



Via Email

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July 6, 2007

Dear Mr Rose,

*Consultation on the Interim Report of the Market Participants Group on Choice in the UK
Audit Market (the "Report")*

We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of institutional and private investors, corporations and advisors from 38 countries with capital under management in excess of US\$10 trillion. The aim of the ICGN is to contribute to raising standards of corporate governance through the exchange of ideas and information across borders and development of best practices. Information about the ICGN, its members and its activities is available on our website: www.icgn.org.

The purpose of the Accounting and Auditing Practices Committee is to address and comment on accounting and auditing practices from an investors' and shareowners' perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world.

Our members include a significant number of UK institutional and private investors. Also, among our non-UK members, many hold significant portfolio investments in UK public companies. Indeed, many of our members provide a permanent base of equity capital to the UK markets.

We share the view that there is concern amongst institutional investors 'over the uncertainty and costs that could arise in the event of one or more Big Four firms leaving the market.' We are also concerned that the scope for disciplinary measures against and criminal prosecution of a Big Four firm may already be adversely impacted by of the structure of the market. However, we believe the larger firms must be subject to the same standards as all

other accounting firms. The lack of choice may adversely impact audit quality and hence the reliance that investors can place on audited financial statements. We agree with the view that the ‘risk could be mitigated through increased choice of auditors.’

While in some industries, a choice of four suppliers may be perfectly acceptable, we do not believe that such a choice is sufficient with respect to audit. We believe that such a small choice may not only adversely impact audit quality (see above) and increase cost, but it can also be an impediment to innovation.

In consequence, we wish to thank the Market Participants Group (the “Group” as defined on page 3 of the Report) and the Financial Reporting Council (FRC) for their initiative to determine possible actions that market participants could take to mitigate the risks arising from the characteristics of the market for audit services to ‘public interest entities’ (“PIEs,”).

ICGN supports the criteria used for assessing the merits of provisional recommendations as set out on page 11 of the Report. Rather than commenting on each provisional recommendation, we would like to point to the following major issues in the report:

- The first issue relates to promoting the entry into the market of additional firms with the capabilities of auditing multi-national companies as required by PIEs (Item A.1.2. on pages 18 and 19). Provisional recommendation 2 is as follows: ‘Audit firms should disclose the financial results of their work on statutory audits and directly related services on a comparable basis.’
- A second issue relates to non-Big Four firms’ motivation and incentive to be appointed as auditor of more PIEs (Item A.1.3. on pages 20 and 21). Provisional recommendation 3 is as follows: ‘In developing and implementing policy on auditor liability arrangements, regulators and legislators should seek to promote an expanded choice of qualified auditors.’
- A third issue relates to enabling a more accurate perception of capabilities of many audit firms (Item A.1.4. on pages 22 and 23). Provisional recommendation 4 is as follows: ‘Regulatory organisations should encourage appropriate participation on standard setting bodies and committees by individuals from different sizes of audit firms.’
- A fourth issue relates to companies willing to appoint auditors from more than one network including non-Big Four firms (Item A.2.3. on pages 30 and 31). Provisional recommendation 7 is as follows: ‘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 final issue related to increasing shareowner engagement on auditor selection (Item A.2.6. on pages 36 and 37). Provisional recommendation 10 is as follows: ‘Investor groups, corporate representatives and the FRC should develop good practices for shareholder engagement on auditor appointment and reappointments and should consider the option of having a shareholder vote on audit committee reports.’

We have set out below our comments regarding these recommendations following the structure suggested by the Group and the FRC:

A.1.2 – Provisional Recommendation 2

We support the stated objective of the recommendation.

We agree that this recommendation complements the recommendation to change audit firm ownership rules (Item A.1.1. on pages 16 and 17). We would rate the impact on quality as likely significant over time (as opposed to ‘limited direct effect’) on the premise that improved information should lead audit firms into allocating more senior time into statutory audits. We are somewhat surprised by the assessment of cost whereby the Group seems to indicate that the Big Four firms may need to revamp their systems to allocate costs to statutory audit work. We would hope that the firms already have such information as part of their management information systems.

We would expand the requirement beyond financial results and require the disclosure of key performance indicators to foster greater audit quality. Audit firms should disclose minimum qualifications required by clients to assist other audit firms in building these skill – sets. Possible other key performance indicators that could be disclosed are continuity of staffing per engagement, percent of training dollars spent on staff compared to the fees received for the audit. We note this may already be captured under Provisional Recommendation 5 (Item A.2.1. on pages 26 and 27). We enclose a copy of the recent Survey of Opinion on Financial Reporting and Auditing conducted by the ICGN and the Global Public Policy Committee (GPPC) (the “[Survey](#)”, [Attachment](#)) which highlights disclosure (Quality Control, Governance, Finances, Corporate Social Responsibility & Other) by audit firms that would be of value to investors -Slide 3.4. 76 ICGN members from around the world contributed to the survey. They have assets under management totalling US\$2.5 trillion.

