Non-Professional Ownership Structures for Audit Firms Consultation Report

Comment Letters

OICU-IOSCO

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

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IOSCO Consulting Paper
Non-Professional Ownership Structures for Audit Firm
List of Comment Letters Received

No.	Respondent Organization
1	CPA Australia/Institute of Chartered Accountants/National Institute of Accountants
2	The Compagnie Nationale des Comissaires aux Comptes (CNCC)
3	Deloitte
4	European Group of International Accounting Networks and Associations
5	EUMEDION Corporate Governance Forum
6	Ernst & Young Global Limited
7	FAR SRS (The Institute for the Accountancy Profession in Sweden)
8	Federation of European Accountants
9	Financial Reporting Council
10	Grant Thornton International Ltd.
11	The Institute of Chartered Accountants of Scotland (Audit and Assurance Committee)
12	Instituto De Censores Jurados De Cuentas De Espana
13	Institut der Wirtschaftsprufer
14	KPMG International
15	National Association of State Boards of Accountancy
16	PricewaterhouseCoopers LLP

18 January 2010

Mr Greg Tanzer
Secretary General
IOSCO

E-mail: AuditOwnership@iosco.org

Dear Mr Tanzer

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

Thank you for the opportunity to comment on this Consultation Report. CPA Australia, The Institute of Chartered Accountants in Australia and the National Institute of Accountants (the Joint Accounting Bodies) have considered the report and our comments follow. The Joint Accounting Bodies represent over 180,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

General Comments

The Joint Accounting Bodies in Australia are of the view that the question of non-professional ownership structures for audit firms is a complex matter that merits further study. We understand that the degree of audit firm concentration has the potential to lead to major disruptions in capital markets if a large firm was to withdraw from the market and is a matter of legitimate concern to regulators and the public. Any relaxation of ownership laws will be accompanied by the need for firms and regulators to have in place strong systems and processes to ensure that regulatory obligations of the firms, especially those pertaining to independence, continue to be met. Governments and regulators will also need to be conscious of the potential for different ownership structures to have an impact on the culture of the firms and the possibility that conflicting values and objectives of absentee owners could lead to a diminution of audit quality.

It is not clear that removing legislative restrictions on firm ownership alone will have the effect of encouraging new entrants into public company auditing services. Ideally, policy initiatives of this type would need to be considered alongside other supply side factors such as the number of potential new firms willing to enter the market and the supply of qualified professional accountants. A broader approach to concerns about entry barriers may need to be considered.

Many of the questions raised in this consultation paper cannot be answered with confidence absent empirical evidence to support the views presented. The professional accounting bodies in Australia strongly encourage IOSCO to consider commissioning independent research to inform the policy directives that are ultimately determined. Additionally, it is possible that jurisdictional and cultural issues may impact the policy decisions made by regulators/ legislators, and the firms' (and investing public) responses to these decisions. If that is the case, individual regulators/legislators may wish to consider the commissioning of independent research in their own jurisdictions.

Specific Questions

1. **Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.**

In principle, there appears to be a strong case for regulators/legislators to address barriers to entry in the market. However, this consultation paper focuses on a barrier that is legislatively imposed (i.e., pertaining to ownership laws), and not other, perhaps more significant market barriers that deter, rather than legally prohibit entry.

It is possible that these other market considerations are more pervasive than ownership laws, in preventing new entrants. Incumbency, reputation, size and specialist expertise are some of the market factors about which there are currently no or few legislative barriers. Therefore, before embarking on action that lifts legal ownership barriers, it may be prudent to commission independent research which examines the relative impacts of the range of barriers that currently prevent new market entrants. Of course, some regulators/legislators may be of the view that these other market-based barriers can be addressed with legislative solutions, through the imposition of new legislation.

Other potential research questions that should be considered before significant decisions are made about changes to legislative ownership requirements are: Are there willing new entrants ready to enter the market? Is there a sufficient supply of professional accountants to staff potential new entrants?

2. **What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?**

Without empirical data to support assertions made about the most significant barriers to entry, it is not possible to provide a definitive answer to this question. However, as noted in the response to the question above, it is possible that other barriers such as incumbency effects, reputation and firm size may be important. Clearly, if research were to show that these other factors are significant barriers to entry, regulator/legislators could impose legislative restrictions and requirements, and develop legislative structures to accommodate and promote entry to the market.

For example, legislators could: establish public sector, government owned audit firms to compete with current firms; legislate to restrict the size of current firms in terms of the number of partners/owners; legislate to separate audit and assurance services from other practices of the firms; or legislate to prohibit global network alliances. In reality, it is our view that measures such as these would not be readily accepted as public policy options.

It is not clear what other means are available to regulators/legislators to address audit firm concentration. However, it is critical that if barriers to entry were to be lowered or removed, and if concerns about the concentration of audit firms were to be addressed, regulators/legislators need to be cognisant of the impact this may have on audit quality, and the ability of firms to ensure that they adhere to all regulatory requirements, especially those relating to independence. It highlights the importance of having a strong regulatory oversight/inspection program and high quality robust auditing and assurance standards, quality controls and frameworks. The need for global consistency is important in this area, and thus matters such as the use of international auditing standards worldwide and reciprocity agreements for audit inspections are important.

3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

As noted earlier, it is not clear that addressing one barrier to entry will be sufficient to increase the availability of the sources of audit services. This important question may be best addressed through the commissioning of independent research.

As well as the supply side market factors noted earlier, regulators/legislators may wish to consider the impact that auditor registration and licensing arrangements, auditor rotation requirements and specific competencies and experience requirements, have on the availability of audit services.

4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

Clearly, if greater non-practitioner ownership leads to an increase in the number of audit firms in the market (and hence reduced concentration of firms) it is logical to assume that the threats to continuity of audit services are alleviated, or removed.

A possible impact of expanding non-practitioner ownership, especially where capital raisings are involved, could be increased threats to the continuity of audit services in terms of firms' adherence to independence requirements. Public share ownership means that sales and purchases of shares by companies, their subsidiaries, related organisations, directors, management and employees in a secondary market have the potential to impair independence and could be so severe as to require companies to change audit firms. A question for consideration in any research would be the optimum number of new market entrants required to ensure that companies have sufficient choice if and when changes are imposed upon them.

Furthermore, non-practitioner ownership is likely to have some impact on the culture of the firm. Practitioners (professional accountants) have the *Code of Ethics for Professional Accountants* to which they must adhere. Non-practitioner owners may have ethical or cultural frameworks, or strategic objectives, which conflict with the Code. Once again this is a matter for further research.

5. Could allowing firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

In theory, allowing firms the option of broader non-practitioner ownership may assist new competitors to enter the market. However, the actual impact that such an option permits will be constrained by other factors, such as:

- the number of practitioners available to work in the newly created firm;
- licensing, registration and regulatory oversight inspection requirements that might limit new entrants;
- choices by non-practitioners to attempt to establish a new firm, or to invest in existing firms; and
- the potential desire for investors wishing only to invest in capital raisings of well established, large firms incumbent in the market. It is possible that this policy change could reinforce the position of the larger firms and increase, rather than reduce, firm concentration.

6. Would allowing firms the option of broader non-practitioner ownership allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

In the event that one of the Big Four firms leaves the audit services market, the ability to constitute a new firm could be vital to the continuity of services. It is possible that allowing broader non-practitioner ownership of firms could provide the transitional flexibility required to provide such continuity. However, it is possible that the remaining Big Four firms would see it as an opportunity to recruit new experienced staff, and to expand their operations and lead to a further increase in concentration of firms. Another consideration could be that such events are merely market forces at work and should be allowed to occur without regulatory intervention. These are matters that would be best addressed after conducting independent research.

7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

It is difficult to assess how important existing ownership structures are to the level of audit quality provided. Clearly, this is another area of potential research, which may inform policy settings. An ongoing question in academic research – essentially unresolved – is "What is audit quality?" IOSCO should strive for clarity around this term, as the impact that ownership restrictions have on audit quality may vary depending upon the definition. For example, a definition focused on "issuing the right opinion" (i.e., not issuing an unqualified opinion the year before an entity collapses) might suggest that practitioner ownership (which ensures high level of accounting professional involvement in the management of the firm) may be preferred. However, was the definition of audit quality to be focused on transparency and openness, realignment of cultural values that comes with non-practitioner ownership may be favoured.

The United Kingdom's Financial Reporting Council's publication *The Audit Quality Framework*, developed after much public consultation, is a sound basis for consideration of audit quality.

Arguably, existing arrangements which focus on practitioner (professional) ownership of firms have the benefit of promoting a greater alignment of ethical and cultural values within the firm, as professional accountants are all subject to the same *Code of Ethics for Professional Accountants* and for audit and assurance services, the same standards and framework which govern the delivery of their services. As noted previously, it is possible that potential ethical and cultural differences, conflicting objectives and the potential for independence to be impaired are negative aspects of non-practitioner ownership. In turn, these factors could negatively impact the level of audit quality.

8. What factors other than those set forth above should regulators consider in analysing whether alternative forms of audit firm ownership and governance should be allowed?

Subject to the outcomes of the research suggested, in analysing possible alternative forms of audit firm ownership and governance, regulators would need to consider the reporting and assurance frameworks and arrangements to apply to audit firms. That is, if non-practitioner ownership meant that shares in firms were to be traded on stock exchanges, or subject to some other form of regulation that required financial statements to be prepared and audited, what arrangements would be required regarding eligibility to audit the financial statements of each firm?

9. **Would alternative forms of ownership that includes boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners of directors (licensed or unlicensed) to give due regard to the public interest, be useful?**

Further research is needed into this question. While the concept has appeal, it is not clear that a board of directors with independent members would necessarily lead to reinforcement of an audit firm's public interest obligations and independence. Matters pertaining to cultural fit and conflicting objectives (as noted previously) would need to be considered and addressed.

Compulsory charter provisions would likely go some way towards addressing concerns. Such charter provisions could be based on the requirements detailed in IFAC's *Code of Ethics for Professional Accountants*.

10. **Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?**

It is not possible to determine the alignment of economic incentives of non-practitioner employees absent the availability of empirical data to support assertions made. It is conceivable that a generalisation about non-practitioners incentives is not realistic. Different non-practitioners may have different incentives. For example, a non-practitioner administrative support staff member may have a very different perception of their public interest role versus an IT expert who works with professionals services staff to audit or consult with clients.

By its nature, employee ownership should be treated differently from outside investor ownership, especially in a professional services firm that is subject to strong regulatory oversight and a public interest focus. It is likely that outside investors may not understand, nor have an interest in understanding, the ethical and cultural aspects of the business and the public interest objective. This is especially true of outside investors who have a purely economic incentive to invest in the firm.

It is not clear how more permissive non-practitioner employee ownership would affect a firm's capital-raising capacity and the barriers to entry for audit firms.

11. **What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?**

Arguably existing restrictions on audit firm ownership have the benefit of promoting a greater congruity of objectives and understanding within the firm, through the presence of a Code of Ethics for all practitioners. Furthermore, having practitioners with similar educational backgrounds, the need to meet competency requirements and to comply with the same professional standards, provides greater opportunity for a consistent ethical culture to be promoted.

12. **Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?**

Existing safeguards largely address matters of competency, professionalism, audit quality and independence at the practitioner level. That is, while they are sufficient to promote good practice amongst the practitioner (professional) staff, it is not clear that they would impact the behaviour of

non-practitioner owners. Ethical and cultural differences and conflicting objectives between non-practitioner owners and practitioners are not necessarily addressed by the existing safeguards.

As a minimum, additional safeguards such as those introduced in Japan and described in the Consultation Report would need to be considered. These relate to matters such as prohibiting non-practitioners from providing audit services, requiring non-practitioners to register with the professional accounting body and to comply with the *Code of Ethics for Professional Accountants*, and introducing internal control systems which prevent non-practitioners from exerting inappropriate influence over the conduct of audit services.

13. What level of non-practitioner ownership should concern regulators, and what level should be considered *de minimis*? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

Absent any empirical evidence, it is difficult to determine the optimal level of non-practitioner ownership, and what the regulator may see as concerning from both a maximum and minimum perspective.

Given the importance of independence to the provision of audit services, it is possible that the regulatory models for reporting beneficial ownership that exist throughout the world, may need to be revised. It is important that the reporting of ownership is very detailed, in terms of the quality and timeliness of the information, to ensure that independence is not impaired and the quality of the audit services is not brought into question.

14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

As well as the types of safeguards introduced in Japan and described in the Consultation Report, other safeguards that could be considered include:

- restricting non-practitioner ownership to natural persons only, and not permitting entities, companies, trusts, partnerships etc to be non-practitioner owners. Ownership by persons also allows for the requirements of Codes of Ethics to be imposed on these owners;

- requiring a positively worded annual declaration by non-practitioner owners each year that the firm has met certain regulatory obligations, such as: complying with independence obligations throughout the year; and having systems in place and operating to prevent non-practitioner owners from influencing the conduct of audits. Also, the declaration might include that the non-practitioner owner has read and understood the Code of Ethics, and has complied with its requirements throughout the year; and

- subjecting all non-practitioner owners to regulatory oversight by the auditing regulator.

However, the foregoing could restrict access to capital, and would need to be one of the matters considered in any research.

15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

It is not clear that public ownership will mitigate existing risks to investors. Essentially, investors' main concern is with audit quality, and there is little evidence to suggest that public ownership of firms will lead to an increase in audit quality.

Indeed, public ownership may, as mentioned previously, potentially heighten the risk of reduced audit quality due to the impairment of independence, the increase in conflicts of interest, and the negative effects of diversity in cultural outlook and conflicting objectives within the firm. Depending upon the influence public owners exert over the provision of audit services, it is possible that the public interest focus may be diminished.

Firms may well need to develop and implement more robust and refined systems and processes for monitoring compliance with independence obligations. Also, to address the risk of public owners exerting inappropriate undue influence over practitioners, regulators might consider imposing restrictions on non-practitioner owners, such that they are unable to participate in the operational management's decision-making of the firm.

As noted in answers to previous questions, from a public policy perspective it is not clear that public ownership would address issues of firm concentration and hence the risks that flow from it.

16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

Conceivably, a benefit that could accrue for the audit process from the introduction of new safeguards, are more stringent systems and arrangements in terms of monitoring compliance with independence requirements. Otherwise, any safeguards introduced relate to attempts to mitigate the possible negative effects of permitting public ownership.

17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

Potentially, new safeguards will bring with them increased costs for the audit firms, which are likely to then be passed onto their clients. Therefore, any new safeguards could have the effect of increasing the costs of audit services. Regulators/legislators will therefore need to consider carefully the costs and benefits that result from major policy changes and initiatives in the area of firm ownership.

18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

Absent any empirical evidence, it is difficult to assess the likelihood that potential new entrants would take the opportunity for broader non-practitioner ownership of audit firms. As noted previously, this question is one which may be best answered through the commissioning of independent research.

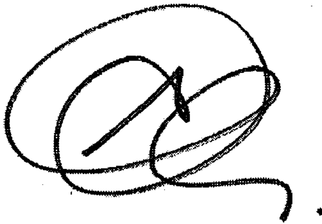
Also, as noted in our response to Question 5, supply side issues are critical in determining policy directives and initiatives on this topic.

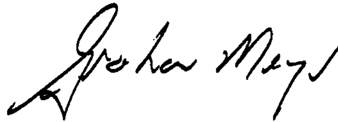
19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

For the reasons noted throughout the answers provided to the preceding questions, it is possible that broadening non-practitioner ownership of audit firms may have the effect of increasing concentration, and allowing the Big Four to consolidate their positions. Supply side factors (limitations and constraints to potential new entrants) and the attractiveness for investors to invest in Big Four or other large firms may result in regulators'/legislators' objective of addressing concentration concerns remaining unachieved. As noted throughout this response, regulators/legislators should consider commissioning independent research to inform their policy decisions.

The professional accounting bodies are committed to assisting where possible in the development and implementation of the highest quality auditing and assurance arrangements and regulatory standards around the world. We hope that the comments provided are of assistance to IOSCO. If you have any questions regarding this submission, please do not hesitate to contact either Gary Pflugrath (CPA Australia) at +61 2 9375 6244, Andrew Stringer (Institute) at +61 2 9290 5566, or Tom Ravlic (NIA) at +61 3 8665 3143.

Yours sincerely





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LE PRÉSIDENT

Mr. Greg Tanzer
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27 January 2010

Dear Mr. Tanzer,

Re: Comments on the IOSCO consultation report on the exploration of non-professional ownership structures for audit firms.

The Compagnie Nationale des Commissaires aux Comptes (CNCC) is pleased to provide you below with its comments on IOSCO's consultation on the exploration of non-professional ownership structures for audit firms.

If you have any further questions about our views on this consultation, please do not hesitate to contact us.

Yours sincerely,

Claude Cazes

President of CNCC

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Exploration of non-professional ownership structures for audit firms
Reply to the IOSCO Consultation Report

The CNCC, the French institute of statutory auditors, welcomes the opportunity to comment on IOSCO's consultation report exploring non professional ownership structures, for audit firms.

Q1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

We believe that regulators and/or legislators should consider carefully the issue of barriers that may exist in the access to the market of audit services by listed companies.

The main reason that justifies this position is based on the finding that there is a strong concentration on this market dominated by four major players.

Risk of loss of one or more players

The risk of loss of one or more of the four main players cannot be considered as a mere academic hypothesis.

We can envisage three cases, which are not extreme, of disappearance of these players, which would result from direct or indirect consequences:

- due to a legal or judicial sanction for the non compliance by one of the four main actors, of regulation applicable to a major geographical area;
- due to a financial penalty related to non compliance of regulation (fines, ...) or to the civil liability commitment.
- due to the case where one of the main players would envisage a withdrawal from the audit market.

The occurrence of such a situation may lead to a systemic crisis that could impact the entire economy because of the material impossibility in which there were many industrial, financial or commercial groups would not be in a position to meet their legal obligations regarding establishment and/or audit of their financial statements.

It should be noted here that the characteristic of the four main global players of audit services is that their activities include both the statutory audit and contractual services. Then these two types of provision of services would be affected in case of disappearance of at least one of them.

Potential conflict of interest

The presence of the four main players in the same markets - statutory audit and contractual provision of services - is a source of conflict of interest.

Conflict of interest for the user entities can quite easily lead to a situation allowing them to distort free competition when choosing their statutory auditor.

Q2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

The study of historical and economic concentration in the international market of audit services to listed entities clearly shows that it is the result of an adaptation to customer needs.

It is because of accompanying economic, geographic and financial development of their clients and in responding to their request for a process related to consistent accompanying, that have formed over time leading international audit firms on the audit market.

This movement is a characteristic of economic development in the Western world throughout the twentieth century and particularly during its second half. It is not intended, currently, to be recurrent. The present situation is therefore constitutive of established positions.

The possibilities of a substantial change in these situations are potentially twofold:

- firstly, a rebalancing of economic forces on the planet, accompanied by cultural and structuring technological changes. This scenario could be that of a strong balance in favor of the BRICS countries ;
- secondly, the recognition by Western states that specific national regulations are barriers that are the main impediment to the emergence of new providers of audit services.

We also note that among the issues that legislators and / or regulators should consider as a priority - because of their very heterogeneous characteristics between countries - is the one related to the liability of auditors (notably financial).

Q3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

We believe that there is no reason to favor a specific barrier but rather, as explained above, to take into account that the audit market, especially for listed entities, would only change thanks to the implementation of economically and culturally founding policies, which include the reconsideration of specific national regulations.

Q4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

We do not believe either that the enlargement of the shareholding to non-practitioners is a major response to face to the non continuity of audit services.

The audit itself is primarily the matter of the issuance of an opinion by a competent and independent professional.

The security of customers is only ensured - and perceived - by the personal commitment of a competent and independent professional.

First and foremost, the assurance of this principle allows an audit firm to endure.

It would not be effective in case of non-practitioner ownership.

Q5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

As a result of the answer to the above question, we believe that it is not a wider opening to shareholders who would not be practitioners that would favor the entry of new competitors in the audit market.

Such an approach would require that the main barrier to entry for new competitors should be the fundraising for new audit firms. That is not our analysis, and this is corroborated by examination of the audit firms financial statements that do a priori not highlight the capital needs beyond the contributory capabilities of partners.

Q6. Would allowing audit firms the option of broader non-practitioner ownership, allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

We believe that the issue related to the failure of one of the Big Four would not find its solution in the opening of the audit firms capital to non-practitioners.

To allow a more detailed analysis of the reply to this question, a risk analysis of the proposed situation should be rather made first. In particular, regarding the possible causes of this disappearance, in order prioritize the reduction of risks by an inventory of possible safeguards.

Q7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

As mentioned earlier, we believe that the essence of auditing is the expression of an opinion by a competent and independent professional.

This statement leads us to believe that the quality of an audit performed by an audit firm is in particular a matter for its independence through one of professionals who practice their activity in its behalf.

This is also the reason why we believe that the views of practitioners practicing in audit firms must always take precedence over the non-practitioners type (in particular investors), which induces for them a majority mechanism.

Q8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

As mentioned previously, the analysis of practices of the main audit firms highlights the mixed nature of their professional services between statutory audit, on the one hand, and other contractual services, on the other hand.

This context should lead to a reflection regarding the breakdown of voting rights among non-practitioners and practitioners on the one hand, between practitioners committing the audit firm in the framework of audit assignments and other practitioners of the audit firm, on the other hand.

At the same time, we should also look at the growing importance of non purely financial or accounting abilities in the conduct of statutory audit assignments.

Q9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

These alternative approaches would be of interest only to the extent that it is demonstrated that a greater opening of the capital of audit firms to non-practitioners (investors?) would lead to:

- an effective response to the barriers that seem to exist in the opening market for audit firms;
- an appropriate response to the expectations of clients of these firms related to the opinion given by a competent and independent professional,

which is not the case.

It is possible to consider opening slightly the capital but ownership should not be laid down as a preliminary condition.

Q10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?

We believe that opening the capital to employees (practitioners but not signatories) could be considered to the extent that all major professional standards that apply to practitioners signing audit reports are intended to be applied at the same time to their employees. On the other hand, it is worth noting that normally, disciplinary sanctions do not apply to employees.

Q11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

It is first of all the consistency of respect of an economic and cultural model. The principle according to an audit firm provides, above all, the assurance of an opinion issued by a

competent and independent professional actually means restrictions on its financial structure and rules of decision making by its shareholders.

Q12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

We are not aware of effective safeguards to preserve the essence of an audit firm whose capital and voting rights could be owned by a majority of investors.

