

STATUTORY AUDIT SERVICES MARKET INVESTIGATION

Views of investors and other stakeholders

Introduction and overview

1. We consider that the purpose of audit is to provide assurance to shareholders regarding the financial reports produced by the management of the companies in which they hold shares. However, other stakeholders such as lenders, suppliers and customers, as well as ratings agencies, also benefit from the assurance audit firms provide.

2. We have received evidence from investors¹ via:
 - (a) an investor questionnaire; and
 - (b) our discussions with investors as part of our case studies and third party hearings with investors.

3. In addition, we have received submissions on investor views from:
 - (a) Oxera, acting on behalf of BDO LLP (BDO) and Grant Thornton UK LLP (GT), conducted its own investor survey² and we have reviewed Oxera's confidential interview summaries;
 - (b) PricewaterhouseCoopers LLP's (PwC's) provision of information from investor surveys it was aware of including its own 2011 survey; and
 - (c) PwC and Deloitte LLP's (Deloitte's) submission of an ICAEW survey of FTSE 100 Audit Committee Chairs (ACCs).

4. The views of investors are particularly relevant:

¹ And credit ratings agencies.

² www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/oxera_investor_survey_report.pdf.

- (a) as a direct measure of whether the audit process is satisfying investors' demand (to the extent that the process delivers outputs visible to them);
 - (b) to whether there are barriers to switching resulting from investor views on either switching auditor or switching to a non-Big 4 auditor; and
 - (c) to the influence investors think they have regarding companies' selection of their auditor.
5. Overall, we found that there was a broad consensus with regard to the role of audit and investor influence. The responses with regard to auditor identity, the effect of changing auditor and whether more information should be provided to investors were mixed.

Evidence base

Investor questionnaire

6. To gather the views of end-users, we sent written questionnaires to 18 major equity investors, eight major UK debt investors and three major ratings agencies. The questionnaires covered views on the role of audit, the influence of the identity of an auditor on investment decisions, views on companies changing auditor and, for equity investors, investor influence on auditor selection.
7. These were selected as follows:
- (a) for debt—the IMA provided list of its fixed income committee members;³
 - (b) for equity—we selected the largest investors in the FTSE 350 (excluding those we had spoken to in the case studies);⁴ and

³ We received responses from: AXA Investment Managers UK, Aberdeen Asset Management, AllianceBernstein, Alliance Trust Asset Management, Artemis Fund Managers, Barings Asset Management, Blackrock Investment Management (UK), Canada Life Asset Management, Fidelity Worldwide Investments, Friends Life, LGIM, M&G Securities, Newton Investment Management, Rathbone Unit Trust Management, Schroder Investment Management, and Standard Life Investments.

⁴ We received responses from: Standard Life Investments, Schroders, M&G Investment Management, Artemis, Threadneedle Asset Management and Invesco.

(c) for credit ratings agencies (CRAs)—we selected the largest three: Fitch, Moody's and Standard and Poor's.

8. Where investors appeared on both the debt and equity selection lists, we asked them to respond separately to each questionnaire (these were tailored to reflect the nature of the investment).
9. We sent questions that covered views on the role of audit, the influence of the identity of an auditor on investment decisions, views on companies changing auditor and, for equity investors, investor influence on auditor selection.
10. We set out summaries of the responses by topic below. In general, there was little difference between the responses for debt and equity, where a particular comment is specific to an investment type this is noted below.

Other hearings

11. In addition to our investor questionnaires, we also held hearings with 'Institutional Investors' (representatives from ABI, IMA and NAPF), and Hermes.⁵ Our case studies included interviews with two Institutional Investors: BlackRock and Legal and General Investment Management (L&G).⁶ Summaries of these are published on our website.

⁵ www.competition-commission.org.uk/our-work/statutory-audit-services/evidence/summaries-of-hearings-held-with-parties.

⁶ www.competition-commission.org.uk/our-work/statutory-audit-services/evidence/case-studies.

