

Matthew Lester
Chairman: The 100 Group Investor Relations and Markets Committee

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Investor Relations and Markets Committee

Via e-mail: auditors@cc.gsi.gov.uk

Inquiry Manager
Audit Market Investigation
Competition Commission
Victoria House
Southampton Row
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WC1B 4AD

18 March 2013

Dear Sir

Statutory audit services market investigation: notice of possible remedies and provisional findings report

I am writing in my capacity as Chairman of The 100 Group Investor Relations and Markets Committee to share with you our views on the notice of possible remedies and provisional findings report resulting from your inquiry into the market for statutory audit services.

As Directors of large international companies, we understand the importance of the audit and the value that the independent auditor's report brings to our shareholders. As we said in our original submission, whilst there has been evidence that many institutions and procedures fell short in the recent crisis, external audit does not seem to have fallen into this category. In short, this investigation, in reaching the conclusion that there is a genuine need for reform of the external audit market for the benefit of stakeholders, appears to be seeking a solution to a problem that our companies do not see exists in a material way. Furthermore, you have underestimated the critical role that the Audit Committee's play in protecting shareholders interests.

Who we are

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Our views

As preparers of financial statements we recognise that the ownership of the audit relationship must be between shareholders and auditors. We do not seek to comment on the requirements of shareholders, however, we express in this letter our thoughts as management in so much as they may be relevant to this matter. You should also be aware that as Finance Directors, we are the main interface between shareholders and their companies. As such we will be aware of the actual expressed level of concern our shareholders have about audit and auditors, relative to other issues.

I would be grateful if you would review our response to your original enquiry which is appended to this letter. We believe the issues and responses remain unchanged and therefore do not support further regulatory intervention in a market that from the participants point of view is functioning satisfactorily.

Whilst we would always welcome more suppliers of any service, audit quality must not be compromised. We believe that the services rendered by the 'Big 4' are of a high quality. Being truly international companies that value significant quality in our audit, there are only a few audit firms that can genuinely service our needs in this regards. The lack of global reach of other audit firms currently result in a Big 4 auditor being the favoured option for the multinational organisations represented by our members. Ultimately, if there were market demand for further competition because of a lack of innovation, poor price or service, the barriers to entry that you have highlighted would be overcome. We are not aware of any fundamental restrictions to other accounting firms merging to create the scale necessary to be able to offer the necessary level of service.

Many of our members act as non-executive Chairs of Audit Committees. We believe that your conclusions have not recognized the role of the Audit Committee in ensuring that shareholders needs are pre-eminent in audit. For example, the scope and fees of the auditor have to be agreed by the Audit Committee. Regular private meetings are required to be held between the Audit Committee and the auditor. These are designed specifically to ensure that the auditor is put under pressure to reveal areas where there is professional judgment to be exercised and to ensure the auditor can raise concerns without coming under pressure from management. Most importantly it is the Audit Committee not executive management that recommends to shareholders who to appoint.

As we said, we value the audit as an integral part of a way of managing the risks of a business. If for whatever reason we do not receive the quality, service or value required, we will, of course, be ready and willing to switch firms.

We fundamentally question whether mandatory tendering or rotation is really going to promote competition. Seemingly, mandatory rotation would just further increase concentration by removing the incumbent from what you point out is a small number of competitors. We would prefer to see smaller firms merging to provide effective competition to the Big 4. We therefore encourage the CC to look very carefully as what has prevented the firms that say they wish to compete for this business from developing the necessary scale and expertise. We would observe that the current model has developed in large part to meet such requirements. We would ask the CC to consider if the market has reached a natural equilibrium. However, we would welcome the formation of further large scale competitors as we have noted above.

The suggestion that possible remedies should include additional reporting or disclosure appears misplaced. Companies' Report and Accounts are already over loaded with boilerplate disclosure as a result of universally mandated regulations.

We urge a truly joined up international approach to this. National action in isolation to reform the audit market risks undermining the relative attractiveness of the UK as a place to do business. We recognise that other regulators, including those in the EU and the US are also examining audit market reform – any action needs to reflect the global nature of both the audit firms and their multinational auditees.

We have addressed some specific questions in relation to the provisional findings and the notice of possible remedies in an appendix to this letter.

Please feel free to contact me if you wish to discuss the views contained within this letter.