A.1.3 – Provisional Recommendation 3

We support the stated objective of the recommendation but do not agree that limiting liability is an appropriate way to achieve the stated objective. We would support proportional liability for a firm’s culpability.

We are concerned, irrespective of assurances to the contrary by the Group, that limiting liability, based on policy developed and implemented by regulators and legislators, may adversely impact audit quality.

Drawing on the key points from the stakeholder meeting held on 10 May 2007¹, we would recommend that the Group and the FRC should consider in more detail the case for audit firms to hold minimum levels of capital. Unfortunately, most audit/accounting firms tend to payout the majority of their profits each year and do not build a significant base of equity to weather financial storms.

¹ A stakeholder meeting was hosted by the FRC at 4pm in London to discuss the MPG’s interim report and initial views on the consultation questions.

A.1.4 – Provisional Recommendation 4

We support the stated objective of the recommendation and are concerned about the role and influence of the Big Four firms in shaping regulation, including standards ([Attachment - refer to Slide 3.3 of the Survey](#)).

We agree with the assessment of the recommendation. However, we believe that participation on standard setting bodies, including interpretation and advisory committees, is particularly important with respect to international standard setters such as the International Accounting Standards Board (IASB), the International Auditing and Assurance Standards Board (IAASB), and the International Ethics Standards Board for Accountants (IESBA). We therefore believe that the recommendation and its assessment should expand beyond the APB and the ASB.

Because of the importance of European Union law in determining applicable standards (e.g., Regulation 1606/2002 on the application of IFRSs, the new Eighth Company Law Directive on statutory audit), the Group and the FRC may wish to recommend that the European Commission takes the leadership on these issues by conducting a review of the governance of these international standard setting bodies with a view to ensure that they are representative of the public interest, which would include providing for participation by non-Big Four firms in standard setting activities.

A.2.3 – Provisional Recommendation 7

We support the stated objective of the recommendation.

We agree with the assessment of the recommendation. We rate this recommendation as particularly important based, among others, on the Survey, where over 80 per cent of respondents expressed concerns about the level of audit quality in emerging markets ([Attachment - Slide 2.6 of the Survey](#)).

We also believe that the recommendation could have much more of a positive impact on audit quality if audit committees have access to firm-specific reports from quality inspection bodies (such as the Audit Inspection Unit or peer reviews) from the jurisdictions where their company has material operations.

A.2.6 – Provisional Recommendation 10

We agree with Provisional Recommendation 10 in the development of good practices for shareowners' engagement on auditor appointments and reappointments. ICGN's Statement on Global Corporate Governance Principles supports Provisional recommendation 10 on allowing shareowners to vote on the reappointment of auditors to support or oppose the re-election of auditors through annual ratification of the auditor.

The ICGN is reviewing its audit principles and at present the Accounting and Auditing Practices Committee does not support a vote on the audit committee report. Although the provisional recommendation also states the consideration of an option to having

a shareowner vote on audit committee reports; we question whether such a vote would improve the quality of reporting by audit committees and whether such a vote would contribute to the objective of achieving increased choice in the UK audit market.

Conclusion

In closing, we reiterate our genuine appreciation for the Group's and FRC's leadership in this matter. We welcome in particular the fact that this initiative provides a useful contribution to the wider international debate on audit market concentration as we believe the ongoing debate around quality and choice is important internationally. We request the FRC foster an international debate with its provisional recommendations because auditor concentration affects the audit market worldwide. We therefore copy our response to the European Commission, the U.S. Government Accountability Office, and the U.S. Securities and Exchange Commission.

Thank you for giving us the opportunity to comment. If you would like to discuss any of these points, please do not hesitate to contact Anne Simpson, our Executive Director at +44 207 612 6098 or execdirector@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,



Mark Anson
Chairman of the ICGN
Board of Governors



Christianna Wood
Chair of the ICGN Accounting
and Auditing Practices Committee

cc: Christopher Cox, Commissioner, U.S. Securities and Exchange Commission
Jörgen Holmquist, Director General, DG Internal Market and Services, European Commission
David M. Walker, Comptroller General of the United States, U.S. Government Accountability Office