



The Hundred Group
of Finance Directors

Investor Relations and Markets Committee

By email: m.janson@businessseurope.eu

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Dear Sir

EU AUDIT POLICY - Audit Tendering processes and costs

We are pleased to submit our views on, and estimates of, costs that companies would have to incur in the organisation and management of an audit tender.

Who we are

The Hundred Group is a non-political, not-for-profit organisation which represents the finance directors of the UK's largest companies, with membership drawn mainly, but not entirely, from the constituents of the FTSE100 Index. Our aim is to contribute positively to the development of UK and International policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the view of The Hundred Group of Finance Directors as a whole, they are not necessarily those of our individual members or their respective employers.

Our views

We have previously responded to the Commission's call for evidence 'Audit Policy: Lessons from the Crisis' to say that we were supportive of the current role of auditors and that any change to Regulations that occurred must promote the quality and relevance of the audit.

We also made clear our view that the right to appoint and evaluate auditors must be retained by shareholders as the strong and necessary arm of corporate governance and that proposals contained within that Green Paper including mandatory rotation and retendering would lead to a significant increase in the burden on preparers of financial statements. We are pleased to have the opportunity to elaborate on this statement.

Before outlining the results of a survey of our members, we would like to highlight an existing body of relevant information that is currently in the public domain.

In 2004, the United States General Accounting Office published the results a survey¹ which included the following evidence in relation to a mandatory auditor rotation regime:

- As regard auditor selection costs, companies surveyed estimated these to be: >20% of initial year audit fee (14% of 198), 15-20% (8%), 10-15% (20%), 5-10% (23%), <5% (23%), 0 (1%) and non basis to answer (11%)
- The population surveyed also estimated additional initial year costs to support the new auditor in excess of those required to support the previous auditor to be: >50% of the new auditors first year fees (11% of 196), 40-50% (8%), 30-40% (17%), 20-30% (28%), 10-20% (23%), 0-10% (5%) and no basis to answer (8%);

Data shows that total 2010 audit fees for constituents of the FTSE100 index were £495 million². If a fifth of audits were subject to mandatory rotation each year, we estimate the additional cost to be approximately £28 million³ per annum for the FTSE100 index constituents⁴.

We are aware that a number of our members, rather than going to full tender, will “market test” their audit fees using independent benchmarks and use these as a basis for fee discussions with their current auditors to obtain a reduced audit fee. Assuming that companies are satisfied with the qualitative aspects of auditor performance and efficiency, this approach is seen by many to deliver a similar outcome to tendering the audit, while avoiding the cost and non-financial administrative burden of an audit tender.

Survey of members

Given the short timeframe available to conduct this exercise, our survey has been limited to a cross section of members who over the past several years have either undertaken an audit tender process or who, in contemplation of launching an audit tender have formed an estimate of the costs involved. The responses indicated the following.

- In the majority of applicable cases, the audit was tendered following a well thought through cost benefit analysis undertaken by the company. We note that your information request does not extend to examining the benefits of a tender process, which in our view risks missing an important element of a company’s evaluation process.
- Unsurprisingly, only those companies whose analysis indicated a net benefit tendered their audits, a decision step that would be denied in a regime which required mandatory tendering or rotation. In our view, periodically reappraising the terms of all suppliers (including the provider of audit services) is based on sound commercial rationale and should be encouraged, however the decision to tender should be

¹ United States General Accounting Office Report to the Senate Committee on Banking, Housing, and Urban Affairs and the House Committee on Financial Services entitled ‘MANDATORY AUDIT FIRM ROTATION STUDY; Study Questionnaires, Responses, and Summary of Respondents’ Comments’ dated February 2004.

² Source: www.financialdirector.co.uk 2010 audit fees survey.

³ Using £99 million (one fifth of total FTSE 100 2010 audit fees of £495 million) resulting in a weighted average auditor selection costs of £7 million and weighted average incremental first year support costs of £21 million.

⁴ In their response to the EU Commission Green Paper on Audit Policy, The UK Government Department of Business, Innovation & Skills estimated the additional annual costs for all listed companies to tender their audits to be in the region of £55 million.

proposed by the Company's Audit Committee having consulted with shareholders, having regard to a well thought through cost benefit analysis.

- The comparison of audit tender costs across organisations is difficult as all retender situations have different characteristics. These include the number of firms invited to tender, the length and complexity of the audit tender process, the scope of the tender, the geographical spread of the company and the company's current financial reporting and legal structure.
- The costs of an audit tender process largely related to management time devoted to establishing, monitoring and participating in the tender process and if the process resulted in a change in auditor, management time spent as part of the auditor transition (which in certain jurisdictions can be particularly onerous if local laws require a timeframe for the completion of the transition).
- Management activities that arose as a direct result of a tender process included drafting tender request documentation, establishing a data room, scoping the tender (particularly relevant for respondents whose groups included joint ventures and associates), participating in information gathering meetings, accompanying the participating firms to site visits, reviewing written submissions, answering written questions, receiving presentations from participants and taking part in internal meetings to discuss the results of the tender. It should be noted that as part of the tender process, those Audit firms wishing to tender each hold a meeting with all members of senior management (on an individual basis), not just within the finance function, which means that this is not a trivial or resource-free process.
- The incremental cash costs of undertaking a tender process tended to be minimal, and where they were relevant, largely related to increased travel costs for management and executives participating in the tender process. One respondent pointed out that a number of current audit arrangements were subject to a fixed term contract and consequently breaking those contracts early could have resulted in contractual payments.

Having regard to the inherent difficulties of estimating and comparing across organisations, our respondents indicated their retendering costs to be a minimum of 5% and a maximum of 30% of their current audit fee, a result which tends to support the findings of the US GAO survey quoted above.

We would add that, if there one aspect of business which our members are experienced at, it is in reducing costs. The imposition of rules to determine how we should go about that activity is unlikely to be seen to be effective, and is in many instances more likely to increase costs with little if any return.

Please feel free to contact me if you wish to discuss the views expressed in this letter.

Yours sincerely

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Chairman
Hundred Group – Investor Relations & Markets Committee