



**The Quoted  
Companies Alliance**

The Quoted Companies Alliance  
6 Kinghorn Street  
London EC1A 7HW  
Tel: +44 20 7600 3745  
Fax: +44 20 7600 8288

Web: [www.quotedcompaniesalliance.co.uk](http://www.quotedcompaniesalliance.co.uk)  
Email: [mail@quotedcompaniesalliance.co.uk](mailto:mail@quotedcompaniesalliance.co.uk)

Robert Hodgkinson  
Project Director  
Audit Firm Governance Working Group  
ICAEW  
Chartered Accountants' Hall  
PO Box 433, Moorgate Place  
London EC2P 2BJ

Email: [auditfirmgovernance@icaew.com](mailto:auditfirmgovernance@icaew.com)

4 February 2009

Dear Robert,

**AUDIT FIRM GOVERNANCE – A PROJECT FOR THE FINANCIAL REPORTING COUNCIL**

***INTRODUCTION***

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation dedicated to promoting the cause of smaller quoted companies (SQC)s, which we define as those 2,000+ quoted companies outside the FTSE 350 (including those on AIM and PLUS) representing 85% of the UK quoted companies by number. Their individual market capitalisations tend to be below €500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in twelve EU member states.

***RESPONSE***

Thank you for giving us the opportunity to comment on the proposals contained in your paper. Please find attached a detailed response to the consultation questions prepared by the QCA's Corporate Governance Committee. However, you will note that we feel that the objectives of Audit Firm Governance should be made more clear at the outset.

If you wish to discuss any of the comments, we will be happy to meet.

Yours sincerely,

John Pierce  
Chief Executive



**The Quoted  
Companies Alliance**

**AUDIT FIRM GOVERNANCE – A PROJECT FOR THE FINANCIAL  
REPORTING COUNCIL**

**Response to ICAEW consultation  
from the  
Quoted Companies Alliance**

4 February 2009

## **CONTENTS**

1. Overall Approach
2. Response to specific questions raised

### Appendices

- A. List of QCA Corporate Governance Technical Committee Members
- B. About the Quoted Companies Alliance

## AUDIT FIRM GOVERNANCE – A PROJECT FOR THE FINANCIAL REPORTING COUNCIL

### 1. OVERALL APPROACH

We believe that any code on governance needs to set out clearly the objectives or outcomes that the code is seeking to achieve and then to identify activities that promote the achievement of those objectives or outcomes.

We consider the QCA's publication "Corporate Governance Guidelines for AIM Companies" and the FRC's "Plan and Budget 2008/09" to be good illustrations of such an approach.

The main advantage of such an approach is that it provides a clear framework for the explanation of any deviation from a recommended activity and the assessment of such an explanation.

We do not believe that the Combined Code on Corporate Governance should be used as the basis for a code on Audit Firm Governance without major adaptation.

#### *Market Participants Group Recommendation 14*

The final report of the Market Participants Group (MPG) made 15 recommendations which were intended to:

- Increase the feasibility of investment in the supply of audit services to public interest entities by existing non-Big Four firms or new firms
- Reduce the perceived risks to directors of selecting a non-Big Four firm
- Improve the accountability of boards for their auditor selection decisions
- Improve choice from within the Big Four
- **Reduce the risk of firms leaving the market without good reason**
- Reduce uncertainty and disruption costs in the event of a firm leaving the market. <sup>1</sup>

The MPG considered that a method of reducing the risk of firms leaving the market without good reason was to "reduce the value of meritorious claims against audit firms<sup>2</sup>", and this led to Recommendation 14 which is "Every firm that audits public interest entities should comply with the provisions of a Combined Code-style best practice corporate governance code or give a considered explanation".

We agree that good governance should reduce the number and value of meritorious claims against audit firms, but consider that any public statement or discussion of how an audit firm achieves good governance is likely to quickly become formulaic and be of little or no value. We believe that enhancement of governance processes is best achieved by adapting the existing mechanisms for the monitoring of audit firms' performance.

#### *Other Objectives of an Audit Firm Governance Code*

The consultation document sets out other objectives for an audit Firm Governance Code which are:

- encouraging changes in governance which are seen as enhancing the way the firms are run;
- enhancing the stature of the firms as public interest entities by giving users of audit services confidence in the firms' governance that allows the firms to stand comparison with the best of their public interest audit clients; and

---

<sup>1</sup> Final Report of MPG p.3

<sup>2</sup> Final Report of MPG p.11

- underpinning other aspects of the regulatory regime for audit, instilling confidence that the regime will deliver high quality audit without needing to cover every eventuality through costly and distracting detailed regulation.<sup>3</sup>

In the light of the often formulaic reporting by companies on their corporate governance, we remain to be convinced how any governance code for audit firms will achieve these worthy objectives.

We also question whether the ICAEW should be looking to extend the objectives of any governance code beyond those identified by the MPG. Extending the objectives increases the risk that any code will create barriers to entry and not increase choice in the audit market.

