

RSM Robson Rhodes

2 August 2006

Mr Julian Rose
Financial Reporting Council
5th Floor
71-91 Aldwych
London WC2B 4AN

RSM Robson Rhodes LLP
30 Finsbury Square, London EC2P 2YU
United Kingdom
T: +44 (0)20 7184 4300 F: +44 (0)20 7184 4301
www.rsmi.co.uk

Our Ref: AC/PLS

Dear Sir

Urgent need to enhance real choice in the UK audit market

Introduction

- 0.1 We welcome the joint decision of the Financial Reporting Council (FRC) and the Department of Trade and Industry (DTI) to commission the report by Oxera on 'Competition and Choice in the UK Audit Market' and the FRC's subsequent decision to publish its discussion paper on 'Choice in the UK Audit Market'.
- 0.2 Our response to each of the seven questions posed in the discussion paper is set out below with the paragraph numbering corresponding to the related question.
1. **Should the focus of debate be on the degree of choice in the audit services market?**
- 1.1 The issue of how to enhance the degree of real choice in the audit market is one of the most critical facing the business community, the audit profession and the Financial Reporting Council today in relation to the future of auditing. There is currently a once in a generation opportunity to make progress in addressing the substantial decline in choice that has occurred over many years. If it is not seized now it is likely to be many years before the conditions are again as propitious for significant progress to be made.
- 1.2 The issue of choice cannot be successfully considered in isolation from liability reform, a continued focus on audit quality and transparency in the audit inspection process (the subject of another consultation). They are all essential to ensuring systemic stability in the market for the audit of listed and other sizeable public interest entities. They are also all needed if we are to have a vibrant, innovative and competitive audit market responsive to the needs of institutional and private shareholders and which is characterised by high quality audits along with high levels of client service.

RSM Robson Rhodes LLP is a limited liability partnership and is an independent member firm of RSM International, an affiliation of independent accounting and consulting firms.

RSM Robson Rhodes LLP is registered to carry on audit work by the Institute of Chartered Accountants in England & Wales and is authorised and regulated by the Financial Services Authority for investment business.

Offices at: Birmingham, Bristol, Cambridge, Dublin, Edinburgh, Hemel Hempstead, Leeds, Manchester. Registered office: 30 Finsbury Square, London EC2P 2YU at which a list of members may be inspected.
Registered in England and Wales No. 0C304188



INVESTOR IN PEOPLE

1.3 We recognise that in the near term the choice for a modest number of leading companies will be restricted to, at most, the four largest audit firms. Some have suggested that this may involve around 150 companies but this total will not include all members of the FTSE 100. The objective should be to reduce this number significantly over the coming years. As importantly requiring attention, however, is the unduly high degree of concentration amongst the same few firms with respect to the audit of other listed companies. This needs to be significantly reduced. In this instance, the challenge is to determine how real choice from amongst the larger number of audit firms already capable of serving the vast majority of listed companies as auditors can be introduced.

2. What are the most important criteria for evaluating opportunities to minimise risks arising from the level of choice in the audit market?

2.1 In evaluating opportunities for mitigating risks arising from the level of choice in the audit market, our natural preference is for market-led solutions though we believe that their impact should be monitored to check that they are achieving the necessary and expected degree of change within a reasonable timeframe. We would not support promoting choice at the expense of audit quality but believe that choice can be significantly enhanced without this occurring since there are a number of firms like ourselves capable, willing, and ready to take on the audits of additional listed companies.

3. How could you increase the propensity of firms to seek to be major players in the audit market for large companies?

3.1 The introduction of audit liability reform would help to provide a level-playing field between different audit firms when competing for larger listed audits. To be effective, the reform needs to allow proportionate liability as is proposed in the Company Law Reform Bill. It must also ensure that any quantifiable limitation on audit liability on individual assignments is not anti-competitive. In addition to the move to proportionate liability we, for example, support an overall limitation for a given assignment based on a reasonable multiple of the audit fee agreed in respect of it. We would not support a cap based on an unduly high flat rate as this would only benefit the very largest audit firms.

4. How could the propensity of audit committees to purchase audit services from non-Big 4 firms be increased?

4.1 The infrequent intervals at which audits are currently put out to tender means that even if there were an increased willingness to appoint firms from outside the Big 4 as auditors of listed companies it would take a long time for this change to manifest itself in a significant change in the number of audit appointments held by them. More frequent audit tendering would thus help promote more choice in the audit market.

4.2 Audit committees of listed companies should be encouraged to disclose in their annual corporate governance reports how they have complied with the provision in the Combined Code on Corporate Governance which calls on them to review the effectiveness of the audit process. Where companies have not put their audit out to tender for, say, the last seven years they should also be invited to indicate when this last occurred and why they believe this is not needed. We would, of course, fully recognise though that when an audit is put out to tender the company may wish to reappoint the incumbent auditors. Where a listed company does put its audit out to tender there may be merit in asking it to disclose which firms were invited to participate in the tender process. The additional information proposed would enable investors to ask more searching questions of audit committees on issues related to choice in the audit market.

4.3 We wish to emphasise that we fully accept it is our responsibility as a firm interested in further increasing our number of listed audit clients to ensure that potential clients are aware of the high quality services offered by us. We do, however, welcome recent initiatives such as those by the Association of British Insurers and by some institutional investors indicating that they are supportive of companies recognising that there is a range of audit firms from which they can make their choice. There does seem to have been a perception among at least some members of audit committees that a Big 4 firm is the preferred choice of a number of institutional investors and major bankers.

5. Which steps would be most likely to lead to increased choice?

5.1 We have discussed above the steps which we believe would help create greater choice in the audit market. There is no silver bullet. A number of initiatives will be needed and they will need to be consistently pursued over a reasonable period of time. The costs of any of the steps proposed would be very modest compared to those which would be faced were an audit firm to fail due to risks encountered with the present liability regime. In addressing this question, we also believe it is important to consider issues related to transparency covering Audit Inspection Unit reports on individual firms which is, of course, the subject of a separate consultation.

6. What steps could be taken to mitigate the risk of unnecessary withdrawal of a firm from the audit market?

6.1 As discussed, audit liability reform of the kind outlined in this letter is undoubtedly the single most important step that could be taken to mitigate the unnecessary withdrawal of a firm from the market though it is only one factor in positively promoting real choice in the marketplace.

7. What steps could be taken to mitigate the effect of a withdrawal of a firm from the audit market?

7.1 Reducing the high quality of concentration in the audit market for listed companies by the means suggested in this letter would go at least some way to helping mitigate the impact of the withdrawal of a major firm from the audit market.

If you would like to discuss any of the issues raised in this letter further, please do not hesitate to contact Chris Connor, Senior Partner (0207 865 2303) or Anthony Carey, Partner (0207 865 2138).

Yours faithfully

RSM ROBSON RHODES, LLP