NON-CONFIDENTIAL VERSION

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Inquiry Manager
Statutory Audit Investigation
Competition Commission
Victoria House
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By email

Dear Sir/Madam

Response to Competition Commission – Statutory Audit Services Market Investigation

Barclays Bank PLC (**Barclays**) is providing its comments, as invited by the Competition Commission in its Provisional Findings Report published on 22 February 2013 (the **Provisional Findings**) and Notice of Possible Remedies (the **Remedies Notice**).

In its Provisional Findings the CC suggests that the current structure of the UK statutory audit market, treated as a whole, causes incumbent auditors to face less competition due to a lack of switching. Moreover, that in general a company's auditors: are neither sufficiently independent of executive management nor sceptical enough in carrying out audits; compete on the wrong parameters for appointment; and fail to address the legitimate concerns of shareholders.

The role of an Audit Committee (AC) in a FTSE 350 company should not be overlooked. Such ACs usually have extensive experience of working with incumbent auditors and other accountancy firms. In Barclays experience, its AC is well informed when annually assessing the performance of Barclays external auditors. The experience and strength of Barclays AC also protects shareholders' interest in obtaining comfort from the audit report that the financial statements of the company are true and fair.

It is Barclays experience, as set out below, that the UK's current regime for the audit of financial statements, so far as it impacts on the business of international banking, is working for its shareholders; to change it may inadvertently be to their detriment. In particular, Barclays would have serious concerns about the UK acting alone in relation to mandatory rotation at a time when the European Union is considering whether or not mandatory rotation is justified.

Response to the proposed remedies

1. Mandatory tendering

As the Competition Commission notes in paragraph 19 of the Remedies Notice, the recently revised UK Corporate Governance Code states that FTSE 350 companies should go to tender for their external auditors at least every ten years or explain why they have not done so. This should be allowed time to take effect before introducing any further changes.

Barclays favours a regime of this kind, as signalled in our recent Annual Report, as it is likely to increase transparency and enable shareholders to make an informed decision whether to tender. However, we consider that the option of whether to tender is a cost/benefit decision for AC and shareholders, and should not be mandatory.

Tendering involves significant disruption to business activities of multinational companies due to their scale, depth and geographical spread. Barclays, for example, has over £1.5 trillion of assets and 150,000 employees active in more than 50 countries worldwide over 40 major business units and 10 functions. Each of the major regional hubs of London, Madrid, New York, Johannesburg, Singapore and India would need to be involved to a significant extent in the tendering process and this would lead to large-scale costs.

Barclays estimates that the cost of a single tender process in terms of man hours for a Group the size of Barclays would involve in excess of 200 staff with a total time spent in excess of 1,000 man days over an estimated project time of two years. Whilst there are, undoubtedly, some common steps to all tenders, this would need to be multiplied by the number of firms invited to tender given that each firm would probably have separate information requirements (especially if an 'open book' basis were adopted, allowing tendering firms to access all relevant information from the company as part of the tender rather than transition process). The above estimate does not include any of the time needed to transition the new firm, or the other costs associated with a retendering regime indicated above (both of which would be considerable).

The tender process is also costly for audit firms. Tendering for statutory, rather than competitive, reasons would likely result in audit firms passing on the costs of tendering to clients, either in the form of a higher "rate card" or as a discreet billable service. This would represent an additional burden on companies which competitors in other jurisdictions would not face. Furthermore, Barclays would be concerned that towards the end of an audit term, an audit firm would increasingly lose focus on the audit being undertaken, and become more interested in the very considerable work required for an audit tender.

Barclays considers that the introduction of a mandatory tender regime would not be an effective method of ensuring non-Big-4 firms are considered by FTSE 350 companies tendering for their audit work. There are compelling reasons why it may be irresponsible for a complex multinational company to appoint a mid-tier firm as its external auditor. This is partly because it is usually most effective to appoint the same external auditor for the Group as well as each subsidiary.

Given that multinational groups can have over a thousand subsidiaries based in dozens of jurisdictions worldwide, most mid-sized firms would not have the experience, capacity or global footprint to meet this demand. Barclays considers that there are only [REDACTED] UK-based auditing firms currently capable of carrying out its audit work (all of which are in the Big 4). Therefore, many mid-sized firms may not have the opportunity to tender for audit work even in the event of a mandatory tender regime being introduced.

2. Mandatory rotation of audit firm

Barclays strongly believes that mandatory rotation would increase risk whilst representing a negative development to the UK's current regime for the audit of financial statements.

