

Inquiry Manager
Statutory Audit Investigation
Competition Commission
Victoria House
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London
WC1B 4AD

auditors@cc.gsi.gov.uk

25 March 2013

Dear Ms Carstensen,



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**RESPONSE TO COMPETITION COMMISSION
STATUTORY AUDIT SERVICES MARKET INVESTIGATION**

We are writing to respond to the Competition Commission's recent investigation into the Audit Services Market Investigation.

We note that you have requested responses both to your provisional findings and to the possible remedies. This response is intended to respond to both papers.

The Financial Reporting Council has recently updated the UK Corporate Governance Code to require companies to tender audit services every 10 years on a "comply or explain" basis. We believe that this change should be allowed time to take effect before introducing any further changes.


We do not believe that your findings and proposed remedies take account of the importance and strength of Audit Committees, which act on behalf of the long term interests of shareholders in overseeing and directing the work of auditors. We are also concerned that the proposed remedies are unlikely to increase competition in the market place and enable mid-tier firms to take on work for bigger and more complex global companies.

Our Audit & Risk Committee takes its role in scrutinising the work of our auditors very seriously. Our Audit & Risk Committee Chairman meets privately with our engagement partner immediately prior to each Audit & Risk Committee meeting. Our Auditors attend every Audit & Risk Committee meeting and indeed at each face to face meeting the Committee has a private session with the auditors, without executive management present. It is our Audit & Risk Committee who recommends the re-appointment of the auditors, agrees the audit plan, and how much non audit work the auditor may carry out, as well as the audit fee and when and whether it feels it is appropriate to conduct an audit tender. In fulfilling this role our Audit & Risk Committee reports to the Board. Our Audit & Risk Committee Chair reports to shareholders on the work of the Committee and the oversight of the Auditors in our Annual Report each year. In addition, our Chairman meets privately with our engagement partner twice a year ahead of the approval of our full and half year results.

The Non Executive members of the Board are particularly keen to ensure that our auditors are independent and carry out their role with rigour, as they provide another means for the Board to oversee the management of the Group and ensure the protection of shareholders.

Please do not hesitate to contact Victoria Whyte, our Company Secretary, (Tel: 0208 047 4509 Email: victoria.a.whyte@gsk.com) should you wish to discuss our response.

Yours sincerely

A handwritten signature in black ink, appearing to be 'S. Dingemans', with a stylized, somewhat abstract form.

Simon Dingemans
Chief Financial Officer
GlaxoSmithKline plc

A handwritten signature in black ink, appearing to be 'J. Lewent', with a long horizontal stroke extending to the right.

Judy Lewent
Audit & Risk Committee Chairman
GlaxoSmithKline plc

RESPONSE TO PROVISIONAL FINDINGS

1. **Companies face significant hurdles in comparing the offerings of an incumbent firm with those of alternative suppliers other than through a tender process**

Correct. It is much easier for companies to assess the service provided by its auditor rather than that provided by other auditors. However, this is the case with any other service provider.

Whilst management may only be familiar with the service levels provided by the company's auditors, most Audit Committees include experienced individuals who are familiar with other audit firms either where they hold executive or non-executive positions. In that respect, Audit Committees are in an excellent position to assess service levels provided by non-incumbent firms, indeed they are often better placed than management to make these judgements because of their current and comparative experience when selecting other service providers.

In addition, there is actually more information published by regulators such as the Financial Reporting Council and the Public Company Accounting Oversight Board on audit service levels than for many other service providers.

2. **It is difficult for companies to judge audit quality in advance due to the nature of audit**

Correct. It is difficult to judge audit quality in advance, but this is the case with any other service provider. Audit Committee members are likely to have experience of other audit firms.

3. **Companies and firms invest in a relationship of mutual trust and confidence from which neither will lightly walk away as this means the loss of the benefits of continuity stemming from the relationship**

A relationship of mutual trust and confidence is important both to companies and auditors, and indeed is crucial to an effective audit, this again is something that would apply to the relationship with any other service provider.

The main key to a successful audit is the engagement partner who runs and manages the audit. Audit Committee members are usually very able to assess proposed candidates and to determine whether they will work with the organisation's culture.

4. **Company management face significant opportunity costs in management time involved in the selection and education of a new auditor**

Correct. We agree that the Audit Committee and management time involved in drafting a tender document, reviewing and analysing the responses, selecting and educating a new audit firm is probably a big factor that discourages an Audit Committee from changing auditors.