---

<sup>3</sup> Audit Firm Governance Evidence Gathering Consultation Paper p.5

## 2. RESPONSE TO SPECIFIC QUESTIONS RAISED

### **Stakeholders of firms that audit public interest entities**

1. *Which groups of stakeholders do you think the Audit Firm Governance Code should primarily serve and in what ways, if any, do they have differing interests?*

Clarifying the objectives of any governance code should allow for the identification of appropriate stakeholders. If the objectives are limited to those set out by the MPG, then the relevant stakeholders are the existing bodies charged with the oversight of auditors.

### **Risk management**

2. *What approach should a Combined Code-style Audit Firm Governance Code adopt to risk management and internal control?*

We do not believe that a Combined Code-style Audit Firm Governance Code is appropriate for the reasons stated above. We also believe that the format of any reporting is likely to be formulaic and so will not be helpful in providing insight into audit firms when directors and shareholders are making evaluations of the firms for the purpose of their appointment or re-appointment as auditors.

3. *To what extent do the firms face unique issues in discussing their principal litigation and claims risks without causing damage to the sustainability of the firm?*

The issues faced by audit firms are identical to those faced by companies, but the consequences may have more public impact.

4. *Do you agree that the Audit Firm Governance Code should focus on risk management and internal control of the firm as a whole including its non-audit business and, if not, what alternatives would you propose?*

This is dependent on the objective of the governance code.

### **International structures of the firms**

5. *In the case of a UK firm that is part of a regional or an international structure, should the Audit Firm Governance Code specify the level at which it is applicable or should the firm be given some discretion to determine the level at which it applies the Code, explaining why this level has been chosen?*

This is dependent on the objective of the governance code. Any “apply or explain” type governance code should always give the opportunity to explain variances from the expected norm.

6. *Do you think that the Audit Firm Governance Code should contain code principles and/or code provisions covering an audit firm’s dependence on, and exposure to the risks of, other network members and how it ensures consistent quality and application of auditing standards?*

This is dependent on the objective of the governance code. We believe that these are important risks that need to be taken into account when considering the risks and controls of an audit firm.

### **Governance structures and independent non-executives**

7. *In principle, do you think that the Audit Firm Governance Code should support the appointment of independent non-executives by the firms and, if so, what might it say on the number or proportion of non-executives and their position, role and responsibilities in a firm’s governance structure?*

This is dependent on the objective of the governance code. We believe that effective independent challenge of risk identification, monitoring and control processes and procedures is useful in all organisations.

*8. Other than matters related to auditor independence, are there any barriers, regulatory or otherwise, to the appointment of independent non-executives to firms?*

Not as far as we are aware.

*9. What other governance structures and models are there that provide for independent oversight which might be considered by the Audit Firm Governance Working Group?*

Please refer to introductory comments. We do not believe that a Combined Code style approach is appropriate. There are existing processes for independent oversight of audit firms that may be used.

### **Scope of firms to be covered**

*10. In order to determine which firms the Audit Firm Governance Code applies to, should the definition of a public interest entity be based upon the narrower listed company market definition used for transparency reporting purposes or the wider definition used by the AIU or some other definition?*

There should be one definition of “public interest entity” that is used by all regulators.

*11. Do you think that a distinction should be made between firms that would be required to apply the Audit Firm Governance Code and firms that would be encouraged to apply it on a voluntary basis and, if so, where should that distinction be drawn?*

This depends on the objectives of the code. If the objectives relate to enhancing choice of auditors for public interest entities, then only those firms auditing (or wishing to audit) such entities should be required to follow the code. Care should be taken that this does not create an additional barrier to entry for new entrants to this market.

### **Implementation and monitoring**

*12. Based on the assumption that the comply or explain approach will apply, to what extent do you think that the implementation of the Audit Firm Governance Code should be ‘left to the market’ because owners of the firms and shareholders and directors of listed companies can be relied on to ensure that the firms apply the Code and make appropriate explanations of non-compliance?*

We do not believe that Audit Firm Governance reports are likely to be able to provide meaningful information “to the market” and consider that reporting on a code is best directed at, and monitoring of the code is probably best performed by, existing regulators. See also the answer to question 2 above.

*13. What need, if any, do you think there will be for:*

- *Audit regulations to require the firms to make comply or explain disclosures in relation to the Audit Firm Governance Code?*
- *A regulatory or other body to monitor and to check either compliance with the Audit Firm Governance Code or the appropriateness of explanations of non-compliance?*
- *Involvement of auditors appointed by the firms?*

We do not believe that Audit Firm Governance reports are likely to be able to provide meaningful information “to the market” and consider that monitoring of the code is probably best performed by existing regulators. As such this may require changes to the remit of those regulators.

*14. Can you suggest any potential deregulatory measures to eliminate possible duplication that could be linked to the implementation of the Audit Firm Governance Code?*

In the light of the often formulaic reporting by companies on their corporate governance, we remain to be convinced how any governance code for audit firms will achieve the objectives set out in the “Chairman’s introduction” to this consultation.

