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Dear Sirs

Investigation into the market for the supply of statutory audit services to large companies in the UK

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to provide comments on possible actions which the Competition Commission (CC) might take in order to remedy, mitigate or prevent the adverse effects on competition (AEC) which it has identified in its provisional findings into the market for the supply of statutory audit services to large companies in the UK.

As one of the leading UK audit firms, Grant Thornton has a particular viewpoint and interest regarding the structure of competition in the audit market and we are well placed to understand and articulate the competition issues that face audit firms outside of the largest four firms in the supply of audit services to large companies. Enhanced competition would inevitably be of benefit to both companies and their shareholders.

The principles and potential remedies which are under consideration by the CC reflect concerns raised by many stakeholders about the structure of the UK large company audit market. We believe that the remedies we discuss in this letter would bring about enhanced competition leading to better outcomes for customers, and would facilitate an increase over time in the number of audit firms with meaningful share in the market for large listed company audits.

Provisional findings and remedies notice
In our view the CC has presented compelling evidence of the need for intervention in this market. Subject to the detailed comments set out in the Appendix to this letter, we believe that the package of measures suggested by the CC will go a long way to addressing the problems with the market that the CC has identified.

However, to ensure that the package of remedies implemented by the CC is capable of effectively addressing the identified AECs, the CC should also implement two additional measures: (i) further constraints on the supply of non-audit services by the incumbent auditor, and (ii) the introduction of either mandatory or incentivised consortia audits. We have set out in the appendix the detailed reasons why we think these additional measures would further benefit audit customers..

Considered in the round, the evidence and analysis (and conclusions) set out in the CC's provisional findings all point towards there being a serious structural/behavioural problem in the large company audit market which requires intervention.

Attempts to link individual remedies with individual (negative) features of the current market dynamic is, we believe, counter-productive. We believe that the proposed interventions (including the additional remedies we are suggesting) need to be taken together and considered in aggregate. The proposed remedies are not mutually exclusive and no one remedy will bring about sufficient change in the market. In our view it is therefore essential that a balanced package of remedies is introduced, which together will bring about positive change for customers. Just as there is no one specific feature of the market that results in the AECs identified by the CC, there is no single "silver bullet" remedy. A holistic approach is needed in identifying both the problems in the market and in considering how they might be remedied.

Grant Thornton is not in a position to be able to provide definitive evidence on all of the costs and benefits of each remedy. However we have indicated what additional information we may be able to provide in due course. In addition, we would encourage the CC to continue engagement with, in particular, investors to seek their views on the costs and particularly the benefits of the CC's package of remedies.

Further, we believe that for many of the proposed remedies their effectiveness (singly and taken together) will be significantly impacted by the precise way in which they are implemented. In our view, getting this detail right is critical.

We set out in the appendix to this letter our views and evidence in response to the CC's Notice of remedies, including those remedies that the CC anticipates exploring further. As per the CC's timetable, we will be responding separately to the CC's provisional findings.

If you have any questions on this response, please contact either Steve Maslin (Direct T: +44 (0)20 7728 2736; E: steve.maslin@uk.gt.com) or Martin Drew (Direct T: +44 (0)1865 799914; E: martin.s.drew@uk.gt.com).

Yours faithfully

Grant Thornton UK LLP

Appendix – Grant Thornton views on individual remedies

Remedies the CC are exploring

1 Mandatory tendering and mandatory rotation of audit firms

1.1 We consider these two possible remedies together given the linked nature of the issue that they will address.

1.2 Grant Thornton supports the adoption of measures to prevent complacency by audit firms in a market where audit tenures are excessively long and which will bring about improvements in innovation, quality and price through increased competition. The implementation of measures such as tendering and rotation would also have the beneficial effect of addressing the concerns of those investors who believe more frequent changes of auditor would take away perceptions of potential loss of independence which arise when an audit firm is in place for too long. While the current requirement for audit engagement partner rotation is an important safeguard for these concerns at the personal level, it is clear that it does not on its own address the perception that a familiarity threat arises between the company and the audit firm.

1.3 Further, we agree with the concern expressed in the CC's provisional findings that, in the absence of a more regular and formal process for assessing the quality, price and innovation of alternative providers of statutory audit, companies have limited visibility of the capabilities of those firms with which they have no existing audit relationship[1].

1.4 In the UK, Grant Thornton has previously supported the proposal by the Financial Reporting Council (FRC) for 10 year tendering under a "comply or explain" basis. This proposal is in the early stages of implementation but the preparedness and ability of large organisations such as BG, Schroder's, HSBC and Barclays to put their audits out to tender relatively quickly is a clear sign that they believe that there are improvements in areas such as price and service quality to be obtained. These improvements are expected to arise even when the tender list does not include firms outside of the largest four firms. However, we believe it is inevitable that over time, with the introduction of measures to change audit buying patterns, more audit firms will be invited to tender and this will provide increased differentiation and competition.

1.5 Although the FRC has introduced a comply or explain structure, Grant Thornton can see in principle merit in the CC's position that, when taken as a package of

[1] See Grant Thornton response to the CC's Issues Statement.

measures the tender requirement should, except in exceptional circumstances, be required to take place within a requisite time period. The CC's analysis has shown that the barriers to a better functioning market are significant. There is, therefore, a danger that in a comply or explain regime the current patterns of behaviour by the relevant stakeholders continues, as the 'easier' option is to explain, rather than choosing to comply. To ensure that the compulsory tendering remedy results in a maximum change in the market dynamics it is appropriate to impose the remedy in the form of a compulsory requirement. Whilst we support the CC's position in principle, it will be important to take note of the views of other stakeholders, especially shareholders, about whether there is a role for a continuing comply or explain framework, with the potential to introduce mandatory tendering subsequently if that does not work.

1.6 In addition, for the reasons set out further below, Grant Thornton believes that mandatory audit firm rotation (MFR), as a backstop to tendering, is appropriate and that for the same reasons, this requirement would be an absolute requirement, not a comply or explain requirement.

1.7 One of the key benefits of more regular tendering is that it ought to help to create an environment in which audit committees (ACs) plan ahead for a tender process which they know will be coming, and therefore go to greater lengths to get to know other firms in advance. More companies should therefore be in a position to understand the qualities and capabilities of a number of firms, and in turn have more meaningful bargaining power in the auditor appointment and reappointment processes. A more regular tender process will also provide a forum for a substantive review of how the audit is conducted and provides increased assurance to shareholders that the auditor selection process is robust, even in a situation when the incumbent audit firm is retained as auditor. The proposed increase in tendering therefore also plays a part in improving the input of ACs (and ACCs) in the tender process and in enabling the audit product to meet better the requirements of shareholders and investors.

1.8 However, of itself, we do not believe that mandatory tendering will be sufficient to change the buying decisions of companies. Grant Thornton supports increased tendering coupled with a back-stop measure of MFR, at a suitable period, to encourage companies to build relationships with new firms, and mandate that a fresh-pair of eyes is required after a certain amount of time. Implementation of MFR alongside more frequent tendering, which is a position supported by many investors[2], addresses the risks that arise when an audit firm has been in place for too long - risks that are not addressed under the current rules which require only a change in the audit engagement partner.

