



Competition Commission Audit Services Market Enquiry

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Deloitte response to the Competition Commission's working paper "Development of the Statutory Financial Audit"

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1. Introduction

- 1.1 Deloitte is grateful for the opportunity to comment on the CC's working paper on the development of the statutory financial audit (the **Working Paper**).
- 1.2 We set out our views on a number of observations made in the Working Paper which we believe require balance.
- 1.3 We note that the CC proposes to publish further working papers which may have a critical bearing on matters covered by this response. We reserve the right to provide further comments and/or develop our position in the light of further material published by the CC.

2. The limited liability partnership act

- 2.1 As noted the Working Paper¹, the Limited Liability Partnership Act (the “Act”) resulted in a level of debate, but the material presented in the Working Paper only provides one side of the debate.
- 2.2 The CC quotes only a single backbencher at the time Austin Mitchell MP (Labour) and there is no basis for relying only on his views. It is critical that the CC properly consider other views on this issue and reflect the balance of opinion in its conclusions on this issue.
- 2.3 For the CC’s benefit we set out below a range of (cross-party) views on the Act.
- 2.4 Dr Kim Howells MP (Labour), the Parliamentary Under-Secretary of State for Trade and Industry, noted the following:

“LLPs were already a well-known concept in the United States of America, and Jersey—not New Jersey, but Jersey in the Channel Islands—was also planning to introduce them. As a result of the process of consultation, we concluded against any reform to the law of joint and several liability, but gave our commitment to the introduction of limited liability partnerships.

Surprisingly, there has been no fundamental change to business entities in Great Britain since 1907, when the Limited Partnerships Act was introduced. Only a company offers all its members limited liability, which perhaps seems a little odd in the 21st century. The creation of LLPs demonstrates the Government's commitment to ensuring that Britain maintains its competitive and up-to-date legal framework for business.

The development of LLPs takes account of the changing business environment, which has become increasingly litigious in recent years. The structure of an LLP means that some firms may find it an advantage over a company, as it offers the freedom for members to arrange their internal relationship to each other and to the LLP as they wish, while having the benefit of limited liability. That is likely to be popular with those who already have partnerships, but it may also prove to be of some benefit to start-up businesses.”

- 2.5 Nick Gibb MP (Conservative, and a chartered accountant) stated:

“Even under the Bill, it will still be possible for partnerships to be sued, but the prospect of partners unconnected with the negligence losing everything will go. It is wrong that, in circumstances where—the Minister alluded to it—99 per cent. of the blame for something going wrong attaches to, say, the impecunious fraudulent director of a company, and the audit firm or solicitor can be shown to be just 1 per cent. to blame for what went wrong, they can be sued for 100 per cent. of the loss. Because many of the partnerships have deep pockets, it is to those firms that aggrieved investors turn for recompense.

¹ See Paragraph 24 of the Working Paper

The general legal concept of joint and several liability will not be changed by the Bill, but the concept of joint and several liability within a partnership will. The limited liability partnership will be suable for breach of contract to the full extent of its assets. The partner responsible for any negligence will, as the Minister said, be liable under tort, but the remaining partners will be able to sleep easy at night knowing that their personal assets will be safe.”

2.6 Stephen O’Brien MP (Conservative) notes:

“From my business experience in this country and abroad, I see the Bill as an important step in acknowledging the reality of the professional and commercial world—in the context of today’s multinational companies and partnerships. The Bill is necessary not only to retain competitiveness, but to maintain and increase confidence in the corporate and legal structures for professional and commercial enterprises in the UK—whether large, medium or small—so that they can continue to take on all corners.”

2.7 Austin Mitchell MP’s comments about the publication of audit firm’s accounts² are misleading. The Working Paper quotes them without noting the response made at the time by Stephen O’Brien MP:

“The whole point about partnerships and about LLPs is that they are a collection of members—they will hold that information among themselves. A plc has many shareholders who have a right to the information. The analogy is not a proper one.”

2.8 Further, we would make the point that the Act requires a level of disclosure in the financial statements of LLPs which is significantly beyond that required for general partnerships, the accounting framework for LLPs being identical to that adopted by companies. These disclosure requirements, coupled with the requirements of the Audit Firm Governance Code and the requirements of EU directives on transparency reporting by audit firms of listed companies result in a significant level of information being available in the public domain.

2.9 In conclusion, there is no basis for relying solely on the views of Austin Mitchell MP in relation to the Limited Liability Partnership Act and we urge the CC to consider a full range of views as well as the requirements set out in the Act itself.

3. The CC’s comments on the banking crisis

3.1 Paragraph 59 of the Working Paper states that “[t]he banking crisis in 2008 highlighted that considerable shortcomings remained in the audit system. Notwithstanding serious intrinsic weaknesses in the financial health of the relevant companies, the audits of those companies, carried out immediately before, during and following the crisis, had resulted in ‘clean’ audit reports.”

3.2 This statement implies that audit reports have been issued which should either have been qualified or should have specifically commented on the ability of the company to continue as a going concern (i.e. an emphasis of matter). There is no basis for this implication.

3.3 We set out below some points the CC should consider in relation to the banking crisis.

3.4 First, we note that the 2007 and 2008 financial statements of banks have been subject to reviews by many organisations, including the FSA and the Financial Reporting Review Panel, and no material misstatements have been identified, nor have any been restated.

3.5 Second, the CC should be aware of the final report of the independent inquiry led by Lord Sharman which covered the approach of directors, audit committees and auditors to the going concern assessment³.

² See Section 42 of the Working Paper

³ The Sharman Inquiry: Going concern and liquidity risks: Lessons for companies and auditors (the **Sharman Report**)

3.6 Although the Sharman Report does make recommendations for improving the assessment, disclosure and auditor reporting, no wrongdoing or lack of appropriate care and skill on the part of auditors is suggested by the Report.

3.7 Third, another independent view which casts doubt on the accuracy of the statement made in the Paper was given by the Hundred Group in their submission to the Competition Commission on 16 April 2012 which states:

“The vast majority of companies...remained strong during the recent financial crisis...Inevitably certain sectors fared less well than others: However to predicate a significant and wide ranging reform on these isolated examples is to ignore the fact that in the vast majority of cases, the role and effectiveness of independent auditors has not been, and should not be, called into question.”

3.8 The audit of banks during this period was a hugely complex area which required a unique and innovative approach by all firms involved. It was unprecedented at the time and Deloitte and other firms initiated discussion with the regulators and the Government on going concern issues on systematically important clients. It was recognised at the time that certain banks would only be going concerns if there was adequate government support. Our work was consistent with existing auditing standards.

3.9 In the case of directors making their assessment of whether or not there is an uncertainty as to going concern, and of auditors in auditing this going concern assessment, consideration is made of the need and availability of finance and of government support through, for example, the Bank of England's liquidity scheme and the Treasury's credit guarantee scheme. Indeed Lord Sharman's report notes that:

“in taking forward the definition of a going concern, the FRC would need to consider making clear that liquidity support from central banks may be a normal funding source for a bank and therefore reliance on such support if reasonably assured, does not mean that the bank is not a going concern or that material uncertainty disclosures or an emphasis of matter paragraph are required.”