**Reporting and communication**

*15. What measures should be taken in relation to how and where the firms disseminate information about their application of the Audit Firm Governance Code so as to enhance its usefulness?*

We do not believe that Audit Firm Governance reports are likely to be able to provide meaningful information “to the market” and consider that monitoring of the code is probably best performed by existing regulators.

*16. Should the Audit Firm Governance Code call for disclosure of specific matters, such as major changes in governance practices, responses to specific concerns raised by the AIU, and any other matters?*

This depends on the objectives of the code. Publication of responses to AIU reports may be useful.

**Areas to be covered by the Code**

*17. Are there principles and provisions in the Combined Code which you think are particularly relevant or inappropriate for application to the firms and are there major issues of relevance to the firms that are not included in the Combined Code?*

We believe that all activities (be they “principles”, “provisions” or something else) should be directly relevant to the objectives of the code, and as such the code should be devised from first principles, rather than by cutting and pasting from the Combined Code.

*18. Are there any compelling reasons for departing from the Combined Code structure of preamble, principles and provisions?*

Yes, there are compelling reasons for departing from the Combined Code structure. We believe that all activities (be they “principles”, “provisions” or something else) should be directly relevant to the objectives of the code, and as such any code should be laid out in a manner that highlights how activities are relevant to the achievement of the objectives.

*19. Can you provide examples, whether or not derived from the Combined Code, from other non-listed company sectors where you think that appropriate governance codes have been developed, giving information on their potential relevance to the firms?*

We consider the QCA’s “Corporate Governance Guidelines for AIM Companies” to be a good example of how a governance code should be structured. We believe that any Audit Firm Governance code should be created from first principles based on the objectives of such a code.

*20. Do you have any other observations about matters not covered by earlier questions that you think would be useful to the Working Group in drafting the Audit Firm Governance Code?*

No.



**THE QUOTED COMPANIES ALLIANCE LEGAL COMMITTEE**

Edward Beale (Chairman)*	City Group PLC
Mirza Baig	F&C Asset Management PLC
Nigel Burton	Advanced Power AG
Anthony Carey	Mazars LLP
Louis Cooper	Horwath Clark Whitehill LLP
Clive Garston	Halliwells
Tim Goodman	Hermes Equity Ownership Services Ltd
Mark Harwood	Baker Tilly LLP
Elaine New	Seven Arts Pictures plc
Andrew Viner	BDO Stoy Hayward LLP
Melanie Wadsworth	Faegre & Benson LLP
Nick Wargent	K&L Gates LLP
John Pierce	The Quoted Companies Alliance
Kate Jalbert	The Quoted Companies Alliance

\*Main Authors

**THE QUOTED COMPANIES ALLIANCE (QCA)**

A not-for-profit organisation funded by its membership, the QCA represents the interests of SQCs, their advisers and investors. It was founded in 1992 and originally known as CISCO.

The QCA has nearly 400 members. 75% of these are smaller companies quoted on the stock market, or companies with aspirations to join. 25% are drawn from the full range of professional advisory firms whose business is either wholly or significantly derived from servicing smaller companies.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- introduction of, or changes to, legislation affecting SQCs
- corporate governance
- share schemes for employees
- trading, settlement and custody of shares
- structure and regulation of stock markets for SQCs; Financial Services Authority (FSA) consultation
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from the Accounting Standards Board
- company law reform

The QCA is a founder member of **European Issuers**, which represents over 9,000 quoted companies in twelve EU member states.

**QCA's AIMS**

As the only organisation dedicated solely to the particular interests of the SQC sector, the QCA has three primary goals:

*Identification*

To create a distinct identify for the SQC sector, and demonstrate its value to the stock markets and the UK economy.

*Representation*

To pro-actively pursue and represent the interests and requirements of the SQC sector to enable it to increase its contribution and ensure that its specific needs are addressed.

*Affiliation*

To build a strong and vocal collective body of support from within the SQC sector, among corporate directors and securities industry leaders.

## DEFINITION

The Quoted Companies Alliance definition of Smaller Quoted Companies (SQC) is:

- all fully listed companies – excluding the top 350 ie with market cap of £340m+
- plus companies quoted on AIM
- plus companies quoted on PLUS

The QCA also represents companies planning to float.

SQCs contribute to the economy:

- there are approximately 2,000 SQCs
- they represent around 85% of the total of quoted companies by number
- they employ 2 million people
- this figure represents around 10% of total private sector employment
- every 5% growth in the SQC sector could reduce UK unemployment by a further 100,000
- They generate:
  - corporation tax paid of £2.0 billion pa
  - income tax paid of £5.0 billion pa
  - social security paid of £2.0 billion pa

The tax figures exclude business rates, VAT and other indirect taxes.

For more information contact:

John Pierce  
The Quoted Companies Alliance  
6 Kinghorn Street  
London EC1A 7HW  
020 7600 3745  
[www.quotedcompaniesalliance.co.uk](http://www.quotedcompaniesalliance.co.uk)