Submissions from parties

Oxera's survey on behalf of BDO and GT

12. Oxera conducted a survey on behalf of BDO and GT which is published on our website.⁷ In addition, we have reviewed Oxera's interview summaries and we set out extracts from some of these, where relevant, here.
13. The respondents to Oxera's survey overlapped to some extent with our investor questionnaire.
14. In the remainder of this paper we set out the evidence gathered in relation to end-user views on:
 - (a) the role of audit—paragraphs 18 to 27;
 - (b) auditor identity—paragraphs 28 to 40;
 - (c) changing auditors—paragraphs 41 to 52;
 - (d) influence of investors—paragraphs 53 to 61;
 - (e) additional outputs that could be provided as part of the audit process—paragraphs 62 to 78.
15. In paragraphs 79 to 82, we set out a summary of investors' views.
16. At the outset, we note that we have limited direct evidence from investors on the price and quality of audits. In our hearings with investors, Hermes said that audit quality was currently invisible to shareholders and that better disclosure of what the auditor had done and the issues that had been examined would make the quality more apparent. The representatives of the institutional investors also said that they had little information with respect to audit quality.

⁷ www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/oxera_investor_survey_report.pdf.

Role of audit

Questionnaires

17. The general views expressed in the questionnaire responses were that the audited financial statements were an important input to investment decisions, although were only one of a number of inputs.

18. Many investors said that they relied heavily on the financial data to evaluate historic performance and as an input into views, and models, of likely future performance. Whilst the timing of publication of audited accounts meant that the information was often cited as being obsolete or having little signalling effect, having reliable historic information was seen as key to making sensible investment decisions. The notes to the audited accounts were important to respondents as they provide more information than unaudited statements from companies.

19. Both the financial information and written commentary was important to investors. For example, Threadneedle said that the accounts were used to assess the financial performance and position of the company, particularly in assessing the underlying 'quality' of the earnings and balance sheet. The commentary in the accounts was reviewed to provide context and an insight into corporate strategy and business prospects.

20. Generally a 'clean' audit opinion, whilst not formally required, was in practice necessary and there would need to be specific, special circumstances for an investor to want to make an investment where the audit report was qualified. Certainly a qualified opinion was likely to require extra work to be undertaken in order to make an investment.

21. For debt investors, a clean audit opinion was noted as particularly important if making an investment in investment grade debt.

Hearings

Representatives of institutional investors

22. The institutional investors said that the audit report itself had only minimum perceived value as it was binary and few reports contained emphasis of matter paragraphs. The value perceived in an audit was in the audit process itself, in that this led to more accurate reporting by company management.

Hermes

23. The value of the audit to investors was more about the enhancement of the company's reporting over the year than the year-end sign-off.

L&G

24. The audited financial statements were very important to L&G (particularly to the active investment team). It was important to be able to trust the numbers and so it was on the audited accounts that the L&G investors focused. The auditor's opinion mattered in itself in exceptional cases when the report was qualified.

Submissions from parties

Oxera survey on behalf of BDO and GT

25. Oxera reported that: 'All investors surveyed confirmed the importance of independent audits of accounts for their investment decisions, and for their confidence in capital markets more generally'.
26. In reviewing Oxera's interview summaries, we noted the following in particular:

(a) [REDACTED]: Investors were looking for an independent assessment of whether financial statements represented a true and fair view, by a professional expert. An audit was of fundamental importance for a shareholder seeking assurance and for investors looking to buy and sell securities.

(b) [REDACTED]: The audit process was about assurance and providing a true and fair view: controls were working properly, proper risk management, appropriate accounting standards—not just about the numbers. The true and fair view was a gold standard that should not be tarnished.

Auditor identity

Questionnaires

27. We received a range of views as to the importance of auditor identity on willingness to invest and view of the quality of the audit opinion.

Equity

28. For some investors, the identity of the auditor had little or no effect on their decision to invest unless it was felt that the chosen audit firm had insufficient resources to complete a quality audit or was not perceived to be independent.

29. Threadneedle said that it was not possible to make a properly informed choice between audit firms other than where they were perceived to have particular industry experience and/or capacity to handle very large businesses. It noted that many firms, including the Big 4, had had issues in their audits and from other commercial activities. There was, therefore a default view that the bigger firms were safer, even though this was not borne out by the evidence.

