

25 October 2010

Hazel O'Sullivan
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Dear Ms O'Sullivan

Consultation Paper on Revised Draft Ethical Standards for Auditors

The British Venture Capital Association (the BVCA) is the industry body of the UK private equity and venture capital industry. With a membership of over 450 firms, the BVCA represents the vast majority of all UK-based private equity and venture capital firms and their advisors.

The BVCA has 25 years of experience representing the UK private equity industry to government, the European Commission and Parliament, the media, regulatory and other statutory bodies at home, across Europe and around the world. It promotes the industry to entrepreneurs and investors, as well as providing services and best practice to its members.

This response has been prepared by the BVCA's Legal & Technical Committee which represents the interests of BVCA members in legal, accounting and technical matters relevant to the private equity and venture capital industry. The views set out in this response do not necessarily reflect the views of all members of the BVCA.

As a general comment we consider that the most important issue for us as investors is for us and our investment entities to be able to have the maximum choice as to who we use as advisers. However, we recognise that in making these choices the Independence of the auditor is an important factor and our members individually have different views on the extent to which non-audit services might impair that Independence. Therefore, we believe that what is important is the transparency of information to enable our members and their management teams to make decisions as to which adviser to use, rather than the imposition of further hard and fast rules

RESPONSES TO QUESTIONS

Question 1: Do you support the approach outlined in paragraphs 2.10 to 2.18? If not, please indicate what, if any, other action should be taken. In particular, does the proposal in paragraph 2.15 present practical difficulties to auditors of small or medium sized entities?

We agree with the APB that a blanket prohibition or a quantitative cap of non-audit services would not be a proportionate response to this issue

In the context of private equity we believe that the services that auditors provide should be a matter of investor choice exercised through the company boards who commission such services. We agree with the APB that disclosures of policies and the nature of services provided, the extent of safeguards applied and the reason why the auditor was chosen would provide investors with the transparency and information that they need to have a meaningful dialogue with management.

We are not convinced that the provision in 2.15 is necessary. To make it a requirement that where fees for non-audit services are, or are expected to, exceed the audit fees, this must be discussed with, and

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approved by the Ethics partner within the firm and reported to those in charge of governance would seem to be an unnecessary piece of bureaucracy which is based on an arbitrary number and would not add significantly to the disclosure regime discussed above.

Question 2: Are the correct services included in the list of audit related services (see ES 5 (Revised), paragraph [AD])? If not, please identify the changes that should be made and indicate whether the provision of such services gives rise to threats to auditor objectivity and independence (other than threats which are clearly insignificant).

Although we do not consider ourselves qualified to comment on the list, we consider that there is a distinction between services that are very closely related to the audit where the auditor is the obvious choice to do the work and for which there is an insignificant or manageable independence risk, and services that are not so closely related.

In the former, it is often important that the engaged firm has the base of knowledge acquired through doing an audit (e.g. financial reporting comfort letters) whereas an outside firm would have to duplicate procedures to achieve the same knowledge

Question 3: Will disclosure of additional information about non-audit services in the form of a template (such as that included as an appendix to ES 1 (Revised)) reduce the perceived threats to objectivity and independence arising out of the provision of non-audit services? Do you have any suggestions to improve the template?

Yes. We support a proposal to provide additional information to the audit committee, directly to investors or those charged with governance, as relevant, in the form of a proposed template. We do not consider that this information needs to be made public for private companies.

Question 4: Will the proposed changes to the FRC's Guidance on Audit Committees reinforce audit committees' responsibility for:

- **determining whether a company's auditor should be permitted to provide particular non-audit services? If not, what further guidance should be given, and**
- **providing information about the non-audit services provided by a company's auditor**

And therefore reduce the perceived threats to auditor objectivity and independence arising from the provision of non-audit services?

Most of our members' investment entities do not have audit committees.

