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REGARDING "GLOBAL CAPITAL MARKETS AND THE GLOBAL ECONOMY: A VISION FROM THE CEOS OF THE INTERNATIONAL AUDIT NETWORKS NOVEMBER 2006"

Dear :

The International Corporate Governance Network (ICGN) is an international network of institutional investors, shareholder advocates and corporate governance experts collectively holding in excess of US $10 trillion in assets. The Accounting and Auditing Practices Committee (the Committee) of ICGN has been active in a number of issues relating to both auditing and accounting standards.

We read your proposals with interest and welcome the contribution they make to the debate about the future of global corporate reporting. We shall not comment on all aspects of the proposals but we should like to convey that there are a number of important ones which concern us.

First, we are concerned at the emphasis given in the proposals to meeting the needs of the capital markets as opposed to meeting the needs of shareholders and investors who we regard as the primary users of corporate reports.

Second, we are concerned that the proposal for 'real time' reporting could encourage short-term investment and otherwise give rise to investment and ownership decisions that are not appropriately informed.

Third, we are concerned that there is no reference to the proposals to 'stewardship', which we regard as a cornerstone of corporate reporting and accountability.

The Committee has previously expressed its views on a number of issues touched upon in your document and I have attached a copy of our “Statement of Concern” dated November 2005.

We look forward to the debate developing as time goes by and we should be pleased to contribute to it, as and when appropriate.

If you have any questions or if you would like additional information, please contact me (contact information below) or Guy Jubb, Investment Director, Head of Corporate Governance, Standard Life Investments (in Edinburgh 131 245 6813 or guy_jubb@standardlife.com).

Sincerely,

C Lamoureux

Claude Lamoureux
Chair, Accounting and Auditing Practices Committee

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Attachment

International Corporate Governance Network
Accounting and Auditing Practices Committee

STATEMENT OF CONCERN ON THE STRUCTURE OF THE AUDIT MARKET

The Committee expresses its concern about the current structure of the audit market as regards the audit of financial information in publicly-listed international corporations. Investors have a key interest in a well-functioning market for audit services, and we think that the present situation is far from ideal.

Currently, this market is dominated by four major international audit firms[1]. There are virtually no other players with a more than local dimension[2]. Moreover, in some specific industries the degree of concentration is even higher, with only two or three firms auditing the accounts of the main industry players[3]. There is widespread consensus on the fact that market forces alone cannot result in the emergence of new entrants in this market[4].

This situation could lead to oligopolistic behaviour and supplier-imposed price increases for audit services; however, we are not aware of clear evidence of such behaviour to date. Our concern is rather on the effect of the current market structure on the quality of audits. We fear that the limited competition and, quite possibly, the perception that the large audit firms are now "too few to fail" (i.e., that possible failings shall not be duly sanctioned because nobody wants the number of global players to shrink to three or less) may have a negative impact on diligence and quality.

In the UK, the audit profession has proposed an extraordinary limitation of their liability partly based on the "too few to fail" argument, which is scheduled for debate in Parliament. Similar debates may happen in other countries, possibly leading to negative outcomes in terms of avoidance of responsibility.

Moreover, there are no compelling economic arguments – e.g., over economies of scale or diversification of client portfolio – which could justify such a degree of concentration of the audit market for international companies. We do not consider that the consolidation which has occurred during the last quarter-century was unavoidable, supposing the availability of appropriate oversight mechanisms.

Finally, the partnership structure of audit firms currently results in a near-total absence of public information about their business model, profitability and financial strength, which does not help the emergence of a well-informed analysis of incentives or disincentives which may have an impact on audit quality. We agree with outgoing SEC Chief Accountant Donald Nicolaisen, who said accounting firms must publish annual accounts and provide information about partners' compensation[5].

The Committee thinks that this state of affairs is unsatisfactory. A high quality of audits is of key importance to investors and, more generally, to the correct functioning of global capital markets.

Therefore, the Committee considers it to be in the public interest that an in-depth collective effort be initiated in order to decisively improve the current situation. Investors themselves should not shy away from their own responsibilities; they are increasingly, though not uniformly, in a position to influence the oversight provided by audit committees on audit services, price and quality. But investors alone cannot address the challenges posed by the audit market. We understand that securities and accounting regulators have had other priorities in the recent times but this is no reason to leave this issue unexplored and unaddressed. We also believe that the audit industry itself should play a leading role in a reforming effort, with the aim of ensuring its own sustainability in the interest of investors and markets. The Committee intends to closely monitor future developments and to stay in contact, as far as useful, with others concerned by a well-functioning market for high-quality audit services.

International Corporate Governance Network
Accounting and Auditing Practices Committee

November 2005

[1] Deloitte, Ernst & Young, KPMG and PricewaterhouseCoopers; all four firms trace their origins back in the XIX[th] century, i.e. none of the many new entrants created in the last century, including Arthur Andersen, has survived as a leading independent firm.

[2] In the United States, "Tier-2" firms such as BDO Seidman and Grant Thornton have been successful at developing a significant customer base but their cumulated audit revenue is less than 4 % of that of the "Big 4", and they are virtually absent from the business of auditing large international companies. In France, the legal requirement of having two auditors instead of one has led to the past emergence of some strong local firms, but only one (Mazars) has survived the last round of consolidation.

[3] This is well illustrated in one of the most comprehensive and impartial analyses in the public realm on this topic, the report issued by the United States Government Accountability Office (GAO) in July 2003 on *"Public Accounting Firms – Mandated study on Consolidation and Competition"* (mandated by the Sarbanes-Oxley Act of July 2002, § 701; report available on the GAO's website). Unfortunately, this study only addresses the US audit market, and no such analysis is known to the ICGN as regards the global market.

[4] For example, the summary of the above mentioned GAO report states that: *"GAO found that smaller accounting firms faced significant barriers to entry—including lack of staff, industry and technical expertise, capital formation, global reach, and reputation—into the large public company audit market. As a result, market forces are not likely to result in the expansion of the current Big 4. Furthermore, certain factors and conditions could cause a further reduction in the number of major accounting firms."*

[5]Quoted in *Financial Times*, November 3[rd], 2005

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