



**The Hundred Group**  
of Finance Directors

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Financial Reporting Council  
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Dear Julian

**Consultation Paper – Choice in the UK Audit Market  
Interim Report of the Market Participants Group**

I am pleased to submit the comments of The Hundred Group of Finance Directors on the above discussion paper. We appreciate the opportunity to contribute feedback to this important subject.

The Hundred Group of Finance Directors represents the views of the finance directors of the UK's largest corporates drawn largely, but not entirely, from the constituents of the FTSE100 Index. Our members are the finance directors of corporates whose market capitalisation collectively represents over 80% of that of corporates listed on the London Stock Exchange.<sup>1</sup>

Our overall comments are set out below. A more detailed response is dealt with in the Appendix.

***Audit choice is an important issue but should not be promoted at the expense of audit quality***

We support the Market Participants Group's formation to review audit choice and welcome the emphasis on market driven solutions which do not undermine audit quality to further widen audit choice.

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<sup>1</sup> While this letter expresses the views of The Hundred Group of Finance Directors as a whole, such views are not necessarily those of individual members or their respective employers.

***A degree of audit choice currently exists for most large corporates but we would welcome a relaxation of the independence rules***

The current market for audit services for large corporates is a complex one and in some respects is unsatisfactory.

For example, the choice of audit provider can be restricted by independence rules especially where a public entity is US listed and there may only be one other viable alternative audit provider. Hence, a widening of choice (subject to maintaining quality) in some cases would be welcome.

A widening of choice in this instance could be achieved by regulators globally reviewing whether the existing independence rules are excessively stringent and have acted to restrict choice against the public interest. More scope could be given to Audit Committees to decide whether or not an audit firm's independence is compromised in their particular situation subject to certain principles and safeguards.

However, we would note that the current audit market for most large corporates does allow a degree of choice. The audit market that does exist is subject to a healthy degree of competition based on audit tender activity and pricing.

We recognise there is a real risk that a reduction in choice and competition would occur in the event that the Big Four were reduced in number. However, we do not believe it is in the market's interest to prevent a reduction in audit choice at all costs. Equally, we do not believe that regulators should precipitate such an event through disproportionate regulatory activity.

We do not believe that the current amount of audit provider choice is so restrictive that it requires other non-Big Four audit firms to be forced or unduly incentivised to compete in this market. We would not support any moves to fragment the existing Big Four firms to create an artificial increase in choice.

***The Hundred Group supports market driven change rather than regulatory intervention. The Hundred Group does not support the idea of imposing a joint audit requirement on corporates***

We welcome the emphasis that the Market Participants Group has placed on market driven change.

We believe any regulatory reform to increase audit choice by artificially increasing the number of audit firms could potentially diminish audit quality whilst also potentially increasing costs.

For instance, we would be especially concerned that any measure to introduce joint audits through regulation could have the effect of a marked reduction in audit quality due to, for example, the degree to which (i) responsibility between the audit firms is established (especially in the event of an issue arising post an audit opinion being given), (ii) the level of communication required in practice between audit firms to communicate the audit evidence obtained without excessive cost and (iii) the potential to reduce competition given the number of audit appointments could double in number (if not in size, although we would envisage a substantial increase in cost for no discernible benefit to the capital markets).

We acknowledge joint audits can be useful in certain circumstances and are supportive of the option to appoint more than one auditor in such cases.

***The Hundred Group supports a high quality audit profession which will help maintain market choice***

We believe that auditing has to remain an attractive profession to avoid a reduction in audit quality and in time, audit choice. Market driven change is more likely to create a sustainable audit model in the longer term.

We believe that the UK has a very good auditing profession and it is incumbent on the UK regulatory bodies to maintain the attractiveness of the auditing profession.

Examples of short term improvements which could be made to maintain the attractiveness of the profession would include:

- An increase in the audit partner rotation period from 5 years to 7 years - the current model appears to be unsatisfactory from both the perspective of large corporates and audit partners. In some instances, the length of time it takes for an audit partner to get to really understand the dynamics of the underlying business can be a substantial proportion of the five year rotation period and this cannot enhance audit quality. This issue of understanding the business naturally increases in relevance as the underlying business becomes larger and more complex in nature;
- Introducing a measure for new partners to facilitate their understanding of a business, so that they can be allowed to work on an audit for a limited time – perhaps two years - without this time qualifying towards their rotation period;
- Review the two year cooling off period for auditors to join clients – the current regime diminishes the attractiveness of the profession by restricting the opportunities to work in commerce should the partners choose.

Please feel free to contact me if you wish to discuss our comments.