Yours faithfully

A handwritten signature in black ink, appearing to read 'ML', is positioned above the typed name.

Matthew Lester
Chairman

The 100 Group: Investor Relations and Markets Committee

Appendix 1: The 100 Group views on the provisional findings and notice of possible remedies

Provisional findings

Barriers to switching

We believe that our Audit Committees have and should continue to have the ability to appoint auditors and are going to be well placed to assess the different firms' offerings. UK Corporate Governance generally works well in the UK and Audit Committees perform their duties effectively and diligently. They will assess the current state of the audit and will be inclined to change if necessary – they also have access to information that would enable them to be well informed as to the quality of the operations of any other audit firms and would thus not face any significant barriers that would prevent them from recommending change to auditors through a process other than a tender.

It is difficult for companies to judge audit quality in advance due to the nature of audit

This would appear to be a criticism of Audit Committees – they are sophisticated bodies that can clearly assess audit quality of differing firms based on a wealth of information that is available to them, not least via the FRC and the Audit Quality Review Team.

Companies and firms invest in a relationship of mutual trust and confidence from which neither will lightly walk away as this means the loss of the benefits of continuity stemming from the relationship

This is not unhealthy. We can get genuine benefit to our shareholders through reducing costs if we can achieve efficiency gains through fostering positive relationships. The complex nature of an audit means that fostering a transparent relationship is vital to an effective audit.

Opportunity costs

This is something that we are willing to incur if we see a lack of quality in our audits and/or uncompetitive pricing.

Experience and reputational barriers

Being truly international companies that value significant quality in our audit, there are only a few audit firms that can genuinely service our needs in this regard.

We support and encourage any remedies that serve to develop other providers, including those which explore the availability of capital to these firms in order to realistically tackle their global presence and technical depth. It is of critical importance to our members that their auditor is able to provide a consistently high quality audit across our global networks and one of our key considerations is the level of international resource that a firm is able to deploy. We note that this is not something that is addressed within the notice of possible findings.

Misaligned incentives

We cannot support the view that auditors will only compete on the basis of satisfying management and not shareholders. The report does not appear to consider the role of the Audit Committee in sufficient detail.

Shareholder information

As directors, we must be held to account to ensure that we are acting in the interests of our shareholders. We fully understand our responsibilities in this area and that our investors can and will punish companies by selling their shares, because they do not trust management to deliver appropriately for their benefit. We are concerned that there is a misconception in the minds of some commentators that directors are seeking to circumvent the auditor or prevent these firms from being able to engage fully with us as management. This could not be further from our experience.

Although we are strong supporters of cutting clutter in financial statements, this is not a reluctance to permit further disclosure in the accounts that would be relevant (not boilerplate) and helpful to users of the financial statements, including shareholders.

Notice of possible remedies

At this stage we do not seek to comment in detail on the specific questions raised with regards to the appropriateness of the remedies being suggested, however, we have set out our views. We are pleased to see that you have detailed possible remedies that you consider are inappropriate, notably, constraining non-audit services, promoting joint audits, giving others responsibilities for auditor appointment and having independently resourced Audit and Risk Committees. However, we also believe that many of the remedies that you have suggested to be "effective and proportionate" are also inappropriate.

Mandatory tendering

We support the FRC's view that audits should be tendered after a set engagement period of at least 10 years, although those companies who did not tender their audit after this period have the option of providing their shareholders a robust explanation as to why they did not. We believe this approach is already leading to better tendering and suspect that Boards are starting to take this far more seriously than in the past as part of their overall Corporate Governance considerations.

We would not be in favour of removing the comply or explain approach nor in enforcing a shorter time period (less than 10 years) for mandatory tendering.

Mandatory rotation of audit firm

We strongly believe that the right to appoint, evaluate and determine the tenure of auditors should be retained by shareholders as the strong and necessary arm of corporate governance. As management of some of the largest companies in the UK, we have a duty to our shareholders to ensure that the audit is performed to a level of quality that gives confidence over our financial statements. We cannot see how mandatory rotation can maintain this, nor be for the benefit of our shareholders, due to the risk of a reduction in audit quality in the initial and final years of appointment.

Although we oppose mandatory audit firm rotation, we support the regular rotation of key audit partners to decrease the threat of familiarity: with mandatory rotation rules in place at audit firms we believe that this provides a healthy challenge to us as management.