Q13. What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

We believe that the majority of voting rights must be held at least by professionals who practice their activity within the audit firm.

Q14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

We believe that there are no additional safeguards that could effectively mitigate the risk of affecting the threefold criteria: "opinion - competence - independence -", in the case of majority opening of the audit firms to investors.

Q15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

We believe that there is no need for specific measures to reduce the risk of any investor in an audit firm.

Q16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

We believe that there is no need for additional safeguards.

Q17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

We believe that additional safeguards would unduly make more complex an activity which is already highly regulated.

Q18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

We believe that there is a low probability that new entrants would take advantage of opportunities for broader non-practitioner ownership (such as investors). We have in any case doubts that the non-practitioner ownership might result in more global players because financial capital is not regarded as a key factor for going global, neither for the emergence of new audit firms nor for the enlargement of existing networks. As suggested in question 19, the major firms could also use the opportunity. Ultimately this could also strengthen their position in the audit market.

Q19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

We believe that it is possible that large audit firms take this option to meet the wish that professional partners of these firms, operating in the sector of other contractual services (consulting, ...) could have then to finance the development, mainly through external growth, of activities not covered by the statutory audit.

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Deloitte.

Deloitte Touche Tohmatsu
1633 Broadway
New York, N.Y. 10019

January 15, 2010

Mr. Greg Tanzer
Secretary General
International Organization of Securities Commissions
Calle Oquendo 12
28006 Madrid, Spain

Re: Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

Dear Mr. Tanzer:

Deloitte Touche Tohmatsu is pleased to respond to the consultation project initiated by the International Organization of Securities Commissions ("IOSCO") regarding the effect on concentration caused by restrictions that limit ownership and control of audit firms to practicing licensed accounting professionals (the "Consultation Report"). The Consultation Report seeks input on easing barriers to entry into the market for large public company audit work and, in particular, steps that could be taken for the purpose of easing restrictions on non-professional ownership and whether such steps would encourage participation in this market.

Investors and the capital markets benefit from a strong, competitive market for large public company audit work.[1] The Consultation Report raises potential concerns about concentration in the market for providers of audit services to large public companies, and the potential impact of such concentration on the continuity of audit services in this market.[2] The Consultation Report suggests that a primary way to address these concerns is to encourage participation in this market by increasing access to capital through broader non-professional ownership. We support reasonable initiatives to encourage more accounting firms to enter the market for providing large public company audit work. It is not clear, however, that easing

[1] Consultation Report at 4.

[2] *Id.*

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restrictions on non-professional ownership will increase entry into this market. Several factors exist that may detract from the attractiveness of such an investment to outside investors, including a lack of convergence in standards and potential liability exposure that audit firms confront in multiple jurisdictions. Increasing external ownership also presents potential risks to audit quality that need to be carefully evaluated. Thus, any strategy for increasing participation in the market for large public company audit work needs to consider these other potential barriers to entry and related potential risks, together with any measures easing ownership restrictions.[3]

In addition, we note that recent studies indicate that concentration in the market for large public company audit work does not correlate to a lack of competition.[4] These studies also suggest that to the extent there is a perception that only audit firms that are associated with a Big Four network have the depth and reach to participate in this market, such a perception may not be valid as other audit firms also have been identified as having the requisite resources (both in terms of geographic reach and experience with auditing public companies).[5] These studies indicate that large public companies currently have options beyond the Big Four networks from which to choose in selecting an audit firm.

I. Ownership Restrictions as a Barrier to Entry[6]

The Consultation Report points out that many jurisdictions require that audit firms be wholly or majority owned and controlled by practicing licensed accounting professionals, and, as a result, audit firms' access to certain sources of external capital may be limited.[7] A number of

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[3] *Id.* at 2 ("the Task Force recognizes that the ultimate strategy for reducing concentration may need to address several barriers to entry (and any related solutions) together.").

[4] U.S. Government Accountability Office, *Audits of Public Companies: Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action*, 4, 5 (2008) (hereinafter "January 2008 GAO Report"); http://www.gao.gov/new.items/d08163.pdf.

[5] *See, e.g.*, January 2008 GAO Report at 40 (Table 2).

[6] This section includes responses to, or discussion of, certain aspects of questions 4, 5, 6, 7, 8, 11, 12, 14, and 18 of the Consultation Report.

[7] Consultation Report at 6.

governmental bodies, including the European Commission, the United Kingdom's Financial Reporting Council, and the U.S. Government Accountability Office ("GAO"), have previously considered whether such limitations on non-professional ownership present a potential barrier to entry into the market for large public company audit work. These studies suggest that easing ownership restrictions could allow audit firms greater access to capital.[8] Yet, as one of these studies suggests, easing ownership restrictions alone is not likely to encourage greater participation in the market for large public company audit work. A majority of the accounting firms surveyed in this study agreed that merely "being able to raise capital from [outside] sources would have little if any effect on their ability to expand their market share."[9]

In addition, it should be recognized that measures that merely permit more outside investment do not necessarily ensure that such investment will actually occur. In fact, studies have identified several factors that make the market for large public company audit work less attractive to potential entrants and investors. As we discuss in more detail in Section II, such factors include the lack of convergence in standards, overlapping regulatory regimes, liability risks for audit firms, and independence constraints.[10] Therefore, in evaluating measures that ease restrictions on non-professional ownership, these other factors should also be considered in order to increase the likelihood that outside investors would be willing to invest in firms seeking to serve the market for large public company audit work.

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[8] European Commission, *Directorate General for Internal Market and Services Working Paper: Consultation on Control Structures in Audit Firms and Their Consequences on the Audit Market*, 5 (2008) ("Consultation on Control Structures"), http://ec.europa.eu/internal_market/auditing/docs/market/oxera_consultation_en.pdf; January 2008 GAO Report at 59-60; Market Participants Group of the Financial Reporting Council, *Choice in the UK Audit Market - Final Report of the Market Participants Group*, 19 (2007), http://www.frc.org.uk/documents/pagemanager/frc/FRCMPG%20Final%20Report%20for%20web.pdf.

[9] January 2008 GAO Report at 59. The study also indicates that 61 percent of the smaller and mid-sized firms surveyed stated that providing more financing avenues would "be only slightly effective or not at all effective" in expanding their client base. *Id.* at 60.

[10] London Economics in association with Prof. Ralf Ewert, Goethe Univ., *Study on the Economic Impact of Auditors' Liability Regimes*, 69 (2006) (the "London Economics Study"); http://ec.europa.eu/internal_market/auditing/docs/liability/auditors-final-report_en.pdf; *see also* January 2008 GAO Report at 38.

Moreover, while we believe that models where external investors have an ownership interest in an audit firm may be feasible, further study should be performed to evaluate unintended consequences associated with such models, including, as the Consultation Report notes, potential impacts on audit quality, recruitment and retention of qualified professionals, and independence,[11] as well as potential safeguards against such risks. Such further studies should include the following considerations:

- Professional standards, licensing, and oversight serve to focus audit professionals on maintaining high standards of competence, training, and integrity in providing high quality audit services, with the recognition that failure to do so could give rise to professional consequences. It is unclear to what extent these same incentives would apply to or motivate non-professional owners.
- An increase in non-professional ownership could create a tension between the desire of non-professional owners to maximize investment returns with the need to allocate resources to invest in audit quality. As the Consultation Report notes, this may result in pressures to reduce investments in training and systems enhancement in favor of short term profits, which "may likely have long-term negative effects on audit quality."[12] As a result, among other things, the ability of audit firms to attract, develop, and retain the most qualified partners and professionals could be adversely impacted.
- Non-professional owners that hold interests in a firm could be subject to independence requirements to the same degree as professionals.[13] Thus, to make investment in firms attractive, certain modifications to independence requirements may need to be considered for non-professional owners who do not function in a professional capacity.

Even if safeguards could be devised to address these considerations, it should be recognized that any positive impact that non-professional ownership might have on increasing participation in the market for large public company audit work would occur slowly and gradually. For example, reputation takes time to cultivate, and reputational issues need to be considered in the context of addressing barriers to entry, as brand recognition, or the absence

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[11] Consultation Report at 9.

[12] *Id.*

[13] *Id.* at 13-14.

thereof, may limit the extent to which some firms are able to access the market for large public company audit work, at least in the short-term.[14]

II. Significant Other Potential Barriers To Entry[15]

As noted above, there are several significant potential barriers to entry in the market for large public company audit work beyond ownership restrictions that should be considered in evaluating measures that may increase participation in this market. These include liability risks, the lack of convergence in standards, overlapping audit oversight regimes, and independence constraints.

Liability Risks. The liability exposure of audit firms has been identified as an important barrier to entry for smaller and mid-sized audit firms because of the difficulty of managing litigation risk and of obtaining affordable liability insurance.[16] In this regard, firms that audit large public companies are often unable to obtain insurance against potential damages claims that may threaten the viability of the firm.[17] In a recent survey conducted by the U.S. government, 61 percent of smaller and mid-sized audit firms reported that liability reform would be at least somewhat effective in helping them increase their market share.[18] A study commissioned by the European Union in 2007 also identified liability risk as a barrier to entry that should be investigated in parallel with non-professional ownership structures. In part to address this issue, the European Commission recommended audit liability reforms in June 2008.[19]

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[14] London Economics Study at 35, 42, 48; January 2008 GAO Report at 43, 44.

[15] This section includes responses to, or discussion of, certain aspects of questions 2 and 3 of the Consultation Report.

[16] *See* U.S. Government Accountability Office, *Accounting Firm Consolidation: Selected Large Public Company Views on Audit Fees, Quality, Independence, and Choice*, 45 (2003); http://www.gao.gov/new.items/d031158.pdf.

[17] U.S. Treasury, Advisory Committee Report on the Auditing Profession, II:7 (2008); http://www.treas.gov/offices/domestic-finance/acap/docs/final-report.pdf.

[18] January 2008 GAO Report at 55.

[19] Consultation on Control Structures at 8.

While some countries have made efforts to implement such reforms, progress is needed in many other jurisdictions. Indeed, in some jurisdictions, audit firms bear liability risks that could potentially reach the full market capitalization of the client, despite the fact that the fees earned from the engagement are a small fraction of the potential liability. These liability risks could threaten the viability of audit firms and, as noted, for smaller and mid-sized firms could serve as a disincentive to enter the market for large public company audit work. We are confident that meaningful reforms could be developed that would protect against catastrophic liability risk and reduce disproportionate damages awards, but at the same time continue to provide a strong incentive to perform high quality audits. To be clear, liability reforms should not eliminate the ability to obtain damages awards, nor fail to punish culpable parties. We also note that limitations on auditor liability may serve to increase the availability of insurance to audit firms, which would also help to increase participation in the market for large public company audit work.

Lack of Convergence in Standards. Convergence towards a single set of internationally accepted, high quality accounting, auditing, and independence standards across jurisdictions, would not only be beneficial to investors for understanding financial statements and related reporting globally, but also would help reduce the challenges involved in providing services to large, multi-national audit clients. As it stands, smaller and mid-sized firms may be disadvantaged because of the disproportionate costs associated with training their professionals in disparate standards, and maintaining polices and compliance mechanisms for audits that cross jurisdictional boundaries. A uniform set of standards would allow firms the ability to train their personnel and gain relevant experience needed to perform audit services on a more cost-effective basis. We also encourage consideration of convergence towards a uniform set of ownership rules.

Overlapping Audit Oversight Regimes. Overlapping and sometimes inconsistent regulation among audit oversight regimes also has been recognized as a potential barrier to entry.

For example, audit firms must comply with registration, reporting, and inspection requirements in multiple jurisdictions, which generates substantial (and duplicative) costs that disproportionately affect audit firms with fewer multi-national audit clients. Increased cooperation among audit oversight bodies leading towards a system of mutual reliance could help alleviate this potential barrier.[20]

Independence Constraints. Independence requirements also may make the market for large public company audit work less attractive to some smaller and mid-sized firms,[21] and may need to be considered in evaluating measures that could increase greater participation in this market.

* * *

Given that studies show that measures easing restrictions on non-professional ownership alone are unlikely to encourage greater participation in the market for large public company audit work, such measures should be considered concurrently with measures addressing other potential barriers in order to encourage participation in this market. In addition, further study should be encouraged to evaluate unintended consequences, including potential adverse impacts on audit quality, that are associated with non-professional ownership models.

We thank IOSCO for circulating the Consultation Report and appreciate the opportunity to comment on it. If you have any questions concerning our comments, please contact Charles A. Horstmann at +1-212-492-3958 or J. Denise Pacofsky at +1-212-492-2841.

Yours very truly,

Deloitte Touche Tohmatsu

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[20] *See, e.g.*, January 2008 GAO Report at 48.

[21] *Id.* at 38.

EGIAN
European Group of International Accounting Networks and Associations

Greg Tanzer
Secretary General
International Organization of Securities Commissions
C / Oquendo 12
28006 Madrid
Spain

13th January 2010

Dear Mr Tanzer

Exploration of Non-Professional Ownership Structures for Audit Firms

1. Introduction

EGIAN welcomes the opportunity to comment on the above Consultation Report and commends IOSCO for looking at issues related to the future shape of the audit market for large public company audits. EGIAN's membership is made up of 21 global organisations which offer audit, accounting and business advisory services. The combined turnover of our members is US$ 34 billion. In this response we set out our views and would be very pleased to discuss them in more detail with you if that would be helpful.

2. Competition and choice the overarching issue

In looking at the future structure of the audit market the overarching issue that needs to be addressed is how to enhance competition and choice and reduce the unduly high degree of concentration that exists among the dominant four audit firms in nearly every country. One reason for addressing this is that if there were a less high degree of concentration the impact of one of the dominant players failing would be reduced. This, however, is not the only reason. We believe a more competitive market would be likely to be more responsive to the needs of shareholders in public interest companies and more innovative.

3. No 'silver bullet' to address competition and choice

There is no single 'silver bullet' reform that will bring about the change necessary to enhance competition and choice. The situation has been allowed to develop over a number of years and a variety of measures will be needed. We believe the key ones include those relating to:

- regular re-tendering of large public company audits. The public sector tenders regularly with the result that more firms are actively involved;
- a level playing field when re-tendering occurs;
- ensuring investors and boards and their audit committees are aware of the skills; and experience and capabilities of other leading firms as well as the Big 4.

We also believe there is a need for appropriate liability reform.

4. Non-Professional Ownership Structures not a key issue

We are not inherently opposed to extending existing non-professional ownership structures but we are equally not convinced that such a reform would have much impact on the extension of competition and choice in the market for the audit of large public interest companies. Moreover, if it were not to be detrimental on quality and independence grounds it would need to be accompanied by significant new safeguards to deal with the impact of the separation of the owners of the firms and the audit partners or their equivalent.

5. Further discussion

Our detailed responses to the questions in the Consultation Report are set out the appendix to this letter. If you would like further information or discussion, please do not hesitate to contact Andrew Brown, chairman of EGIAN or Anthony Carey, chairman of the EGIAN Competition and Choice Steering Group.

Yours sincerely,

Andrew Brown

EGIAN
European Group of International Accounting Networks and Associations

EGIAN response on Exploration of Non-Professional Ownership Structures for Audit Firms

1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

We strongly believe that it would be in the public interest for regulators to address barriers to entry in the market for audit services for large public entities. Recent years have clearly demonstrated that market-based initiatives have not succeeded in achieving the necessary changes and so regulators must now increasingly be in the forefront of this issue.

There is no reason to suppose that the market for large public entity audit services is substantially different from markets generally in the sense that the introduction of greater competition and more choice would be expected to increase the responsiveness of the providers of audit services to their clients- the shareholders, to whom their audit reports are addressed- and, linked to this, increase innovation in this important market.

Moreover, if the degree of market concentration were reduced it would be likely to lessen the impact of one of the current four dominant players leaving the market as a result of an audit failure or for other reasons.

2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

We believe the most significant barriers to entry by far are on the demand side.

The degree of concentration is far higher than is necessary, or justified, if one has regard to the skills, expertise and capacity of a number of firms outside the Big 4.and their related alliances and networks.

We believe the principal reasons for this include:

- a lack of regular tendering for audits in many national markets
- a lack of a level playing field in the way appointments are made when audits do come up for tender
- the existence of interconnected networks linked to the four dominant players

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whereby alumni of the firm often have senior executive positions in large public companies as well as non-executive positions on their boards and roles with investors and other participants in the capital markets.

These are the issues that need to be addressed vigorously if the level of concentration is to be reduced. We need regular re-tendering of audits, mechanisms to ensure that firms with the capabilities to undertake a particular large public entity audit are fairly considered, whether or not they are one of the dominant four players, and initiatives to ensure that audit committees and boards of, and major investors in, public companies, gain a better understanding of the skills, expertise and capacity of players other than the Big 4.

We note, for instance, that there seems to be a less high degree of concentration in public sector audit markets in a number of countries than in the corresponding ones for listed companies. The reasons for this could usefully be explored with particular reference to the appointments process and a public sector requirement to have regular tendering.

It is also observable that France is the only major developed market which does not have an extremely high level of concentration in the market for public entity audits which appears due to the appointment of joint auditors. Again, further exploration of the benefits and drawbacks of appointing joint auditors more widely may be helpful.

It would in addition be helpful to address the audit liability issue in a fair way. The primary change needed is a move from a system of joint and several liability where it exists to the much fairer system of proportionate liability under which auditors pay fully for their own mistakes but not for those of others as well. Care needs to be taken if liability reform involves liability caps as the introduction of a cap at an unduly high level would only benefit the four dominant players.

It is also the case that increased regulatory requirements may contribute to the high levels of market concentration as the costs of compliance with regulation increase in such a way as to deter new entrants into the market for large public companies.

3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

We believe there is no ‘silver bullet ‘whereby if one particular barrier to entry were addressed a significant element of the problem would be solved. Rather a

co-ordinated approach addressing the issues referred to above is needed.

4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

We do not believe that expanding the scope of non-practitioner ownership is likely to have much impact on the degree of threat to the continuity of audit services for large public entities. Our reason for this view is based on the fact that audit firms are already able, for example in the European Union, to have a substantial minority of their capital held externally and there has been little take up of this option. Secondly, through the consolidator model, firms which include an audit practice can already be effectively majority owned from outside.

It is hard to tell in advance whether any impact would be in the direction of creating, alleviating or removing any threats to the continuity of audit services. It would all depend on the circumstances. You could not rule it out creating new threats, if, for instance, the larger entity of which an audit practice was part failed for reasons unconnected to the practice. This could lead to the audit firm being brought down with it. One could also envisage situations in which the reputation of the holding company were damaged and contaminated the audit practice leading to a loss of confidence and of clients.

5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

Whilst in theory broader non-practitioner ownership could assist new competitors to enter the market for public company audits, in practice it would be unlikely to have significant effect as it is unlikely, though not wholly impossible, that a new entrant could build a substantial presence in terms of capability, capacity and brand in a short space of time. Moreover, even if they did so it would probably not be commercially viable. Given how seldom audits come up for tender in many markets it would be extremely difficult for a new entrant to build an acceptable market share in a reasonable timeframe. Many providers of external capital may also consider the risk of claims out of all proportion to fees earned on audits does not make it an attractive market to enter.

6. Would allowing audit firms the option of broader non-practitioner

ownership allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

As with question 5 above, this is unlikely to be the case in practice even though one could construct theoretical situations where this could happen.

If , for example, one of the dominant firms collapsed as a result of audit failure, it would be unlikely that there would be a rush of external capital to enable the existing partners in that firm to build a new practice as it would not be an ideal time for them from a reputational perspective even if this were rather unfair if the audit problem involved was linked to a particular audit rather than to systemic problems. A far more viable option, as has happened in the past, would be for one or more existing firms/networks/alliances with an intact reputation to take on part of the failed operation .

7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

The existing ownership restrictions have some inbuilt safeguards related to audit firm reputation which would need to be established separately for the owners as well as the audit partners, or their equivalent in a corporate model, if the two were to be separated. We would emphasise that we are not inherently opposed to relaxing audit firm ownership restrictions we just do not think such a move will have much effect and great care will need to be taken if it is not to lead to unanticipated adverse consequences. This will involve a significant commitment of time which could be more usefully directed to introducing the more important changes we have discussed in our response to Question 2.

Issues that would need to be addressed would include:

- would it matter if the owners, if a single entity, were in a completely unrelated field?
- would it matter if the owners were not financially sound or had faced legal or compliance problems?
- would the board of the owners need to be made up of people adjudged to be ‘fit and proper’ to be in control of an audit practice
- would the audit practice need to be in a separate entity and ring-fenced from the rest of the business?
- would the same independence requirements apply to the rest of the

company as to the audit practice (which could make it very difficult for financial institutions to own audit firms even though they would be the most likely candidates to do so)?

Clearly, a number of the challenges raised above would not arise in the case of certain multi-disciplinary partnerships where, for instance, a legal firm owned an audit practice

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8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

As discussed above, the real issue is whether the time and effort involved would be likely to yield substantial benefits in practice of which we are very doubtful and, secondly, whether there was a significant risk of unintended consequences which we think may well arise.

9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

We think the idea of introducing public interest charters and independent non-executives into audit firms, which do not require alterative forms of ownership and are perfectly feasible within the current model, have significant merit and should be fully explored. In this context, we note that a number of UK firms associated with networks or alliances that are members of EGIAN will soon be implementing the FRC/ICAEW Audit Firm Governance Code.

10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?

There is nothing in the current model to stop firms granting minority ownership rights to employees and if one looks at certain other owner-managed financial institutions it would only be likely to be a minority of ownership rights that would be held by members of the team other than those at the most senior level. Furthermore, it needs to be borne in mind that there is already fairly dispersed

ownership rights in audit firms amongst a range of partners.

11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

We consider the potential problems identified in our response to Question 7 are automatically avoided.

12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

As discussed in our response to Question 7, we believe additional safeguard would be needed to deal with the separation between the owners and the audit partners.

13. What level of non-practitioner ownership should concern regulators, and what level should be considered *de minimis*? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

There do not seem to be undue problems associated with the requirements of the European Union's Eighth Directive on the statutory audit which permits minority external ownership subject to certain safeguards concerning voting rights related to the management of the firm. We do not see why there should be a de minimis level of non-practitioner ownership- it is perfectly reasonable not to have any external ownership.

14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

We have discussed the additional safeguards that would be needed in our response to Question 7. As discussed there, it would be hard to know in advance whether such additional safeguards would achieve their purpose and not introduce unintended adverse consequences.

15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address

sufficiently any remaining risks?

