

PwC response on Evidence relating to the Selection Process: Tendering, Annual Renegotiations and Switching

- 1 This paper contains PwC's response to the Evidence relating to the Selection Process: Tendering, Annual Renegotiations and Switching working paper (the **Selection Process WP**). We set out below an overview of our comments on the Selection Process WP, followed by an Annex outlining our concerns in more detail.¹
- 2 We have a number of concerns regarding the Competition Commission's (**CC**) "*key initial indications*" on the auditor selection process (as summarised in paragraph 2 and the Selection Process WP in general). In summary, while we recognise and agree with the CC's initial indications that both audit firms and large companies take the tender process seriously and firms compete fiercely to win new appointments through formal tenders, the Selection Process WP significantly understates the degree of competition outside of tenders. This understatement is repeated in the CC's working paper on the Nature and Strength of Competition (the **Nature and Strength of Competition WP**) leading the CC to reach initial views in that paper which are flawed and unsupported by the evidence.
- 3 In particular, the Selection Process WP does not recognise the following:
 - (a) **The evidence shows that companies succeed in demanding high quality and value for money audits from their existing audit firm without having recourse to tenders:**
 - (i) In this respect, we simply do not recognise the CC's description in paragraph 2(e) of the Selection Process WP of annual reappointments being typically a "*standardized process*", in which a company "*may or may not*" challenge the proposed audit scope and fee; and only "*usually*" discusses the scope and fee. Further, the CC's statement that companies "*may*" carry out benchmarking; and in "*some circumstances... may threaten to tender... or use other firm's proposals to challenge the incumbent*" both understates the widespread use of these methods to exert competitive pressure on the existing auditor and also importantly fails to appreciate the various other possible methods of achieving the same aim that are available to knowledgeable, experienced and sophisticated purchasers². In fact, the evidence shows the following:
 - (A) Companies apply pressure at various points in the annual audit cycle and in particular almost always challenge fees in the annual renegotiation. Indeed, the CC's Survey finds that 93% of FTSE 350 companies negotiate the audit fee every year.³ In light of this finding, those companies that "*may not*" challenge the audit fee each year are limited to a maximum of only 7%. In

¹ Our comments include some references to: (i) the IFF Survey Results Presentation of July 2012 (the **CC's Survey**); and (ii) our Submission of 12 January 2012 (our **Initial Submission**).

² See our response to the Nature and Strength of Competition WP for more detail on these methods.

³ See slide 46 of the CC's Survey. 100% of FTSE 350 companies negotiate fees at least every 2 to 3 years. The finding that almost all companies conduct annual fee negotiations is consistent with the CC's case studies, which also show that companies vigorously challenge fees - for example, the Company G case study states that the company "*was able*

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the case of some of this very small minority of companies, this may be due to them having agreed a two to three year fee framework agreement that avoids the need for an annual fee negotiation absent unforeseen changes in activities leading to changes in audit scope.⁴

- (B) The success that large companies have achieved as a result of their negotiations is made evident by the fact that in our experience audit fees are going down in aggregate.⁵ Moreover, analysis that was included in our Initial Submission shows that there is no relationship between the profitability of our FTSE 350 audit engagements and the length or tenure of these engagements, demonstrating that companies that do not switch are just as able to negotiate competitively scoped and priced audit as those that do.⁶
- (C) Further, the CC's Survey confirms that the vast majority of FTSE 350 companies - 91% - carry out a post-audit quality and value review annually, either internally or with the auditor.⁷ The CC's case studies also show that such exercises are both detailed and wide-ranging.⁸ Such scrutiny of quality and value, (undertaken in accordance with the FRC: Guidance for Audit Committees) allows the company to monitor auditor performance closely, judge to what, if any, extent it may fall short of the expected standard, and informs the annual appointment process.
- (ii) To achieve competitive fees and high quality service levels, companies often threaten to tender.⁹ Such a threat may be express or more likely implicit. Regardless of whether the threat to tender is in fact expressed, to examine the ability of large companies to achieve a competitive audit service primarily by reference to the number of *actual* tenders is to ignore the reality that it is the constant and very real *threat* of tenders - discussed in (b) below - which underpins continuous competitive pressure on auditors:
- (A) Where we are the existing auditors, we feel competitive pressure to produce a high quality and value for money audit exerted by companies closely monitoring our performance and pushing for improvements (as described above). We are always aware of the real threat of a tender and the fact that

to negotiate by trading off inflationary increases (such as wage bill increases) against audit process efficiencies' (paragraph 32).

⁴ See paragraph 4.4 below on the evidence previously submitted to the CC as part our response to the MFQ, question 87.
⁵ See Figure 10 in our Initial Submission, which shows declining hourly rates. This evidence is reinforced by the CC's data as presented in Chart 9 and paragraph 35 of the Descriptive Statistics WP, showing that while audit hours have remained broadly static, nominal audit fees have declined by 15% in the last five years (implying an even higher decline in real terms).

⁶ See our Initial Submission, figure 11, which plots our audit profitability (in terms of our internal CPy measure) against audit tenure - there is no indication that shorter tenure clients are more or less profitable than longer tenure clients (i.e. those who have not recently switched).

⁷ See slide 46 of the CC's Survey.

⁸ We set out in our response to the Nature and Strength of Competition WP a summary of the items covered in the annual review by each of the case study companies.

⁹ This is supported by the case studies - for example: (i) Company D's FD said that in 2010 they "*asked the current auditors to undertake an informal retender....The Audit Committee would judge the new approach and if it was not satisfied the audit would go out to a broader tender process*" (paragraph 24); and (ii) Company G's ACC "*said PwC*

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if the company decided to hold a tender because it was dissatisfied, we would likely be replaced.¹⁰ This is why we have invested in our Audit Relationship Risk Diagnostic that allows us actively to manage the various competitive threats we face in our portfolio of large companies - as well as in our various and extensive client feedback processes.¹¹ We would not spend money and effort on such activities, which we take very seriously and feature in our business KPIs, if it were not for the intense competitive pressures that we feel as auditors.

- (B) Where we are not the existing auditor, we constantly seek to win new audit business. The ongoing “churn” of the FTSE 350 index, illustrated very clearly in our Initial Submission and the infographic which is available on our website,¹² means that we must do so just to retain, let alone attempt to grow, our market share.¹³ We have various initiatives to target new clients (in particular, to develop relationships which are vital to winning tenders) and believe that our competitors do likewise.¹⁴ [§<]¹⁵

(b) The levels of tenders and switches are sufficiently frequent to keep the threat real and credible:

- (i) The fact that audit tenures typically last several years does not mean that tenders and/or switches are too “infrequent”.¹⁶ Indeed, the CC asserts this is the case without providing any supporting evidence; it appears simply to be a subjective view. In fact, the current rate of tendering and switching is at the appropriate level given the economic characteristics of the supply of and demand for audit services, for the reasons explained below.
- (ii) Tenders, when they occur, involve substantial costs for both companies and audit firms - in particular:
- (A) For audit firms, the CC rightly notes that while tender preparation costs are proportionate to the size and complexity of the audit, costs are usually “high”, with tender preparation taking one to three months, requiring considerable involvement of senior staff, and costing on average 20% to 60% of first year audit fees (and can exceed the first year fee in some circumstances).¹⁷

knew only too well that the company could tender and so there was a dynamic mutually respectful relationship” (paragraph 75).

