

[address redacted]

Tuesday 17th July 2012

Inquiry Manager
Audit Market investigation
Competition Commission
Victoria House
Southampton Row
LONDON
WC1B 4AD

Dear Sir or Madam

I have noted with interest the evidence gathered by the Competition Commission in connection with the Audit Investigation Market following referral by the OFT in the wake of the House of Lords Select Committee hearings which were not a ringing endorsement of the accounting profession. The following submission summarises specific evidence of failings in outcomes from the viewpoint of those who the audit certificate is deemed to serve namely **the shareholders** and offers three solutions.

I have made a cursory glance of the Big Four Firms presentations and others to you following your site visits. As an investor, I find these are nothing more than marketing smoke and mirrors. Specifically I would mention the following if only because they have occupied considerable notoriety in the financial press. From my own professional work, I know there is more.

Naive professional work failed to identify risk management issues at Landsbanki, Northern Rock, Cattles, Connaught, and Satyam in India, J P Morgan, and Barclays Capital is lamentable. RSM Tenon is the latest formal investigation. These are all PwC clients. **Critical mass and knowledge** built up over many years did **not** prevent wholly unacceptable outcomes borne out of complacency, from occurring. It is more likely to have contributed to it aided by rash management and aggressive accounting that has replaced strategic thinking in the UK.

PwC and others presided over **fraud and false accounting** at Fairfield Sentry in Toronto by Bernard Madoff who is in prison, Conrad Black in prison, Dennis Kozlowski CEO at Tyco International in prison, Parmalat and Maxwell of course in the UK is the headline cases only. Auditors' attitude to fraud, allegedly now in a range of £38 billion to £73 billion in the UK continues to rise and corruption has been contradictory. An audit certificate that ignores the underlying frauds that have occurred is worthless because it fails to deal with the underlying **loss to shareholders** written off to profit and loss and masks a failure in internal control within the clients business.

Lord Lawson has commented in the House of Lords, it is baffling that not a single firm of auditors has been sued. (**Accountancy April page 6**). None of this is given comment by those with vested interests who wish to retain the status quo. All of the foregoing demonstrates the current structure is not fit for purpose. Why would we need any more evidence before action is taken? My own preferences are much more root and branch.

Part of my pre-qualification training was with the prestigious firm of the twentieth century, **not the biggest**, Cooper Brothers under the chairmanship of Sir Henry Benson. I can recall at least seven other firms at that time held in good regard and sufficiently competent to undertake audit work of FTSE 100 companies. This is no longer true and needs to be reversed. The concentration leading to the Big 4 has already led to a degree of systemic risk. Lord Myners has warned in his evidence to the House of Lords the existing set up suits the accounting profession who have faced very little examination in the wake of

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the financial crises and sail serenely on. The last decade has seen a cartel emerge. Standards epitomised by a procession of failed clients following audit, have diminished. Choice has contracted.

Firstly, a transition to the de-merger of principal firms to form at least seven firms will enhance competition. It would enable **a cap to be put in place of no more than 20% of the FTSE 100** be held by more than one Audit Firm at a time.

I agree the EC Proposal to prevent non-audit services by the audit firm makes no sense because wider **understanding of the client business model** is achieved. The larger and more diverse activities in the client group render this more not less important. The EC should be challenged on this issue.

Secondly, I see no reason why shareholders advised by their **Audit Committee**, cannot adopt mandatory rotation seven to nine years. External Auditors report **to shareholders not** the directors and that needs greater emphasis. The Dutch Lower Parliament has approved mandatory rotation. (**Accountancy April page 72**)

Those of us with Turnaround experience support an idea advocated by Lord David James of Blackheath.

Each corporate audit should include a Twelve Month Certificate of Working Capital. This would have the advantage of acting as an early warning system and make the audit as much a test of future resilience as well as confirmation of past financial performance. It would underpin the requirement to ensure audit clients were a Going Concern. Do you think Northern Rock would have got a Working Capital Certificate? (**Daily Telegraph 12th July 2008**).

Yours Faithfully

Keith V Potts
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