30. Some investors did say that they were more comfortable with audits by the larger firms, although whether this was the Big 4 or a wider group varied between investors. For example:
- (a) [X] considered the Big 4 firms to provide greater confidence for companies listed in emerging markets.
 - (b) Schroder considered the 'Top 4' to be the best. 'Investors are always going to prefer companies to be audited by the big 4'.
 - (c) [X] gave the Big 4 the highest rating and said that third-tier auditors would be a cause for concern for listed equities.
 - (d) M&G said that lesser-known firms gave rise to further scrutiny. It said that there was a presumption that UK-based firms could be relied upon to produce a satisfactory audit opinion.
31. Invesco said that auditor identity could affect its decisions to invest but did not state how. Standard Life Investments said that the criteria that could make a difference to its view of an auditor included the reputation of the firm, brand recognition, and the appropriateness of the firm for the entity concerned.

Debt

32. The responses for debt investors were broadly similar to the responses for equity investors. [X] said that having a 'Top 4' auditor was particularly important for companies domiciled in emerging markets. Alliance Bernstein said that the identity of the auditor made no difference within the 'top 6–8' firms. M&G was largely indifferent to the auditor's identity; the Big 4 firms and the next layer of credibly-sized and resourced firms were fine, but it would have concern if smaller regional firms were used.

Credit ratings agencies

33. As set out in the Cardiff Business School (CBS) report (which summarized the agencies' responses to our questionnaire):⁸
- (a) Standard & Poor's stated that 'The identity of a company's auditor has no bearing on Standard & Poor's analysis'.
 - (b) Fitch's response discussed a hypothetical case of a very small audit firm auditing a very large company to illustrate that, in principle, auditor size and capability did matter, though it acknowledged the difficulty of defining procedures and policies around this issue. Fitch then noted that, in practice, auditor identity would be discussed at a rating committee meeting and judgement exercised. In its rating criteria, Fitch discussed an 'asymmetry' surrounding accounting and audit integrity (as part of corporate governance issues more generally), pointing out that where they were deemed adequate or strong they had no impact, but where there were perceived deficiencies, these might result in a negative impact on ratings.
 - (c) Moody's said that in the vast majority of cases the identity of a company's auditor was not a concern, but in a very small number of cases, it had concerns about the abilities of the chosen auditor. In a small minority of cases, the identity of the audit firm was important, since the incumbent might not be sufficiently reliable, independent or well resourced to perform the audit role adequately. A lack of satisfaction with the auditor's level of capability and/or independence may result in withdrawal of a rating or a refusal to provide one in the first place.
34. The CBS report noted that there was no suggestion that audit firms immediately outside the Big 4 would be a cause for concern, and that in itself, a change in auditor

⁸ www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/cbs_auditor_clauses_report.pdf: Section 3.2.4.

would not have much impact upon ratings (though the factors associated with the switch might).

Hearings

Representatives of institutional investors

35. The institutional investors did not consider that there was a difference in audit quality between the Big 4 firms and the others. They could discern some strengths and weaknesses with regard to certain issues from reading Audit Inspection Unit (AIU) and Public Company Accounting Oversight Board reports. Within firms, there were differences between partners. Investors, however, would not have knowledge of the abilities of particular partners within firms.

BlackRock

36. BlackRock said that the identity of the auditor was unlikely to affect its decision to invest due to the concentrated pool of auditors appointed to provide auditing services to FTSE 350 companies. It considered that there would be no issues with one of the top four to six firms auditing any of the companies in the FTSE 350.

L&G

37. L&G saw no barriers from an investor's perspective to more FTSE 250 audits being conducted by Mid Tier firms, particularly for those FTSE 250 companies that were primarily operating in the UK.

Submissions from parties

Oxera survey on behalf of BDO and GT

38. Oxera reported that: 'The investors surveyed generally take note of the identity of a company's auditor, but, with the exception of either the very largest companies or

those with very widespread multinational interests, would have no concerns with the larger mid-tier firms auditing companies in the FTSE 350.'