¹⁰ Indeed, the Paper notes that only 20% of tenders are won by the current auditor (paragraph 125).

¹¹ See paragraphs 2.67, 4.44 - 4.48 and 6.59 - 6.62 of our Initial Submission where we describe our use of various feedback processes.

¹² <http://www.pwc.co.uk/who-we-are/the-uk-statutory-audit-market-infographic.html>

¹³ See paragraphs 4.4 - 4.14, including Figures 4 - 7, of our Initial Submission for further explanation of this issue.

¹⁴ See Section 4C of our Initial Submission where we describe our use of various client targeting strategies, such as Tanks on Lawns and Net 635.

¹⁵ [§<]

¹⁶ Paragraph 2(b). Paragraph 2(f) indicates that the average audit tenure is roughly 11 years and that on average 3.3 per cent of FTSE 350 companies switch auditor each year.

¹⁷ Paragraph 115.

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- (B) For companies, there are potentially substantial costs (in terms of management time and consultancy fees) of conducting a tender process.¹⁸
- (iii) After a switch of auditor, there is a considerable management time commitment and a greater audit risk for the company while the new auditor gets up to speed and significant investments are demanded of the audit firm while it does so.¹⁹
- (iv) It is therefore in the interests of both the company and the audit firm to achieve a competitive outcome without the company needing to resort to an actual tender and/or a switch - although the evidence indicates that companies will switch if they need to.²⁰ In such negotiations the company holds most, if not all, of the cards as a tender would involve significant cost to an audit firm, not to mention the potential loss of a revenue source if (as is most often the case) the existing audit firm is replaced, and the auditors know that companies do not lack credible choice. The loss of high profile FTSE 350 clients will also have wider ramifications for the audit firm's reputation, as is recognised in the Nature and Strength of Competition WP.²¹
- (v) In the context of advantages for both companies and audit firms in continuity of a competitive service, greater numbers of tenders and switches would in reality indicate the market delivering a sub-optimal outcome. In the current situation companies and audit firms benefit from the investments they both make following an audit appointment, while companies are able to use their freedom to switch and their buyer power to ensure a competitive service, often without actually needing to tender or switch.
- (c) The evidence shows that mid-tier firms have the opportunity to present their credentials for appointment:**
- (i) Although the CC notes at paragraph 2(c) that the four largest audit firms are invited to tender twice as often as smaller firms, in fact the CC's Survey shows that almost a third of tenders include at least one mid-tier or smaller firm.²²
- (ii) This demonstrates that mid-tier and smaller firms fail to win FTSE 350 audit engagements not because they are not invited to tender (or for any other reason)

¹⁸ See our response to the Switching Costs WP for more details. The CC's case studies generally refer to costs being substantial but also note that companies would still be willing to change audit firm if dissatisfied with their current auditor - for example, the ACC of Company A said "[i]f the auditors did poor quality work, then the Audit Committee would change them. The ACC thought that changing auditor was risky, especially in the first year of appointment where the auditor had to familiarize itself with the business and management" (paragraph 76).

¹⁹ This is supported by the CC's case studies - for example, Company C's CFO said that "[t]he largest costs of switching were time and disruption. The selection process itself was somewhat onerous and time consuming but the real issue was educating the new audit team" (paragraph 29). See also paragraph 5.36 of our Initial Submission and our MFQ Response, question 39 (in particular, paragraphs 39.5 - 39.9). As explained in our Initial Submission, the audit firm will invest in the early years of a new audit appointment to ensure appropriate quality is provided - this is likely to be through increased hours spent on the audit, especially in the first year. The CC's Switching Costs WP notes the evidence on this.

²⁰ See our response to the Switching Costs WP.

²¹ At paragraphs 162-164.

²² Slide 54 of the CC's Survey shows that 30% of FTSE 350 tenders in the last five years included at least one audit firm from outside the four largest firms.

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but because they lack the attributes to undertake large and complex audits and have failed to invest in developing these attributes and building client relationships.

- 4 It may be that the reason the Selection Process WP reaches initial indications that we do not recognise or accept is because of the limited evidence to which the CC has had regard in producing it. The CC states that it has limited the material included in the Selection Process WP to certain responses to the Market and Financial Questionnaires (MFQ) and tender data - specifically excluding the evidence from the CC's Survey and the case studies, and apparently other evidence we have submitted, including our Initial Submission and exhibits.²³ This approach - as opposed to considering the totality of the evidence collected by the CC to date - fundamentally undermines the initial conclusions reached in the Selection Process WP:
- (a) Contrary to the stated position in the Selection Process WP, the CC in fact refers to other evidence from time to time, but this appears to have been done on a selective and inconsistent basis. We believe that the Selection Process WP would reach different conclusions if it included all of the relevant evidence presented to and collected by the CC. We highlight in the Annex particular examples of evidence that we believe should be considered in this respect.
 - (b) As regards the evidence the CC has relied upon, there are significant problems concerning the completeness and accuracy of the tender data. Although the CC acknowledges the problems with the tender data at various points throughout the Selection Process WP,²⁴ the CC uses the results of its tender analysis in its key initial indications in paragraph 2 without any such warning. This is unacceptable given the significant problems with the data.

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²³ Paragraph 10.

²⁴ For instance, at paragraphs 16 and 90.

ANNEX

In this section we set out our main concerns regarding the Selection Process WP. In particular, we have a number of concerns about the selective use of evidence and findings which are at odds with the extensive evidence that we have submitted to the CC and other material such as the CC's Survey. The main headings below reflect those in the Selection Process WP.