The response to this question is subject to too many variables for one to be able to speculate in a useful manner. It would depend on whether the safeguards introduced to deal with the separation of ownership from the audit partners were robust, which firms- new or existing- made use of external capital; the characteristics of both the firms involved and the external capital providers and how the capital was used.

16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

We do not believe you need to change the rules relating to ownership in order to gain ancillary benefits for the audit process. If, for example, there were seen to be benefits in having independent non-executives as part of a public interest charter these ideas could be developed in their own right.

17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

We believe the question is not so much whether new safeguards, of themselves, would bring ancillary detriments but rather whether the new safeguards would be as effective as the current ones they would be replacing if the link between ownership and audit partners were weakened. As previously discussed, it is hard to determine this in advance by means of a desk-top exercise.

18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

As mentioned, the existing opportunities, for example in the European Union, have not seen significant take-up, in fact quite the reverse, and there is not strong reason to think that allowing majority external control would lead to a substantial change of interest.

19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

The first part of the question we must leave to the Big Four firms to answer for themselves. An injection of external capital may strengthen the firm's capital cushion but, as discussed, they could conversely suffer from being linked to the external owners' financial fortunes as well as their own. It would also depend on whether the external owners felt there was currently a sufficient return on capital or whether they pushed for more intensive use of capital. It clearly could increase concentration if one of the already dominant four firms used an injection of external capital to increase their market share at the expense of firms outside of the Big Four.

EUMEDION
CORPORATE GOVERNANCE FORUM

IOSCO General Secretariat
Secretary General
Greg Tanzer
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Spain

Subject:	Public Comment on the Transparency of Firms that Audit Public Companies, on the Auditor Communications and on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Reports
Ref.:	2.009.068
Amsterdam,	10 December 2009

Dear Mr. Tanzer,

Eumedion, the Dutch corporate governance forum for institutional investors, is pleased for having the opportunity to comment on three related consultations of the Technical Committee of IOSCO on 'Transparency of Firms that Audit Public Companies', 'Auditor Communications' and 'Exploration of Non-Professional Ownership Structures for Audit Firms'. The three consultations contain analyses and questionnaires in order to obtain input from investors, audit oversight authorities, industry and other relevant stakeholders.
By way of background, Eumedion is the Dutch corporate governance forum for institutional investors. Eumedion has 65 Dutch and foreign institutional investors as participants at present. Together they have more than 1 trillion Euro of assets under management. Eumedion's participants invest for Dutch beneficiaries and in listed companies worldwide.

Eumedion supports and appreciates the work that the Technical Committee of IOSCO has undertaken. Many of the issues raised in the report are related to the interests of institutional investors. Since the financial reporting crisis of 2001/2002, society, securities regulators and institutional investors alike paid more attention to the role of auditors in the capital markets. It is fundamental that institutional investors have sufficient, relevant and transparent information upon which they can base their investment decisions. Audits are designed to enhance the degree of confidence of investors and users in financial reports. Therefore, investors have a tremendous interest in auditors' and audit firms' competence, independence, transparency and communications - which all contribute to audit quality.

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Some issues mentioned in the report on Transparency of Firms that Audit Public Companies and the report on Exploration of Non-Professional Ownership Structures for Audit Firms fall outside the scope of Eumedion's objectives. Therefore, we have focused our comments on specific elements in these two reports. At the end of our contribution, we answer the four specific questions raised in the consultation on Auditor Communications.

Consultation report on transparency of firms that audit public companies

Transparency of audit firms may have, directly or indirectly, a positive effect on institutional investor's confidence in financial reporting of listed companies and the way the reporting is audited. Transparency applied by audit firms contributes to an environment in which audit firms compete not solely on factors as reputation, size and audit fees. This is important, as competence and experience of auditors and firm's governance (*e.g.* quality control systems, safeguards against conflicts of interests, and education programs) are other relevant factors for audit quality.

We believe disclosure requirements could sharpen the focus of audit firms on important aspects of audit quality control. Enhanced disclosure may influence how audit firms internally manage audit quality. Only with disclosure we can compare quality control measures between audit firms. By including other information that institutional investors and other users may have, a better judgment of audit quality is facilitated. We therefore generally support IOSCO's approach to consider further transparency of audit firms.

In our view, transparency is needed on potential conflicts of interest as well. We must have an insight into internal governance measures to prevent conflicts of interest. We must know which audit firms offer which audit-related services and which non audit-related services (*e.g.* tax and consulting services) to the same companies, as well as the aggregated fees applicable.

Considering enhanced transparency, it should be taken into account as well that in the European Union a substantial framework of disclosure requirements for audit firms, including elements of firm governance, already exists. In fact, the requirements, based on EU Directive 2006/46/EC[1], are relatively new. EU Members States were required to implement the disclosure measures by June 2008. We believe that further initiatives on disclosure should be approached carefully - as the effectiveness of the existing disclosure framework has not been evaluated yet.

[1] Directive 2006/46/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC (OJ L 157).

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Consequently, if it is decided to provide enhanced transparency of audit firms, we will suggest to encourage further disclosure by non binding recommendations first. If these proof to work in practice, one could consider including elements in legal requirements. At the same time, if it would turn out that just a few audit firms comply with these possible recommendations, it could be discussed whether it would be appropriate to turn the recommendations in legislation afterwards.

Exploration of Non-Professional Ownership Structures for Audit Firms

As legislation requires public companies to disclose audited financial reporting and that investors must rely on these audits, the continued availability of independent and high quality audit services is fundamental. We believe that the high degree of concentration in the audit services market for large public companies is an issue of serious concerns. More competition is needed. However, the current ownership and governance rules within audit firms stimulate conservatism. In our view, it is just a question of time before the private partnership model will no longer be tolerated by the users of audit services, as many audit partners – also those without extraordinary performance – become extraordinary rich, while the governance of some of these firms is relatively poor. It is just a matter of time before people recognize that by introducing a 21st century business model for audit firms one could carve out the dead wood in the partnership structure. This will contribute to the functioning of audit firms, will make their prizing more reasonable and by allowing career opportunities which are less focused on 'all or nothing' create a more healthy and open internal control structure. Besides that, the existing firms tend to focus on existing markets and development of value-adding services for existing markets and clients. While we as investors would like to seek the opportunities in new developing markets and regions, for example in China.

Due to legal ownership restrictions almost all firms are organized as private partnerships and do not raise capital through public markets. The existing restrictions on ownership of audit firms can avoid firms from accessing non-private capital that could be used to develop firms in order to be able to audit large public companies and challenge the Big Four. Currently, by lack of a true alternative, clients of audit firms show signs of conservatism. Many large public companies have business activities in international markets and the complexity of their industries impacts their financial reporting. Those companies simply require audit firms with international coverage. As a result, no new firms have managed to compete structurally with the Big Four in the market since Arthur Andersen collapsed.

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Opening up the audit market for large public companies could have several advantages. The most important ones are swift access of investors to new emerging markets and the entrance of new audit market players. Reducing ownership barriers may contribute to the availability of choice of audit services for large public companies. Allowing for non-practitioner ownership may create more alternatives and safeguards for large public companies and their investors, in case one of the Big Four unexpectedly gets involved in an Arthur Andersen scenario.

We recognize the potential risks associated with changes in ownership rules on auditors' independence, professionalism and long term public interest focus. However, we believe that these risks can be reduced by implementation of practical solutions. Under the current ownership rules, risks to auditor independence and quality exist as well. One should not forget that the most important stakeholder of audit firms are the users of financial information, *i.e.* the investors. Investors are dependent on the quality of audit and are those that pick up the bill for the audit services provided. A profit maximizing strategy *vis-à-vis* holdings in audit firms will jeopardize the sustainable profitability of all other investments. Hence, there is an automatic incentive to go for quality; perhaps an even better one than current 'guarantees'. Consequently, we do not believe that external shareholders have an incentive to take decisions in an audit firm that would hamper audit quality.

However, a minimum of proportional safeguards to protect audit quality, others than those related to practitioner ownership, must be put in place. Strengthening audit firms' quality control networks and independence standards, as well as introducing new structures in firms' governance, for example board of directors with a more independent mindset, might create such safeguards. Currently audit partners are supervised by audit partners of the same firm. This is suboptimal supervision.

The introduction of non-practitioners in the governance of firms is needed. We would, however, not be in favor of the concept of "passive non-practitioner ownership" (non-binding voting) as a way of avoiding potential conflicts of interests within audit firms. That would intervene with the principle of "one share one vote' which is generally recognized as an important element of appropriate corporate governance. We doubt whether the range of potential non-practitioner owners should be limited. The composition of the board must be a fair constellation of the true constituents, the users of audit services. The personalities that serve in those boards must be carefully selected. In fact, introducing substantial restrictions *ex-ante* could have a negative influence on the ability of audit firms to raise capital, which should be, as a matter fact, an open choice. Audit firms' existing option for debt funding can in our view not be seen as a strong argument not to enhance the access to equity financing. It could be valuable for audit firms to

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have a choice between debt finance and equity finance in order to raise substantial funds, both in going concern and when times get tough.

Auditors communication

As far as the Consultation Report on Auditors Communications we would like to respond as follows:

Question 1. Is the standard audit report useful to investors? If not, why?

The existing standard is to some extent useful for institutional investors, since it offers investors an impression of the auditors' view on the financial statements and the basis for that view. Nevertheless, we believe the audit report could be much more valuable for investors. For the purpose of investors' decision making, it can be worthwhile when further information on the audit process (what the auditor actually did) and the quality of the financial statements (level of conservatism in management accounting decisions, analyses of risks) would be included in the audit report. Hence, we are in favor of requiring auditors to disclose the report of assumptions as well as a summary of the management letter without elaborate disclaimers. Investors and other users should be offered more information on the auditor's work on risk management, risk monitoring as well as relevant sensitivity analyses. At the same time, disclosure must be to the point and focus on only a few substantial issues. Extensive overviews and graphs can be left to the domain of auditors *vis-à-vis* audit committees.

Question 2. Would investors prefer a more concise audit report (e.g. a one-sentence report that includes only the auditor's opinion on whether the financial statements are fairly presented)? If so, why? etc.

The current form and language of the audit report are highly standardized. Due to its "pass/fail model", any "in between" is not allowed. As a consequence, the auditor can not truly weigh the quality of financial reporting and express this in their opinion. The level of standardization causes persons to become so familiar with the wording that the informational value is close to zero, while the audit report should be the most important form of communication between auditors and investors. A more tailored report that for instance reflects the judgments by the auditor throughout the audit process may enable investors to better understand the financial statements and the performed audit. The possibility to include findings on specific reviews called for by the investors and which had been reflected in engagements letters would facilitate a steep increase in the informational value of audit opinions and better reflect the actual principle-agent connection between investors and auditors.

Question 3. Are investors receiving information about the audit that they need to make informed investment decisions? If not, who should provide this information, the management or the auditor?

It is difficult to answer this question in general, since the adequacy of received information varies from case to case. However, we believe that further disclosure of relevant information by the auditor and/or the company will primarily decrease the risk investors do not have enough information to take appropriate investment decisions. It is important that the disclosed information not only focuses on financial facts and figures, but also includes relevant non financial and quality issues. In concrete terms, we would support when more information is provided on the scope and conduct of the audit, the consistency of company's accounting policies and the quality of financial statements in terms of clarity and verifiability. In our view, by providing a more concise audit report, investors will be able to better understand the audited financial information and its context. We prefer having as much as possible additional audit information included in the audit report. Providing additional information outside the report, for example in appendixes or additional documents, might negatively affect the coherence of the auditor's communication.

Question 4. If new or revised auditor communications are desired, would such communications be practicable? What legal, regulatory and practical challenges would preclude such communications? What criteria or principles should regulators use to determine what additional information should be provided?

We recognize revising audit communications, depending its form and extent, could result in certain legal, regulatory en practical challenges. Given, however, the public interest of audit functioning as a safeguard for the reliability of financial reporting in order to protect investors and other users, we are convinced that the benefits will outweigh these potential problems. Some of the potential problems, for example the need to amend existing legislation and audit standards, do not have a structural nature. Of course, the costs of more communications should not become excessive. At the same time, as investors ultimately pay these costs, it should be them to worry about "the bill" most. By and large, we believe that the challenges faced could be overcome.

When considering to what extent additional auditor communications are needed users' interests should be the primary objective, as referred to page 1 of the consultation paper. Investors and other users heavily depend on receiving adequate and reliable information from both listed companies and auditors, for them to take appropriate investment decisions. When this is

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achieved, investors will maintain confidence in the functioning of capital markets, including the services rendered to investors by audit firms.

If you would like to discuss our views further in detail, please do not hesitate to contact us.

Yours sincerely,

Rients Abma
Executive Director Eumedion

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15 January 2010

Greg Tanzer
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Spain

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

Dear Mr. Tanzer:

Ernst & Young Global Ltd., the central entity of the global Ernst & Young network, welcomes the opportunity to offer its views on the consultation report on the Exploration of Non-Professional Ownership Structures for Audit Firms issued by the International Organization of Securities Commissions in September 2009.

We agree with IOSCO that auditor choice is important for our markets. Choice promotes competition, and we believe that appropriate competition in the market for audit services has a positive impact on audit quality. As a result, competition is in the best interests of audit clients, investors and other stakeholders.

Looking at the market for audit services, we believe that small and medium size enterprises have a significant range of audit firms to choose from. Although the choice at the top end of the public company audit market is comparatively smaller, we are not aware of any studies which indicate that the level of competition in that market segment has adversely affected audit quality. Based on our own practical experience we can confirm that competition in the public company audit market is intense.

We believe the number of audit firm networks provide sufficient choice at the present time, subject to there being safeguards in place to counter the risks of firms being forced to leave the market as a result of catastrophic litigation or having to scale down their audit businesses.

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Regulators and policymakers need to ensure that the business environment within which audit firms currently operate is as pro-competitive and efficient as possible. An extension of non-professional ownership may, subject to appropriate safeguards, help to enhance competition. We believe, however, that non-professional ownership alone will not be sufficient to achieve that without further regulatory reforms. For example, increased efforts to promote regulatory convergence and sensible limitations on auditor liability would do much to promote longer term sustainability of the private sector's ability to deliver high quality audit services. It could also encourage smaller audit firms to seek to enter the larger listed company audit market.

Nevertheless, we welcome reasonable efforts to promote choice and facilitate participation of more audit firms in the public company audit market, provided non-professional ownership is not made mandatory. We recognize that IOSCO's focus on ownership restrictions is being undertaken with the acknowledgement that there may be other approaches to addressing concentration concerns.

In this context, following the format of the consultation report, we provide the following comments:

Ownership Restrictions as a Barrier to Entry

At Ernst & Young we believe that allowing broader non-professional ownership of audit firms could, in principle, contribute to lowering the barriers to entry to the market for audit services. It may help audit firms raise outside capital which they could use to strengthen their market position. Thus, in the worst case scenario of one or more audit firms leaving the market, modified ownership rules may also help facilitate the creation of new audit firms or strengthen the capital base of existing firms.

While we encourage consideration of alternative ownership models, the current partnership model has evolved and survived for a reason, which we attribute to the prioritization of independence and quality. In this regard, permitting alternate control structures might increase the potential for smaller networks to grow, but steps should be taken to make sure that these priorities could not be undermined, lessening confidence in the audits these and other firms conduct. We discuss this further below, under the caption of independence.

We encourage policymakers to re-appraise the existing rules which require audit firms to be majority owned by qualified auditors.

In this context, however, full consideration should be given to the effects of barriers to entry other than ownership restrictions, including the shortage of human resources, liability regimes, and the need for regulatory convergence. Related challenges regarding independence requirements are addressed in a separate section below.

Shortage of human resources

For an audit firm, human capital and financial capital are equally important and finite resources. One cannot exist without the other. An audit firm needs economies of scale to absorb the cost, resourcing and risk involved in auditing large companies. Building this level of capacity not only requires substantial financial investment, but first and foremost it takes a considerable amount of time and resource to recruit, train and support the professionals needed to provide audit services to such companies.

We believe that the finite supply of adequately qualified professionals is a significant barrier to entry to the market for public company audit services. Indeed, all audit firms, larger or smaller, are in a constant competition to attract and retain qualified people. Because of this pressure, most firms are reluctant to make large scale redundancies even in an economic downturn because they know how difficult it is to fill these vacancies when the market picks up. Therefore, aside from recruiting new beginners, audit firms often have to attract qualified people from other established audit firms.

We believe that new entrants will find it even harder to attract a sufficient number of qualified auditors than established audit firms.

Liability regimes

We believe that auditor liability regimes can act as barriers to entry to the market for public company audit services. The unlimited and uninsured nature of liability risk threatens the future of the private sector public company auditing function. Thus, addressing liability risk is essential not just for increasing competition, but indeed to ensure that the private sector audit function is sustainable.

Many jurisdictions provide for unlimited auditor liability. As a result, audit firms auditing larger companies face accordingly bigger liability risks and need to seek insurance coverage commensurate to the size of their audit engagements at a significant cost, however in some jurisdictions it may not be feasible to obtain adequate insurance coverage. Both the liability risk and the insurance cost to cover it, in our view, deter smaller audit firms from taking on bigger audit engagements.

Moreover, unlimited liability not only deters smaller audit firms from entering the market for public company audit services, it also increases the likelihood that a larger audit firm leaves the market because of catastrophic litigation.

Various private sector organisations have considered the issue and agreed that action should be taken – as have government bodies in the European Union, the United Kingdom and the United States. Many countries have already recognized the need to reform unlimited auditor liability regimes. The European Commission has issued a recommendation to limit auditor liability and nearly half the EU Member States either have

a statutory cap in national law or a cap in draft law. Moreover, countries such as Australia and Canada have moved to limit auditor liability in the past few years.

We believe sensible measures to limit liability could do much to promote the long term sustainability of the profession and the provision of high quality audit services.

Need for regulatory convergence

Currently, there is a large number of different financial reporting, auditing, ethical and regulatory standards in different countries. Audit firms auditing international groups of companies have to comply with a number of such different standards, which is costly and demands broad expertise.

In our experience, larger audit firms with a bigger number of international audit engagements can absorb the cost that results from such divergent compliance requirements much more easily than smaller audit firms. The latter have to bear a disproportionate cost burden, which may deter them from entering the market for public company audit services.

As an example, convergence toward a single set of internationally accepted high quality accounting, auditing, and ethical standards would help remove cost burdens that fall disproportionately onto the smaller audit firms with fewer international audit clients. Moving towards convergent standards and mutual reliance on home country regulation would in our view reduce the compliance cost burden and thus lower or even remove a barrier to entry.

Possibilities for Further Minimizing Risks and Improving Investor Protection

As mentioned above, we believe that modifying the rules on non-professional ownership may contribute to lowering a barrier to entry to the market for public company audit services/ Accordingly, we believe that any modification would require careful assessment and further study of both existing and possible additional safeguards around non-professional ownership.

Independence

We believe that maintaining an audit firm's independence is one of the key challenges in the context of allowing more non-professional ownership. We believe that the external ownership of audit firms could have a negative effect on their independence, to the extent that new market opportunities become severely restricted as potential clients become "conflicted out." Such restrictions could be driven by the likelihood that a non-professional (co-) owner of an audit firm will have other investments and business relationships. Its directors may also hold directorships with other companies. All of these could create conflicts of interest and breaches of independence requirements, which would preclude the

audit firm from the pursuit of a number of potential clients, in particular those that are SEC registered and subject to some of the most exacting independence rules.

These conflicts could, in turn, place such firms at a commercial disadvantage, and make it more difficult for them to recruit and retain the best talent (See discussion of human resources above). External ownership could have other implications too if such an audit firm were seen to be "less independent" due to perceived pressure on it to reduce investment in audit quality in order to pay a commercial rate of return to its external investors.

We are concerned that therefore the net effect of allowing more non-professional ownership could be more capital for more audit firms but at the same time less choice for audit clients.

Relaxing independence requirements to counter this risk, however, in our view requires careful study of the various existing sets of independence rules. We think that de minimis thresholds for non-professional owners, as discussed in the consultation report, may be an option that should be pursued. We do not believe, however, that without further study of existing independence rules we can make a robust suggestion as to the percentage of ownership that should constitute the de minimis threshold. Furthermore, we think it needs to be borne in mind that while de minimis thresholds may help to resolve the independence challenges of non-professional ownership, they would limit the amount of outside capital audit firms could attract and would therefore limit the positive effects an extension of non-professional ownership may have.

Audit quality

Under the current audit firm ownership rules, the practitioner-owners make an investment in their audit firms on which they desire an adequate return. At the same time, in performing audit engagements, they are personally bound by professional standards. In addition, they are incentivized to build and maintain a personal reputation for audit professionalism. As a result and as the consultation report correctly points out (please see page 12), the current "professional obligations encourage accountants to focus on long-term profit maximization goals and returns on their investment, rather than short-term financial incentives that might jeopardize the accountant's compliance with professional standards".

In our view, an extension of non-professional ownership needs to be implemented in a way that maintains the above described encouragement to focus on long-term professional reputation and long-term profitability rather than short-term returns.

We believe that one way of achieving this is to curb the influence of non-professional owners on the day-to-day running of the audit firm's business, and to exclude any influence of non-professional owners on issues relating to individual engagements or relating to exercising professional judgement.

Another option that we think should be explored would be to limit non-professional ownership to silent participations. Furthermore, the above mentioned de minimis thresholds could also help to manage the influence of non-professional owners on an audit firm's business.

We are aware that these limitations could make non-professional ownership less attractive for investors, at least for investors interested in short-term returns. We believe, however, that it may be possible to find long-term investors with an interest in maintaining audit quality and professionalism similar to the interest of practitioner-owners.

Impact on Audit Firm Concentration

As set out above, while there are issues that require consideration, we believe that allowing more non-professional ownership could have positive effects and in theory contribute to encouraging new entrants into the public company audit services market. We do also believe, however, that while non-professional ownership may help to achieve increased participation in that market, it would not make a significant difference, particularly as long as the barriers described above and mentioned again below continue to exist:

1. Absence of liability reform

   The expected use of additional equity capital raised from non-professional owners is not clear. In the absence of liability reform, capital could not be raised to provide an adequate reserve for even a single catastrophic loss due to litigation. Moreover, this risk would likely be too great for a market driven return on investment. So, investors would not only, as described above, have to take a long-term view on their investment for reasons of maintaining audit quality, they would also have to accept a high degree of risk. Because of this combination, we expect it would be difficult for audit firms willing to enter the market for public company audit services to raise a sufficient amount of capital to make a discernible difference.

