

STATEMENT OF Mr PAUL BOYLE  
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BEFORE THE  
ADVISORY COMMITTEE ON THE AUDITING PROFESSION

WASHINGTON, DC – 3 DECEMBER 2007

Mr Chairmen and Members of the Committee,

It is my privilege to appear here today as the Chief Executive of the Financial Reporting Council (FRC) the United Kingdom's independent regulator responsible for promoting confidence in corporate reporting and governance. The FRC has six strategic outcomes which contribute to our overall aim, covering corporate governance, corporate reporting, auditing, actuarial practice, professionalism of accountants and actuaries and our own effectiveness as a regulator. Within our auditing outcome, we recognise the importance of an efficient market for audit services in the UK.

I hope that our mission means that we are in a position to assist the Committee in its review of the sustainability of the US auditing profession.

Over the last eighteen months we have facilitated a public debate in the UK about the efficiency of the market for audit services in the UK. I have submitted the results of that debate in the FRC's response to the Committee's Discussion Outline ( [http://comments.treas.gov/\\_files/051107LettertoTreasuryAdvisoryCommittee.pdf](http://comments.treas.gov/_files/051107LettertoTreasuryAdvisoryCommittee.pdf) ). My testimony today does not repeat that response but is focussed on how the work that we have facilitated in the UK might be relevant to the issues now being considered by the Committee in relation to Firm Concentration and Competition.

The debate in the UK has been facilitated by the FRC but has had considerable participation by market participants, including companies, investors and auditors. The debate went through several stages. It started with a general view that the current situation in respect of firm concentration and competition posed some risks to the

capital markets and to the wider aspects of the economy which rely on the availability of audited financial statements. Informed by an independent study of the market prepared by a firm of economic consultants, it evolved to recognise that the primary risk was of uncertainty and costs in the event of one or more of the Big Four firms leaving the market. There was general agreement that there would be serious difficulties in the market if the number of major firms fell from four to three. It is neither possible nor desirable to reduce to zero the risk that one of the existing major firms would leave the market.

This led to broad agreement that the fundamental issue was one of auditor choice rather than competition issues such as pricing or quality. It was also agreed that the most attractive way to address the issue was to enhance the efficiency of the market, whilst protecting or enhancing audit quality and avoiding unacceptable costs. Stakeholders also expressed a clear preference for market-led actions, rather than regulatory interventions, to address the issues. However, there was recognition that the audit market has been subject to extensive regulatory requirements for some years and that, as a result, enabling actions by professional bodies, regulators or legislators may be needed.

The FRC established a Market Participants Group (MPG), which consisted of investors, companies and audit firms, to advise the FRC on possible actions that market participants could take to mitigate the risks arising from concentration in the market. The MPG developed, following a public consultation, 15 recommendations to achieve a more efficient market by assessing and addressing the market characteristics that were acting together to limit choice. The process adopted by the MPG leads me to believe that there is extensive support from across the UK market for both the need for change and the selected means of achieving it.

I believe that the Group's recommendations will result in individual market participants having greater incentives to act in ways that could, in the long term, lead to increased choice of auditors. Non-Big Four firms should have greater incentive and ability to invest in the supply of audit services. Boards of directors should be more accountable to their shareholders for their auditor selection decisions and should find selecting a non-Big Four firm, in suitable circumstances, less risky. Shareholders

should be better informed about the capabilities of different audit firms and less concerned about decisions to select a non-Big Four firm, in suitable circumstances.

We are now in the implementation phase of our work. The FRC's response to the Committee's Discussion Outline, to which I referred earlier, included a table summarising the plans for implementing the MPG's recommendations. The FRC has also made a commitment to report publicly every six months on the progress on implementation.

Although the issues faced by your Committee are considerably wider than those considered by the FRC during this debate, in the area of Concentration and Competition there are likely to be a number of important parallels.

In our work on choice in the audit market we have explicitly recognised the importance of audit quality and auditor liability. Although the issues are inter-related, we found it convenient, for reasons of focus, to have separate projects on choice, audit quality (see, for example, our most recent publication on audit quality <http://www.frc.org.uk/press/pub1418.html> ) and auditor liability (see, for example, the announcement of our project <http://www.frc.org.uk/press/pub1352.html> ).

Throughout our extensive deliberations and consultations on this issue we were unable to identify one specific measure which of itself would substantially lower the risks. It is for that reason that the MPG produced a package of 15 recommendations each of which address different aspects of the problem.

My own view is that the recommendation which has the greatest long-term potential to reduce the level of risk is the one relating to the ownership of audit firms. To increase choice it is necessary for one of the existing smaller firms to grow at a rapid rate or for there to be a major new entrant. For either of these to happen substantial capital will be needed to fund the investment required. The existing ownership rules are a major constraint on the potential rate of investment.

Concerns have been raised about the risks to auditor independence and audit quality arising from changes to the ownership of audit firms. I believe that some of those

concerns are overstated and that others are capable of being mitigated. And, of course, the risks of change need to be weighed against the risks associated with the status quo. The FRC is currently preparing a discussion paper on this topic which I will be happy to send to the Committee when it is published in early 2008.

There was a view in the UK that this is an international issue and one that could only be addressed through international cooperation. Rather than respond by doing nothing, we took the view that useful progress could be made in the UK alone. However, we also recognised that progress on some issues would be faster and more effective if complimentary solutions were adopted in other major countries. We hoped that the debate in the UK could make a useful contribution to a wider international debate. In this context we regard the establishment of your Committee and the work being done by the European Commission (see, for example <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1570&format=HTML&aged=0&language=EN&guiLanguage=en> ) as being very significant developments.

I look forward to contributing to the Panel discussion and answering your questions.