We estimate that our members costs of tendering and rotation are between 5 and 30% of the audit fee depending on the extent of the tender process.

Expanded remit and/or frequency of Audit Quality Review team (AQRT) reviews

We are not opposed to increasing the frequency of these reviews but the additional costs of this proposal would need to be compared with the benefits that may accrue to stakeholders before updated regulation becomes applicable.

Prohibition of 'Big 4 only' clauses in loan documentation

This is not something that we would oppose but note it is ultimately at the discretion of lenders as to whether they would approve use of the services of audit firms outside of the Big 4.

Strengthened accountability of the external auditor to the audit committee

The role of the Audit Committee is one of the fundamental pillars in the audit process. We strongly encourage effective communication between the auditor and the Audit Committee but, the practicalities of attempting to solely engage the auditor with the Audit Committee on areas such as discussing whether a material audit issue has arose, without engaging with management, is completely impractical.

Enhanced shareholder-auditor engagement

As we have detailed previously in this letter, we believe that Audit Committees function appropriately in protecting shareholders interests. We are not opposed to further, open dialogue between auditors and shareholders if that is what shareholders desire.

Extended reporting requirements

We are cautious of developments which may, either directly or indirectly, affect the relationship between the auditors and the Audit Committee or which lead to a proliferation of prescriptive disclosures in an attempt at transparency.

We understand that an expectation gap may exist and see no reason why additional explanatory material could not be disclosed, however extending disclosures goes against moves to make opinions or reports more understandable and accessible.

With multiple current proposals for altering the form and content of auditor opinions and Audit Committee reporting, we are pleased to see recognition of the requirement for a joined up approach with the FRC. However, we note that the auditors are not responsible for, nor should be requested to present information on, the strategy, risks and management of the company. This is at best repetitive, and at worst fundamentally undermines the relationship between Directors and investors.

We further note that our Audit Committees consistently provide a frank and open environment which challenges both management and auditors. Requiring the Audit Committee to publish its own report invites the inclusion in the financial statements of boiler plate disclosures which do not improve transparency. Such reports should focus on the nature, rather than the substance, of Audit Committee deliberations.

Appendix 2: Letter dated 16 April 2012 to Laura Carstensen

Robin Freestone
Deputy chairman: The Hundred Group
c/o Pearson Plc
80 Strand
London
WC2R 0RL



Laura Carstensen
Inquiry Chair
The Competition Commission
Victoria House
Southampton Row
London WC1B 4AD

16 April 2012

Dear Laura

Proposed Reform of the External Audit Market

I am writing in my capacity as deputy chairman of the Hundred Group of Finance Directors to share with you the Hundred Group's views on the proposed European reform of the external audit market and the results of a recent survey undertaken on this topic amongst the Group's CFO membership. I hope you will find this useful context for your current inquiry into the market for statutory audit services for large companies in the UK.

Who we are

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Proposed European reform of the external audit market

As Directors of large public companies, Hundred Group members recognise the value to shareholders of the financial statement audit. The independent auditor's report is important in ensuring the smooth and efficient operation of capital markets and consequently any action taken to reform this market should be aimed at enhancing, and not diminishing, audit quality.

The case for reform is overstated

However, we strongly believe that the case for reform has been significantly overstated and it is not clear to us, what is the problem the reforms are attempting to address. The vast majority of companies, both in the UK and in the rest of the EU remained strong during the recent financial crisis, and indeed weathered the very difficult economic conditions admirably. Inevitably certain sectors fared less well than others: However to predicate a significant and wide ranging reform on these isolated examples is to ignore the fact that in the vast majority of cases, the role and effectiveness of independent auditors has not been, and should not be, called into question.

Even within the most adversely affected sectors, there is no evidence that particular audit firms performed better or worse than others.

Concentration in the audit market

The biggest concern for many, and in our view the key issue to be addressed, is the further concentration in the audit market that would result from the failure of a 'Big Four' audit firm. The proposals do little to address this key systemic risk, nor the lack of global reach of other audit firms which currently result in a Big Four auditor being the favoured option for the multinational organizations represented by our members.

We do not see how the changes envisaged to the appointment regime will increase competition in the audit marketplace and indeed we are concerned that the reforms' unintended consequences will actually result in concentrating the market even further. The combination of shorter engagement contracts, a cooling off period and prohibitions on non audit work will preclude participation in the audit tendering process of any firm providing non audit services, who are typically for our membership, other Big Four firms. Our members face the real prospect of not being able to recommend to shareholders the appointment of precisely those audit firms best equipped to provide a globally robust audit opinion.