1 Sources and data

Limitations of the sources used by the CC

- 1.1 The CC says that the content of the Selection Process WP: (i) is essentially confined to the responses to certain of the MFQs and tender documents submitted by the audit firms (see paragraphs 3 and 9); and (ii) does not cover evidence from the CC's Survey and the case studies (paragraph 10). As a matter of principle we do not consider it appropriate to limit the scope of the evidence considered in the Selection Process WP.
- 1.2 Indeed, in practice, we note that: (i) information relating to PwC is often taken from our Initial Submission as opposed to our MFQ Response of 24 February 2012 (our **MFQ Response**) (e.g. see section 5 below which identifies several examples); and (ii) in various places the CC does actually cross-refer to its Survey Results WP or case studies (and also uses the public database).²⁵ Both the case studies and the CC's Survey questioned companies extensively on their views on and experience of auditor selection, and the fact that many of the initial views in the Selection Process WP are undermined by that evidence (as explained further below) only emphasises the necessity of considering the full range of evidence in drawing any initial views.
- 1.3 We do not understand why the CC has not drawn more heavily on all the relevant and important sources of evidence. This undermines the validity of the initial indications set out in the Selection Process WP. At the very least, the approach taken by the CC means that caution must be exercised when interpreting the content of the Selection Process WP - and the CC should add an appropriate warning to its key initial indications in paragraph 2.

Limitations of the tender data

- 1.4 At various points in the Selection Process WP the CC acknowledges the incompleteness and related limitations of the tender data it has collected and, indeed, states that: (i) it has therefore been cautious in interpreting or placing reliance on the results of its analysis of this material²⁶; and (ii) there is certain analysis it would like to have undertaken, but could not do so because of these limitations²⁷.

²⁵ Footnotes 37, 43, 44, 45, 47, 48, 55, 56 and 60 of the published version of the Paper all cross-refer to the CC's Survey or Survey Results WP. Footnote 45 also refers to the case studies section of the CC's website. The published database is also used by the CC for switching analysis - see paragraph 180 and Tables 10 - 18.

²⁶ For instance, the CC states: (i) at paragraph 16 that, due to the data set limitations, it has used the statistics from the data as market trend indications rather than definitive results; and (ii) at paragraph 90, that the incompleteness of the data set makes the CC cautious in interpreting the results reported in that section.

²⁷ For instance, at paragraph 130 the CC states that it could not study the relationship between the value of non-audit services supplied and success in winning a tender due to lack of data.

- 1.5 The flaws in the tender data are often significant - e.g. paragraph 95 notes that the CC has only 50 winners for 69 FTSE 350 audit tenders and in 23 instances only one firm submitted information. However, in the CC's key initial indications in paragraph 2 the CC refers to the results of its tender data analysis without any mention of the data limitations and need for caution, and there are other places in the Selection Process WP where tender data is used without highlighting the deficiencies, or where this is only mentioned in a footnote.²⁸ The CC should be clear about the problems with this data wherever it is relied on.
- 1.6 In addition to this overarching concern, we also have the following more specific concerns:
- (a) Tables 16, 17 and 18 show percentage change of audit fee after switching segmented in various ways. However, these tables do not include any classification or analysis by reason for the switch. This is of critical importance in any analysis of changes in fees following switching as, for example, there will likely be significant audit scope changes after a switch that was the result of company M&A. Particular caution is needed regarding the data in Table 18 given the acknowledged small sample size and that it is possible that some of these fee changes reflect client-specific matters impacting audit scope and hence fees. We are also not clear how the CC has calculated -83% as the fee change for switching auditor from one of the four largest firms to a smaller firm.
 - (b) We also reiterate the concerns we have previously expressed about how our putback response regarding the factual accuracy of certain of the tender data has been incorporated into the Selection Process WP.²⁹ It defeats the purpose of asking for amendments for factual accuracy if, once these are acknowledged, the amendments are not made. [X] We note that the CC will rectify such errors in the statistics prior to publishing its provisional findings. However, it is frustrating that parties are being asked to comment on data in a document that the CC knows is inaccurate and could have been rectified prior to publication. [X]
 - (c) Finally, without access to the CC's tender list we cannot verify the accuracy of various results - e.g. in paragraph 125 the CC states that there are ten occasions when the existing audit firm has won the tender, whereas we have identified only nine such occasions.

2 Obtaining new clients outside the formal tender process

- 2.1 We agree with the CC's finding (paragraph 2(a)) that it is relatively rare for an auditor to win an audit engagement except through a competitive tender process. However, in reaching this conclusion and focussing specifically on the tender process, we believe the CC has overlooked competitive pressure outside of tenders, including the continuous pressure on audit firms to provide high quality and value for money throughout the audit engagement. The CC's key initial views in paragraph 2 do not mention competition outside of tenders and the main body of the Selection Process WP covers this briefly in just a few paragraphs (paragraphs 18-25). However, competitive pressure outside of tenders is key to informing annual renegotiations and

²⁸ See, for instance, footnotes 40 and 42.

triggering future tenders and is a fundamental element of our competitive activity. For this reason the selection process as a whole should not be evaluated without considering thoroughly the important role of competition outside of tenders.

- 2.2 In particular, the Selection Process WP notes in paragraph 18 that the largest four firms all have strategies to approach FTSE 350 companies outside of tender processes - a significant distinction when compared to the lack of any such strategy on the part of other audit firms.
- 2.3 It is striking that mid-tier and smaller audit firms do not maintain contact with companies outside of tenders and have less (or no) advance knowledge of tenders. In this respect, we note that in paragraph 35 the CC states that audit firms other than the existing auditor generally seem to have advance knowledge of plans to tender before an official announcement if they know the company well and have a strong relationship with them. In paragraph 36 the CC says that thanks to our continuous work targeting new clients, PwC is almost always aware of impending audit tenders and BDO, Deloitte and Ernst & Young often have advance knowledge where they know the FTSE 350 company well and have a strong relationship with them. In contrast, Grant Thornton only has advance knowledge of tenders if it is the existing auditor and Mazars said it never had advance knowledge.³⁰
- 2.4 It is open to all firms to develop strong relationships with potential audit clients, and the failure of smaller firms to invest in doing so is indicative of the wider failings of mid-tier and smaller firms to develop the necessary attributes to be capable of providing high quality audits to FTSE 350 companies. Mid-tier firms say that want to win more FTSE 350 audits and claim to have the attributes to do so, yet this seems to be contradicted by their failure to take obvious steps to demonstrate this to large companies and improve their chances of winning tenders.
- 2.5 Our experience is that the existence of an ongoing dialogue between a company and alternative auditors leads to pressure on fees and the increased possibility of a tender process. We believe the CC rather understates the position in this regard in paragraphs 2(e) and 22 - in our experience attempts by rival audit firms outside of tenders to win our clients' audits are constant (and we have provided the CC with numerous examples)³¹ and are commonly used by companies to reduce audit fees.³² Indeed, the CC's Survey shows that 78% of FTSE 350 companies have informal contact with other auditors outside a tender process every year.³³ These approaches mean that companies are well-armed to challenge their audit firm's fee and/or threaten a tender, ensuring the existing auditor faces constant competitive pressure.
- 2.6 A specific method of approaching a company outside of a tender could be through a "cold" or unsolicited bid. While the CC is correct to note in paragraphs 23-25 that such approaches generally have little chance of bringing an appointment by themselves, they can have a competitive effect and form part of the ongoing dialogue described above.