1.9 In terms of time periods for each of these measures, a logical approach which is widely supported by other investors and stakeholders would be audit partner rotation at 5 years (in line with existing requirements for UK listed companies which

[2] See an investor letter signed by large institutional investors and investor associations managing assets of > €2trn - http://www.uss.co.uk/Documents/Audit%20-%20Group%20position%20paper%2022%20Feb%202013.pdf

have little opposition), mandatory tendering at a maximum of 10 years (being two partner terms and consistent with the FRC requirement in the UK Corporate Governance Code which is well supported) and mandatory rotation after 15 years. Grant Thornton has been engaged in discussions around the world on mandatory firm rotation and has seen 14 or 15 years as a time period which is not considered inappropriate by many who support a fixed rotation period. In the European context, 14 years is two terms of European audit partner rotation limits of 7 years. The CC may consider therefore that 15 years is a more "logical" period for mandatory rotation of audit firms in the UK, being 3 audit partner terms of 5 years. The period of 5 years between a regime of maximum tendering at 10 years and rotation at 15 years, would also provide the incumbent audit firm with significant motivation to continue as audit firm. The fact that there is significant competition for one-off transactional non-audit assignments for fees far smaller than a potential 5 year audit fee provides evidence that would be the case.

1.10 There is also merit in a mandatory rotation period of 20 years, which would still significantly increase the current switching rates in the FTSE 350, but our view is that this is likely to be perceived as too long a period for an audit firm to remain appropriately independent in the context of a large listed company with a diverse shareholder base. The backstop period need not be a multiple of the tendering period. All that is required is that there should be at least one tender between initial appointment, and the backstop period for mandatory rotation.

1.11 Grant Thornton concurs with a view expressed by many stakeholders that tendering at 5 years and MFR at 10 years is too aggressive. However a 15 year rotation period (or 14 years[3]), coupled with tendering at least every 10 years (as introduced by the FRC), would limit disruption to the audit market and allow sufficient time for the benefits of an auditor's accumulated knowledge to be built up during the firm's tenure, before the perception of objectivity concerns arise. We suggest that the period could be further extended, say to 21 years, in the case that two or more auditors are appointed[4] (see section 8).

1.12 A counter argument which is used by opponents of MFR is that it leads to market disruption, and a loss of the knowledge of the incumbent auditor for the company – we discuss these points in further detail below. While these arguments might have some validity where MFR is required on a too frequent basis they cannot be used to justify a company **never** switching audit firm (or only doing so after many years of incumbency). In our view, there can be no argument that there comes a point during an audit firm's tenure when the benefits of switching audit firm outweigh the costs of losing the knowledge of the incumbent auditor.

1.13 Grant Thornton consider that the costs of these remedies are minimal and likely to be overstated by those who oppose their introduction. On an appropriate timescale, the cost of changing auditor is unlikely to be unpalatably restrictive to large

[3] This would correspond to twice the maximum audit partner rotation period of 7 years allowed by the International Ethics Standards Board for Accountants (IESBA) Code, because audit partner rotation is widely acknowledged as an effective safeguard of auditor independence in earlier years of appointment.
[4] Even a 21-year rotation period would reduce the duration of audit engagements in the UK FTSE 350 market where the average tenure is currently 48 years for auditors of the 100 largest public companies, and around 35 years for the next 250 largest companies.

companies (and their investors), and the competitive process of more regular tendering is likely to lead to lower audit fees[5]. Many investors would be willing to incur some additional costs where the value they perceive from the audit increases [6]. It should also be noted that it has increasingly become absolutely normal commercial practice for large companies to conduct tender processes in respect of the provision of a wide range of professional and non-professional services (whether these be legal, IT, consultancy etc.). Any switch of service provider will incur a loss of familiarity and requires certain investments on the part of both the service provider and the company. However, this has not prevented companies from tendering for such services in order the generate the benefits that tendering produces. Specifically, in previous submissions we have drawn the CC's attention to the public sector audit market, where tendering and switching of audit firms is more frequent and which market is commonly regarded as having the features of high quality, good value for money and innovation.

1.14 The most significant additional cost would fall upon audit firms in familiarising themselves with a new company, and we stress that under current practice it is almost unanimously the case that audit firms "absorb" these costs as an investment in the audited entity (i.e. the cost is not passed on to customers). We believe that these costs should be ignored in considering the overall cost of implementation of this remedy.

1.15 In our experience, evidence that is available on tender costs for companies suggests that they are not significant in the context of the market caps of the companies concerned. Further, there is an almost inevitable outcome of more frequent tendering that the unit costs of tendering will fall as companies and audit firms become more familiar with efficient and effective tendering processes (in a market with, say, 35 – 50 tender events a year audit firms would be forced to focus their tender efforts solely on audit quality and not the other matters that often go into the tender effort at present.).

1.16 The FRC's recent requirement for 10 year tendering will already place a burden of additional costs upon audit firms and companies. The incremental additional costs incurred by sector participants arising from the tendering proposals put forward by the CC, are likely to be minimal. In addition, the costs of rotation are not significantly different from that of tendering as the most significant costs, those of preparing the tender and familiarising the audit firm with the company to a level which allows an appropriate presentation to be made, are borne during the tender process. Additional costs which will be incurred owing to a rotation requirement will include the opportunity cost of management time spent familiarising the auditor with the company and its systems and internal control processes. While Grant Thornton is not best placed to provide details of the time involved in this process (which will invariably be different depending on the complexity of the company), it seems very likely that the time spent by companies would be significantly less than that the auditor spends in familiarising themselves with the company (on the basis that the management already understands its business and the audit firm will be the one making the most significant investments in familiarising itself with the

[5] See CC evidence on the impact of switching on fees.
[6] See investor comments from CC survey and Oxera survey.

company). Grant Thornton would be able to provide further detail on this in due course if it would be helpful to the CC.

1.17 A further argument of opponents of MFR, is that MFR leads to a fall in audit quality and a loss of auditor knowledge. Grant Thornton does not believe that MFR will reduce audit quality for the investor and has yet to see any reliable academic evidence that suggests it will. Indeed the CC has identified in its own findings that audit firms "invest" in an audit in the early years to avoid any adverse impact on quality which their unfamiliarity with the company might otherwise bring[7]. Further, in countries where MFR has been adopted, this has not resulted in evidence of a fall in audit quality.

1.18 In our experience there is often a significant benefit to the audit quality arising from switching in the sense that the new auditor may unearth issues previously unnoticed by the incumbent auditor, as new audit techniques bring a fresh approach, and a new firm is likely to be more sceptical because it starts from a position where it has no preconceptions.

1.19 There are also many examples in the public sector which indicate that frequent switching goes hand in hand with strong audit quality[8], and it might be helpful for the CC to elicit the views of the NAO, Audit Commission and Audit Scotland about the impact of a change in auditor on audit quality, since they will have monitored the audit quality, service and audit price of many entities where such a change has occurred over such short periods as every 5 years. Our understanding is that increased frequency of audit firm rotation in the public sector has led to good value for money and improved quality and service for the institutions involved. Grant Thornton can also try to illicit more information about audit quality, service and price in the public sector (in particular), where switching is more frequent, if that would be helpful to the CC.