39. In reviewing Oxera's interview summaries, we noted the following in particular:

(a) [X]: Most people would not differentiate between the quality of the audit from any of the Big 4 firms. There was a big question to ask, when a major (eg FTSE 100) company was using a non-Big 4 auditor—was there any implication that audit quality was different? [X] had no pre-conception that non-Big-4 auditors were of lower quality, although recognized that there was a debate about capacity.

(b) [X] said that concerns would arise if independence appeared to be conflicted.

The investor referred to a few examples in the USA, describing one case where a small audit firm had become too reliant on a large client and the opinion had become impaired. The investor did not think that there was a significant gap between the Big 4 firms and others: it would use GT for due diligence and ad hoc report support—therefore it saw no technical distinction. Capacity and international reach might create a gap. It would not want the client of the audit firm to be so large that the independence of the auditor might be questioned.

(c) [X] said that identity did not even register with the investor. It was often not important when voting over the reappointment of an auditor. If the auditors were a UK firm regulated by chartered accountants, it saw no difference in capability—a small or large firm would have the technical ability to audit any company.

However, it thought that resources could be a big issue.

(d) [X] thought that for large companies (ie multinational companies working in hundreds of offices), there was a genuine gap, eg resourcing, international reach, specialisms. For mid-250 companies, it was hard to get around the brand factor in a function that was all about reliability. It was sure that they were just as well qualified for a mid-250 company. However, it was not qualified to comment on the resources of smaller firms.

- (e) [X] said that in the listed market, a small unknown auditor would catch people's attention, but there was a good number of respected auditors. There were about 14 or 15 firms that investors would trust (and there could be more). For the FTSE 350 firms, increasingly it appeared to be only the Big 4 firms competing. Investors did try to make the point to companies not to just look at the Big 4 firms, but this had not made an impact. Companies preferred to appoint the Big 4 firms, which could offer a much more comprehensive—total service— package.
- (f) [X] said that the perception gap was wider for firms outside the Big 4 +2. It was not just BDO and Grant Thornton that should be considered. Firms such as PKF (UK) LLP, Mazars LLP and Moore Stephens LLP outside the big six should be considered.

Changing auditors

Questionnaires

40. For a large number of investors a change in auditor was not seen to be an issue so long as the rationale for the change was explained by the company. For example, Threadneedle said that a change in auditor was of interest and would merit discussion but in and of itself not necessarily change investment decisions.
41. However, Rathborne considered there to be a reputational risk to switching auditor and Invesco said that a change of auditors could be a concern depending on the circumstances. Artemis considered a switch in auditor from a Big 4 firm to a 'division 2' firm always merited attention because it could be indicative of a company seeking a more lenient interpretation of its financial affairs from that offered by the incumbent auditor or even looking to conceal a problem altogether. Artemis considered that a division 2 auditor would be relatively lightly resourced and possibly more accommodative towards a client that represented a large proportion of its business. [X] said that a move from a Big 4 firm to one outside that group (with one or two exceptions)

would raise warning flags particularly for a FTSE 350 company. Schroder said that a change in auditor was a big concern if it was a change from the Big 4 but not if it was from a small to a big firm.

42. In terms of barriers to switching, [X] considered that large and complex companies needed large and expert auditors which it said could prevent some companies from switching outside the Big 4 firms. Standard Life Investments considered there to be perceived issues of competence when it came to firms outside the Big 4 auditing major financial services companies.

Cost of capital

43. Barings Asset Management said that changing auditor could have the effect of a possible small increase of the cost of equity based on potential (however small) for restatements arising from change in auditor. It had no specific examples of this occurring.
44. Threadneedle did not think a change in auditor had an effect on the cost of debt although it had not formally analysed this as the focus had been more on the correlation between higher levels of non-audit fees and a higher cost of debt.
45. [X] thought that a change in auditor needed to be explained otherwise it could cause a change in the cost of capital, although it said that a change in auditor was usually the result, not the driver, of change in company's cost of capital.
46. [X] said that a change from a Big 4 to a non-Big-4 firm would raise a flag but would not always be an issue. It considered that a change in auditor would have no effect on the cost of debt and that the market discounts for a lack of credibility in a

company's accounts before, and independent of, a change in auditors was deemed suspect.