2. Shortage of human resources

   An extension of non-professional ownership may make the competition for qualified professionals and more costly. Both established and new audit firms would compete even more intensely to recruit and retain high quantities of a finite supply of the best talent, from local and emerging economies. For example, in our experience it was recognized during the transition to IFRS in the European Union that appropriately qualified auditors were in short supply and most firms were only able to increase their capacity by attracting talent from their competitors.

3. Risk of reduction of choice and competition

   As described above, we are concerned that an extension of non-professional ownership may lead to independence issues, which, unless properly addressed, may

cause a reduction of choice for audit clients and, as a consequence, restrict rather than enhance competition in the market for audit services.

4. Risk of diversion of audit firms' funds

   Furthermore, allowing more non-professional ownership may carry the risk that audit firms may have to divert funds earmarked for investment for risk and quality control purposes to pay a sufficient rate of return to their non-professional investors. This could undermine audit quality and possibly increase the risk of audit firm failure. Thus, it may not only reduce the number of current market participants but also dissuade potential new entrants looking to invest in the provision of audit services.

Furthermore, to our knowledge, there is no evidence to suggest that audit firms would have an appetite for soliciting non-professional investors or that there are investors willing to invest.

Finally, we would like to point out that the topic of non-professional ownership has been discussed by a number of groups, including the European Commission Consultation on Control Structures in Audit Firms and the U.S. Treasury Advisory Committee on the Auditing Profession, as well as others named in the consultation paper. We suggest the results of this work should be considered in any advanced work on this topic.

In summary, we believe that an extension of non-professional ownership may be beneficial but that its benefits can only be reaped if it is accompanied by further regulatory reforms such as moves towards greater regulatory convergence and reasonable limitations of auditor liability.

We would be pleased to discuss our comments with IOSCO or its representatives at your convenience. Please send any correspondence for the attention of Trevor Faure, Global General Counsel (trevor.faure@uk.ey.com).

Yours sincerely,

Ernst & Young Global Ltd.

FAR SRS

The institute for the accountancy profession in Sweden

Greg Tanzer
Secretary General
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15th January 2010

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

FAR SRS, the Institute for the Accountancy Profession in Sweden, is responding to your request for consultation on the matters discussed in your Consultation Report on Non-Professional Ownership Structures for Audit Firms.

FAR SRS fully supports FEE's response (see attachment) to the IOSCO Consultation report.

In addition FAR SRS will strongly underline the following points:

1. FAR SRS is of the opinion that changes in auditors' liability regimes are of far greater importance than the role of financial capital for achieving more competition and choice in the audit market.

2. FAR SRS is also of the opinion that in order for small and mid-tier firms to afford recruiting adequate expertise and thereby enable them to accept bigger and often more complicated assignments, all kinds of regulation should be subject to simplification and continued harmonisation. It is FAR SRS' opinion that there is still potential for further simplification in areas such as accounting, company law and tax, also for listed companies.

FAR SRS

Anna-Clara af Ekenstam
Chairman of FAR SRS section for large entities

Dan Brännström
Secretary General

Attachment: FEE response to IOSCO consultation

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Federation of European Accountants
Fédération des Experts comptables Européens

Mr. Greg Tanzer
Secretary General
IOSCO General Secretariat
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Spain

12 January 2010

Ref.: AUD/HvD/HO/PW/MB

Dear Mr. Tanzer,

Re: FEE Comments on the IOSCO Technical Committee Consultation on Exploration of Non-Professional Ownership Structures for Audit Firms

FEE (the Federation of European Accountants) is pleased to provide you below with its comments on the Technical Committee of the International Organization of Securities Commissions (IOSCO) Consultation on Exploration of Non-Professional Ownership Structures for Audit Firms (the IOSCO Consultation Paper).

FEE is of the opinion that auditing is fundamentally underpinned by the ethics of professional services, the quest for quality and a commitment to the public interest.

FEE recognises that there is currently a debate about (i) choice in the audit market, (ii) sustainability of the audit profession in particular in the context of liability issues and (iii) the potential systemic impact of an involuntary withdrawal of one of the major existing audit providers.[1]

The European Commission organised recently a consultation on control structures in audit firms and their consequences on the audit market, which broadly addresses similar issues as these covered by the IOSCO consultation. It could be useful for IOSCO to consider answers to this consultation, which have been published on the European Commission's website[2].

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[1] Study on the Economic Impact of Auditors' Liability Regimes, Final Report To EC DG Internal Market and Services By London Economics in association with Professor Ralf Ewert, Goethe University, Frankfurt am Main, Germany, September 2006

[2] 69 comment letters and a summary report prepared by the services of the European Commission – Directorate General for Internal Market and Services are available at: http://ec.europa.eu/internal_market/auditing/market/index_en.htm

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

FEE would also recommend that IOSCO similarly publishes the responses received to its Consultation Paper, as well as a summary thereof to aid transparency towards all stakeholders concerned.

Our main comments to the IOSCO Consultation Paper are summarised below:

1. FEE is of the view that there is no single element which can create more choice and less concentration in general. These issues need to be addressed with great prudence, following a holistic approach and assessing the impact of any steps to be taken. In any instance, solving the liability issues both at individual country level and globally is an essential precondition.

2. The matter is complex and consideration should be given to potential impacts on capital markets, stakeholders' confidence and audit quality. This complexity mainly stems from the fact that:

   - There are different parts of the audit market, and only one where choice could be seen as a source of concern: that of larger multinationals active across the globe and sometimes with several listings;

   - This market situation has developed over a long period of time and will only evolve over the long term.

3. FEE is not convinced that lifting all bans on non-professional ownership in audit firms as suggested in the current consultation might result in more global players in the audit market.

Our detailed comments and responses to the questions raised in the consultation paper are provided in the appendix attached hereafter.

FEE would be pleased to discuss any of the points raised in further details. To this end, or for further information, please contact Henri Olivier (henri.olivier@fee.be) or Petra Weymüller (petra.weymuller@fee.be) from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

Appendix – Detailed comments

This appendix contains FEEs detailed comments and responses to the questions raised in the IOSCO Consultation Paper on Exploration of Non-Professional Ownership Structures for Audit Firms.

Q1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

(1) In principle, it would be helpful if legislators created a context that facilitates access for medium-sized audit firms to the market of public audit services. Such measures would not only relate to entry but also encourage medium-sized firms to stay and develop in this market.

FEE doubts however that organic growth or mergers in the medium-sized audit market could in the short or medium terms close the gap between existing larger international audit firms and small and medium-sized audit firms and that concentration in the audit market would be reduced as a consequence.[3]

(2) FEE would like to highlight that the current number of audit firms' networks is a result of market forces and history. It also depends on the size of the jurisdiction that can make it difficult for all audit firms' networks to be represented.

Q2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

(3) FEE believes that market mechanisms should shape market structures and that historically regulatory intervention has already had an indirect impact on market structures and consequently on the number of market players.

Education, training, licensing, registration, quality control requirements, liability regimes and especially independence provisions, although necessary for audit quality, are still largely determined by national jurisdictions. This constitutes a barrier for all audit providers to operate across jurisdictions. As in other domains, for instance accounting and auditing standards, the application of international standards, would reduce these national barriers.

[3] World Survey 2008, International Accounting Bulletin, 18 December 2008, page 6 to 14; also Final Report of the U.S. Treasury Advisory Committee on the Auditing Profession of 6 October 2008, Page VIII:4

Appendix – Detailed comments

As demonstrated in a major FEE study on Trans-national Organisations and Practices (2008) the accountancy profession's trans-national evolution within Europe (and further afield) has been strongly moulded by the fragmented, jurisdiction-specific approach to regulation across the world and to the different legal systems and cultures. The profession has had to develop specific structures to make possible the servicing of trans-national client needs while also respecting national regulatory and legal requirements and related factors.

Other barriers, which were largely removed in Europe, can still exist in other part of the world, such as restrictions on multiple location, fees, advertising, and similar ethical restrictions.

(4) FEE is convinced that ensuring the limitation of auditors' liability is a prerequisite to facilitate a broader access of audit firms to the market related to listed companies.[4] FEE would also like to point out that the international and in particular the US litigious environment resulting in the issue of potential extension of liability to networks, definitely inhibits the further development of current or new players. It is relevant to note that many indemnity insurance contracts in Europe exclude from coverage, all business activity involving a US client. It appears that certain mid-tier firms have recently been taking measures to reduce trans-national quality assurance programmes in light of concern over the implications for liability risk.

(5) Companies, their external advisors (banks, lawyers) and regulators are often influenced by the "IBM effect" whereby they select a statutory auditor and often go to the larger firms without necessarily fully considering the real capabilities and competencies of other audit firms.

(6) Regulators should turn their attention first to the demand side and the process for selecting statutory auditors and audit firms. The following measures which do not necessarily require regulatory intervention could be considered:

- Stronger governance principles regarding the role of audit committees in selecting the external auditor;
- Transparency of tendering procedures with a view to ensure that smaller firms are not prevented from competing. In this respect it should be noted that mandatory rotation of firms would be counterproductive and that experience has shown that it may well hinder audit quality.

(7) Regulators should prohibit contractual clauses on the basis of " big 4 only "or requiring companies to disclose any provisions in the agreements that limit their choice of the auditor. (See EC Summary Report, p.19)

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[4] See Impact Assessment to the European Commission's Recommendation concerning the limitation of the civil liability of statutory auditors and audit firms, dated 5 June 2008, page 18 and 28

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(8) Regarding the supply side, FEE would like to suggest prioritising the following actions:

- Continue progress on auditors' liability reform;
- Enhance convergence of standards and adopting the clarified ISAs;
- Ensure convergence on independence requirements;
- Consider the impact of the scope of statutory auditing (including thresholds to exclude categories of companies) outside the audit market for listed entities on the capacity of smaller firm to gain experience and attract qualified staff;
- In Europe, ensure a consistent implementation of the Statutory Audit Directive and avoiding divergences such as with the network definition.

Q3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

(9) As indicated in the answers to the previous questions, holistic approaches addressing all barriers to entry merits close attention. Actions could possibly be taken equally on the supply side and on the demand side.

Ownership Restrictions as a Barrier to Entry

Q4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

(10) The concept of non-practitioner is unclear. FEE suggests making a clear difference between four groups:

- (registered) statutory auditors,
- Statutory auditors registered in another jurisdiction[5],
- Professional accountants who are not registered as statutory auditor (whatever the reason) and professionals of another discipline employed by the (accounting) audit firm,
- Outside investors (in particular banks and other financial institutions) having only a financial interest in the audit firm.

[5] Considering the provision of the Statutory Audit Directive, in this case, the EU Internal Market needs to be considered as a single jurisdiction.

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(11) The outcome of possible discontinuity of audit services of one of the major players is unclear. It is not excluded that some partners and staff would join a smaller network which would then be able to provide services to larger listed companies. FEE suggests that before trying to address this question, regulators should first help providing an answer to the liability problem, which is the major if not the only threat to the continuity of audit services.

Q5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

(12) Of course, audit providers need capital to:

- Set up structures to cover all the jurisdictions where there is client demand,
- Recruit the necessary talent and
- Develop systems to deliver and ensure the highest quality.

Nevertheless, as confirmed by IOSCO, FEE is not aware of any real difficulty in finding and maintaining such capital. Therefore, it is unclear whether new sources of finance would have any material effect on the decision to enter the market for public company audits. (See question 18)

(13) The Consultation Report states that "Permitting broader ownership might increase the number of providers of audit services for large public companies. For example, permitting broader ownership might encourage new entrants to enter the market, including through expanded capital-raising in public market" (p7.)

FEE believes that financial capital may play a certain role but is not regarded as a key factor for increasing choice in the audit market. Auditing is not a capital-intensive activity, but a human capital intensive one.

(14) In Europe, annual accounts and transparency reports published by the firms generally exhibit a low level of debt.[6]

[6] see for example http://annualreport.deloitte.co.uk/2008/financial-statements, http://www.kpmg.eu/docs/KPMG_AR_29.12.pdf, http://www.ey.com/Global/assets.nsf/UK/EY_annual_review_2007/$file/EY_Annual_Review_2007.pdf , http://www.pwc.co.uk/annualreport08/AR_2008.pdf, http://www.bdo.co.uk/BDOSH/SharedContent.nsf/i/4E0E9151164E9CC0802575080054C293/$file/bdo-figures-consolidated3.html,

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Q6. Would allowing audit firms the option of broader non-practitioner ownership, allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

(15) In the overall strategy to have more audit firms active in the segment of the audit market concerning listed companies, FEE believes that external capital is unlikely to be a key factor.

Audit Firm Ownership Restrictions: Background

Q7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

(16) It is important to recall that non-practitioner ownership has existed in certain countries before the European Eight Directive on the Approval of Statutory Auditors was enacted in 1984. At those times, audit firms could be owned by banks or by the state. The model was put into question because of its perceived risks for auditors' independence and was finally abandoned.

(17) The perceived risks result in particular from the fact that non-practitioner ownership is characterised by the possibility of majority and thus controlling shareholders seeking short term gains.

(18) In the European Union, the Statutory Audit Directive provides that a majority of the voting rights in an entity must be held by audit firms approved in any EU Member State or by natural persons who satisfy at least the conditions imposed by this Directive; accordingly it allows a minority to be held by non-auditors.

Since 2006, the criterion of "a majority" must be interpreted at the level of the EU, not within a single Member State. It is true to say that this provision of the European Directive has been transposed in such a way that diverging regimes continue to exist in some EU Member States, which is not conducive to the development of more audit providers operating with potential greater international capacity. It is however relevant to note that few audit firms use the maximum of this possibility when authorised by national law in Europe. (EC Summary Report p.12)

(19) FEE is of the opinion that auditing is fundamentally underpinned by the ethics of professional services, the quest for quality and a commitment to the public interest.

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FEE fully subscribe to the statement in the Consultation Report (p.9): "Limiting majority ownership and control to individuals who meet acceptable licensing credentials arguably promotes competence and a culture of professionalism, and prevents non-practitioners from influencing, through management or control, the attestation practice without having the attendant competence, professional obligations and experience. The practitioner's status as an accounting professional subject to attendant obligations is believed to temper the firm's focus on its economic interests and provide assurance that management decisions are made with the benefit of professional knowledge and obligation to the public interest. In addition, the impact of an adverse judgment arising from a violation of professional standards could be greater for practitioners, increasing the deterrent effect of liability."

Q8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

(20) It is relevant to observe that accountants carry out services other than statutory audit and therefore do not necessarily need to be registered as statutory auditors, a fact which strengthens the need for multi-disciplinary structures. Furthermore, many professionals of other disciplines, e.g. lawyers, tax advisors, business and IT consultants are also working in audit firms and have ambitions of becoming a partner. However FEE maintains the view that it is beneficial to retain the majority ownership requirements established by the EU legislation.

(21) Among other difficulties that should be addressed in alternative forms of audit firm ownership and governance, ethical rules can be highlighted, including confidentiality (professional secrecy) and indeed independence rules. Since ethical principles should apply to them, outside investors might create additional conflicts of interests and eventually reduce the choice in the audit market.

Q9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

(22) Alternative forms of ownership that include boards of directors with independent members might be a useful factor for reinforcing auditing firms' obligations and independence in the public interest but this is not directly related to the objective to facilitate market access. Furthermore it would not be a sufficient additional safeguard to avoid that non professional objective cause undue pressure on the work of statutory auditors.

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(23) ICAEW/FRC issued this year a Consultation Paper on Audit Firm Governance which addresses among others the issue of independent directors in audit firms[7]. Commenting on this consultation paper, FEE noted that the objective of the Code is to encourage firms to adopt governance arrangements, and to communicate information on those arrangements, so as to enhance the confidence of shareholders and others in the way that all the firms covered by the Code, i.e. not only the largest firms, are run and thereby enhancing choice. FEE however observed that there is a potential risk that the compliance costs associated with the Code will form a further barrier for smaller audit firms.

Q10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?

(24) As mentioned above (paragraph 21) FEE believes that the removal of existing restrictions to the access to partnership for professionals employed by the audit firm is a possibility to facilitate the emergence of multi-disciplinary networks and therefore of new market players.

(25) Firm employees who are not practitioners should be treated differently from outside owners. A person working in the audit firm is directly interested in the quality of the professional service delivered by the firm. By contrast the risk of influence may be considered to be greater when the shares are held by persons whose only interest in the firm of statutory auditors would be capitalistic and, in particular, when the shares are held by financial companies. External shareholders are not necessarily as sensitive to the ethical and professional constraints as those who are professionally engaged in the firm of statutory auditors.[8]

(26) External perception might differ if external capital (and/or detention of the majority of voting rights) is owned by other professionals subject to the rules of their professional bodies working within the audit firm as opposed to financing organisations external to the firm.

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[7] The Consultation Paper and comment letters including the FEE comment letter can be downloaded from the ICAEW website:
http://www.icaew.com/index.cfm/route/161380/icaew_ga/en/Technical_and_Business_Topics/Topics/ICAEW_consultations/Governance_of_firms_that_audit_listed_companies

[8] FEE Discussion Paper on Free movement of Firms, October 2001, p.7

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Q11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

(27) As indicated in the introduction, FEE is of the opinion that auditing is fundamentally underpinned by the ethics, independence, the quest for quality and a commitment to the public interest.

(28) There is a risk that outside shareholders would focus on the revenue from their investment rather than on ethics and quality of audit services. If they own the majority of votes, this could have an impact on the credibility of statutory auditors towards investors and ultimately on the audit profession as a whole.

(29) Changing the existing model could also have an (negative) effect on other aspects, notably:

- The selection process of statutory auditors by companies and audit committees;
- The recruitment of staff.

Possibilities for Further Minimizing Risks and Improving Investor Protection

Q12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

(30) FEE acknowledges the importance of Article 24 of the EU Statutory Audit Directive stating: "Member States shall ensure that the owners or shareholders of an audit firm as well as the members of the administrative, management and supervisory bodies of such a firm, or of an affiliated firm, do not intervene in the execution of a statutory audit in any way which jeopardises the independence and objectivity of the statutory auditor who carries out the statutory audit on behalf of the audit firm."

(31) FEE believes however that a majority of externally-owned capital and control would probably have an impact on the applicable independence rules, the consequences of which would require careful analysis, both in relation to the internal workings of audit firms and to external perceptions.

(32) Internal quality control systems as required by the IAASB standard on quality control (ISQC 1) or national equivalent might potentially be affected by the intervention of non-practitioners (e.g. on cost grounds), although the performance of individual audit engagements could not be affected.

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Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

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Q13. What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

(33) In the EU, the minimum required is that a majority of voting rights must be held by approved audit firms or natural persons who satisfy at least the qualification conditions imposed by the Statutory Audit Directive. However, some Member States have adopted a more restrictive approach, asking for more that just a simple majority of voting rights[9]. The same legal provision requires a majority – up to a maximum of 75% - of the members of the administrative or management body of the entity to have the same quality[10].

(34) An additional question relates to the possible limitation for certain categories of non-practitioners to be associated in an audit firm. For instance a distinction could be made between specialists of other disciplines employed in the firm and outside investors. It could be worthwhile investigating the potential for enabling multi-disciplinary practices where the majority of voting rights could not necessarily be in the hands of statutory auditors or audit firms. This leaves open however the definition of disciplines that can be associated in such multi-disciplinary partnerships.

Q14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

(35) In Europe, the Directive on Statutory Audit provides for adequate requirements on education, continuous professional development, independence and ethics, quality control.

[9] It is noted that the Directive refers to voting rights, not to share capital, which can lead to different situations in Member States depending upon the legal rules applicable to companies.

[10] Art.3.4 of the EU Directive 2006/43/EC of 17 May 2066 on Statutory Audit

(36) The reservation of the majority ownership to auditors is a safeguard in itself. Were such safeguard to be removed, another safeguard would most likely have to be found to close the gap. Additional safeguards, which could become necessary if outside investors have the majority of voting rights are however very difficult to identify. In its study for the European Commission, the consultant OXERA quoted in the IOSCO consultation, did not make any convincing proposal in that respect. It should also be noted that any additional regulatory measure(s), which would bring more complexity, would ultimately be an additional barrier to enter the market.

(37) The suggestion of the IOSCO paper (p.14) of passive ownership might not be fully workable if for some important decisions, non-voting shares recover their voting right. Furthermore, non-voting shareholders could still have the indirect possibility to put pressure on the management of the audit firm to improve the profitability of their investment.

Q15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

(38) FEE does not see any existing risks to any investors which might be mitigated by public ownership. FEE believes that the current model has proved very successful overall.

Q16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

(39) Under the current circumstances and legal regime, FEE believes that there are already ample safeguards to protect auditors' independence. For example Article 24 of the Statutory Audit Directive mentioned above.

Q17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

(40) Any new safeguard would most likely bring more complexity. In this way, such additional safeguards risk entrenching, rather than reducing, the concentration of firms in the audit market.

Impact on Audit Firms Concentration

Q18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

(41) FEE has in any case doubts that the non-practitioner ownership might result in more global players because financial capital is not regarded as a key factor for going global, neither for the emergence of new audit firms nor for the enlargement of existing networks.

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(42) As suggested in question 19, the major firms could also use the opportunity. Ultimately this could also strengthen their position in the audit market.

Q19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

(43) FEE has no opinion on possible plan of the major audit firms in that respect

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About FEE

FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level

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22 December 2009

Dear Mr Tanzer

Exploration of Non-Professional Ownership Structures for Audit Firms

The Financial Reporting Council (FRC) is the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting and governance.

The FRC welcomes the opportunity to comment on IOSCO's consultation paper 'Exploration of non-professional ownership structures for audit firms'. The risk to the continued supply of high quality independent audit services posed by the concentration in the market for the audits of the largest companies has been of concern to the FRC for some time and we are therefore grateful to IOSCO for raising global awareness of this issue.

In 2006 the FRC established a Market Participants Group (MPG) to advise on possible actions which could be taken to mitigate the risks arising from concentration in the audit market for large public interest entities. The MPG published fifteen recommendations in October 2007 and this IOSCO consultation is an enabler to the MPG's first recommendation: 'to provide wider understanding of the possible effects on audit choice of changes to the audit firm ownership rules, subject to there being sufficient safeguards to protect auditor independence and audit quality'.

1 The case for intervention

The continued supply of sufficient choice of high quality audit is crucial to the effective functioning of a developed economy. Currently, only four firms are in a position to provide this to the very largest, global and most complex companies. In

the current market there is no evidence that the collapse of one of the Big Four would result in a replacement firm emerging and the likelihood is that such a collapse would result, at best, in a "Big Three" and at worst in the disappearance of private sector audit services for the largest companies.