1.20 For the reasons expressed above, Grant Thornton supports the CC's proposal to introduce more frequent tendering and MFR to help address the issues which have been identified in the market. But on their own, more regular tendering and MFR are not capable of addressing the adverse effects on competition identified by the CC. Grant Thornton advocates that tendering and MFR needs to be accompanied by other measures, as part of a balanced package, to be effective. There are a range of additional measure which will help materially in addressing the risks to audit quality from long audit tenure, and assist in breaking down barriers to entry for audit firms outside of the four largest providers.. Measures range from those which require companies to act and will have a more immediate impact, to those which incentivise companies to use more firms. These options include:

- Restricting the provision of non-audit services by the auditor of large companies (see section 7);
- Requiring or adequately incentivising consortia audit (see section 8).

[7] See section 9 of CC provisional findings

[8] See the Audit Commission's 2012 Quality Review Programme report at http://archive.audit-commission.gov.uk/auditcommission/SiteCollectionDocuments/AnnualReports/2012/20120621-quality-review-programme.pdf.

Specific CC questions on mandatory tendering

What an appropriate time frame for requiring mandatory tendering might be, given the bounds suggested above?

1.21 We support maximum ten years, as described in the UK Corporate Governance Code, which was revised in 2012 to include a requirement that FTSE 350 companies "should put the external audit contract out to tender at least every ten years". This requirement was included following consultation with investors, ACCs, FDs and companies and has been widely accepted.

Whether and for what reason the measure may be subject to 'comply or explain' implementation?

1.22 Grant Thornton has previously supported the FRC's revisions to the UK Corporate Governance Code which provide a useful starting point in attempting to change audit buying practices. A "comply or explain" implementation should be a minimum requirement.

1.23 Although the FRC has introduced a comply or explain structure, Grant Thornton can see in principle merit in the CC's position that, when taken as a package of measures the tender requirement should, except in exceptional circumstances, be required to take place within a requisite time period. The CC's analysis has shown that the barriers to a better functioning market are significant. There is, therefore, a danger that in a comply or explain regime the current patterns of behaviour by the relevant stakeholders continues, as the 'easier' option is to explain, rather than choosing to comply. To ensure that the compulsory tendering remedy results in a maximum change in the market dynamics it is appropriate to impose the remedy in the form of a compulsory requirement. Whilst we support the CC's position in principle, it will be important to take note of the views of other stakeholders, especially shareholders, about whether there is a role for comply or explain with the potential to introduce mandatory tendering subsequently if that does not work. As noted by the FRC, companies should put the audit contract out to tender earlier than they would be expected to under any tendering requirements if they feel it is appropriate to do so, and shareholders should feel free to request them to do so.

How a valid 'tender' and its constituents should be defined, including whether and how best to provide access to relevant information on an 'open book' basis?

1.24 We support the FRC's intention to hold discussions with audit committee chairs, finance directors, audit partners and investors to consider whether further guidance on tendering would be useful, as a result of the revisions to the UK Corporate Governance Code.

1.25 Further we support the point made by the FRC that in order for there to be time to undertake an effective tendering process, and to allow shareholders to provide input to the process should they wish, a company should announce its intention to tender in advance of the commencement of the tendering process.

1.26 Grant Thornton is of the opinion that equal access to appropriate information should be available to all companies involved in the tender process in order that the

process is conducted in an open and transparent manner. Such information should be sufficient to provide the tendering firm with information to allow their tender and, in particular, fee quote to be as accurate as possible, including the provision of equal access to management. Such a process might include a requirement for a tendering company to send information to those audit firms that it wishes to tender, including; details of the group structure, reporting requirements, systems, processes and controls, finance team details, Board structure, reporting responsibilities etc. Clearly the above is not an exhaustive list but provides details of some of the items of information that an auditor would require to tender effectively.

1.27 We believe that fair and open tendering is another area where there are lessons to be learned from the public sector, where tenders are frequently conducted through publicised tender criteria, with underlying documents made available to tenderers via a data room.

What costs and benefits would arise as a result of this remedy?

1.28 See above for our detailed comments. As stated previously, we would be concerned if costs and benefits of individual remedies were considered in isolation. We strongly support the CC's proposal for a range of remedies, and therefore any impact assessment should consider the costs and benefits in totality. With a package of remedies pointing in the same direction we believe that the combined benefits will greatly exceed the sum of the costs (and greatly exceed the benefits of each individual remedy).

1.29 At present FTSE 350 companies tender their audit so infrequently that it is a one-off event, if it ever happens. More frequent tenders should bring cost efficiencies for companies and audit firms in this process. As noted above, tendering for services is standard corporate practice and most large firms employ procurement specialist that would be able to design and implement and efficient and effective process. We suggest that the CC could contact specialist organisations that deal in advising FTSE companies on outsourcing other substantial professional services contracts, to determine what information is available as evidence on the costs and benefits of changing professional advisors.

1.30 Within reason we believe that costs to audit firms of tendering should be ignored for the purposes of this exercise. Unless they are a very high proportion of income, these are costs that firms will incur in the normal course of business, and firms will find ways of increasing their efficiency in the production of tenders. In addition, the market itself will respond to reduce the total costs of individual tenders as they become more frequent and more a 'normal' part of the business operations. Given these market dynamics we think that just extrapolating from current tender costs in this market proportionally for an increased tender frequency will significantly over-estimate the resultant increase in the costs incurred by firms. An activity that is extremely rare – a big company tendering their audit – will become much more "run of the mill".

1.31 Further, there will be inevitable scale benefits and more opportunities to tender will incentivise firms to become more efficient in their tender processes. In addition,

audit firms may become more selective in accepting an invitation to tender and therefore, although there would be more tender opportunities we would not expect to see a strictly proportionate increase in the number of tender processes actually undertaken by firms.

1.32 A further benefit of tendering, as the CC has identified during its investigation[9], is that it leads to a fall in audit prices for companies, particularly where auditors outside of the largest four firms are invited to participate.

1.33 Finally our experience is that the process of tendering itself can also lead to improved service quality, even if the incumbent audit firm is reappointed, because the knowledge of an imminent tender will ensure the firm is kept "on its toes".

What should be the requirements for phasing in this remedy? For example, those companies with the longest period since last tender may be required to tender first within a specified period.

1.34 There must be transitional provisions, which will phase in the requirements to tender (and rotate audit firms). We think that these two requirements should be coordinated. The objective should be to move to the position where the tender and rotation requirements are evenly distributed through time. This indicates that the regulatory requirements will, in the steady state, at a minimum require around 23 changes of audit firm per year (on a 15 year maximum auditor engagement length), and around 35 tenders (including those as part of an audit firm rotation requirement) where there is a 10 year tender requirement. This in turn suggests that in the first instance the cut-off point for a compulsory tendering in the first year of operation of the policy should be where this produces around 23 companies in the FTSE 350 requiring a rotation of auditor. In addition, the cut-off time limit for tender should be set so that an additional 12 companies require a tender process. However, to avoid bunching the audit rotation requirement, these additional companies should be those that would not require an audit firm rotation in the short term. As a result, companies over both the tendering requirement and the rotation requirement would be phased in according to their rotation requirement. In addition, it may be appropriate to allow some companies who are at the most extreme end of the length of audit firm engagement (and therefore, would immediately become subject to a requirement to rotate) to be given one or two years to plan the process and, in particular, to ensure that conflict rules allow the appointment of a new, suitable, auditor.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

1.35 We have nothing to add to our comments made above.

[9] See in particular the CC's working papers entitled "Descriptive statistics" and " Evidence relating to the selection process: tendering, annual renegotiations and switching".