Hearings

Representatives of Institutional Investors

47. The Institutional Investors thought that a change of auditor or ACC should be a trigger for investors to ask questions and understand the reasons behind the change. However, since often they were not aware of the change until the AGM, this was difficult. Further, because of confidentiality arrangements, it was very difficult for investors to obtain any real information from the auditor about the reasons for the auditor's departure. Investors also had very little visibility regarding prospective tenders for auditors. On rare occasions, investors had voted at AGMs against the reappointment of an auditor. This had tended to be for reasons of independence and the level of non-audit fees that an auditor may be earning from a client, rather than because of any inherent judgement of the auditor's quality.

Hermes

48. Investors might have more confidence in companies that had recently switched auditor: this should be reflected in a lower cost of capital for that company, and its shares should trade at increased earnings multiples.

BlackRock

49. From the BlackRock investors' perspective, a change of auditor had no impact and largely went unnoticed. It was not therefore in itself a cause for concern except in extremis where the audit firm had resigned and put out a statement highlighting particular concerns. Likewise, a company having an auditor for a long time would not concern the Investors. They said that whether having the same auditor for a long

time was best practice was an open question, but in itself it would not affect their decision to hold shares.

L&G

50. A change in auditor was not in itself a concern for the Investor. The statement from the resigning auditor was useful but often said nothing more than 'we lost the tender'. This was helpful in that it suggested that there were no issues between the auditor and management, but a statement from the relevant company explaining why the new auditor was selected and the benefits it was expected to bring would be more useful.

Submissions from parties

Oxera survey on behalf of BDO and GT

51. In reviewing Oxera's interview summaries, we noted, in particular, that [X] said that when it saw a change in auditor firms, it became more nervous. It could suggest that the company may have been opinion shopping. To investigate, it would have a discussion with a senior independent member of the board and/or Chairman of the company, at least one of whom is normally on the Audit Committee. If, for example, the new auditor was offering a reduction in audit fees, it was reassured as it was clear that there was another reason for switching (ie not just opinion shopping).

Influence of investors

Questionnaires

52. The majority of investors said that they had no influence on auditor choice. Investors were able to vote at AGMs and some had voted against the board's recommendation in cases where there were concerns about conflicts (particularly in relation to non-audit services). AXA Investment Managers (in relation to its equity business) had previously voted against the reappointment of auditors because of concerns about

the audited accounts. However, investors were not aware of auditors failing to be appointed as a result (eg [X]). Some investors noted their ability to discuss the audit when they met with the Chairman of the board to discuss governance and stewardship.

Hearings

Representatives of Institutional Investors

53. The Institutional Investors thought they had no meaningful influence on the initiation of the audit process, its operation, or output. They considered that auditors were unwilling to speak to shareholders since auditors had access to privileged information. This left the general meeting as the only forum where it would be possible to speak to the auditor. This rarely happened because the Chairman of the meeting controlled access to the auditor. On those occasions where investors had sought to put issues to the auditor, they had been blocked by the Chairman.
54. The representatives said that company management rarely discussed the choice of auditor with investors. Investors usually heard about a change in auditor only after it had taken place. ACCs equally did not discuss the issue with shareholders.
55. The Institutional Investors referred to some recent examples of engagement on audit issues. For TUI Travel, the switch of audit firms was forced by the controlling shareholder. In this case, the representatives thought that investor engagement had been fairly futile and time-consuming.

Hermes

56. Hermes considered that it was a challenge to try and influence the choice of auditor. It attempted to do this in dialogue with the ACC. It was possible for Hermes to have some contact with the ACC, and its success in influencing the auditor recommen-

dation depended on the strength of its case. As a single shareholder (typically holding 1 per cent), it could not demand too much time with an ACC, and would only seek a meeting if it had a specific concern. It would aim to get this across in a single meeting, but occasionally it might have more than one.

57. It had more influence via this route than through the exercise of voting rights at AGMs. It was a huge logistical task to attempt to coordinate sufficient shareholders to be able to defeat a management recommendation. It was not aware of any instance where this had been successful. Most shareholders were not bothered by the choice of auditor.