In our opinion the Big Four bias exists because the quality, breadth and experience offered by the Big Four is unmatched by other providers. In order to address this inequality we support and encourage measures that serve to develop other providers, including those which explore the availability of capital to these firms in order to realistically tackle their global presence and technical depth. We hope that the availability of capital will facilitate a period of consolidation amongst smaller audit firms which will result in the formation of a number of new global networks capable of providing a credible alternative to the appointment of a Big Four auditor.

Auditor appointment

We strongly believe that the right to appoint, evaluate and determine the tenure of auditors should be retained by shareholders as the strong and necessary arm of corporate governance. Audit firm rotation risks a real reduction in audit quality in the initial and final years of the appointment. The inevitable reduction in audit quality that would result from mandatory rotation could only be alleviated by increased audit fees during the transition years – a cost which very few investors have expressed a desire to incur.

We do not recognise, and have seen absolutely no recent evidence of (so called) 'institutional familiarity'. In our view, the regular rotation of audit partners, every 5 years, is sufficient to maintain an independent and robust audit. In our experience, this is complemented by the regular rotation of senior audit staff, which although not mandated, is a common feature of audit engagements in practice.

We support the FRC's view that audits should be tendered after a set engagement period of at least 10 years, although those companies who did not tender their audit after this period have the option of providing their shareholders a robust explanation as to why they did not.

Non Audit Services

We agree that it is appropriate to prohibit auditors from undertaking certain specific non audit services (e.g. consultancy) where independence could be impaired. However with appropriate safeguards in place, the quality of both the external audit and other specific non audit services can be enhanced if undertaken by the auditor without any impact on independence, and at lower cost.

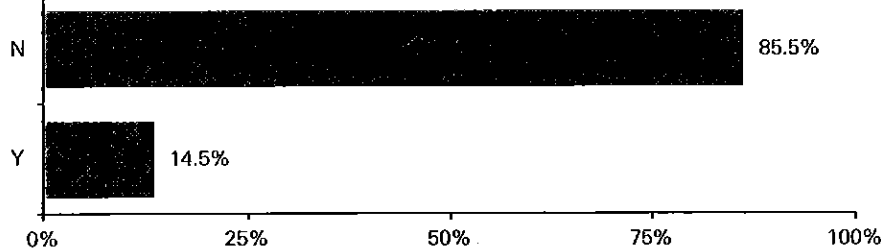
Audit only firms

We also oppose the creation of specialist audit firms as these will undermine the ability of firms to recruit the appropriate quality of audit staff, with consequent highly negative implications on long term audit quality. A very significant number of UK graduates enter training contracts and qualify as accountants with the big 4 and other professional firms because of the spread of experience they can attain. That has benefits across UK industry in the supply of high quality business executives, many of whom go onto to be Chief Executives in UK plc's. Audit only firms are highly unlikely to attract such talent, which will then go elsewhere.

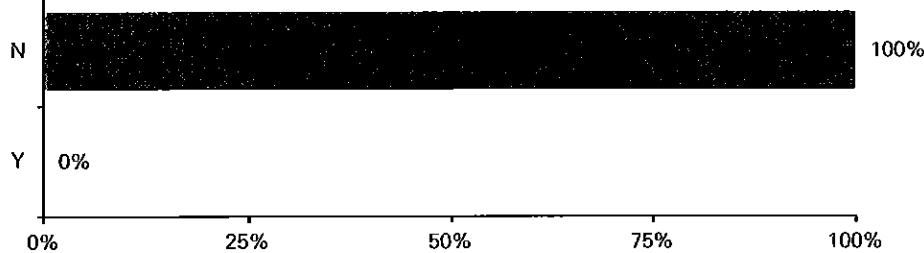
Membership survey results

In November 2011, we undertook a survey of our membership to gauge our CFO members' views on the proposed reform of the audit market. Around two thirds of our current membership responded and I set out the results below.