Question 5: Do you support:

- **the approach taken to the provision of 'extended audit services' in ES 5 (Revised), paragraphs [AH] and [AI]?**

Yes, we agree that when extended work on financial information or financial controls is performed by the existing client team for the company, it should be considered as 'audit related'. We are not convinced that it has to be integrated with work performed in the audit or performed on the same principal terms and conditions

- **the additional guidance on the threats and safeguards approach in ES 5 (Revised)?**

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Generally we are supportive of the guidance given in this area however we do have a concern with 'the likely relevance and impact of the subject matter on the financial statements' as a risk and would prefer 'the likely relevance and impact of the work done on the financial statements'

This is because if we take a service such as pre-acquisition due diligence, the subject matter (a major acquisition) may have a major impact on the financial statements but the actual work done does not. We believe that the fact it is a major acquisition does not risk the independence of the auditor because the impact on the financial statements is based on a management decision taking into account many factors as well as the accountants' work. Such services are also seen as acceptable internationally and we do not think the size of the acquisition should be a factor in deciding who does the work unless the management or investors reach that conclusion

- **the application of the remuneration and evaluation policies to all members of the engagement team in ES 4 (Revised), paragraph 38?**

We have no comment on this matter

Question 6: Are there any reasons why the revisions to the Ethical Standards proposed by the APB in Sections 2, 4 and 5 will be difficult to implement for audits of financial statements for periods commencing on or after 15 December 2010? If so, what further transitional arrangements might be necessary?

Yes. To the extent that companies need to make changes, they are at present dealing with a considerable number of new reporting and systems initiatives so we think a longer implementation period is required

Question 7: Which of the options (to address the self review threat arising from the provision of restructuring services) set out in paragraph 6.14 should the APB adopt? Should the option that you have chosen apply to all entities, or only to listed entities?

We believe that whatever option is chosen it should apply only to listed entities. We consider that choice of adviser is important to privately held companies and that the close relationship that usually exists between management and investors produces enough of a safeguard in this area without building in further restrictions other than the general requirements that will already exist.

For listed entities we consider that a threats and safeguard approach should be adopted to deal with specific perceived threats and that this should take into account the importance of choice, the existence of audit committees and the new proposed disclosure rules as being safeguards in their own right.

Question 8: Does the revised definition of a 'contingent fee basis' give rise to any practical issues?

Question 9: Which approach do you consider that the APB should adopt in relation to contingent fees and why?

We consider that the ability of companies to be able to negotiate a differential hourly fee with all their advisers of professional services is important to maintain choice. Particularly for private companies the ability to obtain early stage advice at lower rates can be important to them so to ban differential hourly based fees would be a significant impediment to maintaining a full choice of advisers. We consider that

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differential hourly fees should be allowed except if they are linked to an event or the result of the work performed. We also note the point that the APB makes recognising that no particular instances of abuse have been identified.

We consider the ability to negotiate a smaller abort fee if a deal does not go through is also important for private companies who have limited resources to spend on advisers' fees in connection with transactions that are aborted. If a transaction is aborted, the risk to the adviser is much lower and the value of the advice may also be lower, therefore we believe negotiation of lower fees in certain circumstances to be good business practice.

In both these areas we think that maintaining as much of a level playing field between the auditor and other advisers is important for choice and competition. If it is considered that the rules must be tightened in these areas we would prefer a limit on the amount of the differential rather than an outright ban.

Question 10: Does the definition of a 'connected party' give rise to any practical issues? If so, how could those practical issues be addressed? What are the relative advantages and disadvantages of the alternative approach suggested in paragraph 8.6?

We would be concerned if any definition of connected party would, as under SEC rules, restrict the services the auditor could offer to one of our members' controlled investment entities just because they audited another of our members' investment entities given that our investment entities tend to be independent of each other.

Question 11: Would the adoption of any of the approaches discussed in Sections 6, 7 and 8 give rise to any significant costs that would not be outweighed by the benefits of the relevant proposal? If so, please describe and, to the extent possible, quantify the costs that you think would be incurred and why the benefits would not outweigh the costs.

We have no additional comments other than those relating to our concern about whether there are significant benefits to the proposals which we have expressed above

We would be very happy to discuss the issues by telephone or in a meeting if that would be useful.

Yours sincerely,



SIMON WITNEY
Chairman, BVCA Legal and Technical Committee

cc.

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