Note that, although other industries may be able to function effectively with only three major players, audit firms are subject to unique ethical and independence requirements. In particular, independence restrictions limit the ability for firms to provide both audit and non-audit services to their clients. In the event of a Big Four firm leaving the market, firms providing non-audit services to the failed firm's audit clients may be unable or unwilling to cease to provide those services in the short to medium term, leaving some of those clients unable to find a suitable auditor.

In view of these issues, we believe it is entirely appropriate for regulators and legislators to address barriers to entry into this market.

2 Ownership restrictions as a barrier to entry

The MPG report identified a number of barriers to entry into the market for large public interest audits. These barriers apply both to brand new market entrants and equally to existing audit firms seeking to compete with the Big Four in the market for audits of the very largest companies.

Whilst restrictions on ownership may be a barrier to capital raising and market access, it is clear from the MPG report and other studies that this is not the only barrier to entry into this market. Many others exist; not least perceptions amongst some market participants that only Big Four firms are capable of delivering high quality audit services to fully listed companies, whereas as noted above the point is only valid in relation to the very largest and most complex. Any attempts to reduce concentration in the market must address all of these barriers.

3 Ownership and its relationship to audit quality

The FRC sees no reason why current restrictions on ownership should be crucial to maintaining audit quality. However, we recognise that some market participants do have valid concerns around relaxing current restrictions, particularly with respect to the potential effect on the culture of a firm where audit practitioners find themselves in a minority. We are also aware that some market participants believe there is further risk that outside investors in particular could drive down audit quality for the sake of short-term profits. For the reasons explained below, however, we believe that such concerns fail to appreciate the nature of major audit firms in today's environment.

It would be naïve to assume that the current owners of firms are immune from commercial pressures. Most large audit firms are highly commercial enterprises whose partners and staff are often incentivised in a way which encourages them to focus on short term-targets.

In the UK up to 50% of an audit firm's owners may be non-auditors, and there are many non-auditors at senior levels within firms of all sizes. Such partners are likely to be motivated by the same economic incentives as their auditor colleagues and also likely to be influenced by the culture of the firm. Many firms also require non-auditors to comply with the same ethical requirements as audit practitioners. As a result, in practice their behaviours are unlikely to be significantly different.

Human capital is an important factor for audit firms and some commentators have expressed concerns that it is more difficult to provide adequate remuneration to attract and retain high quality senior personnel under such a corporate structure than it is with the traditional partnership model. However, remuneration is not the only factor motivating employees, and other industries have moved from a partnership to a corporate structure without losing their ability to attract and retain high quality staff.

It should also be noted that recent legislative change in the UK now permits law firms, which have historically been subject to similar ownership restrictions as those imposed on audit firms, to operate under alternative business structures.

4 Possibilities for further minimising risks

The FRC considers that existing safeguards relating to audit quality and independence could continue to be effective in firms which are more broadly owned by non-practitioners. In particular, the following will continue to be of relevance and should act to mitigate concerns on audit quality:

- Auditor training, examinations and continuing professional development requirements;
- Technical standards and guidance for auditors;
- Ethical standards and independence requirements;
- Independent inspections by regulators;
- Disciplinary arrangements of professional bodies and regulators; and
- Disclosure and transparency requirements.

As noted in the consultation paper, non-practitioner employee ownership poses different issues to a model involving external investors. In the latter case regulators/legislators may wish to consider the introduction of a "controllers regime" which would require all those who wished to hold above a de minimis percentage to seek prior approval from an appropriate regulatory authority. Such a regime would ensure that an audit client company, for example, could not exercise undue influence over the firm in question and ensure that any external individuals with significant shareholdings met fitness and propriety tests.

The level which should be considered de minimis is a matter for national regulators.

Additional safeguards might include prudential supervision of audit firms and the introduction of new governance arrangements such firms. These governance arrangements might include the appointment of non-executive directors and/or

mandatory transparency disclosures. A new governance code for audit firms is due to be implemented in the UK in the near future.

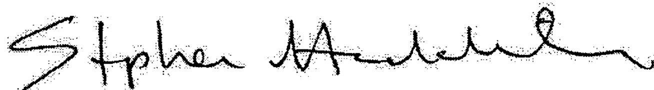
It should also be noted that audit firms with wide public ownership would be subject to the same corporate governance requirements as other listed companies, leading to increased transparency.

5 Conclusion

In conclusion, the FRC believes that it should be possible to liberalise ownership restrictions without sacrificing audit quality and that such a change may encourage new entrants into the market for the audits of the largest companies. There are however other important barriers to entry, notably the question of market perception.

If you would like to discuss any of the comments made, please contact Paul George on +44 20 7492 2340.

Yours sincerely



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15 January 2010

Dear Mr Tanzer

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

Grant Thornton International Ltd (Grant Thornton) welcomes the opportunity to comment on the above-referenced consultation report. Below we provide a number of general comments on the consultation paper, and in an appendix hereto we answer the specific questions posed.

A robust, competitive public company audit market benefits investors and the capital markets, and therefore Grant Thornton supports the engagement of regulators in addressing excess market concentration. We also support the concept of relaxing restrictions on audit firm ownership because they unnecessarily restrict the options available to international audit networks. As a practical matter, however, we believe that relaxing audit firm ownership requirements will likely have no meaningful effect on concentration.

To achieve meaningful, long-term reductions in audit firm concentration, we believe regulators should address contractual provisions restricting companies from hiring non-big four auditors. Our research of public documents has revealed numerous examples of such provisions, which we believe are far more significant to audit market concentration than are ownership restrictions. We therefore ask that regulators require the full and fair disclosure of these contractual restrictions. A detailed discussion of this issue follows.

Concentration should be addressed by regulators and other capital markets participants

Grant Thornton believes that the current structure of the large company audit market is unsustainable and may threaten the stability of the global capital markets. Companies in certain jurisdictions or market sectors already face a limited choice of audit firms, and the potential failure of a major audit firm (warranted or not) may pose a threat to market stability. Investors, regulators and companies widely acknowledge that the solution to excess market concentration is a sustainable net increase in the number of audit firms with meaningful market share.

Removing restrictions on non-professional ownership of audit firms will likely have no meaningful effect on concentration

We believe the solution to concentration lies within existing non-big four audit firms who wish to expand their market share, but we do not believe that changes to ownership rules will be important in helping them to do so. Through discussions with chief executive officers and audit leaders in a number of Grant Thornton member firms — including Argentina, France, Japan, the United Kingdom, and the United States — we found 100% concurrence in the belief that relaxing ownership rules will have little practical effect on concentration. To elaborate:

- We do not believe that investing in audit firms will be attractive to outside investors because of (1) the difficulty that investors would face in finding a return on their investment, and (2) audit firms' numerous auditor independence restrictions, limiting the type of work performed and possibly the rate of return on outside investment.

- Permitting outside investment in non-big four firms will not enhance their ability to compete against the big four for the largest public company audits because it will do nothing to help them attract qualified auditors. The single most important resource of audit firms is their human capital, and it is difficult to find personnel with the experience and expertise to audit public companies. As the consultation paper notes, the big four audit 98% of the 1,500 U.S. public companies with annual revenues of over $1 billion. If every firm outside of the big four merged into one firm, it would still audit only 2% of such companies. This means that any invested capital would have to be directed toward the difficult task of acquiring clients and, more importantly, audit personnel from the big four firms — something that likely would have to occur quickly, given the typical demands of an outside investor. Even if investors would find this to be a sound business model, these firms often would be unable to compete with the big four for reasons we discuss elsewhere in this paper — namely, restrictions that prevent or restrict companies from engaging non-big four audit firms.

- Outside investment would likely increase pressure on short-term earnings. Conflicts of interest are also more likely to occur (e.g., a significant investor, without the auditor's knowledge, invests in an audit client). While these conflicts may be manageable, they further compound the issues that result from outside investment.

Our belief that a relaxation of ownership rules would not be sufficient to reduce concentration is shared by many outside of Grant Thornton. In November 2008, the European Commission issued a consultation on control structures in audit firms. After reviewing the responses, the Commission noted the following in a press release: "[M]ost of the respondents consider that lack of access to external financial capital is not the most important barrier preventing emergence of new players. It would not, therefore, be sufficient simply to change the current rules on the control of audit firms; a comprehensive analysis on a greater number of priorities would be needed."[1] We agree.

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[1] *See* European Commission, ***International audit market: consultation respondents recognise need to remove barriers to entry*** (15 July 2009), available at

Grant Thornton supports a simpler, yet more effective, response to concentration: addressing contractual provisions restricting companies from hiring non-big four auditors. Our research of public documents has revealed numerous examples of such provisions, which we believe are far more significant to audit market concentration than are ownership restrictions. If unsustainable market concentration is to be resolved efficiently, barriers to a "free market" for audit services must be removed, allowing companies and audit committees to change their audit buying patterns. We therefore ask that regulators address these contractual restrictions by requiring their full disclosure. Below we discuss this action and other recommended measures.

Addressing contractual restrictions on audit firm competition is critical to the issue of concentration

We believe that contractual restrictions on auditor choice represent the most significant barrier to increasing audit firm market share. These contractual restrictions often state that only four audit firms are authorised to provide services to a company, thus excluding all but the big four firms from acting as auditor, from conducting due diligence work and/or from advising on a transaction.

Contractual restrictions that prevent or restrict companies from choosing among a broader range of auditors have no bearing on audit quality and often result from the misinformed view of audit committee and board members, banks, underwriters and legal advisers as to the firms that are qualified to conduct high-quality international audits. The restrictions have the effect of reducing competition and can be extra-territorial in effect when loans are made to companies with foreign subsidiaries or by banks' overseas subsidiaries.

To our point, Grant Thornton has numerous documented examples of these contractual restrictions from the United Kingdom and the United States, and we are aware of other examples from France, Germany, Spain, and a dozen other countries. We provide a number of examples in Appendix B to this letter.

By taking the following steps to eliminate auditor choice restrictions, regulators can act against concentration in the larger public company audit market.

- First, regulators should require public companies to disclose their third-party agreements that limit auditor choice.

- Second, we recommend requiring institutional investors, other finance providers and intermediaries to state their policies on auditor appointments, both in general and in conjunction with specific transactions. While disclosure of specific restrictive covenants is important and necessary, disclosure alone will not resolve concentration. Disclosure by the company being audited will generally occur long after an auditor has been selected, leaving firms that are "restricted by omission" with no opportunity to compete for the work. Lacking further regulatory actions, disclosure is "too little too late" to achieve healthy competition among a broader range of audit firms. With access to these stated policies on auditor choice, audit

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(http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/1139&format=HTML&aged=0&language=EN&guiLanguage=en).

firms would be better positioned to address restrictions on competition and compete for audits.

- Third, we request that regulators consider discouraging companies and financial intermediaries from entering into agreements containing auditor choice restrictions — perhaps by requiring them to state their reasons for such clauses. We believe that restrictive clauses are often part of boilerplate provisions and are included without being negotiated.

We believe that appropriately addressing restrictive covenants will allow firms such as Grant Thornton to compete for and win additional engagements to audit larger public companies.

Other initiatives to raise awareness of audit firm capabilities

The following actions by regulators can also raise awareness of audit firm capabilities:

Publish inspection results. We encourage national audit regulators to publish fair and balanced results of individual firms' audit inspections. We believe that the publication of inspection reports could reduce concentration by addressing market misperceptions that non-big four firms are inferior to big four firms. Importantly, however, where individual firms' inspection reports are published, it is critical that the inspection results be reported fairly, in context (i.e., include both positive and negative comments). Audit committees and others can then make auditor appointment and re-appointment decisions based on balanced independent audit quality assessments rather than on perception.

Independent study. We believe that audit committees misperceive investor attitudes toward auditor appointment (i.e., that "biggest is best"), reinforcing institutional bias and audit market concentration. An independent study of shareholder appetite for a broader choice of audit firms could send a powerful message to audit committees, dispelling their misperception with facts.

More positive public statements. We believe that regulators have a responsibility to speak to the capability and capacity of firms outside the big four. By failing to exercise their strength and reach to involve a broader representation of audit firms in committees, public fora or other projects, regulators contribute to, rather than resolve, concentration. Regulators should also avoid suggesting, even unintentionally, that only four firms are capable of conducting high-quality audits of public companies. This includes characterisations in consultation papers such as this one, which, for example, discusses the global reach of the big four, but does not mention that other firms also have global reach. Such language may serve to embed the very institutional bias that regulators are seeking to address — and that organisations like Grant Thornton are fighting to overcome.

* * *

Appended to this letter are our responses to the questions posed in the consultation paper. If you have any questions, please contact April Mackenzie (phone: +1 212 542 9789; email: April.Mackenzie@gt.com), Jon Block (phone: +1 202 861 4100; email: Jon.Block@gt.com), or Nick Jeffrey (phone: +44 207 728 2787; email: Nick.Jeffrey@gtuk.com).

Yours faithfully

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Appendix A – Consultation Questions

Introduction

Question 1: ***Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.***

Grant Thornton response: Yes. We believe that regulators and/or legislators should address barriers to increasing market share and entry in the market for large public audit services. As detailed in the body of our letter, we believe that concentration in the large public company audit market is an issue for the capital markets, and barriers should be addressed appropriately by regulators.

Question 2: ***What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?***

Grant Thornton response: We believe that the most significant barriers to increasing market share are contractual restrictions preventing or restricting non-big four audit firms from competing for large public company audit work. We believe that these restrictions result from market misperceptions about the capability of global audit networks other than the big four. As discussed in the body of our letter, legislators and regulators can address these barriers in a number of ways, including: (1) requiring public companies to disclose contractual limitations on audit choice found in their agreements with banks and other financial intermediaries; and (2) requiring financial intermediaries to state their policies on choice of auditor.

Other factors affect concentration in the large public company audit market. In particular, we believe it would be appropriate for regulators to address the following:

- The threat of unlimited liability, which: (1) can deter smaller audit firms from entering the market for audits of large public companies; and (2) if realised, can also cause further consolidation in the larger public company audit market if it results in the collapse of a large audit firm.

- The lack of regulatory convergence, which increases costs and reduces choice. For example, numerous regulators have recently begun inspections of audit firms located outside of their jurisdiction, resulting in duplicative and overlapping inspections of the same audit firm. This greatly increases costs to audit firms and can dissuade firms from taking on multi-national clients.

Question 3: ***Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?***

Grant Thornton response: As noted above, we believe that the most significant barriers are contractual restrictions on auditor choice. We believe that addressing such restrictions would be critical, but addressing the other matters outlined in our response to Question 2

and taking the other initiatives described in the body of our letter would also have a positive effect.

In general, two types of restrictions can prevent or restrict audit firms from entering the larger public company audit market or from increasing their share of that market — supply-side restrictions and buy-side restrictions. The consultation paper focuses on the supply-side restriction that stems from restrictions on non-professional ownership of audit firms.

While we are supportive of reducing such supply-side restrictions, we believe more strongly that focus on buy-side restrictions — such as contractual restrictions on auditor choice — is more critical. Removing supply-side restrictions will have little effect on concentration if buy-side restrictions remain in place. In effect, we will see little impact on concentration if audit firms are allowed to increase non-professional ownership, but are still excluded from competing for large public company clients.

We have two additional comments with respect to the focus of this consultation paper on ownership restrictions:

- First, on page two, the paper states that the Task Force decided to focus on ownership restrictions "because while other market barriers are akin to business considerations that deter but do not legally prohibit some potential entrants to the large public company audit services market, ownership restrictions limit such entrants by law or regulation. Thus, while addressing other barriers may make market entry more desirable from a business standpoint ownership restrictions can continue to bar motivated potential participants from the large public company audit market."
    - Our response to this statement is that while contractual limitations may not be found in law or regulation, they do in fact prohibit or restrict firms from competing for the audits of public companies. Consequently, we believe that the Task Force should also focus on this aspect of restrictions on competition.
- Second, also on page two, the paper recognises the complexity in making changes to ownership restrictions and states that "in many jurisdictions securities regulators do not have the authority to affect change in audit firm ownership restrictions."
    - We agree that making changes to ownership restrictions could involve complexity and thought — as described in Sections IV and V of the paper — and may be beyond the authority of many securities regulators. However, requiring disclosure of restrictions on auditor choice (particularly by companies, but possibly also by intermediaries) is well within the authority of most securities regulators, as requiring disclosure by issuers is one of the most accepted, least invasive and least controversial types of regulation available to securities regulators.

Ownership restrictions as a barrier to entry

Question 4: ***Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.***

Grant Thornton response: We believe that expanding the scope of non-practitioner ownership could possibly alleviate threats to the continuity of audit services, but we are sceptical that doing so would have an effect in the near term and possibly even in the long term.

- We doubt that expanding non-professional ownership would have an effect on firms exiting the market due to, for example, catastrophic litigation because we do not believe that increased access to capital would necessarily diminish the threat caused by a very large judgment against an audit firm.

- For the reasons set forth in the body of our response and below in question 5, we also question whether expanding non-professional ownership would have an effect on firms entering the market.

Question 5: ***Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.***

Grant Thornton response: Allowing broader non-practitioner ownership could possibly assist **new** competitors to **enter** the market for large public company audits, but we believe relaxing ownership restrictions would be more likely to enable existing competitors already in the market for large public company audits to increase their market share. In order to enter the market, or to increase an existing firm's market share, it will be necessary to attract and retain key personnel and to have systems and processes in place to handle audits of large, multi-national companies. Given that large audit firms such as Grant Thornton already compete in the market for large public company audits, we have existing personnel who are trained in such audits. Further, we have international infrastructures and global audit methodologies and quality control policies that support audits of large multinational companies. Therefore, it would be far easier for Grant Thornton to leverage our existing global expertise, as opposed to a new firm entering the market.

That said, as we discuss in the body of our letter, we believe that changes to ownership rules will have no meaningful impact in reducing concentration, and any such changes would not be the most important action that regulators can take to help firms increase their market share. In fact, we are aware that some accounting firms in the United States and the United Kingdom have been acquired by large public companies or have third-party investors, but these acquisitions and investments have not resulted in those firms increasing their share of the public company audit market.

Question 6: ***Would allowing audit firms the option of broader non-practitioner ownership allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?***

Grant Thornton response: Should a big four firm leave the market, we believe the most likely scenario is that other large global audit networks would provide for continuity of services by, among other things, hiring auditors from and retaining clients of the defunct big four firm. As noted in our response to question 5, it seems unlikely to us that an entirely new firm could be created that would have the necessary infrastructure and expertise to enter the market — especially on the expedited basis that would be required if a big four firm suddenly left the market.

Audit firm ownership restrictions: background

Question 7: ***How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?***

Grant Thornton response: Ownership restrictions are important, but are by no means the only factor in promoting audit quality. Ownership restrictions promote audit quality by ensuring that auditors —– who are rigorously trained, governed by strict ethical codes and have public interest obligations — are ultimately responsible for owning and managing audit firms. If alternative forms of audit firm ownership have the effect of decreasing the focus on training, ethics and the public interest, audit quality would suffer.

Question 8: ***What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?***

Grant Thornton response: We believe that the consultation paper appropriately focuses on the key considerations, namely: auditor independence, auditor training, and the auditing profession's concern for the public interest, rather than merely short-term profits.

Question 9: ***Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?***

Grant Thornton response: Boards of directors with independent members could provide reinforcement of auditing firms' public interest obligations and independence, but audit firms could retain independent board members without removing restrictions on audit firm ownership. Some Grant Thornton firms, such as those in Sweden and Australia, already have external directors. They have chosen this route for the expertise and insight that these individuals can bring and for their knowledge of public interest factors.

Further, the recent consultation by the Institute of Chartered Accountants in England and Wales (ICAEW) and the Financial Reporting Council (FRC) in the United Kingdom explores the role that independent non-executives could play in audit firms. Importantly, however, the draft code makes it clear that the duty of care of the firm's governance structure (including independent non-executives) is to the audit firm and its partners, since it is the firm and its owners who have most to gain from mechanisms that help the firm to abide by, and be seen to abide by, its public interest responsibilities.

Question 10: ***Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?***

Grant Thornton response: We believe that audit firm non-practitioner employees have economic interests more in line with practitioner owners than with outside investors. Non-practitioner employees are often professionals — attorneys, valuation professionals, management consultants, etc. — who are similarly bound by ethical codes or are otherwise highly motivated to protect their professional reputations. Therefore, it is reasonable to believe that they would run the business in a prudent, long-term fashion that also serves the public interest. By contrast, outside investors would be less focused on reputation and more focused on their return on investment. Consequently, we believe it would be reasonable to treat non-practitioner owners differently from outside owners.

Despite the foregoing, we doubt that more permissive non-practitioner employee ownership would lessen barriers to entry, and more permissive non-practitioner employee ownership seems unlikely to affect the firms' capital-raising capacity in the near term.

Question 11: ***What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?***

Grant Thornton response: Existing ownership restrictions help audit firms to focus on independence and audit quality. As noted elsewhere in our letter, however, we do not believe that ownership restrictions are necessary to ensure independence and audit quality, and therefore we believe that ownership restrictions can be relaxed if appropriate safeguards are in place that also address independence and audit quality.

Possibilities for further minimizing risks and improving investor protection

Question 12: ***Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?***

Grant Thornton response: We believe that existing safeguards, such as the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants ("IESBA"), would mitigate the above-referenced concerns, but the application of such safeguards to new ownership structures would have to be analysed carefully to ensure the proper application to non-practitioner owners.

More importantly perhaps, we note that the consultation paper (including questions 12 through 17) focuses significantly on the potential negative impacts that could arise from relaxing ownership restrictions. The fact that the consultation paper gives such great consideration to issues of independence, audit quality, etc., further supports our conclusion that addressing contractual restrictions on auditor choice is a simpler and more effective initiative to help reduce concentration than is permitting non-practitioner owners. Indeed,

requiring disclosure is a relatively simple task for regulators, and it is one of the least controversial, least invasive actions securities regulators can take. There is less risk of unintended consequences and far less complication in terms of threats to competence, professionalism, audit quality and independence.

Question 13: ***What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?***

Grant Thornton response: It is difficult to settle upon a particular percentage that should concern regulators or, alternatively, that is de minimis. As the consultation paper notes, the various states in the United States have required a majority of owners to be licensed accountants. If ownership rules are relaxed, thereby permitting outside investment into audit firms, then having such audit firms report their beneficial ownership in a manner similar to what is currently required for public companies in the United States seems appropriate.