Yours sincerely

**Philip Broadley**  
**Chairman**  
**The Hundred Group**

## Appendix

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

<b>Effectiveness:</b>	<b>Whether actions would, when combined with others, contribute to achieving the intended outcomes:</b>
<b>Quality:</b>	<ul style="list-style-type: none"><li>• <b>Whilst at least maintaining audit quality</b></li></ul>
<b>Cost:</b>	<ul style="list-style-type: none"><li>• <b>At a cost which is proportionate to the likely benefits and which is lower than the alternatives offering equivalent benefits.</b></li></ul>

We support the criteria used. We believe audit choice is an important issue but should not be promoted at the expense of audit quality.

We support the Market Participants Group's formation to review audit choice and welcome the emphasis on market driven solutions which do not undermine audit quality.

However, we do have concerns that the number of audit related initiatives may perversely serve to undermine the perception of audit quality with a detrimental impact on the efficiency of the capital markets. We support the FRC in continuing to clearly articulate the purpose of each consultation at each stage of the process.

### Provisional recommendations

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 alternate or additional recommendations could achieve the desired objective in a way that meets the assessment criteria?**

The Hundred Group supports the recommendations for the most part but a widening of audit choice is more likely if an international approach is agreed

Our comments have been made in the context that this is a UK regulatory consultation. A significant widening of audit choice is unlikely without an international consensus amongst regulators and market participants.

We fully support the FRC's approach in engaging with international regulators on this matter as this is likely to be the most efficient way to effect change.

We agree that no one initiative or market participant is likely on its own to make a major difference so welcome the range of ideas that the Market Participant Group have suggested.

As noted, we agree in principle with the suggestions made and the assessment of each recommendation for the most part subject to the points of clarity which we note below.

*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 (A2.1.)*

As noted in our response with regards the discussion paper on Promoting Audit Quality, we believe that the audit profession perhaps together with the help of other market constituents (including the FRC) need to more clearly define what “audit quality” should mean and provide the qualitative and quantitative measures that could be used to assess the “audit quality” definition. We support the FRC’s efforts in this area but believe it is incumbent on the individual audit firms to support this initiative.

We would note that “*the development of enhanced information on the results of independent audit inspections carried out by the Audit Inspection Unit*” (page 27) seems at odds with the FRC’s previous position on Audit Quality Monitoring.

Whilst we accept the House of Lords extended the Freedom of Information Act remit to the work of the Audit Inspection Unit and therefore the FRC needs to work within the law, the Hundred Group, amongst a number of recipients, did not favour any publication of reports on individual audit firms being made either with reference to specific corporate audits or where the Oversight Board’s public criticism could adversely affect the audited corporates of that individual audit firm by association.

Furthermore, we believe that it is incumbent on the FRC to clarify what is meant by the statement as arguably even public censure of just one audit (which may not reflect the function of an individual audit firm as a whole) could in fact reduce audit choice if audit risk is perceived to increase. We continue to hold the view that the role of public monitoring and reporting by the AIU is supported by the Hundred Group and the threat of public disclosure of persistent audit failure should be a sufficiently strong deterrent to ensure audit quality is maintained and improved.

*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.)*

We would have thought that public entities are a key constituent for establishing such a mechanism from both the perspective of how they may be able to facilitate any such mechanism (if at all) and how they would be impacted. In principle, the Hundred Group is supportive of the idea but the practical application of such a mechanism would need to be supported by the public entity involved. This may be a recommendation where the FRC would need to monitor and ensure adequate consultation takes place (including public entities) to ensure any mechanism is fit for purpose.

*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.)*

The interim report states (on page 31) that: “Where the group auditor plans less reliance on the work of an auditor from outside of its own network or where differences in audit methodologies require additional procedures there can be some adverse cost implications through the duplication of audit effort. The group auditor should be able to justify this to the audit committee on the basis of delivering audit quality rather than attributing this as a specific requirement of auditing standards.”

We believe this sentiment is misplaced. The effort required by an auditor when relying on an auditor outside of its own network is almost certainly going to be greater. This extra effort does not necessarily guarantee audit quality and given “audit quality” does not yet appear to have been objectively defined, is unlikely to be an argument which can be proved by the auditor.

Given the choice between an auditor that can be held to account for actions of its network audit firms and the use of an auditor outside of the group auditor’s network (together with the fact that the former will be at an invariably cheaper cost due to communication and other forms of duplication being eliminated), the idea that justification of the use of a auditor outside of the group auditor’s network can be used on the basis of audit quality will in most cases be implausible.

Whilst we support the FRC issuing guidance where corporates choose to have more than one auditor as this may help in more cases than present, the limitations of this recommendation need to be recognised.

**We would be especially concerned that any measure to introduce joint audits through regulation could have the effect of a reduction in audit quality as noted in the main body of our letter.**

*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 selection decision.*

Some form of guidance may well be helpful provided it is not overly prescriptive. Some argued at the third stakeholder meeting held by the FRC on 10<sup>th</sup> May that this could inhibit audit rotation which we feel is slightly misguided as Boards should and do, in our experience, have the courage of their convictions including those relating to choice of auditor. We would note that this is an area of disclosure which may become boilerplate given the lack of a definition of what constitutes audit quality.

