



# Governance for Owners

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Competition Commission  
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24 January 2012

Dear Sir/Madam

## **Statutory Audit Market Inquiry: consultation on the CC's selection of subjects for case studies**

The Commission has set out how it intends to select subjects for case studies in order to allow interested parties to contact you directly, or to indicate other persons (or categories) who you should consider as subjects for case studies.

By way of background, and to put our comments in context, Governance for Owners (GO) is an independent partnership between its executives and long term investors such as Railpen, CalPERS and IPGL. GO offers a number of investment management and shareowner services products, including:-

- The GO European Focus Fund that invests in a small number of European public companies where value can be added through exercising owners' rights to address key structural or strategic governance issues that have historically impaired company performance.
- GO Stewardship Services that offer independent voting, corporate engagement and other advisory services on environmental, social, and corporate governance (ESG) matters.

GO has also made a number of submissions to the UK Financial Reporting Council (FRC) on audit matters, including our submission on the subject of Audit Choice, which was the genesis of a number of the FRC's conclusions leading to the formation of the Market Participants' Group, whose work features prominently in the FRC's submission to the Commission.

At the heart of our Audit Choice submission is that measures to widen choice must be cost effective and not inadvertently lead to a reduction in audit quality. As investors, we rely upon and require audits of the highest quality. For example, whilst a sensible cap on the market share of FTSE listed audits for any one audit firm could help, too low a cap might increase choice at the price of a reduction in overall quality.

You have indicated that you are very interested the experience of large companies concerning competition in the provision of statutory audits. These case studies will provide you with insight into the way the market operates, and in particular the relationship between stakeholders and the audit process and help you to understand

how audit relationships operate and develop in practice. This would cover such issues as negotiation of fees, the role of audit committees in resolving audit issues and evaluating audit effectiveness/quality, the scope of non-audit work, how new regulatory requirements have affected the audit process; and the companies' reasons for selecting and (possibly) switching auditors.

You state that you intend to select companies for case studies from the following categories:

- (a) FTSE 350 companies whose auditor supplies the company with statutory audit services only or with statutory audit and audit-related services, but no other non-audit services.
- (b) FTSE 350 companies whose auditor also supplies the company with other non-audit services in addition to the statutory audit.
- (c) FTSE 350 companies that have switched auditors within the last ten years.
- (d) FTSE 350 companies whose shares are also listed in other financial centres such as the USA or Hong Kong.
- (e) Entrants within the last ten years to the FTSE 250 or FTSE 100 that have switched auditor to one of the four largest auditors in advance of, on, or soon after entry.
- (f) FTSE 350 companies whose audit has not been of adequate quality within the last ten years. You are considering how to define this and would welcome submissions on this point. Options include: unsatisfactory rating by the FRC; adverse court judgments against auditors; cases of companies that collapsed despite unqualified audit opinions.
- (g) FTSE 350 companies who have had an audit relationship extending longer than 15 years. This would also include companies that infrequently tender for their audit services.

We offer the following comments:

- 1 We welcome the use of case studies in this way.
- 2 We suggest that the division between (a) and (b) in your list be "softened" to include companies where the non-audit or audit-related fees amount to less than, a small proportion (say 25%) of audit fees. We think that those companies where that percentage is low are more similar to those where there are no audit fees than those where the percentage is much higher. Indeed, we further suggest that if the companies chosen under category (b) were ones where the percentage on non-audit or audit-related fees were high (say, over 100%), any contrasts between the two categories would become clearer and more helpful to the Commission.
- 3 As we indicated in our submission on your Statement of Issues, we consider that a selection as case studies of companies that have tendered their audits and either retained the incumbent auditor or changed from one Big Four firm to another Big Four firm (and rejected the selection of a non-Big-Four firm in that process), would be of real value to the Commission in evaluating assertions around why non-Big-Four firms have not won more audit appointments and around barriers to entry.
- 4 You have asked for suggestions in relation to category (f), audits that have not been of adequate quality. Three potential sources of "low quality audits", possibly on a confidential or unacknowledged basis, are:

- a. The work-out teams at the major UK clearing banks who have been involved in restructurings of companies in the period of interest to you;
- b. The major investors who have contacted you, all of whom are likely to have had experience of what they have perceived to be poor quality audits; and
- c. Any company whose share price has dropped dramatically (say by >50% over a short period). This would include both companies that collapsed into liquidation or other insolvency regime and those that either recovered or were rescued in some way.

We trust that you will find our suggestions helpful. If you would like to discuss these or require any further information, please contact Eric Tracey, Partner (Tel: 020 7614 4750; email: e.tracey@g4owners.com).

Yours faithfully

A handwritten signature in blue ink, appearing to read 'E Tracey', with a long horizontal stroke extending to the right.

E F Tracey  
Partner