Specific CC questions on MFR

What an appropriate time frame for requiring mandatory rotation might be, given the bounds suggested above and how this might relate to mandatory tendering periods if this were also to be pursued?

1.36 See answers above.

1.37 There is a trade-off between the disruption to a company from changing audit firms and the undoubted advantages that flow to the company, and the wider market from greater competition and increased transparency. The additional benefits of rapid rotation would appear to be low beyond those achieved from rotation at some reasonable frequency. However, the optimal period for rotation is not going to be an exact science. In addition, the benefits of rotation are related to other policies, in particular the tender requirements and the audit partner rotation. On the basis of Grant Thornton's experience we would suggest that the optimal, or at least a good, trade-off would be around 15 years for compulsory rotation, fitting into a tendering requirement of 10 years and auditor partner rotation of 5 years.

1.38 In particular we believe that compulsory rotation periods of 7 and 10 years are too short. Audit partner rotation at 5 years mitigates the need to change auditor at 7 years. A further partner change at ten years combined with a tender mitigates the **need** to change auditor at ten years. However at some point further tenders and changes in audit partner do not address investor perception that audit quality is threatened by long tenure. In our view a backstop period of mandatory rotation after a 15 year period is therefore appropriate.

1.39 The backstop period need not be a multiple of the tendering period. All that is required is that there should be at least one tender between initial appointment, and the backstop period. for mandatory rotation.

Should any such measure be subject to a waiver from the regulator (FRC) if a company's choice of auditor was substantially constrained and how would such a waiver operate?

1.40 In our view there is potential for a general waiver system to be abused, and any waiver system should be very closely drawn. For example, it is sometimes held that a company has "limited choice" of who can be auditor because the only other firms it considers able to be auditor are conflicted by providing non-audit services. In our view that limited choice is to a degree self-inflicted, in that the company chooses to award non-audit services to a potential alternative auditor when other firms will almost certainly have the capabilities to be able to provide those non-audit services.

1.41 If a system were introduced whereby a company had time to plan for a change in auditor both by getting to know a wider group of firms and by forward thinking with regard to providers of its non-audit services, and an accounting firm can plan to compete for audit and/or non-audit services over time, then we believe that the need for a waiver will disappear.

1.42 However, it may be that in a very small number of cases in the early years of implementing remedies that a waiver could justifiably be used if transitional provisions do not give a small number of companies sufficient time or flexibility to get their affairs in order.

1.43 In addition, there again may be some, extreme, cases where a requirement to rotate could be delayed by one, or possibly two, years. Such circumstances could include, for example, when a company is subject to an unexpected hostile take-over. However, in general, we would think that it is reasonable for companies to organise themselves so that complying with the minimum rotation requirements becomes part of their normal corporate strategy.

How a valid 'tender' and its constituents should be defined as a prelude to rotation, including whether and how best to provide access to relevant information on an 'open book' basis?

1.44 See answer under mandatory tendering above.

What costs and benefits would arise as a result of this remedy?

1.45 The benefits of mandatory firm rotation have been addressed above (and also identified by the CC in the Remedies Notice).

1.46 As regards the costs to audit firms, we have explained above why we believe that such costs should be ignored as they will be "absorbed" as part of the audit firm's investment in the relationship with the company.

1.47 Although audit firms are not well positioned to comment on the costs to the company, we have also explained above, why we do not consider that such costs will be material in the context of the benefits to be achieved. Further, it should be observed that audit firms will have a strong incentive as part of the tendering process to make the investment necessary to ensure that the costs borne by the company and shareholders from rotation are as small as possible. In other words, minimising costs and disruption for the company will be an issue on which auditors can be expected to compete.

1.48 Opponents of rotation say that it means that accumulated knowledge is lost, and that it can deny the company its auditor of best fit. We believe that these concerns are at best overstated and are used when it suits and ignored when it does not. In our view they should therefore be ignored. In addition, even if these arguments were to be valid for rotation periods which are too short, they cannot be valid when applied to any rotation period on the basis that, if that principle were accepted, no company would ever change its auditor.

What should be the requirements for phasing in this remedy? For example; those companies with the longest period since last rotation may be required to rotate first within a specified period.

1.49 The requirements for phasing in this remedy should interact with the phasing in requirements for tendering, which we have discussed above.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

1.50 Any departure from the status quo will almost certainly attract some form of criticism. However, as was seen following the implementation of audit engagement partner rotation requirements, the claimed potential adverse effects of change are almost always overstated whilst the benefits are understated. For example, when the proposal for 5 year audit partner rotation was first muted, there were concerns over the cost of implementing such a requirement and over the impact on audit quality of too rapid change. These concerns did not materialise in practice and there has not been any contention, of which we are aware, that audit quality has either fallen or that costs significantly increased for companies or their shareholders. However, market forces have not led to desired levels of liquidity and instead have caused investors to question the adverse impact on audit quality of long periods of tenure. Changing auditor too frequently may not be optimal, but never, or very rarely, changing auditor does not meet investor demand either. The desired result is somewhere in between. When market forces deliver an adverse outcome then regulatory intervention becomes appropriate. Given opposition expressed by many companies to changing auditor, we believe that audit firm rotation is required in the law.

1.51 In addition, in order to bring about the desired change in market structure by rectifying the market imbalance unnecessarily in favour of the largest firms and thereby facilitate a better quality audit product to meet shareholder demand, we believe that there should be an incentive attached to consortia audit. Companies should be incentivised to test and use a wider range of audit firms by allowing an appropriate extension on the rotation period (say 6 or 7 years for it to be meaningful) for those companies using consortia audit.

2 Expanded remit and/or frequency of Audit Quality Review team reviews

2.1 Grant Thornton supports the introduction of better AQRT reviews, in terms of the degree to which they allow more effective, and transparent, comparison between different audit firms. If achieved, we agree that this would reduce barriers to switching by providing a better objective benchmark on the performance of different audit firms, and thereby assist, over time, in facilitating switching.

2.2 Grant Thornton does not believe that AQRT inspections need to be more frequent "across the board" to achieve this objective. We believe what is important is that the information that is provided in public reports, and privately to companies, in AQRT reports is relevant in helping auditor selection decisions. One way to accommodate this is to increase the regularity of AQRT reviews on audit firms which are not amongst the four largest firms, such as Grant Thornton, so that those reviews are undertaken on a comparable frequency to those of the four largest firms, where companies of a comparable size and complexity are being audited. That is, there should be an identical frequency of publishing reports for all 9 major firms who are the subject of AQRT inspections.

2.3 Further, a small measure which would have a meaningful impact is to report the AQRT results of the 9 major firms in the same way, to avoid the perception that the largest four firms are different from the others. At present, the reports of the largest four firms are released at the same time under the guise of "Big-4" reports, whilst the other firms are published separately.

2.4 Regarding the content of the inspections, we support efforts to ensure that AQRT reports refer specifically, where possible, to the output that investors are concerned about, including a review of the ethical practices which the audit firm undertook prior to providing any non-audit services and the level of challenge and scepticism which is evident over material accounting issues.