Question 14: ***Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?***

Grant Thornton response: We believe that existing safeguards, such as the IESBA Code of Ethics for Professional Accountants, could help ensure that audit firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership. As noted above, the application of such safeguards to new ownership structures would have to be analysed carefully to ensure the proper application to non-auditors.

Question 15: ***What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?***

Grant Thornton response: We cannot point to any risks to investors that might be mitigated by public ownership.

Question 16: ***Could new safeguards bring ancillary benefits to the audit process? If so, what are they?***

Grant Thornton response: We believe that existing safeguards are sufficient.

Question 17: ***Could new safeguards bring ancillary detriments to the audit process? If so, what are they?***

Grant Thornton response: Any additional safeguards should be analysed from a cost-benefit perspective to ensure that the safeguards provided outweigh any additional costs.

Impact on audit firm concentration

Question 18: ***What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?***

Grant Thornton response: As noted previously, we believe the likelihood is remote that potential new entrants would take advantage of opportunities for broader non-practitioner ownership in a way that would lessen concentration in the large public company audit market. This is especially true in the near term, and we also believe it to be the case in the long term. We believe that existing large global networks such as Grant Thornton would be more likely to take advantage of opportunities for broader non-professional ownership than would completely new entrants. However, we continue to believe that the critical issue with respect to concentration stems from the buy side and not the supply side — that is, market misperceptions about the capabilities of firms such as Grant Thornton, which can lead to contractual provisions that prevent or restrict our member firms from competing for audits.

Question 19: ***What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?***

Grant Thornton response: We are unsure if one or more of the big four firms would take advantage of broader non-professional ownership rules.

Appendix B – Examples of Contractual Restrictions on Audit Firm Choice

We have found numerous instances of contractual provisions that restrict in some manner the choice of auditor. The following are a few examples:

- From a severance agreement: "Tax Opinion. Subject to the provisions of Section 3(b), all determinations required to be made under this Section 3 . . . shall be made by a big 4 accounting firm selected by the Company (the "Tax Firm")".

- From a credit agreement: "The consolidated balance sheet of the Initial Borrower . . . and the related consolidated statements of income, shareholders' equity and cash flows . . ., reported on by a Big 4 Accounting Firm, copies of which have been delivered to each of the Lenders, fairly present, in conformity with GAAP, the consolidated financial position of the Initial Borrower . . . ."

- From a shareholders agreement: "The Company undertakes to appoint one of the Big 4 Accounting Firms as auditors of the Company and the Group no later than six (6) months after Completion and in any event in time for the audit of the audited financial statements referred to in . . .."

- From a change in control agreement: ". . . all "excess parachute payments" within the meaning of Section 280G(b)(1) of the Code shall be treated as subject to the Excise Tax, unless in the opinion of tax counsel selected by one of the "Big 4" independent registered public accounting firms and acceptable to Executive such other payments or benefits (in whole or in part) do not constitute parachute payments . . . ."

- From a lending or overdraft agreement: "Covenants. The borrower agrees as follows:…Auditors: the borrower shall maintain one of PriceWaterhouseCoopers, KPMG, Deloitte & Touche or Ernst &Young as its auditors or such other firm as shall be approved by the lender from time to time."

- From a lending or overdraft agreement: "Auditors. The company shall not (and the company shall procure that no other Group Company shall) change its auditors without the prior written consent of the Bank. The Bank's consent shall not be required for a change from [one of the big four] to [one of the big four]."

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15 January 2010

Dear Mr Tanzer

PUBLIC COMMENT ON THE EXPLORATION OF NON-PROFESSIONAL OWNERSHIP STRUCTURES FOR AUDIT FIRMS: CONSULTATION REPORT

The Business Policy Committee is the Institute's committee which monitors developments in the rules and regulations affecting businesses generally and considers legislative and other proposals deriving from bodies such as HM Treasury, BIS, the FRC, the FSA, IOSCO and the European Commission. The Committee is broadly based, with members representing different sizes of accountancy practice, industry, the investment community, and the legal profession.

As the Institute's Charter requires, we act in the public interest, and our proactive projects, responses to consultation documents etc. are therefore intended to place the general public interest first, notwithstanding our charter requirements to represent and protect our members' interests.

The Committee's consideration of the above consultation report focused on the impact of audit firm ownership restrictions on concentration in the market for auditing large issuers and reviewed the nineteen consultation questions.

The Committee acknowledges the global work that IOSCO undertakes in relation to accounting and finance related matters and is fully supportive of its efforts surrounding exploration of non-professional ownership structures for audit firms.

The Committee's view on the exploration of non-professional ownership structures for audit firms is set out below.

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While the Committee recognises the concerns IOSCO has in relation to the risks to the capital markets presented by concentration in the market for large public company audit services, we believe that market forces should be the driver of change in this area.

If other audit firms want to compete in the market of the audit of large public companies (and there is no persuasive evidence to suggest that there is any great appetite for this in the UK) then they are already free to do so and we would suggest that they are already aware of the practical issues they would face in achieving this such as international networks and overall resources. We would also suggest that they are fully aware of the potential increased litigation risk this would create and will make their decision on whether or not to try and enter this market based on their assessment of these decisions and how they fit with the individual firm's overall business strategy as opposed to any other external pressures.

The Committee does not necessarily see the relationship between changing the ownership structure of an audit firm and the ability to enter into the market of the audit of large companies.

The Committee also has concerns that the introduction of outside investors into audit firms could have a negative effect on the independence of the audit firm and may even impact on audit quality. For this to proceed there would have to be sufficient processes in place to ensure that the independence of the audit firm and audit quality are not compromised for the sake of investor returns.

Ethics play a vital part and it is important that those who are involved in the ownership and governance of audit firms, and especially those involved in the audit of large public companies, meet the standards of competence and professionalism that would be expected of them. There are obvious ethical risks that would need to be considered if external investors were introduced to audit firms.

We would agree that there is a public perception concern in relation to which audit firms are capable of effectively and efficiently performing the audit of a large public company. One way this could be mitigated is by having non Big Four firms performing some of the non-audit work that is currently undertaken by the Big Four company auditor.

The area of audit versus non-audit services is currently under consideration in the UK by the Auditing Practices Board (APB) and we would suggest that IOSCO takes into consideration the APB findings and recommendations in this area when they are finalised and made public.

We would also advise that ICAS is actively engaged in the debate on audit versus non audit services and has set up a working party to consider this matter in detail, with representatives from the accounting profession, academia, business and the investment community involved. The findings of the working party will be made public towards the end of January 2010 and we would recommend these to IOSCO for consideration.

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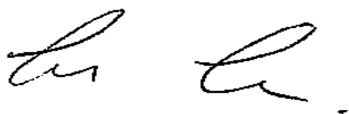
We hope these comments have been useful to you and please do not hesitate to contact me if you want to discuss any of these points further.

Yours sincerely



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15 January 2009

Re: Consultation IOSCO : Exploration of Non-Professional Ownership Structures for Audit Firms

Dear Sir,

The ICJCE welcomes the opportunity that IOSCO is giving to the profession to comment on the Consultation Exploration of Non-Professional Ownership Structures for Audit Firms.

The ICJCE is an organization that groups professionals authorized to carry out statutory audit in Spain. In December 2009 our membership was comprised of 5509 individuals and 590 audit firms. These numbers represented more than the 80 % of the total turnover in audit services in Spain in 2008.

The European Commission organised recently a consultation on control structures in audit firms and their consequences on the audit market, which broadly addresses similar issues as these covered by the IOSCO consultation. It could be useful for IOSCO to consider answers to this consultation, which have been published on the European Commission's website. In particular, the ICJCE provided its comments which are attached for your convenience.

In general terms, our opinion on that issue is that there is no single element that causes concentration. Choice is a client option and sometimes comes from the strategic decision of mid-tier firms of not accede to the quoted companies' market due to other reasons different from those linked to capital structures and access to finance. In our opinion the existence of different regulations in liability regimes and independence requirements are the most important barriers for mid-tier firms to access to listed companies' market.

Should you have any question on our answers to the questions in the consultation or if you wish to comment on them, please do not hesitate to contact me at presidencia@icjce.es or our International department Director at internacional@icjce.es, we will be very pleased to provide you with any further explanation.

Yours sincerely

Rafael Cámara Rodríguez-Valenzuela

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Q1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

In principle, it would be helpful that legislators create a legal framework that facilitates access to the large public audit market to medium sized practitioners since facilitating the entry of mid-tier firms to the listed companies' audit market would increase the options for choice. However we do not think that there is a single way to address that issue and finally is the business community who has to decide on the sufficiency of the current number of audit firms in the market.

For instance, statistical information shows that a merger among small or medium-sized firms would not create a fifth big firm.

Q2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

As stated in our answer to the EC consultation on the ownership and control structures in the audit market, a common regulatory framework is one of the most important points to consider specially in areas as liability or independence that may prevent SMPs to entry into the market due to the high cost to comply with different legislations in different countries.

Costs to deal with different regimes are very often unaffordable for audit firms other that the biggest ones.

On the demand side the proper implementation of the 8CLD would also enhance the confidence of the big companies in the mid-tier firms which are applying the same standards and are subject to public oversight.

To sum up, liability risks, overlapping audit oversight bodies regimes and independence requirements could represent significant potential barriers for SMP's to entry the market. The cost associated to deal with independence requirements and different local liability and other regulations should be considered in the design of potential measures to facilitate the access to the large public companies audit market.

Q3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

As stated in a previous answer there is no single answer to that issue although basically we are of the opinion that barriers mainly come from the lack of common regulation.

Q4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain

Nowadays the law allows non-practitioner ownership, and the main problem that we see in expanding this possibility is the independence issue.

We are not aware of any study linking ownership and continuity of audit services since liability is the major, if not the only, threat to the continuity of audit services.

Q5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

The ICJCE is of the opinion that access to finance is not the primary barrier to SMPs to enter the market. We are not aware of any current real difficulty in finding capital.

Q6. Would allowing audit firms the option of broader non-practitioner ownership, allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

As stated above, we are of the opinion that capital is not a crucial factor to have more audit firms in the segment of audit of listed entities.

The problem that we see in the entry of non-practitioners in the audit firms' ownership is the independence in appearance of the firm and on the other hand the liability issue that constitutes the most important barrier.

An extended non-practitioner ownership is unlikely to remove any of the barriers for SMP to become global players as the main obstacle is not access to finance. Therefore the access of non-practitioners will probably not lift any barrier to entry while it will generate new issues regarding independence and competition.

Q7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

The current ownership restrictions are mainly linked to independence issues. Non-practitioner ownership has always existed in Spain. Restrictions to ownership, stated the Audit Law (article 10 of the audit law in force)[1], only refer to a majority of partners and of members of the Board of Directors being authorized auditors.

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[1] Art 10.1 of the ACT 19/1988, of 12th July, on auditing: "*1. Audit firms may be incorporated, as long as they fulfill the following requisites:*

a. That all the partners are individuals.

b. That at least the majority of partners are auditors and, at the same time, they hold the majority of the capital and voting rights.

c. That the majority of the administrators and directors of the company are audit partners, in case of a sole administrator he or she must be an audit partner.

d. That they be registered on the Official Register of Auditors."

The law does not prevent non-professionals to be shareholders of an audit firm but in a minority. Problems regarding the elimination of restrictions to ownership deal with:

- Independence, since the public perception of the independence of the audit firm could be damaged.
- Quality, since objectives of the non-professional shareholders may be to obtain short term benefits.
- Public Interest, as the "investors' model" is more a business model against a professional model more focused on audit quality, and culture of professionalism.

Q8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

A single regulation, particularly with regard to auditors' liability would help mid tier firms to access the top segment of the market. The current situation of different independence rules applied simultaneously for the same international client, different auditing standards, different approaches taken by different regulators create a heavy and unnecessary burden which is difficult to manage without huge resources. Such resources are not dedicated to maintain or improve audit quality but just to comply with overlapping regulations and regulators.

Q9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

From our point of view boards of directors with independent members are not a useful reinforcement to the audit firms' public interest obligations and independence and additionally may create additional barriers due to the associated increase of costs.

Q10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?

The concept of non-practitioners has a broad sense. It may refer to those authorized auditors that are not partners, or persons without any link to the audit profession. Personnel working in the firm should be treated differently from outside owners since they have a direct interest in the quality of the work. As stated in our answers above, non-practitioners owners who are not employees in the audit firm may have different objectives and interests, therefore the external perception of the firm's independence could be damaged.

Q11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

The ICJCE is of the opinion that a partnership form of ownership does not seem to be indispensable in order to recruit and retain human capital in audit firms but in Spain this formula seems to work properly for this purpose. The possibility to become partner of the firm is an important point to offer to the professionals joining a firm.

Q12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

Competence, professionalism, audit quality and independence are in the core of the audit. Audit firms are required to analyze any threat to their independence and put the necessary safeguards to eliminate or to mitigate such threats to an acceptable level. Even shareholders, staff and other that do not perform the audit are required to fulfil these requirements; therefore we do not see a need for further independence regulations, although we foresee that modifications to internal quality control of the firms would be needed.

Q13. What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

The current system of majority works properly in Spain.

Q14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

The current ownership [2]restrictions are by themselves the safeguard which ensures that auditing firms maintain their competence, professionalism, audit quality, and independence regarding the ownership and management of the firm. If this safeguard is removed it's probable that another one would need to be put in place. On the other hand and as stated in our prior answers other safeguards might mean more complexity and finally new entry barriers to the smaller audit firms.

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[2] Ownership restrictions are stated in Art.10.1 of the ACT 19/1988, of 12th July, on auditing and include:

a. That all the partners are individuals.

b. That at least the majority of partners are auditors and, at the same time, they hold the majority of the capital and voting rights.

c. That the majority of the administrators and directors of the company are audit partners, in case of a sole administrator he or she must be an audit partner.

d. That they be registered on the Official Register of Auditors."

Q15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

We do not see any existing risk which might be mitigated by public ownership

Q16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

Under the current circumstances and legal regime, ICJCE believes that there are already ample safeguards to protect auditors' independence. For example Article 24 of the 8CLD[3]

Q17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

Any new safeguard would bring more complexity and at the end would increase the concentration due to the cost to apply such more complex safeguards.

Q18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

As we consider that capital is not a crucial factor to facilitate the entrance of new players we do not see any change to the current situation other than the concerns expressed above.

Q19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

We do not have any opinion on what Big Four Firms would do in such case

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[3] Art 24 of the 8TH Company Law Directive : *"Member States shall ensure that the owners or shareholders of an audit firm as well as the members of the administrative, management and supervisory bodies of such a firm, or of an affiliated firm, do not intervene in the execution of a statutory audit in any way which jeopardises the independence and objectivity of the statutory auditor who carries out the statutory audit on behalf of the audit firm."*

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January 15, 2010

Mr Greg Tanzer
Secretary General
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by Email: AuditOwnership@iosco.org

Dear Mr Tanzer

Re.: Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

The Institut der Wirtschaftsprüfer (IDW) [Institute of Public Auditors in Germany] is pleased to have the opportunity to comment on the above-mentioned consultation report. We support the work IOSCO has done and is continuing to perform at international level in response to the increasing concentration in the market for audit services of the largest public companies. We hope that our comments may be helpful to IOSCO in its further consideration of this issue.

General Comments

Identity of Potential Entrants to the Market

We were interested to note that although the consultation report refers to *"motivated potential participants"* on page 2, it is not at all clear who such parties could be.

On the one hand, there is a discussion as to whether mid-sized firms may be enabled to enter the market for large public company audits. However, page 17 of the consultation report points to studies, practice and the experience of various others in this regard, revealing no real appetite on the part of existing

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firms to raise additional capital by lifting current ownership restrictions to fund their expansion into the market. On the other hand, page 7 states *"For instance, the absence of ownership restrictions could facilitate the rapid creation of a new audit firm to replace one or more firms leaving the market…."* We are unsure whether this is intended to imply that the IOSCO Task Force believes there may be a desire on the part of non-professional investors to create such a firm, perhaps by buying-in auditing expertise, as there is no further discussion within the consultation report.

Without a clear case that there are indeed parties interested in entering the market for large public company audits, it seems somewhat premature to focus on the question of whether easing ownership restrictions might be a potential measure to ease the concentration. In bypassing this issue, the consultation report conveys the impression that the Task Force views it as a foregone conclusion that such a measure is needed.

Necessity of Identifying All Key Issues Hindering Entrants to the Market for Audit Services of the Largest Public Companies and Developing an Integrated Solution

In this context, we appreciate that there are concerns at an international level about the possible consequences of a large audit firm leaving the market. However, as we explain more fully in this letter, we believe it is unrealistic to expect that introducing non-professional ownership structures might be either appropriate or able to alleviate this situation to any meaningful degree. Indeed, section VI of the consultation report essentially comes to the same conclusion.

In our opinion, considering, in isolation, the merits of only selected individual possible measures that could be aimed at easing the current level of concentration in the market for audit services of the largest public companies is unlikely to be able to ease this situation. Rather, there is a distinct need to first consider whether preventive measures that may help reduce the risk of a Big Four firm leaving the market, second, as explained above, identify parties looking to enter that market and third, to identify all key factors which such parties themselves perceive as barriers thereto before attempting to address them in an integrated solution. In publishing this consultation report together with the two accompanying reports IOSCO has not considered whether preventive measures could be taken to help reduce the risk of a Big Four firm leaving the market, including but not limited to liability regimes in individual jurisdictions; rather the report has concentrated on only a few specific aspects, disregarding many other factors such as those discussed below, which also

interrelate with and to one-another in contributing to the current market concentration.

Current Ownership Restrictions in Germany

In Germany, audit firm ownership and management is not restricted to Wirtschaftsprüfer (German public auditors). Multi-disciplinary firms are common, in which German tax advisors or German lawyers may also be part-owners in such firms, provided that the controlling interest is held by German public auditors. This ownership structure was introduced over a period of time from the 1960s onwards and has proven to be a workable alternative to the model in a number of other jurisdictions under which only qualified professional accountants may own audit firms. Permitting qualified members of other professions, such as lawyers and tax advisors, to own stakes in auditing firms is, in our opinion, a better alternative than allowing non-professional ownership, as there are certain similarities such as professional requirements, which do not apply to non-professionals.

Indeed, Germany has experienced less extreme concentration than some other countries, as many mid-tier network firms are significantly involved in auditing public companies (especially those on the S-Dax, M-Dax and Tech-Dax). In our opinion, this does not point to ownership structures being significantly relevant in the debate.

Possible Other Aspects of an Integrated Solution not Addressed

It becomes clear for a number of other issues addressed in the consultation report that international rather than national solutions are increasingly needed. In our view, a major hindrance to firms seeking to enter this market is the perception held by many audit committees or others responsible for auditor engagement that only the so-called Big Four firms have the requisite expertise to perform audits of the desired quality consistently on a global basis.

Such perceptions might well, over time, be changed if global requirements and standards for auditing, for quality control within firms and for ethical behavior were established. This ultimately speaks in support of a world-wide adoption of ISAs, quality control standards, ethical requirements, and external quality assurance requirements, etc. This is one area which we believe regulators ought to address urgently. Such harmonization would also help to facilitate the expansion of medium-sized audit firms’ networks (common quality control

measures; use of common auditing standards, common training, etc.). In Germany, we are increasingly observing a move away from alliances to more collaborative networks as standards are becoming increasingly common.

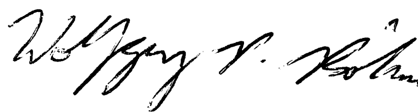
An integrated solution would also need to address the effects of existing regulation which may deter audit firms from seeking to enter the market for the audit of publicly listed enterprises or exacerbate concentration. For example, many audit firms choose not to enter this market because of the costs of compliance with such regulation. Aspects such as banned services might also be considered further, since market concentration has also become increasingly acute because, due to perceived independence threats, companies can no longer use the services of their audit firm in other areas (consultancy) as freely as in the past. In this context, the IDW, for one, has urged regulators to adopt a more principles-based approach to such issues, as in some circumstances synergy effects of additional audit firm involvement may enhance the quality of audits performed. In our opinion, due consideration of these types of issues would be equally appropriate at international level.

Furthermore, the lack of regulatory harmonization and cooperation across national boundaries exacerbates the barrier to entry for transnational audits of publicly listed entities.

We were disappointed but also concerned that this issue was not addressed adequately within the consultation report, as we are convinced that this would be a major step in the right direction that cannot be ignored in arriving at an integrated solution.

We would like to stress that in formulating our responses to certain questions posed in the consultation report we do not purport to provide investors' perspectives, as the IDW represents its members who are German public auditors. However, we trust that our comments will be helpful to IOSCO in its further consideration of this issue.

Yours sincerely



Klaus-Peter Feld
Executive Director

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Director, International Affairs

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APPENDIX

Responses to Questions Posed in the Consultation Report

Q1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

In general, we believe that market forces ought to govern the market for large public audit services, without undue or inappropriate intervention from regulators or legislators in the ownership structures of firms. For the reasons explained above, we are not convinced that it would actually be possible for regulators or legislators to address barriers to entry in the market for large public audit services in a really effective manner.

That is not to say that regulators ought not to play a role, as we explain further in our responses below.

Q2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

Our members have indicated to us that access to sufficient funds is not one of the factors that prevent the larger medium-sized firms from entering the large public company audit market. This appears to mirror the experiences in other regions as mentioned on Page 17 of the consultation report. As far as Germany is concerned, we are encouraged to note that mid-sized firms within international mid-tier networks are becoming increasingly stronger by means of market forces.

There are, however, many factors which contribute to the current concentration in the market for large public company audit services. Indeed, as we have reasoned in our letter, establishing an environment in which the quality of audit work would be consistent at an international level could also to be a part of the solution. The world-wide harmonization of auditing standards/ independence rules/ auditor oversight, etc., would be a first step to create a level playing field.

Regulators and/or legislators have also established specific rules and regulations to, among other things, ensure that auditors are independent of the entity they are to audit, both in fact and appearance. Certain rules designed to safeguard a firm's independence from its audit clients in appearance may serve to exacerbate market concentration. On page 4, the consultation reports that *"Currently, some larger public companies feel that their choices in audit firms are limited and use some or all of the remaining perceived choices in audit firms to perform non-audit services… therefore, certain large public companies believe that … their selection of another auditing firm is either impossible or significantly limited because of auditor independence rules"*. Certain rules and regulations, including those relating to, for example, auditor rotation, or bans on the provision of certain services could be reconsidered to assess whether the current level of stringency is indeed necessary in all cases (e.g., de minimis exceptions) or whether amendment might be appropriate. For example, particular threats to independence in appearance may be negligible such that they are outweighed by the synergies that arise from the provision of non-audit services, which may be a cost-effective means of helping to increase audit quality in some circumstances, since a firm providing non-audit services may well have gained a broader understanding of the entity subject to audit than might otherwise be the case. Similar considerations may apply to rules governing the rotation of partners and other key players within particular timeframes. We note that particular jurisdictions have recently revisited specific rules and regulations that were felt to have been overly stringent. For example, in the UK audit partner rotation has been eased from a five year period to allow a seven year period under certain circumstances and subject to certain conditions.