Any change to the audit firm would result in the company's external auditors being less familiar with the business. This compromises audit quality and the effectiveness of the assurance that is being provided to shareholders as to the truth and fairness of the financial statements. In particular, in the early years of a new engagement, auditors unfamiliar with the business would be less able to provide a robust challenge to management, especially in complex and judgemental areas for banks such as the level of impairment allowance, the valuation of illiquid instruments, accounting for structured transactions and the disclose of financial risk. In Barclays view, this outweighs the potential benefits of a change.

There are unique independence rules that apply to firms that audit financial services organisations. The most stringent of these are the U.S. Securities and Exchange Commission rules, a copy of which we attach to this response. Barclays currently provides banking services (including lending, deposit, investment and wealth management services) to many audit firms excluding its own auditors. Barclays also acts for audit firm partners, employees and their relatives in the personal capacity. An enforced change in auditor would be immensely disruptive to these relationships due to the requirement to maintain auditor independence. In the long term it could also lead to market distortion as audit firms, their partners and employees realign banking relationships to banks based outside the jurisdiction in order to avoid being caught by these rules.

For these reasons, mandatory tendering every five or seven years, potentially accompanied by mandatory audit firm rotation after any second consecutive audit term, could result in unreliable statutory opinions being issued on an unacceptably frequent basis.

3. Expanded remit and/or frequency of Audit Quality Review team (AQRT) reviews

Whilst Barclays considers that the UK's current regime for the audit of financial statements works well, Barclays has no objection in principle to refining the remit and/or frequency of Audit Quality Review Team (AQRT) reviews. Barclays considers that greater availability of AQRT reviews for the FTSE 350 subset could provide an additional tool for Barclays AC to measure external auditor performance against, as well as offering further information to assist shareholders in making an informed decision to appoint or remove auditors.

4. Prohibition of 'Big 4 only' clauses in loan documentation

Barclays does not have a systematic policy of insisting, as a condition of providing financing, that borrowers use one of the Big 4 accountancy firms for audit purposes and is supportive of the Competition Commission proposed requirement that lenders do not adopt a systematic policy of requiring borrowers to appoint Big 4 auditing firms as a condition of lending. However, Barclays does not consider that it would be proportionate or appropriate to prohibit lenders from ever requiring borrowers to appoint one of the Big 4 firms as auditor, if such action were appropriate in the particular circumstances of a transaction.

5. Strengthened accountability of the External Auditor to the Audit Committee (AC)

Barclays considers that the Competition Commission has understated the extent to which external auditors are already accountable to ACs in FTSE 350 companies like Barclays, as well as the significant time investment currently made by ACs and Audit Committee Chairs (ACCs). For example, Barclays ACC spends [REDACTED] working days focussing on the Group's audit-related work. As well as dealing with issues as they arise, the ACC meets [REDACTED] with the Group's external auditors, holds [REDACTED] meetings with the Group's internal auditors [REDACTED], and [REDACTED] with local audit teams at Barclays locations across the world to build relationships and better understand the business. In addition, Barclays AC holds up to [REDACTED] meetings with the Group's external auditors each year. Notwithstanding the substantial and valuable role carried out by the AC and ACC, Barclays considers it appropriate that senior financial management also have influence over the decision to appoint or reappoint the auditor. Whilst the AC is responsible for ensuring shareholders interests are furthered in the production and delivery of audit reports, external auditors must be able to work constructively and effectively with senior financial managers in the course of auditing the company. It would therefore be difficult, if not impossible, to appropriately assess auditor performance without input from financial management to the AC.

6. Enhanced shareholder-auditor engagement

Barclays considers that a strong and well informed AC will be well placed to protect the interests of shareholders in this regard. Barclays is not, therefore, convinced of the need for change in this area. However, Barclays would welcome any planned further discussion to consider whether additional measures might enhance dialogue in this area.

7. Extended reporting requirements

Barclays considers that extended auditor reporting requirements would not be an effective method of addressing the adverse effects identified by the Competition Commission. An audit report should provide shareholders with a succinct statement of comfort in relation to the truth and fairness of the financial statements.

Extended reporting requirements, especially through an increase in the length of audit reports, would result in a dilution of that message and would be likely to make auditors more conservative.

It is not Barclays experience that senior managers within FTSE 350 companies are reluctant to disclose information about the audit process (paragraph 58 of the Remedies Notice). Indeed, Barclays recommends that any additional reporting on control or audit related matters should be included within the disclosures that management is required to provide, since management is responsible for the preparation of financial statements and the judgements made.

Yours sincerely

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