Kingston Smith

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The Competition Commission
Victoria House
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Dear Sirs

Response to working paper produced on the views of investors and other stakeholders

We have written this letter in response to the working paper recently published on your website in respect of your investigation into the audit market for larger listed companies, which focuses on the views of investors and other stakeholders. We have relatively few comments on this working paper but there is one particular issue which we believe needs to be raised, specifically the misperception that a Big Four audit is automatically a better audit which is one of the most damaging barriers to entry that currently exist and one of the most difficult to overcome.

We were pleased to note from the working paper that a number of investors have no issue with the use of audit firms outside the Big Four and that indeed in some cases investors believe that companies could consider using not just Grant Thornton or BDO, but also firms such as Mazars and Moore Stephens. This indicates a genuine willingness on the part of some investors for companies to consider alternatives and may well help to indicate that such investors believe the market at present is too concentrated (although this is not explicitly stated in the working paper).

However we are extremely concerned by the view expressed by Artemis in paragraph 41 of the working paper that *'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'* and 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'*. An unnamed investor and Schroders also appeared to agree that a switch away from the Big 4 was of concern and later in the working paper (paragraph 51) an anonymous investor appears to have commented in responding to the Oxera survey that such a switch could represent 'opinion shopping'.

Such a suggestion is not only a misperception without foundation – it is frankly offensive. There may be many reasons why a company may seek to switch auditor. In the case of some companies, it may well be that a disagreement over accounting treatment with an incumbent auditor is one of them, but the comments referred to above appear to imply that the investors in question believe that the mid tier not only lack the technical robustness of the Big 4 but also lack integrity. Mid tier firms do not 'bend the rules' in respect of their larger clients' compliance with the relevant financial reporting standards.

Moreover, the larger mid tier firms are not 'lightly resourced' – they have considerable headcount and resources both in the UK and in their international networks and associations, including technical resource. It is precisely to address any issue of actual or perceived lack of independence as a result of taking on large audits that the Ethical Standards for Auditors include a prohibition from acting for a listed audit client where the fees for that audit represent more than 10% of the total annual fees of the firm in question (or indeed the part of the firm by reference to which the audit partner's profit shares are calculated, if profits are not shared on a firm wide basis). In effect, Artemis and the other investors referred to above have implied that firms outside the Big Four may not comply with professional standards. This is quite simply untrue as is any suggestion of lack of integrity.

Our firm has in the past faced situations where a disagreement over a technical matter has led to losing the client, as a direct result of our refusal to compromise in our interpretation of accounting or ethical standards. Losing the client as a result is unfortunate but standing one's ground on the matter in question is the only ethical and professional course of action.

Coupled with the widespread and damaging misperceptions such as those expressed by large companies in the case studies, such views – even on the part of only a minority of investors – inevitably add to the barriers to entry that prevent mid tier firms from making any significant inroads into the reference market. It is unsurprising that a company would elect to maintain the status quo if a significant investor believes that to switch to a mid tier firm would indicate 'opinion shopping' and therefore cast doubt on the company's own integrity as well as that of its potential new auditor.

We trust that our comments are useful to you. Should you have any questions, then please do not hesitate to contact me.

Yours faithfully

TESSA PARK
Technical Partner
On behalf of Kingston Smith LLP