²⁹

[redacted]

³⁰

Paragraph 39.

³¹See paragraphs 4.41 - 4.43 of our Initial Submission - for example, [redacted] reported "*offers from other Big 4 - he said at least two of them - to do the audit for half our current fee*".³²

As confirmed by Mazars, see paragraph 171 of the Paper.

³³

Slide 46 of the CC's Survey.

- 2.7 This continuous pressure to perform is why we spend so much time and resource on client feedback programmes - such as Independent Senior Partner Reviews, Client Perspective Reports, Client Satisfaction Surveys, Post Decision Reviews and the Audit Relationship Risk Diagnostic³⁴ - to identify how we can improve our offering to clients and head off risks that would otherwise cause our clients to switch audit firm. We would not invest so heavily in these processes unless we felt it was necessary in order to meet the competitive pressure in the market.

3 Tenders

Frequency

- 3.1 In paragraph 2(b) the CC states that tenders are “infrequent” with “only” 4% of FTSE 350 companies tendering their audit each year. Although the main body of the Selection Process WP sets out data on the number of tenders and length of audit tenure (at paragraphs 90-98 and 180-192) there is little or no analysis of this material - in particular, the only specific reference in the Selection Process WP to tenders being “infrequent” is in the CC’s key initial indications in paragraph 2(b).
- 3.2 We disagree with any suggestion that tenders are too “infrequent”:
- (a) The CC asserts that this is the case without providing any supporting evidence. This appears to be a subjective view based only on some sort of “common sense” perception that the observed average number of years between tenders is somehow too large. However, the context is critical here: it would be highly inefficient for a company to tender its audit every year and so it is not clear what the CC would consider to constitute “moderate” or “frequent” tendering in this market.
 - (b) Tenders are as frequent as companies want them to be. Where companies are satisfied with the quality and value for money provided by their auditor (and the ACCs and FDs are comfortable that they are meeting their governance requirements) it would be illogical for them to go out to tender, given the costs involved, including the loss of knowledge and continuity and the resulting greater audit risk for the company in the initial years after switching while any new auditor “gets up to speed”.³⁵ Indeed, the CC’s Survey indicates that 70% of companies which had not tendered in the last five years said that this because the quality of service was good and/or the audit fee was competitive and/or they were “happy as things are”.³⁶ Indeed the sum total of the positive unprompted responses

³⁴ See paragraphs 2.67, 4.44 - 4.48 and 6.59 - 6.62 of our Initial Submission for further detail.

³⁵ The case studies support this - see, for example, Company A where the ACC said “if it ain’t broke you don’t have to fix it” and the ACC thought “having a top firm doing top-quality work and using the auditor effectiveness review properly was ... better ... than changing auditor for the sake of changing” (paragraph 67); and Company B where the “FD considered that it did take time for an auditor to get to know the business and that it made sense not to switch auditor too frequently” (paragraph 20).

³⁶ Note to slide 60 of the CC’s Survey.

for not having tendered the audit cited in this slide in the CC survey comes to 133%, as compared with a sum total of 29% negative unprompted reasons.³⁷

- (c) Greater numbers of tenders would indicate market failure as this would demonstrate greater dissatisfaction with audit firms. Nonetheless, there is a sufficient level of switching for companies to demonstrate the threat of tendering is real and credible.³⁸ This allows companies to exert competitive pressure on their auditors, and the fact that existing auditors have a poor win rate in tenders³⁹ means that audit firms must continuously perform to head off the risk of a tender.
- (d) Companies do not need to resort to actual tenders to improve their audit provider's offering, because they can use the ever present threat of tenders to obtain lower audit fees and ensure quality is maintained. We note that all audit firms (both the four largest and the mid-tier) have experience of clients explicitly threatening tenders, with Deloitte and KPMG reporting that in their experience such threats are "*increasingly common*" (paragraph 165) and "*common*" (paragraph 166) respectively. Even if the threat is unspoken, we know that it exists and provide a service that we hope will head off any tender.
- (e) To the extent that intense competition outside of tenders, and consequent company satisfaction with their current audit suppliers, reduces the average frequency of large company audit tenders, this also means that (as the CC acknowledges) audit firms compete fiercely to win those tenders that are held.⁴⁰

Participation of mid-tier and smaller firms

3.3 At paragraph 2(c) of its key initial indications the CC notes that the four largest audit firms are more likely to be invited to tender than other firms, and are invited twice as often as other firms. We agree that the four largest firms are more likely to be invited to tender, but would stress that:

- (a) This is because they have the necessary attributes to carry out large and complex audits whereas this is not always the case for mid-tier and smaller firms (by their own admission). However, as demonstrated by the CC's Survey, 30% of FTSE 350 tenders involve at least one smaller firm, so such firms do participate in a significant proportion of tenders.⁴¹
- (b) More informative than tender participation is how successful the mid-tier firms are in the significant number of tenders in which they do participate. The CC's Survey indicates that the four largest firms win significant proportions of audits from the mid-tier both within

³⁷ See our responses to the Survey WP and the Nature and Strength of Competition WP for further discussion of the CC's misrepresentation of the statistics in slide 60.

³⁸ See for example the Company G case study where "[t]he ACC said PwC knew only too well that the company could tender and so there was a dynamic mutually respectful relationship" (paragraph 75).

³⁹ Winning only 20%, as confirmed in paragraph 125 (we note this figure is 21% in paragraph 49 of the Survey WP).

⁴⁰ See paragraphs 5.42 and 5.43 of our Initial Submission for a summary of the considerable lengths that PwC goes to in attempting to win tenders, and paragraphs 162 - 164 of the Nature and Strength of Competition WP on the CC's view that audit firms compete aggressively when tender opportunities arise.

⁴¹ See slide 54 of the CC's Survey.

and outside the FTSE 350.⁴² This is because all of the four largest audit firms can demonstrate the experience, expertise, international network, sector and other specialisms and consistent methodology to a greater extent than the mid-tier firms. Even where the mid-tier firms might have the attributes to provide a competent audit service, it is entirely rational for a large company to select a firm with greater attributes and which objectively is able to offer a better value for money offering.