A further factor our members have mentioned in this context is that there is considerable uncertainty surrounding the professional liability issues that may affect audit firms at both at national and cross-border levels. This uncertainty has a marked deterrent effect on smaller and medium-sized firms, as they may well not consider that they are in a position to take on the potential liability risks attaching to an audit of a multinational entity, particularly as they may not be able to obtain adequate insurance for such risks when, in their national environment, liability regimes are significantly different. This situation also hampers the further integration within the existing networks of smaller and medium-sized firms.

Furthermore, worldwide there has recently been a noticeable tendency for increasing thresholds for statutory audits. This means that the audit market is not a growing market and consequently, the profession is not expanding in audit services. Furthermore, in this restrictive economic environment firms are

competing against other growing professions and industries for qualified human resources, which causes the profession to be relatively less attractive. Further measures that might serve to make auditing profession less attractive would undoubtedly worsen the situation. For instance, specific aspects of current and proposed regulation may make it unattractive to potential entrants if firms themselves perceive that the associated compliance costs will outweigh the probable benefits. This is also a factor that regulators do need to bear in mind.

Q3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

We would like to point out that increasing the availability of the sources of audit services to large public companies is not synonymous with addressing one of the barriers to entry into the market. These are two separate issues, upon which we comment as follows:

1. Increasing the availability of the sources of audit services to large public companies: As we have already discussed, many factors play a role in market concentration. For example, certain laws and regulations designed to ensure auditor independence in appearance may exacerbate the concentration currently experienced in the market, in that they cause smaller firms to perceive entry “is not worth their while”. In this context, we also refer to our general comments above, in which we propose that an integrated solution be developed, including reconsideration of the need to retain the current degree of stringency of certain laws and regulations that we believe may currently exacerbate the situation and the further harmonization of standards and regulations.

2. Barriers to entry into the market: As explained above, we are also not convinced that the ability and willingness of mid-tier firms to enter the Big-4 dominated areas can really be influenced, certainly not in the short-term. To our knowledge, many mid-tier firms have developed a “niche” (individual reputations built over time, specializations in specific fields) and may be reluctant to change in the short term. Certainly in Germany, the cleft between the smallest so-called Big Four and largest medium-sized firm may be too wide already such that it may not be realistic to expect that a new “Big Five” firm could emerge in the near future.

Q4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

As explained above, we do not believe that such measures will provide a workable solution to the problem of market concentration. We are interested to note that page 6 of the consultation report states that *"Many IOSCO member jurisdictions require that firms be wholly or majority owned and controlled by practicing licensed accounting professionals."*. The subsequent discussions on pages 8, 9, and 10 do not reason that such measures are no longer warranted. Indeed, the EU recently considered this issue and retained certain restrictions.

Q5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

No, we do not believe this measure would assist new competitors in entering the market for large public company audits. Not only potential new entrants would be allowed access to more capital, but also the Big Four firms would potentially be able to grow in a similar manner. This might, rather than reducing the gap, even cause it to become more pronounced.

In our opinion, it is far more likely that certain networks will grow and enter this market; however, this is unlikely to have much impact in the short term but needs to be viewed as a long term measure.

We also refer to our comments above.

Q6. Would allowing audit firms the option of broader non-practitioner ownership, allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

No, we do not believe this is a realistic proposition. We refer to our comments above.

In our opinion, it is far more likely that certain networks will grow and enter this market; however, this is unlikely to have much impact in the short term but needs to be viewed as a long term measure.

Q7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How

may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

The ownership restrictions commonly in place in respect of audit firms were historically designed to ensure that firms are fully subject to professional rules and regulations, covering issues such as auditor independence, competence etc. These remain of paramount importance; i.e., it is not acceptable for auditors to be a little bit less independent in fact or a little less competent and claim that this is the price to pay for expanding the market.

As outlined on pages 9 and 10 of the consultation report, allowing non-professionals to own audit firms would potentially threaten firms' pro-fessionalism, ultimately compromising audit quality. In particular, those seeking short-term gains followed by a quick sale of their stakes will have no interest in the long-term effects of their actions on the reputation of the firm. Even passive ownership carries this risk, since there would be added pressure to achieve certain targets. The consultation report considers several possible safeguards, none of which is really convincing.

A key aspect of the conclusion on page 19, with which we wholly agree is that potential benefits do not justify any compromise to audit quality.

Q8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

In our opinion, there should be no regulation for regulations sake, rather there needs to be a proven need for regulation and as to the effectiveness of measures, including due consideration of any detrimental impact they may have such as cost considerations.

If purely business decisions aimed at maximizing profitability were to drive audit firms, then there will undoubtedly be some form of pressure to either increase audit fees, or to make savings in audits and thereby potentially decrease audit quality. Alternatively, owners may determine that audit work is insufficiently lucrative and reject specific engagements. Neither of these scenarios is advantageous.

Q9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as

compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

In our view, such possible safeguards are unlikely to be fully effective in combating what we perceive as potential threats to a firm's professionalism. For example, we are not convinced that, without considerable recent audit experience, members of an independent board would possess the necessary knowledge and experience to enable such a board to function as an effective safeguard. Indeed, we are aware of other initiatives considering the need to introduce supervisory boards or similar into audit firms, but do not currently believe that such measures are appropriate currently.

Q10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital-raising capacity or otherwise affect barriers to entry for audit firms?

As mentioned above, multidisciplinary practices have evolved in Germany.

Ownership by firm employees who are not practitioners but who are amongst the professional staff and therefore subject to professional standards and requirements might be an option to consider, although generally, to the extent that they are often students, and examination candidates or newly qualified auditors, they may not have access to significant funds.

Q11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

The main additional benefit lies in the historical incentive for members of the profession to aspire to becoming a partner. This may be one aspect that encourages quality personnel to remain with a firm rather than leave the profession.

Q12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

We are not convinced that the options discussed in the consultation report would appropriately mitigate these concerns. We refer to our comments above.

Q13. What level of non-practitioner ownership should concern regulators, and what level should be considered de minimis? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

As mentioned, in Germany the law governing the profession of German Public Auditor allows for multidisciplinary firms in relation to certain kinds of public professionals (e.g., lawyers and tax advisors), but requires majority control of the firms by public auditors, irrespective of which permissible legal form has been chosen. Non-professional ownership is not permitted for the reasons we mention in answer to questions 8 and 14. Therefore, without commenting on whether de minimis exceptions (which would not be relevant from a capital funding point of view) ought to be acceptable, we do not consider non-professional ownership to be appropriate.

Q14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

In our view, multidisciplinary firms as encountered in Germany may provide a suitable solution as owners, who are members of a profession, will be a better safeguard in maintaining a firm's competence, professionalism, audit quality, and independence. As professional owners they have a long-term undiversified illiquid investment in the firm, unlike non-professionals who may be directed solely at short-term financial gain.

Q15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

The risks of public ownership to investors revolve around any potential decrease in audit quality arising from a desire to maximize liquid profitability that is not tempered by professionalism. This danger is present, irrespective of whether non-professional owners might have passive holdings or be actively engaged in running the business, since active engagement partners would undoubtedly come under pressure to meet short-term targets without the same degree of consideration as to their professionalism, which would be forthcoming from professionals who have an undiversified illiquid long term investment.

Q16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

We have not identified any significant benefits from such new safeguards. The consultation assumes that access to funding would be improved and be the main benefit. As we have explained above, we do not believe this is likely to be the case.

Q17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

We refer to our comments above. The consultation report discusses the shortcomings of potential safeguards and does not present a convincing argument that these measures would be effective in safeguarding audit quality. In our opinion audit quality is of paramount importance to investors.

Q18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

We refer to our comments above. We are not convinced that potential new entrants have been identified to justify the introduction of non-professional ownership structures.

Q19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

Not only potential new entrants would be allowed access to more capital but also the Big Four firms. As we have pointed out above, the cleft between the smallest Big Four and the largest medium-sized firm may be too wide already such that it may not be realistic to expect that a new “Big Five” firm could emerge in Germany, at least in the near future. There is a real danger that the Big Four might benefit more than smaller firms, particularly as it is likely that their reputation would sway the public towards investing in them. Rather than narrow, the gap might become more pronounced.

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Our ref ws/dlg/

15 January 2010

Dear Mr Tanzer

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

KPMG International Cooperative[1] (KPMG International) is pleased to respond to IOSCO's consultation on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report issued in September 2009 (the "Ownership Consultation"). This response is submitted on behalf of the international network of KPMG member firms.

KPMG Supports Choice in the Audit Market

A robust, competitive public company audit market makes a positive impact on audit quality, and is therefore in the best interests of investors and the capital markets. There is extremely strong competition in this global marketplace, but we recognise that choice can be limited. We welcome reasonable efforts to encourage greater participation by more accounting firms in the largest public company audit market. KPMG believes that any consideration of alternative forms of ownership of audit firms must recognise the need to maintain independence from clients and sustain high quality professional audit capacity. However, we do not believe that ownership structure is the most critical issue with regard to significant barriers to entry; in our view, more significant barriers are the liability environment and the significant costs of differences in standards (auditing and accounting), qualifications, independence requirements and regulation between jurisdictions. Thus market choice would be best broadened by adoption of consistent international standards globally and much greater regulatory co-operation and alignment.

[1] KPMG is a global network of professional services firms providing Audit, Tax and Advisory services to a wide variety of public and private sector organisations. KPMG International is a Swiss cooperative, a legal entity formed under Swiss law, with which all the member firms of the KPMG network are affiliated. KPMG International does not provide professional services to clients; audits of public companies together with other services are all provided by member firms.

KPMG has consistently emphasised the importance of a level playing field so as to support choice in the audit market. For example, in our response to the European Working Paper – Consultation on Control Structures in Audit firms and their Consequences on the Audit Market – we stated:

We agree that the market for the audit of international companies should be opened up as this will make it easier for audit firm networks to meet their clients' needs for a seamless service across borders. Creating a more coordinated legal and regulatory environment across Europe with fewer differences between national requirements will encourage firms to enter this market. At present, firms find this fragmentation difficult to deal with.

The market for large public company audits is a mature market that has evolved over decades as other mature markets have done, responding to the market demands of global companies into one with a few large global players. In this context, another key consideration is that the audit market for larger public companies is primarily an international market and thus regulators should help to ensure sufficiently favourable market conditions consistently throughout the world. We believe that artificial measures to apparently promote choice which are not market based, such as mandatory firm rotation or joint audits, can distort markets, further exacerbate differences between jurisdictions and often actually reduce market choice. Market-led measures focused on reducing the barriers to entry into the market are likely to be more successful and have significant benefits for audit clients and the investing public.

Liability and Complexity of Regulation are Key Barriers to Expanding Choice

KPMG believes that there are specific areas where the regulatory environment could be improved on a worldwide basis and, where appropriate, enhanced regulatory co-operation could help choice in the audit market. First, unlimited auditor liability discourages the emergence of further competitors as there is limited insurance coverage available, and thus could create further consolidation in the larger public company audit market by causing the collapse of a large firm.[2] Secondly, the complexity of international audit regulation should be addressed. Specifically compliance with different auditor independence requirements becomes more difficult to administer as individual countries maintain national rules. This is a challenge for networks such as KPMG as inconsistencies across jurisdictions make it increasingly difficult to develop global compliance solutions which are able to track all these different requirements.

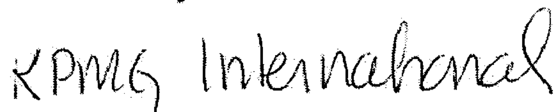
[2] The 2008 report of the U.S. Government Accountability Office (GAO) noted that the "risk of being sued appears to reduce some audit firms' willingness to seek out additional public company audit clients." A survey conducted for the report found that "over half of mid-size and smaller audit firms reported that liability/tort reform would be at least somewhat effective in helping them increase their market share." The European Commission, in its liability recommendation of June 2008, stated as follows: "Since unlimited joint and several liability may deter audit firms and networks from entering the international audit market for listed companies in the Community, there is little prospect of new audit networks emerging which are in a position to conduct statutory audits of such companies." Both London Economics (in their September 2006 study for the European Commission) and Oxera (in their October 2007 study for the European Commission) found that liability risks combined with a very limited insurance capacity are barriers for major mid-tier firms or other players seeking to enter the statutory audit market for large public companies.

We urge those responsible for auditors' ethical standards to align their requirements as far as possible with a globally consistent framework, such as the IFAC Code of Ethics. This code was last revised in July 2009 to better incorporate public interest considerations and we believe that it provides an appropriate framework for internationally consistent independence requirements.

* * * * *

We applaud efforts by IOSCO and its counterparts and members to enhance and rationalise regulatory requirements in order to support high quality audit and financial reporting in increasingly global capital markets. We look forward to contributing to any further work in this area. Our detailed responses to the questions raised are given in an appendix to this letter. We would be very happy to discuss any of these points further; if you have any questions then please contact Dr Wienand Schruff, Head of Global Regulatory Issues, at +4930 2068 1480.

Yours sincerely



KPMG International

Appendix – responses to IOSCO questions on ownership

I. Introduction

1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

KPMG agrees that audit market should be further opened up by reducing the key barriers to market entry through a global approach to limiting audit firm liability, more co-ordinated cross-border audit regulation and adoption of international standards. From KPMG's perspective, the creation of a level playing-field should be one of the objectives of any regulatory debate. Key issues to be resolved include effective limitation of auditor liability and the reduction of complexity in audit regulation, including ethics and independence principles for audit firm professionals. Other barriers for regulators and legislators to address include burdensome registration requirements in cross-border situations, licensing requirements which are exclusively nationally organised and effective and efficient cooperation of auditor oversight regimes.

As noted in our cover letter, there have been several independent research organisations that have identified unlimited liability as a barrier to entry. For example, the October 2007 report by Oxera – *Ownership rules of audit firms and their consequences for audit market concentration* ("Oxera report") - identified as a significant impediment the issue of catastrophic claims that could cause the collapse of a large audit firm network. Both IOSCO and IFIAR initiated debates in 2007 around scenarios for emergency and contingency planning should one of the major audit firms fail. As noted by the impact assessment accompanying the European Commission's 2008 liability recommendation, this means that these organizations believe that the risk of a major firm failure is sufficiently tangible as to warrant further consideration. Consequently, reasonable liability reform should be undertaken in order to address this liability risk.

Another area is the restriction on audit firms providing non-audit services to audit clients. Different principles, and sometimes specific prohibitions in different countries, severely limit the choice of available networks for a global corporate in appointing an auditor The complexities and scale of these restrictions is also a barrier to entry as many accounting networks will not risk the high bid costs and loss of non-audit work. Ensuring consistency, e.g., around the IFAC Code of Ethics would provide an international level playing field and reduce a major barrier to entry. The most important goal for regulators should be to coordinate regulatory efforts to aim at achieving high quality audit regulation that is consistent around the world.

2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large companies?

As noted above and in our cover letter, we believe that unlimited auditor liability and inconsistent regulatory requirements are two significant barriers that should be addressed to support an increase in choice in the audit market.

The barriers to entry are of two principal kinds – regulatory and market-related.

Principal regulatory barriers include:

- Liability risks – addressing the issue of auditor liability is key to establishing a level playing field for audit services and to creating an attractive environment for those considering entering the large public company audit market.

- Ethical requirements - there is a lack of consistency in how various jurisdictions approach auditor independence requirements. Regulators around the world need to ensure that their approaches to auditors providing tax, legal or consulting services are consistent and do not unduly may make the audit market unattractive to potential entrants.

- Regulation – there is a wide range of different regulatory requirements in different countries. Internationally consistent audit regulation is important to expanding choice on a world wide basis. There are very significant costs in registration, reporting and inspection requirements which are heightened by the global nature of capital markets meaning that many global public companies list on more than one market and those with a single listing are often in a different jurisdiction from the audit firm. Reliance on the home country principle for registration, reporting and inspection with sharing of information and results between regulators according to global protocols would remove another growing barrier.

Principal market-related barriers include:

- Internationality – major global companies require auditors that are members of a network that has a global reach

- Incumbency – the existing networks of large firms already have systems, controls, and methodologies, among other things, in place and can move swiftly to audit large international public companies

- Maturity - the audit market for large public companies is a mature market; market related barriers, especially the need to build an international brand/reputation and high upfront investments in training methodology and software, may deter potential outside investors from entering the audit market.

- Public perception - investors and lenders generally prefer to use one of the large networks of firms because of their perceived strengths – also the large networks of firms are often judged best placed financially to meet claims. A contribution could be made to public confidence in the quality and reputation of audit firms by independent regulation and inspection in all major economies.

These market related barriers have to be considered by those who want to enter the market for auditing large international companies. Regulators and legislators need to address regulatory barriers as a necessary first step to expanding choice in the large public company audit market.

3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so, which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

The current situation has arisen because of a complex combination of factors – legal, professional, regulatory and commercial pressures. Unlimited auditor liability and overly complex independence regulation should be addressed urgently by members of the international regulatory community. If this can be done in a consistent manner around the world, it should help reduce the barriers to entry for medium-sized networks and new players and thus increase choice in the large public company audit market.

II. Ownership restrictions as a barrier to entry

4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

On paper, an easy solution might appear to be to provide additional non-practitioner capital to capitalise a firm. However, such a solution would not resolve reputational issues or ensure that audit professionals will stay at the firm. Therefore we consider that any solution has to be carefully tailored to the actual situation - non-practitioner capital may only help in very limited situations, e.g. to meet specific investment needs.

Non-practitioner ownership, for example by a bank, could create significant threats to the continuity of audit services if the potential for failure of an owner threatened the viability of the audit firm that it owned. Also, allowing such ownership would require careful consideration of independence requirements in order for the inherent business interest of such an owner not to decrease confidence in the audit services provided or to weaken trust in the audit profession in general.

5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

In the medium term, it may help to bring new competitors into the market; however, potential independence issues for non-practitioner investors will need to be addressed.

Independence requirements will have to adequately address funding through a public offering or private investments, especially situations where non-practitioner investors may have an interest in the outcome of an audit. There is also a need to consider whether mechanisms are required in order to mitigate potential pressures on the professionals to prioritise short term return on investment before audit quality.

Furthermore, the provision of audit services is a "people business"; new firms must be built from scratch or existing firms have to be significantly expanded. It is important not to underestimate the amount of capital required to accomplish this. What would be required is building not only a national practice but also an international network able to deliver high quality consistent audits on a worldwide basis. This means that professionals will have to be hired and significant upfront investment made to have a functioning firm equipped with all the quality control mechanisms that the existing networks of audit firms have already established.

6. Would allowing audit firms the option of broader non-practitioner ownership allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leave the market?

Broader non-practitioner ownership could help to make it easier for a firm/network to be constituted to take over from one of the large firm networks in the event that it left the market, and a larger number of bigger competitors will increase the choice for international companies when selecting a new auditor. However, ultimately this will need to be a market solution where the audit is put out to tender by the client and given to the audit firm network with the highest competence at a reasonable fee.

It must be recognised that creating a new competitor via regulatory incentives may not necessarily lead to a new network that would be capable of providing comparable service right at its inception or that can inspire the same degree of confidence by stakeholders.

One of the large audit networks leaving the market would create enormous pressure for clients to put new auditors in place as quickly as possible. The turmoil from such an event would likely encourage a "flight to safety" – companies would have difficulty justifying choosing an auditor other than from one of the surviving larger networks.

It is important that the same independence and other quality control requirements should apply to all firms regardless of their capital structure. Those firms with non-practitioner capital should not be allowed exemptions from independence or other regulatory requirements.

III. Audit Firm Ownership Restrictions: Background

7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

Audit quality is helped in that partners who provide their capital have a natural incentive to look from a professional's perspective for high audit quality in the whole audit firm. However, alternative ownership arrangements could be structured in a way to ensure the continuation of these incentives for audit professionals to maintain high standards of audit quality.

The separation of ownership and management which accompanies non-professional ownership introduces potentially conflicting goals between both parties. For example, non-practitioner investors might seek to obtain a return on their investment that could have a negative impact on audit quality. Care would have to be taken to ensure that incentives are in place to properly align the interests of management and owners.

8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

Issues that regulators may want to consider include:

- Risks or sacrifices to audit quality due to non-professional ownership (whether due to economic incentives, the absence of professional responsibilities and oversight, lack of reputational interests, or otherwise);
- Governance structures that allow for inappropriate interference of investors into the outcome of a specific audit;
- Public involvement at national or local level in audit ownership could potentially, without clear independence, lead to undue pressure to influence judgements and outcomes of audits of entities with significant public or national interest;
- The propriety of relaxing independence rules for non-professional owners, particularly owners who do not function in a professional capacity;
- Whether rates of return sought by non-professional owners might have an impact on the culture or operation of audit firms that could impact the ability of audit firms to recruit and retain the most qualified professionals;

- Whether audit firms have an appetite for soliciting outside investors, and whether outside investors are willing to invest;
- The potential scope of authority, powers and any limitations (including on percentage of ownership) of non-professional owners; and
- Globalisation – networks of firms able to provide audit services and that match the global reach of multinational entities.

9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partner or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

The inclusion of public interest representatives may be one mechanism for seeking to align non-practitioner interests with the wider public interest. However, at present, there are differing legal requirements across jurisdictions concerning the legal form and governance of an audit firm and therefore careful evaluation at the local level is required to examine whether such a mechanism could be meaningfully implemented.

In practice the key prerequisites for a sustainable, high quality audit firm are, first, the tone at the top and the culture. Secondly, the right incentives, especially through performance assessment. To this end, charter provisions may only reconfirm the public interest obligation. We note that many of the inspection regimes administered by independent oversight bodies include an assessment of these factors and we believe that independent oversight is an effective way to ensure that audit firms are fulfilling their public interest obligations and independence.

Another means of encouraging recognition by auditors of the obligation to pursue the public interest perspective in their work could be by making its formal acknowledgement part of the admission of auditors to the profession where such requirement does not already exist.

