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Your ref

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Dear Mr Gadhia

Audit Market Investigation
KPMG Response to "Investor Views" Working Paper

We welcome the chance to comment on the Competition Commission's Working Paper on "Views of Investors and other stakeholders" (the "Working Paper"). We note the overall conclusions of the CC that there is a broad consensus among investors and other stakeholders with regard to the role of audit and investor influence but mixed views on auditor identity, the effect of changing auditor and providing more information to investors[1]. These views broadly align with our own experience of investor views.

Audit is valuable to investors

We note the comments made by a number of investors in the hearings to the effect that the value to them of an audit is more about the process and what it means for corporate reporting than the published audit report per se. The recognition of the value of an audit as an important input to investment decisions is consistent with other surveys[2], the statutory underpinning of audit reinforced in the 2006 Companies Act[3], the EU 8th Company Law Directive[4] and our long experience. While there is an important debate to be had about future reporting and the scope of audit, the current audit of historical financial statements continues to be critical for the millions of investors and those that make decisions on behalf of those investors.

[1] Paragraph 5 of the Working Paper.
[2] See US Centre for Audit Quality survey from September 2012 http://www.thecaq.org/newsroom/release_09192012.htm and ACCA/SIAS Singapore survey http://www2.accaglobal.com/pdfs/international/singapore/VOAPAC and 2011 EU ACCA/MARC Research http://www.accaglobal.org.uk/content/dam/acca/global/PDF-technical/audit-publications/extended_audit_reporting.pdf and ICGN global investor survey https://icgn.org/files/icgn_main/pdfs/research/2007_financial_reporting_&_auditing.pdf
[3] 2006 Companies Act, section 475 requirement for audited accounts.
[4] Directive 2006/43/EC on Statutory Audit, Official Journal of the European Union 9.6.2006, article 27

It is against this background that the question of whether there is an unmet demand from shareholders should be considered. In this context there are clearly divergent views as to what if any additional information should be provided about the audit and corporate reporting process and if so by whom – companies or auditors. As we have said before[5], the lack of progress on this front is not because of lack of competition, but the lack of demand being presented to individual companies or their auditors particularly in the absence of any strong consensus emerging from investors. Collective action from regulators, companies and the audit profession is therefore needed to build that consensus.

Investors influence on the auditor and appointment

We note the CC's findings that investors believe that they have little influence over auditor choice. Clearly, as a matter of fact, investors vote annually on the appointment of the auditor and have the opportunity to vote against any appointment. If enough investors hold a consistent view then the resolution regarding the auditor appointment will not be passed. That this occurs rarely in practice is because insufficient numbers of investors vote against the proposed appointment[6].

We also believe that investors have increasing insight into the quality of audits both through the published results of regulatory inspections and published commentary of Audit Committees in Annual Reports, although we support the latter being enhanced as we made clear in our response to the Financial Reporting Council on its proposed revisions to the UK Corporate Governance Code[7]. This enables them to take collective action on those rare occasions that they think it essential to do so.

We acknowledge however that investors have less perspective than company Audit Committees on audit quality, primarily because they have less direct involvement in the process. Although enhanced reporting may improve their insight it will not eliminate the differential with the company's knowledge and understanding. Nor is it clear that all investors want an enhanced dialogue with the auditors even leaving aside the confidentiality constraints imposed on the auditors. For example we approached one institutional investor to ask whether they had any particular concerns on our audit clients that we should be aware of and take into account in planning our audit. The response has not encouraged us to repeat this experiment.

Moreover, this position is no different to other matters of importance to shareholders where visibility is greater to the company's Board. As a result the premise that the Board is responsible for the governance of the company on behalf its shareholders and reports to those shareholders on the stewardship of executive management remains a fundamental concept of UK Corporate

[5] See our response "Hearing follow up questions – KPMG", 30 October 2012.
[6] The case of TUI which is cited in paragraph 55 of the Working Paper, is somewhat different in that there is a majority shareholder who can therefore pass an ordinary resolution against the wishes of other shareholders (subject to legal protections for minorities).
[7] http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Consultation-Document-revisions-to-the-UK-Corporat/Responses-to-the-consultation/KPMG-LLP.aspx

Governance. If this model does not allow Boards to exercise appropriate stewardship over the external audit relationship (or shareholders cannot rely on this to happen) then there would appear to be a more fundamental issue with UK (and, indeed, international) corporate governance.

Audit Committees are best placed to identify the audit firm best placed to meet the company's needs.

As a consequence we continue to believe that it is the Audit Committee which is in the best position to recommend the selection of who is "equipped to do the best job" (rather than simply who is "capable of doing an adequate job")[8]. It is the Audit Committee which has both the responsibility and the ability to understand the scope of the audit and to engage with the key individuals on the audit team at a more detailed level. In addition the Audit Committee will receive any inspection report on the individual audit when their company's audit is reviewed by the FRC. They are in a good position therefore in our view to assess the capacity and quality both of the incumbent firm and any other firm they wish to consider.

We trust that these comments and observations are useful in informing your consideration. Do not hesitate to contact me if you have any queries or wish to pursue any of these points further.

Yours sincerely

David L Gardner
Director of Public Policy

[8] We have expressed this view in previous submissions. See for example section 3.2 of our response to the CC's working paper "Framework for the CC's assessment and revised theories of harm".