- 3.4 The Selection Process WP refers to a tender in which Grant Thornton were invited to participate but declined because, given the specific circumstances, they considered that the probability of winning was low (paragraph 57(c)). The Selection Process WP does not expand on Grant Thornton's reasons for this view, but even if Grant Thornton were accepting that they were not capable of undertaking the audit, the potential client must have thought that they were potentially capable otherwise they would not have invited Grant Thornton to tender. At the very least this was an opportunity to spend time with senior personnel from that company and to begin developing a relationship, even if Grant Thornton were unlikely to win the audit engagement on this occasion. It is therefore surprising that they refused this opportunity - not least because refusing to participate in a tender (unless there is a good reason and the company agrees) is likely seriously to harm the relationship with the company and jeopardise any and all future work with them.⁴³

Tender costs to audit firms

- 3.5 The CC covers tender costs mainly at paragraphs 2(d) and 99-117 and: (i) emphasises that the costs to audit firms of tender participation are usually high; (ii) queries whether they are so high as to discourage entry; and (iii) indicates that tender preparation takes one to three months and requires a considerable amount of senior staff involvement. We note that firms have provided tender costs data with different degrees of accuracy, which makes it difficult for the CC to draw any firm conclusions on tender costs.⁴⁴
- 3.6 The CC also acknowledges, in paragraph 2(d), that tender costs are driven by the tendering company's needs, including the scale and complexity of the required audit. We agree with this; investment is needed by the audit firm to understand the target company and assess its audit risks (paragraphs 47-52 of the Selection Process WP are indicative of the detailed and extensive information generally required in tender proposals). As far as we are aware the CC has not identified any evidence of tender costs discouraging audit firms from responding to tenders - indeed, as mentioned above, our view is that in practice the contrary is true and at the current frequency of tendering firms respond very enthusiastically to tender opportunities when they arise.

⁴² Within the FTSE 350, the mid-tier won no audits from the four largest firms, and lost over 80% where they were the existing auditor in competition with the four largest firms (see slide 62 of the CC's Survey).

⁴³ [redacted]

⁴⁴ A related point is that we note that Table 5, which contains (redacted) statistics for each firm's staff costs of preparing tenders does not include KPMG and Ernst & Young, but it is not stated why. Footnote 39 states that KPMG and Ernst & Young did not provide data divided by staff grade, but it is unclear whether this is the reason for their exclusion from Table 5 given that the statistics in the table do not appear to be segmented by grade.

Tender proposals

- 3.7 The CC states that the tender proposals prepared by the four largest firms and smaller firms are similar, with proposals professionally presented and containing common features and detailed discussions (e.g. see paragraphs 63 and 64). However, the CC then in fact goes on to identify several important differences between tender proposals from the four largest firms and from others:
- (a) Risk assessments: the CC states that the risk assessments of smaller firms “*tended to be less detailed*” than those of the four largest firms (paragraph 72). In particular, the largest four firms would go on to analyse the likelihood of risks materialising as well as simply identifying them. Given that risk assessment is a key part of a high quality audit, this is a significant potential omission on the part of smaller firms. Mid-tier firms cannot realistically audit large and complex companies if they are unable adequately to assess their audit risks.
 - (b) Transition plans: The transition from the existing audit firm to the replacement new audit firm and the new auditor getting up to speed is a real and significant concern for a company that changes auditor, given the potential costs involved. The CC states that the four largest firms “*tended to have more detailed transition plans, and [...] point to a broader range of experience*” whereas mid-tier firms refer to “*fewer and less prestigious clients*” (paragraph 78). Regardless of the quality of their client examples, the less detailed transition plans of mid-tier firms indicate that they: (i) lack the expertise to achieve an effective transition; and (ii) cannot address one of the potential client’s main concerns.
- 3.8 The lack of expertise of mid-tier firms in assessing risk and achieving a smooth transition may well be significant factors in mid-tier firms failing to win audit tenders.
- 3.9 Related to this we note the CC’s finding that mid-tier firms generally spend fewer hours than the four largest firms in preparing for tenders (paragraph 109). This may be indicative of smaller firms not knowing what it takes to win a tender (e.g. investing less time in their risk assessments and transition plans) or having fewer resources available, or otherwise making a conscious decision to limit their investment in responding to tenders which they doubt they are capable of winning, but again it is likely to have an effect on their prospects of success in the process.
- 3.10 In any case it is self evident from their lack of success in tenders for FTSE 350 audits that, however similar their tender proposals may appear to the CC on superficial factors such as features covered and the professionalism of presentation, the underlying service offerings of the mid-tier firms that their proposals represent are not as attractive to FTSE 350 companies as those represented in the proposal documents of the four largest audit firms.
- 3.11 Finally, in paragraph 74 the CC states that firms do not give particular weight to the role of innovation in their tender documents and innovation in IT services is mentioned in only a small number of tenders. We disagree - we believe that innovation is a very important aspect of tender proposals, although the companies’ focus in practice is likely to be on the benefits achieved as a result of the innovation, rather than the innovation itself. In a market with

sophisticated and knowledgeable buyers, as is the case with FTSE 350 companies, innovation is frequently not explicitly labelled as such. Our views on this issue are explained more fully in our response to the Nature and Strength of Competition WP.

Fee proposals

- 3.12 Paragraph 67 of the Selection Process WP highlights that there are a variety of different approaches to the presentation of fees in tender proposals. We do not believe that any significance should be placed on this. Tender proposals generally provide pricing information in the format and level of detail requested by the company (and, as mentioned in paragraph 47, this can vary). Moreover, whatever is requested and provided, companies are able to compare the fees proposed by the different tender parties (and could and do request further breakdowns if they are not able to undertake a sufficient comparison).
- 3.13 The CC estimates that in roughly 50% of cases the audit firm which wins a tender is not the firm that bid the lowest fee, suggesting that the fee is not decisive in auditor selection (paragraph 126). This is logical - a company cannot appoint an audit firm unless satisfied that it has the necessary attributes to carry out the required audit - and so the firm offering the lowest fee may lose on that basis. Indeed, our experience is that companies typically select auditors based on whether they have the necessary attributes to provide a high quality audit and then negotiate on fees (so, while value for money is important and fees are vigorously negotiated, fees are generally not the most decisive factor for many companies). An audit firm offering the lowest fee will often know it is not competitive on quality attributes and the low fee will reflect its only chance of selection.
- 3.14 This is supported by the CC's case studies. For instance, the FD of Company F commented that "[w]hen considering the fees proposed during the tender, the company focused on value for money, ie what seniority of staff it was receiving for the hours charged... 'there was no point in getting a cheap fee and junior audit experience'" (paragraph 29); and Company H noted that in fact "if there was one very low bid in a tender it would be questionable whether the bid was properly priced" (paragraph 79).
- 3.15 However, as explained below, fees are an important concern for companies at all times, not just during tenders, and therefore there is constant pressure on fees. Indeed, the CC's Survey Results WP indicates that a substantial increase in the audit fee would be one of the most likely triggers for a change of auditor.⁴⁵

Position of existing auditor

- 3.16 Given that companies generally switch audit provider when dissatisfied with their current auditor, the current auditor tends not to retain an audit engagement which is put out to tender. Indeed, the Selection Process WP states that:
- (a) Only 20% of tenders are won by the current auditor (paragraph 125). We would expect that many of these wins are in tenders triggered by governance issues (i.e. cases where

⁴⁵ Survey Results WP, paragraph 56.

the company does not have any issues with the service it is receiving from its current auditor, but nevertheless wants to demonstrate publicly by conducting a formal tender that it has chosen the best firm) rather than where companies go out to tender because they are dissatisfied with their existing auditor.

