortunately, Grant Thornton believes that many intermediaries do not take this as their starting point. Policy disclosure on auditor selection in the public domain would give the excluded audit firms an opportunity to address misconceptions about audit quality that intermediaries might have.

We do not believe that recommendation 9 "... Boards should disclose any contractual obligations to appoint certain types of audit firms" is the most effective way of dealing with the role of intermediaries, and certainly any disclosure by issuers should also cover non contractual influences.

The influence of intermediaries tends to be exerted before any contractual arrangements are finalised. For example, some standard *draft* commercial banking agreements include references to the use of certain audit firms, and although those draft clauses are often changed the influence on auditor appointment has nevertheless been exerted before the contractual arrangement is fixed. Similarly, when issuers release tenders for, say, new corporate finance advisors, those advisors will sometimes comment on the audit firm during the tender process, so that again the influence is exerted before an engagement between the issuer and the intermediary is contracted.

Whilst it is quite proper for other stakeholders to express their views on auditor selection, we believe, as this is a clear public interest matter, that there should be transparency (eg through publication) of intermediaries' policy positions on auditor appointment, where such a policy exists. This would have the benefit of ensuring that other stakeholders can understand the influences being exercised and allow audit firms to understand the needs of those intermediaries. It would also reduce the risk that individual officers of an intermediary will exert influence for reasons other than audit quality, say, at the extreme, where influence might be governed by the desire for reciprocal business.

The FRC might usefully engage with representative bodies of the commercial and investment banking sectors to press for such disclosure by its members. It also seems to us reasonable that such bodies should make announcements similar to institutional investors <sup>(1)</sup> with the sentiment "our members should not just promote individual firms, but instead should support the appointment of audit firms of quality".

If you have any questions on this response, please contact Steve Maslin (phone: 0870 991 2736; email [Steve.Maslin@gtuk.com](mailto:Steve.Maslin@gtuk.com)) or Nick Jeffrey (phone: 0870 991 2787; email [Nick.Jeffrey@gtuk.com](mailto:Nick.Jeffrey@gtuk.com)).

Yours sincerely

Steve Maslin  
Head of External Professional Affairs  
For Grant Thornton UK LLP

Direct T: 0870 991 2736  
Direct F: 0870 991 2736  
E: [Steve.Maslin@gtuk.com](mailto:Steve.Maslin@gtuk.com)

*(1) The Association of British Insurers (ABI) reiterated in June 2006 that public companies should "choose an auditor from outside the Big Four, if this suits their circumstances". In July 2006, in support of the ABI's letter, a group of investors made up of Co-operative Insurance Society, F&C Asset Management, Hermes Investment Management, Morley Fund Management, Railpen Investments and Universities Superannuation Scheme, wrote an open letter to audit committee chairs of all listed companies in which they said "we do not believe that all big companies need to use the Big 4 firms as their auditors. On the contrary, we would welcome more companies in which we invest accessing the skills and capabilities of the next tier of audit firms".*

*(2) "Competition and choice in the UK audit market", prepared for Department of Trade and Industry and Financial Reporting Council, April 2006*

## APPENDIX - GRANT THORNTON'S RESPONSE TO SPECIFIC QUESTIONS RAISED IN THE REPORT

*Question 1: Do you support the three criteria used for assessing the merits of the provisional recommendations, as shown [on page 11]? If not, please propose preferred criteria.*

**Grant Thornton view:** Yes.

*Question 2: 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?*

**Grant Thornton view:** We support all 15 recommendations, and have some comments to make on certain specific recommendations as follows:

- **recommendation 1** (audit firm ownership) - we support the recommendation, but anticipate that it will have limited effect in the short term unless the other "perception" issues set out in the report are tackled successfully. In this regard, liability reform will be seen as a barrier to entry by potential investors in audit firms.
- **recommendation 5** (FRC to promote understanding of audit quality and capabilities of individual audit firms) - we support the efforts by the FRC (and others) to promote greater transparency of audit firms. We note that in the US the leading figures from key commentators (such as Kyla Gillan and Lynn Turner) have stated publicly that they have not detected any systemic differences in the quality of audits of the leading firms outside the big 4 and those of the big 4 themselves.
- **recommendation 6** (improve access to predecessor audit papers) - we support this recommendation, but anticipate that it will have limited effect on auditor choice because it has limited impact on those who make or influence auditor selection decisions.
- **recommendation 9** (disclose contractual obligations to appoint only certain named audit firms) - we support the recommendation, but in addition we would support a recommendation for leading investment and commercial banks to disclose their policy on audit firm appointment; the recommendation for disclosure by issuers themselves should not be restricted to *contractual* obligations.
- **recommendation 11** (review of ethical standards) - we support this recommendation provided this does not lead to relaxation of the provisions relative to the IFAC Code of Ethics.
- **recommendation 14** (audit firms comply with the Combined Code) - we broadly support this recommendation, but believe that a Code that is adapted for audit firms could be more helpful, possibly involving a debate on the suitability of forthcoming disclosures required of public interest auditors by the 8th Directive.

*Question 3: Are there other characteristics of a more efficient market which should be considered for inclusion in the report? What additional recommendations could contribute to the achievement of these other characteristics?*

**Grant Thornton view:** The key characteristic of an efficient market is that market-led decisions are made by stakeholders using the readily available information that they need. In our view the FRC is one of the key bodies able to facilitate market-led decisions, which does not necessarily mean rule making, but does entail encouraging open debate and facilitating development of good practice.