2.5 If further resources are to go to the AQRT, we believe there is merit in considering wider measures of audit quality (e.g. the attributes of audit teams) rather than just results of audit inspections. We believe it is important to record our view that the introduction of independent audit regulation including file inspections has had a positive impact on audit quality.

Specific CC questions

How the AQRT's remit should be designed in terms of enhanced scope and frequency. For example;

(i) How frequently should FTSE 350 company audits be reviewed (and whether this should differ between FTSE 100 and FTSE 250 companies)?
(ii) Should the AQRT be required to published FTSE 350 results separately from other Public Interest Entity results?
(iii) Should the AQRT be required to change the scope of its review and if so, how? For example; should the AQRT be required to revisit key audit judgements based on the information then available?
(iv) How could AQRT reporting be expanded to allow better comparison of Big 4 and non-Big-4 firms?

2.6 As indicated above, balanced and comparable reporting of firm AQRT's should be the target. To achieve this outcome, the regularity of reviews and the substantive work involved in inspecting audit files of companies of similar or equal size and complexity should be consistent. This is likely to mean annual inspections (currently bi-annual) of audit firms outside of the largest four firms to ensure there is a comparable frequency of reviews of all firms who are undertaking FTSE 350 company audits. In the absence of this consistency, the visibility of quality of different firms, for shareholders and companies, is blurred. The FRC may need to adapt a framework or guidelines on what criteria are considered when assessing the comparability of different companies by reference to size and complexity – a split of FTSE 100, FTSE 250 and others may be sufficiently detailed in this regard.

2.7 Given the disparity in audit market concentration between the FTSE 350 and other public interest entities, we believe that separate reporting on FTSE 350 entities would be beneficial in breaking the constraints which FTSE 350 companies have in assessing the quality of firms outside of the largest four.

2.8 In principle we support FTSE 350 AQRT results being published separately. However a critical element of public reporting on firms is that statements in the firm report should not be traceable back to an individual company, as this could create an unfair bias against specific companies whose audits were subsequently be found to be inadequate (i.e. an adverse impact on share price). Given the concentrated nature of the market at present it would be possible to make that connection to individual companies, and so anonymity in public reports is required. In order to overcome this issue, the company currently receives its individual AQRT report via the audit firm and so is able to enforce quality on its own audit. We understand that from 1 April 2013 those reports will be sent direct from the AQRT to the ACC.

2.9 We suggest a more flexible framework for the AQRT would also be to reinforce their current tentative statements on findings in relation to "comparable audits" of different audit firms, with a requirement for them to provide a "broad comparison of findings from comparable levels of inspection rigor on comparable audits" between different audit firms.

How should any expanded remit of the AQRT be funded?

2.10 We consider that an improved process for performing and publishing AQRT reports, including an increase in the regularity by which the audit files of firms outside of the largest four firms are inspected, is unlikely to have a significant impact on the cost of their production.

What costs and benefits would arise as a result of this remedy?

2.11 Currently there is a significant perception barrier in the market which restricts the ability of firms from outside the largest four to compete in this market. This is referred to in our response to the CC's Issues Statement. This concern has previously been noted by the FRC in its written submission to the House of Lords Economic Affairs Committee, which stated "We believe that market perception is the main barrier to the expansion of non-Big Four firms into the audit market for large public interest entities. It is notable how few of the smaller fully listed companies use a non-Big Four auditor in comparison to AIM companies. There appears no other obvious explanation for the difference in concentration between these markets. Mid-tier firms may not have the resources to audit the very largest companies, but they are quite capable of auditing a far broader range of companies than is currently the case.".

2.12 The primary benefit of improved AQRT reporting would therefore be the transparency to shareholders and companies about capabilities of audit firms auditing FTSE 350 companies. In particular, increasing the comparability of different audit firms operating in the FTSE 350 would reduce barriers for companies to switch by providing them with relevant information to be able to assess alternative suppliers. This would be particularly pertinent for shareholders who currently have very limited ability to compare alternative audit firms.

2.13 For the reasons given above, we do not expect the increase in costs to be material.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

2.14 We have nothing to add to earlier comments.

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

3.1 As the CC has noted in its provisional findings, restrictions over the appointment of auditors currently exist in written form in template leveraged loan documentation (e.g. that provided by the Loan Management Association).

3.2 Grant Thornton strongly supports the CC's proposed remedy to prohibit these contractual clauses which act as an anti-competitive way of restricting a company's choice of audit firm. We recognise that there may in some instances be legitimate reasons for a lender, say, in trying to restrict who is able to be appointed as an professional services provider to a company to which they are lending. However the additional restrictions that exist in many agreements represent unjustifiable reputational barriers and restrictions over the choice of auditor which are demonstrably not related to capability or quality of the audit firms involved, as supported by inspection reports issued by regulators. This remedy forms part of the minimum requirements for the creation of a level playing field for all market participants and would ensure that the auditor selection decision is free from bias and properly informed with regard to audit quality and audit firm capabilities.

3.3 The prohibition of "big-4 only clauses" has previously been widely supported by the largest accounting firms, for example in responses to the European Commission's audit policy proposals.

3.4 These clauses also exist, equally importantly, in unwritten form and in agreements outside of the template leveraged loan documentation referred to by the CC (for example in transaction related contracts and in lending contracts which stipulate that a firm outside of the largest four cannot be used for advisory work such as for restructuring or due diligence assignments). Grant Thornton has provided evidence of the types of documentation in which we have identified such clauses in our response to the working paper entitled "Restrictions on entry or expansion". The above practice is also applicable in the case of companies aspiring to be public interest entities, where auditors outside of the largest four can be precluded from acting for them.

3.5 Grant Thornton therefore recommends that the CC prohibit all forms of third party anti-competitive restrictions on who a company may appoint as auditor, unless those restrictions are objectively justified, and additionally considers requiring disclosure by the company in its annual report of any such restrictions, written or unwritten (see section 6). Further, and importantly, the prohibition should extend beyond those that specifically refer to the largest four audit firms, to include those that have the same affect (e.g. a reference to a "reputable audit/auditor" which is sometimes taken to mean one of the largest four audit firms), unless the restriction is objectively justifiable.

3.6 Coupled with the increased transparency requirements in the auditor appointment process that we recommend which would require audit committees to disclose the process of tendering and the reasons of appointment (see section 6), these provisions will also help to mitigate the risk that MFR on its own (without changes in audit buying patterns) will be ineffective.

Specific CC questions

The range of documents to which this prohibition should be imposed and how the prohibition could be best implemented. For example: are there documents in addition to Loan Management Association lending agreements that this prohibition should cover?

3.7 This prohibition should cover any document or informal arrangement between the company and a third party that seeks to influence in any way the company's choice of auditor. Otherwise, harmful contractual clauses will be imposed outside lending agreements. One example we have seen is different lending terms, including interest rates, for different auditors.

3.8 In the US, which to our knowledge is the only jurisdiction where such documents for public documents must be placed on the public record, there are a range of documents which seek to influence choice of auditor. Grant Thornton has provided evidence of the types of documentation in which we have identified such clauses in our response to the working paper entitled "Restrictions on entry or expansion".