- (b) Current auditors that participate in tenders usually offer a significant fee reduction, and an explanation of how they will address the issues that led to the tender (paragraph 70).

3.17 The relatively low prospects of success for current auditors in tenders mean that there is significant pressure on audit firms to ensure that companies remain satisfied with their offering at all times to minimise the possibility that they will decide to tender. This pressure is all the greater given that:

- (a) the constant “churn” of FTSE 350 membership means that companies must win new clients (as well as retaining existing clients) just to maintain their market share and particularly to increase it;⁴⁶
- (b) audit firms therefore target each other’s clients;⁴⁷ and
- (c) companies know that rival audit providers are credible⁴⁸, and that they are willing and available to undertake their audit at competitive fees.

These factors are all part of the ongoing competitive dynamic that we have described above, which feeds into the selection process overall.

4 Annual reappointments and switching

4.1 In paragraph 138 of the Selection Process WP, the CC states that the annual renegotiation process consists mainly of discussing the scope of work and fees. While these are clearly key aspects of any negotiation, we believe the CC has overlooked the importance of quality assessment in the annual reappointment process:

- (a) As confirmed by the CC’s Survey, the vast majority of FTSE 350 companies - 91% - carry out a post-audit quality and value review annually, either internally or with their auditor.⁴⁹ Indeed, the UK Corporate Governance Code (the Combined Code) requires companies to consider the effectiveness of their auditors, and our experience is that company

⁴⁶ See paragraphs 4.4 - 4.14, including Figures 4 - 7, of our Initial Submission for further explanation of this issue.

⁴⁷ As confirmed by CC’s Survey, slide 46, which notes that 78% of FTSE 350 companies are approached every year by firms which are rivals to their current auditors and 88% in the last two to three years. See also our MFQ Response, question 97 and paragraphs 4.41 - 4.43 of our Initial Submission.

⁴⁸ See, for example, case study Company G: “*The GFC had not undertaken a formal assessment of other auditors. However, he was clear on their capabilities ... any future tender would be likely to include the Big 4 audit firms, as they had the capabilities and global footprint to undertake the work*” (paragraph 25).

⁴⁹ Survey Results WP, paragraph 38 and Table 12.

officers take their governance requirements seriously.⁵⁰ This process was well described by a number of ACCs in the CC's case studies.⁵¹

- (b) Further, as acknowledged elsewhere by the CC, ACCs and FDs are “*experienced and knowledgeable purchasers*” of audit services.⁵² This enables them to form an informed judgement about “*what good looks like*” in the context of the quality of audit service provision, and whether they are receiving it from their auditor.⁵³
- (c) We take this scrutiny of audit quality very seriously, and, as referred to above, have invested considerable time and effort in developing a range of client feedback programmes (including Independent Senior Partner Reviews, Client Perspective Reports, Client Satisfaction Surveys, Post Decision Reviews and the Audit Relationship Risk Diagnostic) to allow us to monitor the quality of service we are providing, identify any issues and improve where necessary.⁵⁴

4.2 These factors combine to provide a focus on quality which is part of the company's overall process, overseen by its audit committee, of deciding to reappoint an auditor. Fee negotiation is obviously an important aspect of any negotiation, but in our experience the focus is on both quality and fees - with companies requiring a good level of quality at a competitive fee - and so the aspects of the negotiation related to fees should not be considered in isolation.

Degree of challenge to fees

4.3 At various places in the Selection Process WP the CC downplays the extent to which companies challenge audit fees. In particular:

- (a) The CC states in its key initial indications (at paragraph 2(e)) that “[*a*]nual reappointments are typically a standardized process in which companies may or may not challenge” the scope and fee for the following year's audit and during annual reappointments companies only “*usually discuss the scope of the audit and fee level*”.
- (b) Similarly, in paragraph 172, the CC adds that, based on its analysis of annual renegotiation documents, it appears that the approach taken to renegotiations varies significantly and that “*in some circumstances fees were challenged yearly, while in others, [...] companies accepted price rises without challenge. Generally [...] where companies exert significant pressure upon the firm regarding the fee, they often secured reductions*”.

⁵⁰ This is explained in more detail, together with actual examples of audit effectiveness reviews, in our MFQ Response, question 84.

⁵¹ See, for example, the case studies: Company C carries out “*a formal questionnaire completed by members of the Audit Committee, the Chief Auditor, General Counsel and regional senior management*” (paragraph 25); Company G send a “*thorough questionnaire... each year to around 40 or 50 people around the company who had the main contact with the auditors*” (17-18); and Company H produces a “*full written report on the auditors every year*” (paragraph 30)

⁵² Nature and Strength of Competition WP, paragraph 75.

⁵³ See the comments of the FD in the case study on Company E, paragraph 21.

⁵⁴ See paragraphs 2.67, 4.44 - 4.48 and 6.59 - 6.62 of our Initial Submission for further detail on our client feedback programmes.

- 4.4 In our experience it is extremely rare for companies not to challenge fees and so we strongly object to the CC's downplaying of the importance of the annual renegotiation of fees. Moreover:
- (a) The CC's Survey shows that 93% of FTSE 350 companies negotiate the audit fee every year⁵⁵ and this therefore undermines any suggestion to the contrary in the Selection Process WP, and demonstrates a material failing of the CC in not using the totality of the evidence to produce the Selection Process WP.
 - (b) There are numerous places in the Selection Process WP where the CC indicates that fees are subject to negotiation and challenge by companies or the CC otherwise refers to evidence provided by audit firms supporting this position. For instance:
 - (i) At paragraph 141, regarding the renegotiation process:

"... approval of the planned scope of the audit and the proposed fee was requested from the Audit Committee. The Audit Committee then reviewed, challenged and approved the proposed fees. Depending on the circumstances, the fee might need to be revised before final approval of the Audit Committee" (emphasis added).
 - (ii) Similarly, at paragraph 145:

"On the company-side, typically the Financial Controller and Finance Director conduct the detailed fee negotiations. ... Finance Directors for regions or business lines may also be involved. Other parties involved in the negotiation are the Group Financial Controller and their financial team, who are involved in the fee negotiation for the head office and the overall group fee; the Audit Committee, which oversees the fee negotiation and approval process for the overall group audit fee; and the Chief Financial Officer, who makes recommendation to the Audit Committee" (emphasis added).
 - (iii) At paragraph 147:

"PwC, KPMG, EY, Deloitte, BDO, GT, PKF and Mazars stated that the audit fee was the most frequent element involved in renegotiations of an audit assignment. When renegotiating audit fees, several factors were taken into account..." (emphasis added).
 - (iv) At paragraph 158:

"Firms stated that companies were sophisticated purchasers that exerted considerable competitive pressure during annual renegotiations..." (emphasis added).
 - (v) At paragraph 166:

⁵⁵ Table 12 in the Survey Results WP.