BlackRock

58. The BlackRock investors could not recall an instance when they had voted against a management recommendation of an auditor at an AGM (although they noted that they had voted against management on other matters). They explained that if there was an issue in relation to corporate governance, they would seek to influence management in advance of the AGM vote. An issue in relation to the auditors would be unusual. They had not sought to try to cause a tender or switch of auditor.

Submissions from parties

Oxera survey on behalf of BDO and GT

59. Oxera reported that:

The investors surveyed, especially the larger ones, would typically prefer more engagement and dialogue with the auditors of companies in which they invest, which would help them to derive more value from the audit process and to judge the relative strengths of different audit firms. However, in general, the interviewees do not want any radical change to investors' degree of involvement in auditor selection.

60. In reviewing Oxera's interview summaries, we noted that [redacted] said that auditors did not, would not and sometimes could not talk to shareholders. There had been examples where the Chairman would block difficult questions raised by investors for the auditor.

Additional outputs

Questionnaires

61. A wide range of ideas were raised in relation to whether there was more information that could be provided in the audit report. Some investors thought that the current format of the report was adequate (eg [Alliance Trust]) and others raised suggestions for additional information as set out below. In the main, investors who wanted more information were willing to pay more for this (as long as the price was reasonable).
62. Possible additional information:
- (a) [redacted]: an indication of the way in which firms' accounting policies differ from industry norms would be useful and an opinion on the level of disclosure would be helpful.
 - (b) [redacted]: standardized and detailed disclosure of revenue and profits and assets by region and segment.
 - (c) [redacted]: it would be helpful to know what issues if any the auditors had before issuing clear opinion.
 - (d) Barings Asset Management: in terms of standardized required information, there was little scope for more information without further impeding timeliness of information—a working capital report would be useful.
 - (e) Alliance Bernstein: more clearly identify which numbers were fact and which were opinion.
 - (f) Aberdeen Asset: more information could usefully be included on audit outcomes—at present the audit report was 'boiler-plate'.

(g) Alliance Trust: the report could describe areas of discussion but a clean, ie non-qualified, audit suggests resolution.

63. Threadneedle suggested that three aspects of the audit report could be usefully enhanced to make them more useful and more open to evaluation:

(a) Enhance the scope of the Opinion to cover:

- (i) the accounts being prepared on a prudent basis in addition to them, notwithstanding anything else, providing a true and fair view of the state of affairs of the business and its assets;
- (ii) proper accounting records having been kept;
- (iii) that, following the review of the assumptions made by the board in their assessment of the going concern, the conclusion and disclosures of related judgements and contingencies are complete and reasonable; and
- (iv) distributions being properly made in accordance with the Act, out of realized, distributable profits and reserves.

(b) Provide information:

- (i) confirming (if applicable) that an enhanced Audit Committee report is complete and reasonable (including confirmation that it was an appropriate reflection of the key issues discussed between the audit committee and the external auditor);
- (ii) on items that are the subject of significant accounting judgements or estimates (or confirm there were none);
- (iii) on accounting judgements or estimates that are the subject of significant uncertainty or risk (or confirm there were none); and
- (iv) on any areas or matters that the auditor has not obtained all the information.

(c) Emphasis of matter: the current framework (section 495(4)(b) of the Companies Act 2006) should be strengthened to encourage more effective reporting on

matters an auditor 'should reasonably' draw attention to rather than (just) those they may 'wish to' draw attention to.

(d) This should extend to the enhanced scope of the matters covered in the audit report outlined above.

*CRA*s

64. For Fitch, there was nothing extra they would like to see. S&P, in addition to stating that that there was no specific information that it would expect to see within an audit report that was not currently there, also noted that whilst it did not generally comment on the structure or content of audit reports, on a case-by-case basis it might request additional information or clarification from the issuer about the report or its contents. [X] did not have a 'house position' on this, although it pointed to two articles it had recently published on related topics as example of areas of relevant debate. These areas were: (a) going-concern warnings and (b) (specifically for the CIS region) financial information.

Hearings

Representatives of Institutional Investors

65. The Institutional Investors noted that there was significant debate under way within the FRC in the UK and the European Commission as to whether the audit report could be more informative. The representatives considered that the more important thing to develop at this stage was the Audit Committee report rather than the audit report itself. This was on the basis that in the first instance information should be provided by company directors rather than the auditor. The auditor's view of the Audit Committee report could also be important.