3.9 We suggest that the most appropriate remedy should be a legal prohibition, with proportionate sanctions on the third party failing to comply. Grant Thornton does not consider that non binding guidance or recommendations will be sufficient to bring the use of such clauses to an end. Further, the positive obligation to comply should be supported by a requirement in the Combined Code to disclose any provisions or contractual terms that restrict, or otherwise influence a company's choice of auditor, such disclosure to include details of the provisions/terms and the parties concerned.

What costs and benefits would arise as a result of this remedy?

3.10 Prohibiting restrictions on who can be appointed as auditor is a pre-requisite for a level playing field and in reducing the barriers to switching identified by the CC. In particular, the prohibition of such clauses will remove the direct constraint on the ability of companies to appoint an auditor outside of the largest four firms and, over time, will materially assist in reducing the reputational barriers facing auditors outside the largest four firms.

3.11 Grant Thornton does not envisage that there will be any material costs to any parties arising from implementation of this remedy.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

3.12 In order to avoid discrepancies between head office policy, and actions at a local level, any prohibition should be all-encompassing and absolute, leaving no room for doubt as to the prohibition's intention or loopholes to avoid that intention.

4 Strengthened accountability of the External Auditor to the Audit Committee

4.1 We concur with the CC's provisional finding that the incentives of audit firms are often misaligned with those of shareholders. This has occurred over time as the audit model has evolved to the current situation where auditors spend most of their time communicating with FDs/CFOs, some time with ACCs and no time with shareholders, the ultimate client. We do not believe that the CC's provisional findings is a criticism of auditors or an understatement of a strong corporate governance regime in the UK, more an observation of how the audit role has evolved and the difficulties shareholders have in understanding how the auditor and audit committee have been discharging their responsibilities to them.

4.2 A change in the relationship between the auditor with management and with ACs will help to increase the independence between the audit firm and management and, over time, will help to facilitate greater competition in the market by providing a platform for increased independent review of the performance of audit firms, particularly on areas such as audit quality, price and innovation. In particular, this remedy would increase the influence of the AC on the audit process by aligning external audit resources with the AC's particular responsibility to the shareholders; and increase the independence of the external auditor from executive management.

4.3 Grant Thornton believes that this remedy requires clear consideration and engagement with stakeholders, as it is inevitable that the relationship between the audit firm and management will be difficult to reduce given the interaction which is required during the audit process.

Specific CC questions

How this remedy could be practically specified and implemented? For example, what change to ACC availability and remuneration would be necessary for ACCs to take on an enhanced role effectively? How should this measure be specified to avoid circumvention?

4.4 The AC should be given responsibility for when to tender and rotate (within the constraints imposed by remedies 1 and 2), the tender process including who to invite, auditor appointment and remuneration. Further, the AC should liaise with shareholders on audit aspects, including auditor selection.

4.5 In current practice the ACC has responsibility for approving the audit fee, recommending the appointment of auditors and authorising the provision of non-audit assignments by the auditor. An extension of existing practice to these requirements would require more time of ACCs, but a comparable reduction in the time required by the FD and/or FC in undertaking these responsibilities. We do not believe that these additional requirements of the ACC would create a significant additional cost or resource requirement on ACCs, particularly with regard to the fact that many ACCs are former auditors/accountants themselves who have sufficient familiarity with the processes they would be undertaking. Further, the occurrence of

tendering and rotation requirements is unlikely to be frequent enough to require a significant uplift in ACC resource.

Whether this remedy could be implemented as an extension to the current guidance on the role of the AC? How this could be implemented without affecting the current collective legal obligations of the directors of a company?

4.6 We consider that these changes could be achieved by building on the current guidance on the role of the AC and without materially changing the legal duties of the Directors and the Board of the Company, by giving the AC these responsibilities, and specifying that the AC is acting on behalf of the Board of directors.

4.7 In current practice, the AC makes a recommendation to the Board (management), which can go against AC recommendation.

What costs and benefits would arise as a result of this remedy?

4.8 See above - this remedy would reduce the influence of executive management in the relationship with the external auditor by strengthening the accountability of the external auditors to the AC.

4.9 The most significant cost of implementation would be any additional resource which would be required for AC's, although as noted above we do not consider that this resource requirement would be significant given the fact that many ACCs are former auditors/accountants themselves who have sufficient familiarity with the processes they would be undertaking and that the occurrence of tendering and rotation requirements is unlikely to be frequent enough to require a significant uplift in ACC resource.

4.10 Whilst we are not best placed to assess the exact level of additional resource, we consider that the changes required are more evolutionary than seismic.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

4.11 We have nothing to add to earlier comments.

5 Enhanced shareholder-auditor engagement

5.1 As set out in section 4, we support remedies which will enhance the current level of minimal engagement between auditors and shareholders. This will be helped by improved auditor reporting which is currently being discussed by The International Auditing and Assurance Standards Board (IAASB), but should not stop there.

5.2 In this respect we support a measure which would require the AC to propose 2 audit firms to shareholders upon the completion of a tendering event, with a duly justified preference for one of them, for an affirmative decision during the auditor appointment process. Such a remedy would remove the final auditor appointment decision from management and the Audit Committee, and require Audit committees

to identify two firms that they would be willing to work with. In our view this remedy would provide a powerful rebuttal of the "IBM factor" which currently exists in auditor appointment decisions.

5.3 In our view better engagement requires a degree of discussion between the auditor and the shareholder group. We support an AGM agenda item for a Q&A dialogue with the audit partner and the ACC (CC suggestions in parts (c) and (d) of para 54). This would provide a forum for shareholders, which they could choose to use as they felt appropriate, to engage directly in assessing the audit process and understanding the key areas of focus during the audit. Questions could be sought in advance as a measure to control the process. In much the same way as the company arranges conference calls and internet forums for results announcements, the company could arrange an internet forum between the shareholder group, audit committee chair and the audit partner. There are important issues of confidentiality in this proposal. It could be in the early days that this forum would provide an opportunity for shareholders to make specific comments to and requests of the auditor, in part based upon information in enhanced AC and auditor reports, rather than a Q&A session as such.

5.4 Regarding the other specific suggestions proposed by the CC in parts (a) and (b) of paragraph 54 of the remedies notice, we do not support a requirement to change shareholder voting requirements to include an option to vote for holding a tender for external audit, nor to require an enhanced level of support (i.e. more than a simple majority) if it was proposed that an auditor should remain in place after a mandatory tender. Such requirements should be for fundamental issues of the corporate constitution. It would seem strange for the will of a simple majority not to be allowed to prevail in such a matter.

5.5 A further series of measures with meaningful potential impact would be to require companies to disclose their audit and non-audit policy to shareholders, on the company's website or in the annual report. Such disclosures might include:

- the company's approach to the audit tender and audit firm selection decision, including its approach to re-tendering
- details of how long the audit firm has been used as auditor, and the company's policy on maximum auditor tenure
- any obligations to third parties about the company's choice of auditor
- the company's policy for using a range of accounting firms; and details of how they get to know and use accounting firms which are not among the dominant firms
- the company's policy for using the audit firm for undertaking non-audit services, including maximum volume of non-audit services provided by the auditor, services which may be provided by the auditor but only with prior approval of the audit committee, and use of firms other than the auditor
- the company's approach and policy for ensuring sufficient engagement/dialogue is had with the company's shareholders.