10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms' capital raising capacity or other wise affect barriers to entry for audit firms?

Most KPMG member firms include a significant proportion of non-audit partners. They operate within the same code of ethics, values and culture. Indeed, we would welcome more flexibility for wider ownership by non-auditors in many jurisdictions. Fundamentally, the multi-disciplinary (MDP) model of business and ownership is both highly successful and sustainable, providing alternative career paths and mobility allowing firms to retain the best talent and enabling a more professional and flexible service. The MDP model is good for audit quality as it brings wider experience and expertise to often very complex audit processes.

The kind of funding (practitioner or non-practitioner) should not influence the operation of an audit firm one way or the other.

Allowing broader non-practitioner employee ownership would increase the pool from which firms could raise capital which, all other things being equal should make capital raising easier.

11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified professionals from performing audits are realized by existing restrictions on firm ownership?

It can be argued that having a majority ownership by professional auditors underpins the basic ethos and culture of the firm as well as providing reassurance to the market. However, other professionals sharing the same set of values but bring other skills within an MDP can make an equal contribution. There is an immediate incentive for audit professionals who hold a stake in the firm to perform high quality audits on their own engagements as well as to look for a firm culture which upholds strong internal quality control measures to protect the partners' capital in the longer term.

This is not to argue that other models could not work where there is outside capital, but that there are clear benefits to the proven model with substantial professional ownership.

IV. Possibilities for Further Minimizing Risks and Improving Investor Protection

12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

The management of an audit firm might consider it appropriate to give additional emphasis to the maintenance of a firm culture of high quality. An enhanced review of the tone at the top could be done, e.g. by means of compulsory quality checks, as most firms already do internally and are also increasingly done by independent auditor oversight authorities.

We expect that market incentives will exist to maintain competence, professionalism and audit quality as they form part of a quality offering to the audit market; however, independence may pose more problems depending on the nature of the investing non-practitioners, especially larger individual shareholders which actively want to manage their investment.

13. What level of non-practitioner ownership should concern regulators, and what level should be considered *de minimis*? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

From a free market perspective, regulators should not interfere with the level of non-practitioner investment. This should be generally left to the market to decide. General guiding principles could help to determine whether, in individual cases, a certain level of non-practitioner ownership could compromise the independence of the audit firm with respect to certain audit clients. These guidelines should be aligned to the extent possible with a globally consistent framework such as the IFAC Code of Ethics. One tool that may help to overcome independence problems is the public reporting of non-practitioner ownership, thus allowing the wider public to make an assessment of potential independence problems.

In general, regulators should focus on establishing a level playing field that sets favourable conditions (especially in relation to auditor liability and auditor independence) for investment in auditing activities, rather than seeking to set detailed rules on the level of non-practitioner ownership.

14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality, and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

This is ultimately a matter of effective governance of the audit firm and involves the assignment of responsibility to the individual auditor in a manner that prevents non-practitioner owners from interfering in the conduct and outcome of an individual audit. It is not only independence, but the perception of independence, that is important.

15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

As already said, outside capital is not the only building block to establish a viable firm that is capable of attracting clients and talent.

Ownership by means of a public offering could make possible, in certain circumstances, additional equity investments that cannot be provided by partners. However, the public sector should abstain from engaging itself as investors in the audit market because this may destroy any chance of a level playing field for competition in the audit market and give rise to the potential for undue pressure on certain audit outcomes.

16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

We believe that existing safeguards provide an appropriate basis to safeguard audit quality.

17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

See our response to item 16, above.

V. Impact on Audit Firm Concentration

18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

At the moment, it is unclear whether non-practitioners would be willing to invest in audit firms. In many countries, audit firms face unlimited liability which raises the risk of one of the large audit networks failing due to a catastrophic claim, or series of claims that in aggregate rise to a catastrophic level.[3] This state of affairs would probably make a non-practitioner with resources to invest to look elsewhere to earn a return on his or her investment. Therefore non-practitioners will only have a viable base for long term investments in audit firms if sufficiently favourable market conditions are established via audit regulation.

As we have already said, key considerations for encouraging investment are an adequate solution to limiting auditor liability and reducing the complexity of audit regulation, including rules relating to auditor independence.

19. What is the likelihood that one or more of the Big Four Firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated? Conversely, could this increase concentration, as large firms solidified their market share?

[3] This is shown by the London Economics September 2006 report on auditor liability to the European Commission Directorate General Internal Market and Services– Study on the Economic Impact of Auditors' Liability Regimes (MARKT/2005/24/F), which relied on relevant data collected by AON.

KPMG would not reject the possibility of raising additional capital from non-practitioner sources. However, outside capital only makes sense if it is invested in a firm to build its capabilities; for the time being partner capital is sufficient.

Outside capital will only flow into the audit market for large listed clients if there are attractive returns on investment; therefore, international audit regulation needs to create a sufficiently favourable environment for investments in audit firms; this also includes rational auditor liability regimes as well as the reduction of complexity in audit regulation, especially in the area of auditor independence.

Once such investment conditions are established, there may be movement in audit market shares resulting from outside investments in audit firms.

National Association of State Boards of Accountancy

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December 4, 2009

Mr. Greg Tanzer
Secretary General
International Organization of Securities Commissions
C/Oquendo 12
28006 Madrid
Spain

Via Email: AuditOwnership@iosco.org

RE: Comments on IOSCO's "Exploration of Non-Professional Ownership Structures for Audit Firms – Consultation Report"

Dear Mr. Tanzer:

We appreciate the opportunity to offer comments on the International Organization of Securities Commissions' (IOSCO) "Exploration of Non-Professional Ownership Structures for Audit Firms – Consultation Report" (Consultation Report) prepared by the IOSCO Technical Committee.

The National Association of State Boards of Accountancy's (NASBA) mission is to enhance the effectiveness of the 55 State Boards of Accountancy (State Boards) of the United States. The State Boards have the sole authority to establish licensing requirements for becoming a certified public accountant in each of the 50 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands and Commonwealth of the Northern Mariana Islands, as well as the authority to suspend or revoke such licenses. The primary roles of NASBA are to serve as a forum for the State Boards and to express the views of State Boards on matters that have a potential impact on the Boards' protection of the public. In furtherance of the mission of NASBA, we offer the following comments.

As the IOSCO paper points out, since January 1998 the Uniform Accountancy Act Section 7 (c) (1) clearly states that: "For firms of public accountants, at least a simple majority of the ownership of the firm, in terms of financial interests and voting rights, must belong to holders of registrations under Section 8 of this Act." Further, Section 7 (c) (2) (B) states "all non-licensee owners are active individual participants in the CPA or PA firm or affiliated entities."

In the United States, traditional attest services can only be offered by Certified Public Accountants licensed by State Boards of Accountancy. CPAs can offer other types of services through entities other than CPA firms, and there are no CPA ownership requirements for such entities as long as they do not call themselves "CPA" firms or use the term "CPAs" in association with their name. However, all individual CPAs working in such entities must hold a

valid license and are subject to regulation and discipline by the State Board. That is the key to regulation in the United States: The individual is held accountable to the State Board – including abiding by technical and ethical standards adopted and/or referenced by the State Board as well as meeting continuing education requirements and any other requirements the Board may impose by rule. The individual risks revocation of his or her license to practice public accountancy for failure to meet the Board's standards. In one 12-month period, the State Boards of Accountancy handled over 4,000 enforcement cases nationwide.

States grant licenses on the basis of public protection needs. Services are restricted to licensees because the state recognizes the rendering of a service should be limited to the state's licensees for the public's protection. Every state in the United States has recognized such need relative to auditing. Although several states have held periodic "Sunset Reviews" to determine the need for the continuation of a state licensing board, no Board of Accountancy has ever been disbanded.

We appreciate the opportunity to comment on the "Exploration of Non-Professional Ownership Structures for Audit Firms – Consultation Report" and trust our remarks will assist IOSCO's deliberations.

Sincerely,

Billy M. Atkinson, CPA
NASBA Chair

David A. Costello, CPA
NASBA President & CEO

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January 15, 2010

Public Comment on the Exploration of Non-Professional Ownership Structures for Audit Firms: Consultation Report

PricewaterhouseCoopers ("PwC") is pleased to comment on IOSCO's Consultation Report *Exploration of Non-Professional Ownership Structures for Audit Firms* ("Consultation Report"). PwC refers to, and we are responding on behalf of, the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate legal entity. As a network we are committed to promoting the consistent application of high quality audit practices worldwide in the public interest. We welcome reasonable initiatives designed to advance these objectives and to encourage participation by more accounting firms in the large public company audit market.

Ownership by Qualified Licenced Professional Accountants/Auditors

Existing ownership structures are the result of national regulatory requirements which were put in place to safeguard auditors' independence, objectivity, professionalism and expertise and thus promote audit quality. In most countries, a majority of the equity ownership in audit firms must be held by licensed public accountants. In some countries, ownership may be limited to only licenced public accountants. In most cases, such ownership is further limited to public accountants who are licenced or qualified in that country. In such jurisdictions, accountants or auditors who are licenced or qualified in another country are deemed in effect to have the same status as professionals who have no accounting qualification at all.

PricewaterhouseCoopers International Limited is registered in England number 3590073.
Registered Office: 1 Embankment Place, London WC2N 6RH.

We believe the time has come to liberalise limitations on accounting firm ownership to permit foreign qualified accountants to have equity ownership in audit firms in those countries where reform has yet to occur. Professionals, with commitment to professional standards and independence, should also have the potential for ownership across jurisdictional borders. These changes would reflect the ongoing trends in globalisation by which regional economies have become increasingly more integrated and national barriers reduced so as to facilitate the flow of goods, capital, services and labour, which in turn has made the audit increasingly transnational.

Ownership by Professionals who are not Qualified Accountants/Auditors

We are supportive of widening existing ownership structures to include other professionals who work full time in audit firms and who are subject to substantially the same independence and ethical standards as qualified accountants and auditors. Broadening ownership in this way reflects the many different skill sets which contribute to the audits of complex businesses. We do not believe it would have a detrimental effect on audit quality, auditor independence or tone at the top.

In the last twenty years or so, many developed countries have liberalised ownership restrictions to permit minority ownership in audit firms by full-time practicing professionals who are not qualified in the jurisdiction as accountants/auditors, subject to independence and other ethical requirements. We believe that these changes have had a positive impact on the auditing profession.

Ownership by External Investors

We are not opposed to the principle of ownership of audit firms by external investors. However, any such proposals would require careful consideration by policymakers in order to safeguard independence, objectivity and audit quality. The current audit firm ownership structure maintains focus on independence, audit quality and professional competence. Partners in an audit firm invest their human capital in the audit firm and are wholly dependant on the firm for their financial remuneration. They also have an interest in the longevity and sustainability of the firm. External equity ownership could lead to fundamental changes in the profession and the reporting process which are not considered by the Consultation Report. Any proposals to permit external ownership of audit firms would need to be evaluated carefully against the particular risks associated with such proposals and the safeguards needed to protect audit quality and independence would need to be considered in connection with the specific proposals.

The operational model of most audit firms is one where the owners operate within the practice. Because of the perceived ability of owners to influence the outcome of audits, safeguards exist to reduce to an acceptable level the threat to the auditor's independence of the owners' relationships and financial interests. Identification of the threats and the design of the safeguards is based on a model of individuals, whose principal employment is with the audit firm, contributing their own capital. If a firm's equity capital were to be provided by sources other than professionals employed inside the firm, whether from individuals or institutions through private placements or in public capital markets, this analysis of the threats and safeguards would have to be completely reassessed. We question whether the significant resources that would be required should be expended on developing additional safeguards when there is no indication of demand from investors to be able to take stakes in audit firms.

Our views are discussed in the specific requests for consultations numbered 1 to 19 which follow below.

We would be pleased to further discuss our comments with you. If you have any questions regarding this letter, please contact Kenneth R. Chatelain at + 1 202 312 7740.

Sincerely,

PricewaterhouseCoopers

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In addition to our comments above our responses to the questions posed in the Consultation Report are as follows:

1. Should regulators and/or legislators address barriers to entry in the market for large public audit services? Why or why not? Please explain.

PricewaterhouseCoopers' experience is that the marketplace for audit services is highly competitive at all levels of the market. We support reasonable initiatives to

encourage greater participation by more accounting firms in the public sector audit market, however, we believe it is critical that any efforts to do so must have the right objective in mind; audit quality is the end goal and competition among audit firms is a means to that end.

2. What are the most significant barriers to entry in the market for large public company audit services? How can legislators and/or regulators address these barriers? Are there ways aside from addressing audit firm ownership restrictions to address audit firm concentration and concerns about the availability of audit services to large public companies?

The fundamental barrier to entry is the huge investment in people required for the wide variety of different skill sets in a firm, which contribute to the complex audits necessary, and investment in intellectual property, technology and infrastructure that must be made over an extended period of time and over a wide geographic area to keep up with the operations of multinational clients. Investment of this magnitude can only generate the returns needed to justify it if the enterprise has, or is reasonably assured of obtaining, a large enough multinational client base. Development of this critical mass of clients takes many years. It is our view that assembling the client base needed to justify the increasing need for investment was a driving force behind many of the accounting firm mergers over the years. There are many accounting and auditing firms- for example as of 2009 more than 900 were registered with the PCAOB in the United States-but it is a challenge for firms that wish to do so to develop multinational operations unless they are part of a global network.

Other barriers to entry include restrictive independence requirements and the lack of regulatory convergence which makes it difficult to work across borders and achieve economies of scale. It is our view that professionals in audit firms should have the ability to operate across jurisdictional borders subject to independence and ethical standards. Ownership by foreign qualified owners particularly in certain jurisdictions where this is currently precluded would enable audit firms to further develop networks and combine resources across a network with resultant benefits to audit quality.

A further barrier is the continued ability to attract human capital and maintain the reputation of a firm. Liability risk is also a barrier, as the size of potential claims puts capital at significant risk and there is presently no commercial insurance available to cover the current level of claims asserted against the large audit firms.

3. Is increasing the availability of the sources of audit services to large public companies by addressing one of the barriers to entry into the market possible? If so,

which one? If not, is addressing several or many of the barriers at one time necessary? If so, which ones?

We believe that in the short term there is little that can be done to increase the availability of audit services to large public companies. Over a period of time it is possible for a new or existing firm (or network of firms) to enter the market and grow its client base at a rate that would justify the increasing investment needed. History has demonstrated that the audit market is not static. We have seen changes to the number of firms (and networks) of all sizes through organic growth, merger, and firms exiting the market.

4. Would expanding the scope of non-practitioner ownership create, alleviate, or remove any threats to the continuity of audit services? Please explain.

We believe that the ownership of audit firms by other professionals who work full time in them and who are subject to the same independence and ethical standards is no threat to the continuity of audit services, and in fact can help alleviate threats to continuity by enhancing audit quality. Any proposals to permit ownership by external investors would require careful evaluation of any risk to audit quality so as to protect audit quality, independence and professional competence.

5. Could allowing audit firms the option of broader non-practitioner ownership, including through public sources, assist new competitors to enter the market for large public company audits? Please explain.

Any commercial investor in an audit firm would rightly expect a reasonable return on investment. Such returns on the necessary investment in people, intellectual property, technology and infrastructure can only be generated by serving a significant client base. Accordingly, the development of any new entrant to the audit market could only take place over a significant period of time and would not be dependent on new sources of capital other than those currently available to audit firms. With any changes to existing ownership structures comes the potential for increased risk to independence but we believe any such prospective threat can be overcome by appropriate safeguards.

6. Would allowing audit firms the option of broader non-practitioner ownership allow for greater transitional flexibility to constitute a new firm or otherwise provide continuity of audit services in the event that one of the Big Four firms leaves the market?

The likely causes of one of the largest firms being forced to leave the market are unmanageable liability claims or punitive regulatory sanctions. In neither event is broader ownership by professionals who are not qualified accountants/auditors or by external investors likely to have any impact.

7. How important are the existing ownership restrictions to audit quality? How else do existing restrictions benefit investors and/or promote audit quality? How may audit quality be negatively affected by permitting alternative forms of audit firm ownership?

Restrictions on audit firm ownership ensure that audit firms are controlled by professionals who are governed by a code of ethics, including the obligation to serve the client's and the public interest. Professional ethical values are embedded in the culture of all the major audit firms and this culture of professional ethics is very important to audit quality. Changes to ownership restrictions must not put at risk the continuance of these values.

For this reason, those few jurisdictions that in recent years have moved to permit ownership by professionals who are not qualified accountants/auditors have generally limited levels of ownership such that those professionals could not gain voting control of the audit firms. Because of the professional, client and ethical obligations of a professional accountant/auditor and other professionals employed in audit firms we believe that restrictions on levels of ownership, particularly with regard to controlling interests by persons not subject to similar professional codes of ethics as accountants and auditors, remain important in order to preserve audit quality.

8. What factors other than those set forth above should regulators consider in analyzing whether alternative forms of audit firm ownership and governance should be allowed?

The partnership structure and its variants facilitates the identity of audit firms as professional entities and thereby creates an environment where employees identify themselves with a professional code of conduct which embodies appropriate standards of quality and independence. Similar standards can be achieved within other corporate structures, as is the case in the European Union, where many Member States permit different legal structures for audit firms. That said, audit quality could be negatively affected should ownership be further widened such that accountant/auditor professionals no longer control the audit firm. Loss of professional control will have an impact on the identity of the entity itself and also on those who work in and identify with it.

The auditor’s right to exercise autonomous professional judgement in the interests of securing audit quality is strengthened by the professional ethos in the partnership structure, or in ownership structures that model themselves on the partnership concept. The auditor's ability to exercise his or her professional judgment should not be jeopardised by the setting of inappropriate ownership requirements or goals that are not in the public interest.

As noted earlier, audit firms (and networks) serving large, public multinational companies must increasingly be able to recruit and retain individuals with specialized knowledge and expertise who complement the work of the auditors. This human capital issue should be considered in analysing whether alternative forms of ownership should be permitted. A further aspect of the human capital issue is the interplay of professionals and the independence rules and the potential risk of conflicts of interest and the effect this has on the firm's ability to attract the most appropriate professionals.

9. Would alternative forms of ownership that include boards of directors with independent members provide a useful reinforcement of auditing firms' public interest obligations and independence? Would other arrangements, such as compulsory charter provisions for audit firms that establish a requirement for partners or directors (licensed or unlicensed) to give due regard to the public interest, be useful?

The partners in a firm have the greatest incentive to maintain its long-term viability. This long-term viability depends on maintaining the firm's reputation, which in turn depends on upholding its public interest obligations and retaining its independence.

10. Do audit firm non-practitioner employees have economic incentives more in line with practitioner owners than they would have with outside investors? Should ownership by firm employees who are not practitioners be treated differently from outside owners? Would more permissive non-practitioner employee ownership be likely to affect the firms’ capital-raising capacity or otherwise affect barriers to entry for audit firms?

Owners who work full time in the audit firm, whether qualified professional accountants or not, have identical economic incentives. Other outside owners have substantially different economic interests. Neither form of ownership has a significant impact on a firm's ability to raise the capital that it needs.

11. What benefits beyond avoiding additional conflicts of interest associated with non-professional or outside ownership and prohibiting non-qualified

professionals from performing audits are realized by existing restrictions on firm ownership?

The partnership structure, or similar structures, facilitates the identity of audit firms as professional entities where employees abide by a professional code with appropriate standards of quality and independence. The auditor's right to exercise professional judgement in the interests of securing audit quality is strengthened by the professional ethos in the partnership structure, or in ownership structures that model themselves on the partnership concept. Tying ownership in the firm to the ongoing employment of the senior practitioners helps instil and maintain the culture of the firm in support of the objectives of quality and independence from which long term success follows and is not driven by short-term investing goals. It is important that quality and independence should not be harmed by the setting of inappropriate ownership requirements or goals that are not in the public interest.

12. Could existing safeguards appropriately mitigate concerns regarding competence, professionalism, audit quality and independence if auditing firms were more broadly owned by non-practitioners?

As noted above many jurisdictions already permit ownership by professionals who are not accountants/auditors and this could be widened still further so as to include professionals who work full-time in the firm who would be subject to the same ethical and independence safeguards as accountant/auditor practitioners. In the case of external investors procedures designed to protect audit quality, professionalism, competence and independence would have to be robust and clear enough to preserve audit quality and protect the interests of those stakeholders who rely on the performance of high quality audits by the audit firm.

13. What level of non-practitioner ownership should concern regulators, and what level should be considered *de minimis*? Is a securities regulatory model for reporting beneficial ownership useful for this purpose?

As stated above many jurisdictions in recent years have moved to permit minority ownership in audit firms by professionals who are not qualified accountants/auditors. We support this model.

14. Could additional safeguards, or adjustments to existing safeguards, adequately ensure that auditing firms maintain their competence, professionalism, audit quality,

and independence under broader non-practitioner ownership, including public ownership? If so, what safeguards or adjustments would be needed?

The consideration of both indirect and direct ownership and other business relationships is complex as it is hard to reconcile the interests of the various parties. Potential investors in audit firms may have diverse relationships and business interests. Careful and considerable thought will be necessary before allowing changes which might risk jeopardising professionalism, independence and audit quality but we believe any threats to these might be alleviated by appropriate safeguards.

15. What existing risks to any investors might be mitigated by public ownership and which might remain; which might be heightened? What, if any, additional safeguards could regulators implement to address sufficiently any remaining risks?

We are not aware of any risks to investors that would be mitigated; we believe risks to investors would remain unchanged. Unless one could be satisfied that safeguards existed to ensure the maintenance of audit quality, public ownership may result in deterioration in audit quality which would potentially be damaging to investors.

16. Could new safeguards bring ancillary benefits to the audit process? If so, what are they?

17. Could new safeguards bring ancillary detriments to the audit process? If so, what are they?

Audit standard setters, audit regulators and audit firms are constantly striving for improvements in the audit process. We believe this process of improvement would be unaffected by any changes in ownership restrictions.

18. What is the likelihood that potential new entrants would take advantage of opportunities for broader non-practitioner ownership, either in the near term or long term?

As an existing participant we believe it is for others to say if they would be interested in taking advantage of these opportunities.

19. What is the likelihood that one or more of the Big Four firms would take advantage of this option? Were one or more such firms to do so, would the access to additional capital potentially strengthen the firm's capital cushion, thus reducing the likelihood that the audit services market would be further concentrated?

Conversely, could this increase concentration, as large firms solidified their market share?

To date PwC member firms have been able to obtain the capital they require through currently permitted sources. If new sources were available the option would be examined and explored.

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