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Financial Reporting Council

Discussion Paper: Choice in the UK Audit Market, May 2006

The Institute of Chartered Secretaries and Administrators (ICSA) is an international professional body with some 44,000 members and 28,000 students in over 70 countries worldwide fulfilling a variety of roles in a wide range of different types and sizes of organisations. Many of these members are company secretaries in public companies and would often be secretary to the audit committee.

We are pleased to have the opportunity to input the following thoughts in response to your discussion paper:

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?

ICSA response: Yes. If another of the Big Four firms were to fold that would place enormous strain on companies seeking ‘independent auditors’, particularly since the Big Four inevitably provide services relating to employee share plans, tax planning, etc. which may fall foul of independence criteria. It seems to us that the emphasis should be about ensuring that a wide enough net of services is available to prevent a ‘cartel’ being allowed to form.

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?

ICSA response: We do not believe that the criteria should be market led only. FRC should be encouraging proactively through its operating boards those firms which are not as large as the Big Four to enhance their services and actively to demonstrate their “strength on the bench” in order to enable them to be more active players in the corporate auditing market, particularly among FTSE100 companies. International reach and research arms to keep them ahead of and abreast of new regulation seem to be the key capabilities that are lacking at the moment. A second tier of highly competent firms would be desirable – maybe through firms acting as joint auditors or collaborating to form a joint venture LLP - so as to ensure that the appropriate skills base is covered.

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:

ICSA response: As we mentioned earlier, the smaller firms should see this as an opportunity to break into the market – and maybe strategic alliances, such as a joint venture LLP, would be a way forward rather than pure consolidation via the merger route.

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

ICSA response: Non-executive directors are cautious, and rightly so, of straying from their tried and trusted alternatives. The litigious arena in which they often find themselves, coupled with the onerous demands of US regulation and Sarbanes-Oxley, their own personal liability as well as reputational risk, is driving them (unsurprisingly) towards the big firms with the big reputations. Audit committee chairmen and finance directors will need to be educated that there is another way. Institutional shareholders may have a role to play here in expressing any views they may have on the risk of over reliance on the Big Four.

Personal recommendation is always a useful way to grow business - it is the perception that the second tier is not quite up to it or does not have the appropriate resources which seems so difficult to break. Of course other advisers can help here but only if they too believe it. More often than not, big listed companies will choose the largest law firms who tend, at corporate levels, to work the closest with the Big Four. This serves only to exacerbate the issue. Companies are clearly less likely to go for the tier two option in this environment. Perhaps where law firms have had good working experiences with tier two audit firms they could be encouraged to make recommendations, where appropriate, to their corporate clients.

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

ICSA response: The standards of corporate governance compliance and independence criteria are very high – maybe some reduction in this area would be helpful and should be investigated. We accept that the likelihood of this being achievable for companies with a US listing is likely to be extremely remote.

Q6/7: We invite views on steps that could be taken to mitigate the risk of unnecessary/voluntary/involuntary withdrawal of a firm from the market:

ICSA response: The collapse of the former Arthur Andersen demonstrates the inherent fragility in today's business environment of a business' "licence to operate". More recent problems encountered by KPMG in the US and by PwC in Japan bear out this concern.

We suggest that the FRC should consider laying emergency plans so that if one of the Big Four did collapse, the remaining 'Big Three' would at least hold back from sweeping up the released clients and partners and staff. Would it be unreasonable to ask the Big Four to sign up to a Memorandum of Understanding that, in the postulated circumstances, they would hold back from recruiting staff and clients? Prior consultation with the Competition Commission on the possible impact of competition law on any further consolidation among Big Four firms might usefully inform the FRC's approach to Big Four firms along the lines suggested. However this approach would only be acceptable if the second tier firms had been encouraged and supported (by FRC) to develop plans so as to

be ready to take on clients and staff in the event of a Big Four firm collapsing.

Yours sincerely

A handwritten signature in black ink, consisting of a large, stylized initial 'B' followed by a horizontal line and a small dot.

Bridget Salaman
Head of Policy, Corporate