5.6 We also support a requirement for the AC to name in the annual report the audit firms used by the group, and to disclose those elements of the group that have been audited by a firm other than the group auditor.

5.7 The above requirements would force ACs and companies to spend time considering their policy for the use of accounting firms for audit and non-audit work, and provide shareholders with more transparent information about the audit firm's engagement with the company, and the company's actions to ensure that the audit firm is independent.

Specific CC questions

What are considered to be the most effective means of enhancing shareholder engagement on audit and financial reporting issues?. And suggestions as to how such means could be achieved.

5.8 See our comments above.

What costs and benefits would arise as a result of this remedy?

5.9 The benefit of the above arrangements would be to provide shareholders with a forum to increase their engagement in the audit process and over the appointment of an audit firm, and through that forum an opportunity to proactively exercise their views if there are concerns about the independence of the incumbent audit firm from management. The addition of disclosure by the AC over areas which are a known cause of investor concern would also assist in alleviating such concerns and increasing the transparency around auditor appointment and reappointment decisions for shareholders.

5.10 There are no significant costs in the implementation of this remedy.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

5.11 We have nothing to add to earlier comments.

6 Extended reporting requirements

6.1 We support efforts to improve reporting in the Audit Committee or Auditor's report to meet the demands of investors. The quality of reporting by companies, and audit reporting thereon, can be a direct signal of quality to shareholders. Investors have indicated for a long time that they want enhanced auditor reporting, and yet the audit report has remained substantially the same for a long period of time. Recent action triggered by the European Commission and subsequently the IAASB are considering changes in this area.

6.2 In this regard, Grant Thornton has responded to recent consultations by the FRC and by the IAASB on these topics. We concur with the CC's suggestion at para 60 of the remedies notice and paragraph 64(a) that the FRC is best placed to address this issue with companies and shareholders.

Specific CC questions

How the CC may best support the FRC in establishing enhanced reporting and whether there are other avenues, including direct measures by the CC, that should also be pursued?

6.3 We consider that reporting by the Audit Committee and by the Auditor is substantially a requirement to be dealt with by standard setters at an international, European or national level, and that there is unlikely to be a role for the CC in implementing direct measures. However, the CC may recommend to the FRC measures which it considers are likely to best support the issues that is has identified.

What should be the scope and form of enhanced reporting proposals? For example:

(i) whether further disclosure should be made via the AC's report or the auditor's report;
(ii) what the content of the additional disclosure should be. For example, should this be some form of commentary as to how the company's interpretation of the accounting standards compares with the norm; or commentary on the main topics of debate between auditor and management; or something else; and
(iii) what guidance as to the form of the disclosure should be required.

6.4 See our comments above regarding our views on the content of the additional disclosures

6.5 The disclosures should be the responsibility of the AC, but the auditor might be required to provide assurance that the disclosures are consistent with their understanding of the entity's policies and have been applied as would be expected.

6.6 While we support measures to enhance relevant disclosures in the AC and audit reports, we believe that any changes should leave the respective responsibilities of directors and auditors intact, i.e. it is for the company to report on accounting issues and the auditor to report on audit issues. We do not currently favour an approach in which the auditor and directors give "competing" interpretations of accounting standards and judgements.

What costs and benefits would arise as a result of this remedy?

6.7 The benefit of this remedy would be principally to improve the transparency for shareholders over how the company engages with the auditor and ensures that the audit firm is independent of management. This would help to break down the misalignment of incentives which is currently in place.

6.8 Further, a requirement that companies give due thought and provide disclosure on their policy for using firms outside of the incumbent auditor for non-audit work, and for using more than one audit firm in the group audit, will break down barriers that currently exist for audit firms in the market.

Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?

6.9 We have nothing to add to earlier comments.

Remedies that the CC are not currently minded to consider further

7 Constraining non-audit service provision by the auditor

7.1 Grant Thornton continues to be of the view that the CC should implement a remedy which places further constraints on the ability of the incumbent auditor to provides non-audit services to the company. This remedy would be effective, with other remedies, in reducing the barriers to switching identified by the CC. Moreover, such a remedy would be straightforward to implement and would be low cost.

7.2 The UK listed audit market currently follows the Ethics Standards issued by the Auditing Practices Board which build on the IFAC code of ethics and which stipulate various requirements regarding the provision of non-audit services by the auditor. These ethical rules prohibit the provision of certain non-audit services, which are considered to give rise to an independence or objectivity concern if provided by the auditor, in addition to setting parameters over the size and type of fees which are able to be charged. In many cases non-audit services are able to be provided by the auditor if appropriate safeguards are applied and the audit committee gives agreement to the service provision.

7.3 Notwithstanding acting in accordance with the above regulations, for many companies the first choice provider of non-audit services is currently the incumbent auditor. Grant Thornton's research into corporate reporting within the FTSE 350 "A Changing Climate, Fresh Challenges Ahead" indicates that companies in the FTSE 350 incurred on average non-audit fees of 80% of their audit fees in the period from May 2010 to April 2011 and, of these, 73 companies paid more to their auditor for non-audit services than for audit services. The report also shows that only 10 companies did not use their auditor to provide any non-audit services during the period of review.

7.4 The use of the auditor to provide non-audit services is justified by many companies by the auditor's experience and knowledge of the company and, assuming safeguards are applied, is not in itself an issue. However this scenario results in an environment where it is very difficult for firms outside of the auditor to build relationships and raise their profile with the company – in many cases with non-audit work being allocated to the auditor without consideration of other firms.

7.5 Grant Thornton supports greater restrictions on the provision of certain types of non-audit services and/or limiting the aggregate level of such services that are able to be provided to FTSE 350 companies by the incumbent audit firm as a means for companies to get to know more firms and over time use more accounting firms for the provision of audit and non-audit services. A restriction on the provision of non-audit services by the audit firm will also increase the perception of auditor independence and it would positively impact on market liquidity.

7.6 We believe that if a remedy has a positive impact on liquidity of the audit market and is neutral in all other respects then the remedy should be implemented, for the reasons described in the summary of provisional findings. As identified in para 72 of the CC's notice of potential remedies this measure would be "a key means by which

non-incumbent audit firms could provide company management with experience of their expertise and obtain insight to support potential switching of the audit assignment".

7.7 The CC asserts in its reasons for not immediately proceeding with this remedy, that a prohibition of providing non-audit services would negate the benefit of companies being able to build relationships with more firms. However placing restrictions on the type or volume of non-audit services which **the incumbent audit firm** is able to provide would help to **increase** the number of potential providers of audit services with experience of the company over time.

7.8 We note that the CC expresses a concern, in paragraph 72 of the remedies notice, that through providing certain non-audit services, a firm could be "locked out" of providing statutory audit services to the company in the future. We believe that these concerns are overstated as most significant non-audit services assignments are transactional, i.e. one-off in nature, and would likely not impact on the independence of the firm were they to take up the audit in the future. Further, companies (and auditors) would be very easily able to manage the volume of non-audit services awarded to potential future auditors (for example, as part of managing the period up putting the audit out to tender or, if applicable, mandatory rotation) so as not to exceed relevant thresholds.