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“KPMG said that the threat to change auditors was common when renegotiating audit fees and provided 27 examples of FTSE 350 companies and five examples of Top Track 100 companies that did this...” (emphasis added).

- (c) The following extracts from this evidence (provided as exhibits to Q87 of our MFQ Response) illustrate the pressure exerted by companies over price increases:
- (i) [X]: *“There is an expectation from group management and the audit committee that the audit fee should not increase except where there are changes in scope leading to additional work....To achieve this, PwC UK has asked global teams to ensure that productivity savings are achieved each year to reduce the impact of any local inflationary increases.”*
 - (ii) [X]: *“Over the course of fee negotiations, “PwC was informed that the CEO had written to [X] asking them to make themselves independent in order to make a tender possible.”*
 - (iii) [X]: *“In this year [2009], there was significant challenge on group audit fees before and after the February audit committee. The chairman of [X] stated that he was unwilling to accept the £[X] increase in fees arising from a deterioration in the £/€ exchange rate. As a result, we commenced a two-year project to ascertain where additional efficiencies in the audit process may exist. This resulted in some fees for scope changes being reduced; some fees being delayed into the following year; [X] and agreement that our proposed £[X] inflationary increase would be waived.”*
 - (iv) [X]: *“As part of the 2011 process, management benchmarked the overall group fee as a proportion of revenue, profit and employee numbers against published 2010 data for their competitors, [X] and [X] in order to satisfy themselves that the PwC rates were competitive and that [X] continues to receive a fair fee. The results demonstrate that the proposed fee was significantly below the other groups.”*
- (d) The same point was made clearly in extracts from our client feedback provided in our Initial Submission:
- (i) [X]: *“We think you’re great ... but where we’re likely to fall out is over the fee.”⁵⁶*
 - (ii) [X]: *“We do watch it pretty closely; what we’re paying for.”⁵⁷*
 - (iii) [X]: *“The global fee has substantially improved the relationship so we are not at loggerheads the whole time about value for money”.⁵⁸*

⁵⁶ See Exhibit 6: [X]
⁵⁷ See Exhibit 30: [X]
⁵⁸ See Exhibit 9: [X]

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- (iv) [X]: *“Management were extremely challenging, particularly around fee... overriding concern was that he did not want fees to interfere with the quality of what was delivered and believed that ultimately the balance had been maintained.”*⁵⁹
- (v) [X]: *“Aim was to ensure we get paid a full, fair fee to encourage our top people to be motivated to do a great job on [X] - but not a ‘fat fee’ which takes advantage of the relationship.”*⁶⁰
- (vi) [X]: *“Commercial discussion on fees every year. Company doesn’t take unreasonable stance and PwC is seen as going out of its way to innovate in relation to approach. Value is therefore not seen as an issue.”*⁶¹
- (vii) [X]: *“We’re expected by our customers to reduce our costs every year ... so then really, really, really we ought to expect that of our suppliers.”*⁶²

4.5 This information is therefore clearly at odds with any suggestion that fees “*may not*” be challenged. The reality is that, other than in exceptional circumstances, large companies negotiate the audit fee each year, and regularly subject the fee to serious challenge.

Inflationary fee increases

4.6 At various places in the Selection Process WP the CC also states that inflationary increases in fees are common. In particular:

- (a) Regarding tender proposals the CC states, in paragraph 67, that fixed fees are “*normally*” subject to changes in inflation and “*always*” subject to changes in inflation.⁶³
- (b) At paragraph 150, “[i]nflationary increases have typically been in the range of 3 to 5 per cent a year, but have been as high as around 10 per cent for audits carried out in other countries”.
- (c) At paragraph 151, the CC asserts that “[w]hile inflationary increases are applied in the vast majority of cases, it appears that they are rarely discussed at significant length or challenged” - but when they are challenged they are sometimes waived as a result of broad pressure to decrease the price.

4.7 This is not our experience at all. Inflation-related fee increases are requested in order to reflect in prices the inflationary increases that we experience in our own costs - given the competition in the market for talented individuals and the need for audit firms to reward talent or risk losing it. However, as we have previously explained:

⁵⁹ See Exhibit 116: [X]

⁶⁰ See Exhibit 44: [X]

⁶¹ See Exhibit 117: [X]

⁶² See Exhibit 7: [X]

⁶³ In any event, we note that fees stated in tender proposals are not necessarily the fees applied in future years, given that it is rare for companies not to challenge fees in the annual renegotiation.

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- (a) We typically negotiate with clients annually in an attempt to agree an inflationary increase in our fees, but our success in doing this varies by client.⁶⁴
- (b) When conducting a “bottom up” annual fee negotiation, inflation for the UK is generally negotiated centrally with the group FD (whereas overseas audit teams agree inflation in their territories). This process of negotiation takes on average three months⁶⁵ - which in the context of an annual negotiation is not a short period. Companies can also involve their specialist procurement teams in the negotiation - e.g. the Company G case study confirmed that as well as its Group Financial Controller and one of the managers in his/her team, a member of the company’s procurement and strategic sourcing team is involved in the fee negotiation.⁶⁶
- (c) A regular feature of fee negotiations are “efficiency” and price reduction factors. Large companies frequently require their audit firm to achieve efficiencies each year - e.g. in our proposal to [redacted] we noted that: *“We, like you, also find ourselves in a highly competitive marketplace, and hence have to aim for year on year efficiencies as we cannot easily pass on our cost inflation”*.⁶⁷
- (d) While inflation is to some extent a known benchmark, meaning that not a lot of analysis is necessary, this does not mean that companies simply accept inflationary increases. This is demonstrated in the examples we submitted in our MFQ Response, Q87 - for instance, in the case of [redacted] we reported that *“No general inflationary increases have been passed onto [redacted] through price increases since 2008”*.⁶⁸
- (e) [redacted] We have provided the CC with numerous examples of clients putting pressure on our audit fees and of clients pushing down fees in negotiation.⁶⁹ Indeed, analysis that was included in our Initial Submission shows that there is no relationship between the profitability of our FTSE 350 audit engagements and the length or tenure of these engagements, demonstrating that companies that do not switch are just as able to negotiate competitively scoped and priced audit as those that do.⁷⁰ This conclusion is also supported by the CC’s data showing that the overall audit fee / hour has declined significantly in recent years, given that only around 4% of FTSE 350 companies will have switched in any particular year.⁷¹

⁶⁴ See further paragraph 86.2(e) of our MFQ Response, question 86 and paragraph 5.18 of our Initial Submission.