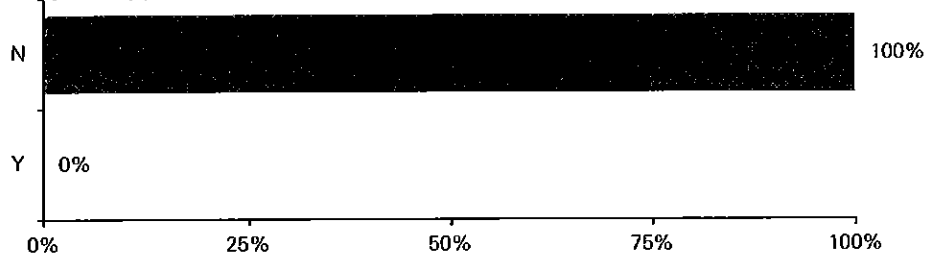
Do you support proposals for mandatory external audit tendering?



Do you support proposals for mandatory external audit rotation?



Do you support proposals for mandatory joint external auditors?



Our survey results emphatically show that the case for reform is overstated. In a separate question considering alternatives to the current proposals, respondents thought that the other critical issue to be addressed was not the reform of the audit market, but of regulations governing financial and narrative reporting. The current regime results in audited financial reports which are often too complex, lack meaning and are cluttered with irrelevant, immaterial information which obscures the key financial information being presented. We support the measures the FRC is taking in addressing clutter in financial statements and I would be happy to discuss the results of our survey with you in more detail if you think it would be useful.

* * *

Taken together, the reform package being proposed does not, in our view, address the key systemic risk of further concentration in the audit market and will have the effect, both directly and indirectly, of reducing audit quality (particularly during the period of transition), increasing cost and diminishing the value of the audit opinion to investors, without any compensating tangible benefits.

Please contact me if you would like to discuss the views expressed in this letter.

Yours sincerely

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Deputy Chairman
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Deputy chairman: The Hundred Group
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80 Strand
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Laura Carstensen
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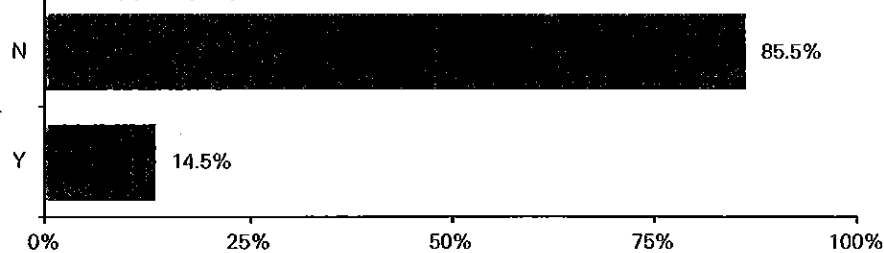
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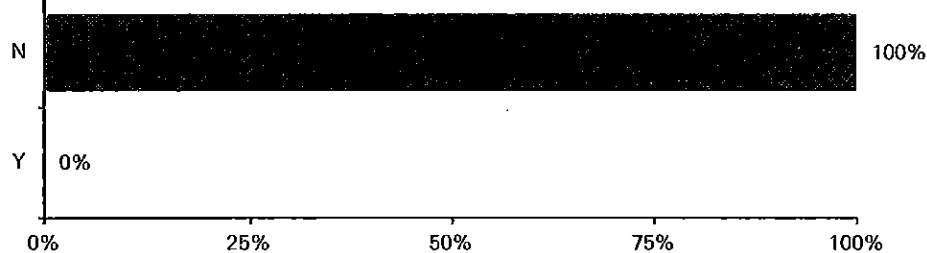
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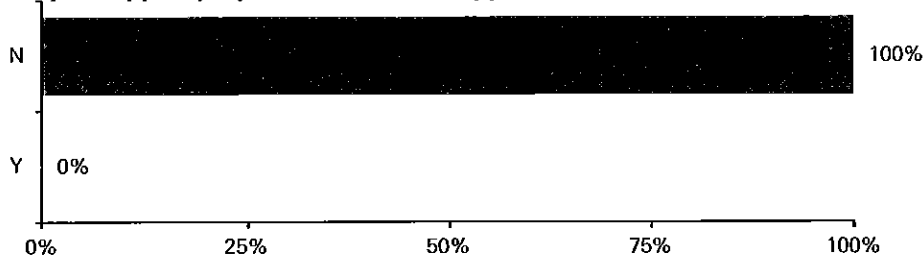
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Deputy Chairman
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