*9. When explaining auditor selection decisions, Boards should disclose any contractual obligations to appoint certain types of audit firms.*

We are aware from the stakeholder meeting that some constituents believe that it may be more appropriate to delete the word “contractual” and disclose any obligations to appoint certain types of audit firms. We would not disagree as in principle there could conceivably be a constructive but non-contractual obligation that exists.

*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.*

We believe good practices already exist and whilst there is always room for improvement, we think it is important any change in this area are subject to considered consultation. There is a significant danger that an “optional” shareholder vote quickly becomes “best practice” from a compliance perspective for institutional shareholders without necessarily adding any real change to the current level of market choice.

We understand given comments made at the third stakeholder meeting held by the FRC that this recommendation is designed to highlight the need for providing shareholder insight rather than instigating a shareholder sub-committee. A degree of practical common sense suggests that any additional measure which increases shareholder insight without undue effort or cost is worthwhile.

*11. Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse effect on auditor choice when compared to the benefits to auditor objectivity and independence.*

We believe that non-assurance work which may impair auditor independence is best assessed by an audit committee using a set of principles that reflects not only the nature of the work being undertaken (including the risk of conflicts) but also how material it is.

The independence rules that exist for auditors are especially restrictive for those corporates who are listed in the US. Given these tend to be larger, more complex businesses, audit choice is especially limiting if one takes the view that the non-Big Four firms do not have the geographical coverage or capability to perform such an audit.

In principle, we support an increase of the rotation period of the lead audit partner from five to seven years without the use of an option. We do not believe creating circumstantial rules (such as change in the finance director at a corporate) is practical or relevant in determining whether the option should be available or not. There is either a risk to independence, in which case the rotation term should remain at five years, or not.

*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.*

There is a risk that the communication with shareholders through the audit committee report may become a boilerplate disclosure. We would recommend that any such disclosure is only made where there is a reasonable risk of such a withdrawal or where there is an absence of market choice or some other factor which would merit the issue being brought to the shareholders attention.

**Are there any 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?**

***Audit choice is an international, multi-constituency issue***

As noted above, our comments are made in the context that this is a UK regulatory consultation. Significant improvement in audit choice is unlikely without an international consensus amongst regulators and market participants. We fully support the FRC's approach in engaging with international regulators on this matter as this is likely to be the most efficient way to effect meaningful change and a widening of audit choice.

***Market driven changes to widen audit choice in the short term are more likely to be achieved for corporates outside of the FTSE100***

The Hundred Group believes the recommendations taken as a whole could increase market choice but are more likely to have the greatest impact in the medium sized corporate market.

There are some fundamental issues which may need to be addressed as a package to widen audit choice for large public interest entities which perhaps are not able to be resolved through the Market Participant Group's recommendations which they duly acknowledge.

Examples of these issues include but are not limited to:

- Unduly prescriptive independence rules – the current rules on what constitutes a potential independence risk can be quite onerous and adversely affect choice for large corporates, especially those that are US registrants. A review of whether the independence rules are fit for purpose could be undertaken. There is enough experience to suggest that the independence rules whilst trying to promote the right corporate behaviour are having unforeseen consequences including potentially a significant reduction in market choice when compared to the risk of a breach of independence.
- Risk profile of auditing large public interest entities – the degree of regulation that exists for such large public interest entities, whether in terms of compliance with industry standards or regulatory oversight, may hinder all but the largest firms to undertake such audits and take on the associated risk.
- Market expertise – certain industry sectors, especially those within the financial sector, require substantial investment in people, training and systems. The intangible skills of this expertise cannot be acquired easily for corporates let alone audit firms.
- Geographical network coverage – whilst the current Big Four may operate as disparate international networks rather than one corporate body, they appear to have a wider geographical spread and consistency as compared to the mid tier audit organisations which is rightly deemed important for managing the risk of corporate Boards.

We remain unconvinced that the current level of audit choice for FTSE 100 entities is wholly inadequate but naturally, would support the option of more choice rather than less if this could be achieved through market driven change.

***Audit choice is partly a function of the attractiveness of the auditing profession***

We believe that the UK has a very good auditing profession and it is incumbent on the UK regulatory bodies to maintain the attractiveness of the auditing profession.

We recognise there is a big risk that a reduction in choice and competition could occur in the event that the Big Four were reduced in number. We do not believe it is in the market's interest to prevent a reduction in audit choice at all costs but equally do not believe that regulators should precipitate such an event through disproportionate regulatory activity.

We believe that the FRC should not disclose its own contingency plans in the event of an audit firm withdrawing from the provision of audit services but that such planning is undertaken as it is an important part of the FRC's role.

The FRC should maintain its current operating style and encourage other regulators that light touch regulatory activity with proportionate action taken where necessary is more likely to facilitate a high class auditing profession through encouraging the right kind of individual into (and to remain within) the auditing profession.