66. That said, more could be put into the auditor's report. In particular, the report could identify issues that had been scrutinized in detail by the company during the audit

process. The Institutional Investors referred to the Audit Committee reports, and Global Disclosure Guidelines which set out guidelines on what could be included in an Audit Committee report, which investors would find useful and interesting.

67. In terms of additional disclosure, the Institutional Investors considered that it might be useful to understand what the five most contentious points discussed at the Audit Committee were. This would give investors an opportunity to discuss any issues with, for example, the Audit Committee if they wanted further information. Certain companies had volunteered more information regarding such key audit issues in recent annual reports (eg BAT, BP, Barclays).
68. The Institutional Investors thought that the quality of reporting would be improved if subjective issues (such as aggressive accounting treatments) were identified and investors notified. At the moment, the representatives considered that the disclosures were not useful. They noted that there were cases of significant variation in the numbers reported by financial institutions that held the same type of instruments, for the same purpose, even where those institutions had the same auditor.
69. The Institutional Investors thought that the reason for such anomalies was that the audit had become too much of a utility product. It was no longer differentiated on the basis of quality as very little judgement was required when undertaking an audit.

BlackRock

70. Further information that the BlackRock investors would have liked to see was an explanation of the differences between the cash flow and income statements. A discussion of the areas that management and the Audit Committee had debated most would also be helpful.

L&G

71. L&G suggested that the risk statements given by many companies could be more tailored: some companies listed 30 risks, which were too many, it clouded the information provided and it would be better for investors to be presented with a shorter list of key risks. The risks considered by the board included non-financial risks which depended on the company specifics such as reputational issues (eg the use of child labour, phone hacking etc). The Investor considered that the auditor was present at meetings where these risks were discussed and was likely to give a view to management on these. The auditor should therefore cover these risks in its review of the Annual Report. The Investor referred to this as 'integrated reporting' (ie reporting on the linkages between strategy, governance and financial reporting) and wanted to see more companies adopting this approach.

Submissions from parties

Oxera survey on behalf of BDO and GT

72. In reviewing Oxera's interview summaries, we noted the following in particular:
- (a) [REDACTED]: The purpose of an audit was to provide a check on financial statements—investors would prefer to try and get a view on anything else directly from companies, rather than through audit. Fund Managers may not feel comfortable with relying on an auditor to provide nuance and colour. It was not clear how this colour could be provided within the audit report and some investors might want certain information to remain private and not put into the financial statements.
 - (b) [REDACTED]: Auditors were much too close to company management, in particular, to finance staff and did not act in the best interests of shareholders. Although that was not to say that auditors did not fulfil what was required of them. The misalignment of incentives resulted in, for example:
 - (i) slightly more aggressive accounting practices than long-term investors would like to see, for example the banking sector, where certain accounting prac-

tices were accepted (eg recognition of profit upfront) that were not in the interests of long-term shareholders;

- (ii) lack of transparency in accounting assumptions: long-term investors had a preference for simplicity and transparency, and when an auditor had become embedded to a company, there was a concern that they would include something complicated and potentially misleading; and
- (iii) lack of colour: investors would appreciate more nuance, eg general commentary about how the accounts were put together and the relative aggressiveness of accounting—but was not sure how this could be done given the cosy relationship between the auditor and management.

Other

73. YouGov survey on behalf of PwC:⁹

(a) Q5: Would you like to see increased disclosures in order to improve market confidence in corporate reporting and the audit process? Base 120:

- (i) Yes: 49 per cent.
- (ii) No: 51 per cent.

(b) Q6: (If YES to Q5) Which of the following increased disclosures would you support? Base 59:

- (i) Enhanced disclosures by the audit committee: 53 per cent.
- (ii) An expansion of the audit report: 61 per cent.
- (iii) Other.