⁶⁵ Paragraph 88.3(e) of our MFQ Response, question 88.

⁶⁶ Paragraph 106 of Company G case study.

⁶⁷ Paragraph 5.21 of our Initial Submission. Further examples of this are provided by the CC’s case studies - the Company E case study states that *“[t]he FD looked to counter fee increases by identifying efficiencies and being tough on inflation”* (paragraph 29); and Company G *“was able to negotiate by trading off inflationary increases (such as wage bill increases) against audit process efficiencies”* (paragraph 32).

⁶⁸ Page 3 of our MFQ Response to Q87. See also [redacted] *“we have been challenged on the rate of inflation included in the UK”* (page 4) and [redacted]: *“the final fee was £[redacted] following a further challenge from [redacted] management in relation to the inflationary increase”* (page 6).

⁶⁹ Paragraphs 6.4 - 6.9, including Figure 10, of our Initial Submission.

⁷⁰ See our Initial Submission, figure 11, which plots our audit profitability (in terms of our internal CPy measure) against audit tenure - there is no indication that shorter tenure clients are more or less profitable than longer tenure clients (i.e. those who have not recently switched).

⁷¹ See Chart 9 and paragraph 35 of the Descriptive Statistics WP, showing that while audit hours have remained broadly static, nominal audit fees have declined by 15% in the last five years (implying an even higher decline in real terms).

- 4.8 As this evidence makes clear, our experience shows that clients put considerable pressure on audit fees to which we need to respond, and we have faced considerable difficulty in achieving even inflationary price increases. Thus, we strongly disagree with any suggestion that inflationary increases are usually approved with little or no discussion or challenge.
- 4.9 We are concerned that the CC misunderstands the importance of fee negotiations (both in general and regarding inflationary increases) because of difficulties with the information it has gathered, as noted in paragraph 137 - in particular a significant degree of variation in the quantity and quality of the information that the CC received and difficulties with discussions taking place either in person or by phone of which there are no records. We would urge the CC to reconsider whether it is appropriate to reach findings based on such incomplete information, particularly where there are other information sources available which the CC has not included in the Selection Process WP. Indeed, we provided material in this regard in our response to the MFQ, question 87 (as described above) but it appears that that evidence has not been used by the CC in the Selection Process WP.

Benchmarking

- 4.10 The CC notes that the documentary evidence indicates that benchmarking is used to inform renegotiations in roughly a quarter of cases (paragraph 148). However:
- (a) While the CC's Survey indicates that 25% of FTSE 350 companies formally benchmark every year, it also shows that two-thirds of companies have carried out formal benchmarking or other formal comparisons at least every five years.⁷²
 - (b) However, formal benchmarking exercises are far from being the only - or even the best - source of information available to ACCs and FDs for comparing audit firm performance. The CC's case studies often refer to the use of benchmarking by the companies concerned which apparently give considerable insights to these companies⁷³ - but these exercises would not necessarily have been considered "formal benchmarking" in response to the question in the CC survey.
 - (c) Companies have many other sources of knowledge about the other options in the market.⁷⁴ The CC recognises some of these in the Selection Process WP, noting that:
 - (i) during annual renegotiations audit firms typically provide companies with benchmark data on the fees paid by comparable companies (paragraph 143(a));
 - (ii) KPMG stated that companies could use as a benchmark the proposals made by competitor firms that provided unsolicited approaches (paragraph 161); and

⁷² Slide 46 of the CC's Survey and paragraph 38(c) of the Survey Results WP.

⁷³ For example: (i) the ACC of Company E "used benchmarking to assess whether the audit fee was fair" and although the company was a "unique business...this did not hinder the effectiveness of benchmarking as there were similar companies in terms of size and complexity" (paragraph 60); and (ii) the GFC of Company G said that he was able to "benchmark the fees the company paid against other banks' audit fees" and "the audit fee was also compared with other global FTSE 100 companies such as BP and Aviva" (paragraph 30).

⁷⁴ In addition, companies: (i) frequently have rate cards for a variety of services negotiated with several of the large firms; (ii) know competitor rates from engaging them on non-audit services, which might include accounting and audit work; and (iii) use their own procurement staff or outside consultancies.

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(iii) “firms mentioned that some audit committee members sit on more than one audit committee and so have information on the audit fees paid by other companies which they can use for benchmarking during negotiations” (paragraph 162 - emphasis added). The CC understates here a point that is particularly apparent from the CC’s Survey Results WP which shows that nearly all ACCs sit on or chair another audit committee (indeed, 20% of ACCs are on three other audit committees).⁷⁵

(d) The level of market expertise on the part of ACCs is recognised in the Nature and Strength of Competition WP, where in paragraph 75 the CC describes FDs, CFOs and ACCs as “*experienced and knowledgeable purchasers of the audit services*”.

4.11 On this basis, we believe that not only does the CC understate the prevalence of formal benchmarking in the Selection Process WP, but it importantly also fails to give sufficient consideration to the other methods available to companies for obtaining sufficient information about the relative attractiveness of their current audit service and fees compared with alternatives from other audit firms.

5 References to evidential sources

5.1 Finally, we note that many of the footnotes referencing source material in the version of the Selection Process WP sent to us on 20 September 2012 have been deleted from the version of the Selection Process WP published on the CC’s website. However, our review of the 20 September document identified several places in the Selection Process WP where references to PwC source material did not appear to be accurate or point to the most relevant material. For the sake of completeness we set these out below (with the numbering of footnotes below reflecting the numbering in the 20 September version of the Selection Process WP):

- (a) Footnotes 52 and 53 should refer to page 107 (paragraphs 5.39(a) and (b) respectively) of our Initial Submission.
- (b) Footnote 76 should refer to paragraph 5.44 of our Initial Submission.
- (c) Footnote 85 should also refer to paragraphs 5.16 - 5.23 of our Initial Submission.
- (d) Footnote 131 incorrectly refers to PwC material to support information relating to KPMG.
- (e) Footnote 133 should refer to paragraph 5.23(b) (not 5.23(e)) of our Initial Submission.
- (f) Footnote 144 should refer to paragraphs 5.28 - 5.30 of our Initial Submission.
- (g) Footnote 192 should refer to page 152 (paragraphs 53.20 - 53.21) of our response to the MFQs.

⁷⁵ Paragraph 24(c) of the Survey Results WP.