

25 July 2006

Mr Julian Rose  
Financial Reporting Council  
5<sup>th</sup> floor  
71-91 Aldwych  
London  
WC2B 4HN

Email: [j.rose@frc-pob.org.uk](mailto:j.rose@frc-pob.org.uk)

Dear Mr Rose

**Discussion paper: choice in the UK audit market**

Thank you for the opportunity to comment on this discussion paper. CIMA has over 155,000 members and students in 155 countries who work across all business sectors. However, as you will be aware, CIMA members cannot conduct statutory audits and therefore view this issue from the perspective of preparers of audited financial statements. On account of this, we believe that CIMA has a valuable contribution to make to the debate.

At this point, however, we should say that we have resisted the temptation to try to arrive at simple solutions to what is an extremely complex and difficult problem. The scale of the issue should not be underestimated and at this stage, the most that may be possible is to identify the questions that need to be investigated more fully. We would acknowledge that some of the suggestions that we have made would need to be fleshed out in more detail. We should also point out that we have not undertaken detailed research into the issue. There are a number of relevant studies in the public domain and we have assumed that the FRC has conducted its own review and analysis of the literature.

CIMA would like to see more competition in the audit market, but to actually achieve this represents a considerable challenge. However, there are a couple of pre-requisites for any remedy :

- First, the solution must reflect the global nature of the issue. It is absolutely crucial that policymakers across the world collaborate effectively to work towards a solution;
- Secondly, the best solution will only emerge from a broad consensus of all the stakeholders in the financial reporting process. We welcome the fact that the discussion paper gives consideration to the role of companies, investors, investment bankers and other key stakeholders. It is essential that these stakeholders are engaged effectively in this consultation process.

While we believe that this consultation process together with the proposed stakeholder meeting will be extremely useful, the complexity of the issue is such that we would recommend that the FRC should then consider commissioning a major consultancy to consider possible solutions. It goes without saying that the appropriate candidates for the work should not include those that are connected (even historically) to any accountancy firm. Given that a major report was commissioned to analyse the state of the market, it seems quite reasonable to us that something on the same scale should be considered to look at possible remedies.

Our responses to the specific questions raised in the discussion paper are set out below.

**Q1 – Do you agree that the focus of the debate should be on the degree of choice in the market for audit services to large public companies rather than other features of this market?**

*It is not clear what this question means in terms of the definition of a large public company and the other features of the market. The focus of the debate should be on the FTSE350 given that this is where there is high concentration. The research that we have seen eg the US GAO report<sup>1</sup> suggests that the most observable impact of consolidation appears to be on choice while the impact of high concentration on fees, audit quality and independence appears to be less conclusive. It would therefore make sense to focus on the degree of choice although the debate does need to take account of other factors.*

**Q2 – What do you regard as the most important criteria for evaluating any opportunities for mitigating risks arising from the level of choice in the audit market?**

*We would agree with all the criteria listed. It might also be helpful to assess whether opportunities for mitigating risks are short-term or long-term in nature. There may be some measures that are appropriate as short-term solutions, but not long-term ones.*

**Q3 - We invite views on how different groups, acting individually or collectively, could increase the propensity of non-Big Four or new firms to seek to be major players in the market for audits of large companies.**

*It is worth noting that the GAO report expresses a pessimistic view on this in that it concluded that market forces are not likely to result in the expansion of the pool of major players in the market for audits of large companies. It also concluded that it was unclear what can be done to address the issue.*

*Again, it might be helpful to distinguish between short and long-term measures.*

*Possible or actual measures include:*

- *Proportionate liability – we note that this has widespread support.*
- *Perhaps it is timely to review the basis of the audit business model. It has been argued that mergers occurred to permit growth due to the dependency on partner-generated capital.*
- *It might be possible to identify particular market segments and limit market shares.*
- *Review of regulatory environment in terms of effect on audit competition. Maybe proposals for all relevant new regulations such as accounting and auditing standards need to include some consideration of their impact on the audit market. Current developments in accounting regulation such as, international accounting standards are resulting in greater complexity and audit firms need larger technical departments as a consequence. This, in turn, contributes to the high barriers of entry to the audit market for listed companies.*

---

<sup>1</sup> United States General Accounting Office – Public Accounting Firms – Mandated Study on consolidation and competition, July 2003

**Q4 – We invite views on how the propensity of companies and their audit committees to purchase services from non-Big Four firms could be increased.**

*Companies and their audit committees will only wish to purchase services from non-Big Four firms if they have sufficient trust in the quality of the services provided. A key issue here is to ensure that information is available to help companies to make considered choices:*

- *The FRC could consider ways of providing improved information by looking at the specific needs of the key players in the financial reporting chain. We note in this regard that the FRC is currently consulting on reporting on audit quality.*
- *In addition, consideration could be given to the development of a code of best practice relating to auditor change to encourage and facilitate auditor change.*

**Q5 – We invite views on the combination of steps that would be most likely to lead to increased choice.**

*Perhaps the best approach would be to create a climate where medium-sized and smaller listed companies feel able to choose non-Big Four firms without adverse reaction from shareholders. Regulators, including the FSA, and business-focussed organisations could all play a key role in persuading businesses and institutional shareholders to reconsider their approach to auditor selection.*

**Q6 – We invite views on steps that could be taken to mitigate the risk of unnecessary withdrawal of a firm from the market.**

- *It is important to balance firms' and individual responsibilities when problems emerge and target sanctions accordingly although of course, it is important to be aware of the moral hazard created by a belief that there are too few firms for one to be allowed to fail.*
- *Again, perhaps the business model needs to be reviewed.*
- *In the event of a problem arising with an audit firm, the regulators and the market would need to ensure provision of accurate and timely information to ensure that a firm did not fail on account of panic and/or misperception of the real situation.*

**Q7 – We invite views on steps that could be taken to mitigate the effects of a voluntary or involuntary withdrawal of a firm from the audit market.**

- *We would suggest that a detailed analysis of the likely impact of what would happen if an audit firm left the market should be undertaken as soon as reasonably practicable. In this regard, we would recommend that a number of scenarios should be created. Possible factors would include the assumption that an audit collapse occurred at the "worst" time of year ie just before the main audit season and a UK vs non-UK audit collapse. These would need to be scoped out in detail. We believe that this would be a useful exercise in generating possible responses (with their attendant costs and benefits) to such an eventuality.*
- *As we have already stated, it is important to make a distinction between the short and long-term. For example, consideration may need to be given to short-term emergency measures eg the suspension of the Listing Rules relating to timescales.*
- *We would also suggest that consideration could be given to the development of the "emergency basic audit" which could be provided if an audit firm left the market. This would need to be scoped out in terms of what it would need to cover, whether it would be acceptable to the market, under what conditions it would be permitted and who would be allowed to undertake it.*
- *It would also be useful to undertake case studies of recent major scandals with conclusions and useful lessons to be learned.*

I trust that these comments will prove helpful in your deliberations and CIMA looks forward to participating in the second stakeholders' meeting on 18 September.

Yours sincerely

A handwritten signature in black ink, which appears to read "Charles Tilley".

**CHARLES TILLEY**  
Chief Executive