74. PwC-commissioned survey Ipsos MORI Global Executive Summary:¹⁰

(a) Opinion on the length of audit reports is evenly split for longer/more detailed or shorter/more succinct reports. The UK sees the greatest demand for shorter

⁹ Source: PwC Response to off the shelf B11. 00062011

¹⁰ Source: PwC Response to off the shelf B11. 00082009

reports (59 per cent vs 33 per cent for the longer version). India, Singapore and Hong Kong tilt in the opposite direction, with opinion more evenly divided elsewhere.

(b) Very few respondents say the amount of disclosure around the existence and management of risk in corporate reports is currently too high but over half consider it to be too little. When looking at responses with regard to IFRS, there is very little difference between IFRS and non-IFRS countries. Four out of ten respondents who would like to see more disclosure indicate that they would like it to be in the areas of financial/currency/investment/debt risk.

75. Audit today and tomorrow—PwC survey (interview of 22 investment professionals conducted in April/May 2011). Key messages:

- (a) the audit affects investment decisions, but audit reports themselves do not give meaningful information;
- (b) investors are selective about where additional transparency could be useful;
- (c) information on the ‘behind closed doors’ aspects of the audit would be valuable, but there would be concern if this constricted open debate;
- (d) there is an appetite for more timely assurance; and
- (e) assurance is sought on metrics and narrative that currently fall outside the audit’s scope.

76. In terms of the additional information, investors would like to see PwC reported in its 2011 Audit Today and Tomorrow report:

The investment professionals interviewed do not believe they currently receive adequate information about the audit process; they offered suggestions of where more information would be valuable. These areas include: the auditors’ debates with management; aggressiveness of accounting treatment; likely areas of material misstatement; and going

concern. However, there are understandably significant concerns over the practicalities involved. In particular, they do not wish this further disclosure to limit the willingness of auditors, audit committees and management to engage in frank debates: as one investor said, 'If you don't have privacy, you don't have honesty'. They also saw no value in additional disclosure if this just results in more bland or formulaic reporting.

77. ICAEW published survey of FTSE 100 ACCs (Brunswick Research):¹¹

Increasing openness is a balancing act

- Transparency is important, but its utility must be clear
 - Many ACCs feel they detail “discharge of responsibilities” already
- Additional reporting at risk of being boiler-plate
 - More data/verbiage does not necessarily equal better understanding
 - Danger of information overload (with 200 page annual reports)
- Reporting of internal discussions could reduce effectiveness
 - Confidentiality enables frank debate; issues would be taken offline
- Additional reporting needs to add real value

Summary

78. Review of the evidence that we have gathered from investors suggests that the following is common ground among investors:

¹¹ Source: PwC Response to off the shelf B11. 00112011 and Deloitte Response to off the shelf B11 111101-AQF171011.

- (a) The audit is valuable to investors—the process and resulting financial statements matter more than the audit report itself.
 - (b) Investor influence is very limited; investors have a better chance of influencing management prior to an AGM than at an AGM. It is not clear that all investors want more influence.

- 79. There are mixed views from investors/end-users concerning:
 - (a) Auditor identity—a minority of investors state that they consider the Big 4 firms to be better than the other audit firms; some investors consider the Big 4 firms to be better able to audit large companies (FTSE 100); however, most investors seem to be comfortable with a larger mid tier audit firm auditing FTSE 250 companies.
 - (b) Change in auditors—in the main does not cause concern if the reasons are adequately explained and for some investors a change in auditor did not even register; however, for some a change particularly from a Big 4 to Mid Tier auditor was seen as an issue and would raise concerns.
 - (c) The need for, and nature of, more disclosure/different outputs from the audit process—some investors wanted nothing more and others provided examples of what could be provided. These were wide ranging with the main areas of consensus among those who desired more information being provision of further information on how aggressive approaches to accounting policy were compared with industry norm, and the main areas of discussion between the auditor and the company.

- 80. We have gathered evidence from major UK investors and we note that a minority of these investors do rate the Big 4 firms as better and that some investors are concerned by a move from a Big 4 to a non-Big-4 firm for listed companies.

81. There is desire from some investors for more additional information. There are mixed views on how this should be provided: some investors felt the auditors could cover more in their reports, whereas others felt the Audit Committee report was a more appropriate place to set out this information. We note the concern raised that by making more information public the quality of discussion between auditor and company may be reduced.