7.9 For these reasons we believe that both prohibitions on certain services (primarily tax consulting and due diligence which are typically transactional in nature and constitute a significant proportion of non-audit services provided by the auditor to the company) and limiting the aggregate level of non audit services by reference to the audit fee (for example, 50% of the audit fee, averaged over three years) merit deeper consideration. Grant Thornton considers that this remedy is a low cost measure to changing buying patterns in the market, as the remedy essentially replaces one supplier with another in markets where there are ample suppliers.

8 Joint or major component audit

8.1 Grant Thornton advocates the use of consortia audit arrangements[10] to either require or incentivise companies to use more firms for their group audit services.

8.2 This remedy would help to overcome one of the issues identified by the CC, that mid-tier firms face barriers to entry in the market. We believe that, over a period of time, the introduction of consortia audits would facilitate the recognition that additional firms are capable of auditing the largest companies, and thus facilitate the involvement of more audit firms in the audit of large listed groups. This should also reduce the risk of the failure or withdrawal from the audit market of one of the dominant auditors or audit firms.

[10] A consortia audit is one where more than one auditor is involved in auditing the components of the group. The other audit firm would be responsible for auditing a significant part of the group (say at least 25%). A consortia audit allows participation of a non dominant audit network in the audit of a large listed group but facilitates a dominant network alone signing the group audit report.

8.3 Incentives for the company to using more than one firm might include an increased MFR period (say 21 years instead of 14 years) or the ability to use the incumbent audit firms for an increased range of non-audit services.

8.4 We note that the CC has "not formed a view as to whether [this remedy] has a beneficial effect on independence or not, nor whether it would be likely to reduce barriers to entry" (paragraph 74 of the notice of possible remedies) but that "the benefits… (eg greater visibility of firms' capabilities) could likely be more effectively achieved through remedy options such as mandatory tendering and enhanced frequency/remit of AQRT reporting" (paragraph 77 of the notice of possible remedies). We find the two statements to be inconsistent. The benefits of joint or component audit bring a degree of certainty of a desirable change in market structure and, further, more frequent tendering combined with change in AQRT remit should bring greater visibility of firms' capabilities, but there are other factors acknowledged by the CC which adversely influence the company's auditor selection decision that this would not correct, such as misperception about global capability and the inherent advantage in the tender process gained by being the incumbent auditor.

8.5 Consortia audits would not increase costs for the company and, in some cases, will result in a reduced audit fee for the entire group. Grant Thornton currently participate in a number of consortia audits of large international groups. Our experience is that the groups concerned are very satisfied in terms of both cost and quality. We have previously provided information to the CC on this area, in particular in our response to the CC's Issues Statement.

8.6 There is no academic evidence that we have seen the adoption of consortia audits or joint audits in other jurisdictions has resulted in a fall in audit quality.

8.7 For the reasons set out above we believe that the benefits from encouragement for consortia audit deserve further consideration.

8.8 We also support a bolstering of the existing Governance Code requirements for ACs to consider multiple audit firms on a group audit. The current guidance for audit committees says "*It might also be appropriate for the audit committee to consider whether there might be any benefit in using firms from more than one audit network*"[11]. The FRC gives guidance to audit committees in these circumstances.

8.9 In addition, we support calls from the likes of the National Association of Pension Funds for more companies to provide increased transparency over their policies for using a wider range of audit firms[12] "*We would.. ...encourage firms to set out within an audit policy their approach to shared audits. Such a disclosure could aid competition in the audit market by highlighting a firm's approach to building relationships with non-Big Four audit firms.*"

[11] See http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Guidance-on-Audit-Committees-September-2012.aspx

[12] See http://www.napf.co.uk/PolicyandResearch/DocumentLibrary/~/media/Policy/Documents/0264_EU_Reform_of_The_Audit_Market_an_NAPF_Position_Paper.ashx

9 Shareholder group responsibility for auditor reappointment

9.1 In our experience shareholders are currently rarely involved in the auditor appointment decision prior to the annual general meeting resolution to approve appointment. Shareholder involvement in the process is critical because the current practice of seeking shareholder approval at the AGM is usually too late to have sufficient influence on the decision.

9.2 However we concur with the CC's Notice of remedies that holding a shareholder group responsible for auditor appointment could lead to a situation where some shareholder views are marginalised and may conflict with the responsibilities of the AC. We set out in paragraph 5.2 an alternative remedy which would facilitate greater shareholder involvement in the audit appointment process.

9.3 We therefore consider that the recommendations made in sections 4 and 5 of the "Remedies the CC are exploring" section are likely to be more effective.

10 FRC responsibility for auditor appointment

10.1 In general we do not believe that the auditor appointment decision should be made by any party other than the company, with adequate input from shareholders. This is because a third party is unlikely to be sufficiently familiar with the particular circumstance of individual companies, which will lead to ineffective appointments.

11 Independently resourced Risk and Audit Committee

11.1 Grant Thornton considers that this possible remedy could incur a significant level of time and effort which would likely lead to a no greater effective measure that those expressed in sections 4 and 5 of the "Remedies the CC are exploring" section.

12 Packages of remedies

Views are invited as to whether any particular combinations of remedy options would be likely to be effective in addressing the AEC we have provisionally found. Views are also sought as to whether there are any particular combinations of remedies which are likely to interact adversely in reducing effectiveness or otherwise lead to undesirable outcomes.

12.1 As stated previously, we strongly support the implementation of a balanced package of measures. There are a number of harmful factors which would not collectively be removed or mitigated by one or two remedies. These factors have been discussed in our earlier responses.

12.2 In summary and for the reasons set out above, the package of remedies which we encourage the CC to implement in order to remedy, mitigate or prevent the adverse effects on competition which it has identified in its provisional findings into the market for the supply of statutory audit services to large companies in the UK is:

- mandatory tendering at a maximum period of 10 years. It will, however, be important to take note of the views of other stakeholders, especially

shareholders, about whether there is a role for comply or explain with the potential to introduce mandatory tendering subsequently if that does not work;

- mandatory firm rotation at a maximum period of 15 years, as a backstop to tendering. This period might be increased to 20 or 21 years where a company uses more than one audit firm for its statutory audit (i.e. a consortia audit);

- further constraints on the ability of the incumbent auditor to provides non-audit services to the company, for example by placing a cap on the volume of non-audit services which an auditor can provide to a company or by prohibiting certain transactional (i.e. one-off in nature) services (see section 7);

- the use of consortia audit arrangements to either require or incentivise companies to use more firms for their group audit services;

- an expanded AQRT process, so that the regularity of reviews and the substantive work involved in inspecting the audit files of audit firms who provide audit services to companies of similar or equal size and complexity is consistent;

- the prohibition of all forms of third party anti-competitive restrictions on who a company may appoint as auditor, unless those restrictions are objectively justified;

- strengthened accountability of the external auditor to the audit committee;

- enhanced shareholder-auditor engagement, including requiring the AC to propose 2 audit firms to shareholders upon the completion of a tendering event, with a duly justified preference for one of them, for an affirmative decision during the auditor appointment process; and increased disclosure by companies over their audit and non-audit policy to shareholders (see paragraph 5.5); and

- enhanced audit reporting requirements.

13 Relevant customer benefits

Views are invited on the nature, scale and likelihood of any relevant customer benefits within the meaning of the Act and on the impact of any possible remedies on any such benefits.

13.1 The relevant customer benefits of the remedies supported by Grant Thornton are set out above.