However, we believe that the main reason long lived audits exist and continue is because of satisfaction with the service provided - just like any other service provider.

We understand that a tendering process involves substantial management time. This remains an issue whether companies wish to switch to another "Big 4" firm or to a mid-tier firm.

We are very concerned that in mandating a change in audit firm in the early years following the appointment of a new audit firm there is an increased risk of a reduction in the quality of the audit service. The new firm would need time to build up a comprehensive understanding of the Group and its issues.

We believe that this failing can be addressed the Financial Reporting Council's change already in place.

5. Mid-Tier firms face experience and reputational barriers to expansion and selection in the FTSE350 audit market

One of the biggest barriers to selecting a mid-tier firm as external auditor is their ability to provide the services needed by a large complex international Group.

We have operations in over a hundred different countries and would have concerns regarding the ability of smaller firms to have the international expertise, scope and resources to resource and handle such a large audit.

We are concerned that none of the proposed remedies address this key issue.

6. Auditors have misaligned incentives as between shareholders and company management and so compete to satisfy management rather than shareholder demand, where the demands of executive management and shareholders differ

This is not the experience of our Audit Committee. Our Audit Committee has developed a relationship with our auditors and management understand that it is the Audit Committee who makes the ultimate decision on when and if the auditors continue to fulfil their brief or need to be replaced.

The role of an effective Audit Committee is to help protect the auditor's independence. There are a number of safeguards in place to ensure that the Auditors remain independent of management:

- There are strict rules in place regarding the ability of the external auditors to undertake certain non-audit services. Auditors give up the opportunity to provide what are often viewed as more lucrative non-audit services to ensure that this independence is maintained.
- Non-audit services at GSK (as a company with a secondary listing in the US) are either prohibited or require the approval of the Audit Committee in advance. This was originally established for US listed companies in 2003 to comply with the requirements of the US Sarbanes-Oxley Act 2002.
- Most Audit Committees hold private sessions with the external auditors without management present on a regular basis. Any concerns that the auditors may have can then be raised.
- The regular rotation of audit partners every 5 years combined with regular rotation of senior audit staff also supports an independent and robust audit.

If these safeguards are not properly enforced, it is a failure of corporate governance within the company concerned and not merely a question of auditor independence.

Moreover, in our experience, auditors are sensitive to the need to protect their reputation and therefore highly incentivised not to risk that reputation by failing to fulfil their role properly. Their work is also overseen by the Financial Reporting Council on an annual basis.

7. Auditors face barriers to the provision of information that shareholders demand (in particular from the reluctance of company management to permit further disclosure.)

We have received minimal interest from shareholders for further information relating to audit work undertaken. Ahead of our Annual General Meeting, we receive very few comments or questions relating to audit work, other than the level of audit fees paid. Shareholders rarely ask to meet with the Chairman of the Audit Committee or raise questions about the audit in meetings with management.

We do not feel that the quality of audit reporting to holders is solely driven by lack of detailed information. Audit reporting is driven by prescribed language in accounting standards. If it is felt that there is an information gap in terms of disclosures, this could be better dealt with by amending those accounting standards.

RESPONSE TO POSSIBLE REMEDIES

1. Mandatory Tendering of the Audit on a more frequent basis

We support the provision in the recently revised UK Corporate Governance Code that the external audit contract should be put out to tender at least every ten years on a “comply or explain” basis. We believe that this new regime should be allowed to operate for a few years before any further changes are made.

We believe that the ten year period is appropriate given the work involved both for the Audit Committee, Management and for the auditor and prospective auditors both in the tendering period, and should a change of auditor be the outcome, in the early years of educating the new auditor about the Group.

We also believe that it is important that the “comply or explain” basis is retained as there could always be some reason that makes it inadvisable for the long term interest of shareholder to tender the audit in year ten, for example when there is a new Chief Financial Officer, new Chairman of the Audit Committee or takeover activity.

We do not understand how tendering the audit every ten years necessarily increases the likelihood of more mid-tier firms being appointed auditors to FTSE-350 companies. We believe that mid-tier firms are put off tendering for FTSE-350 contracts because of the time and resources required to tender and immediately after appointment.

2. Mandatory Rotation of Audit Firm

We do not support mandatory rotation of audit firms.

Our Audit Committee wishes to appoint the best firm for GSK and its shareholders. If having conducted a formal tender process it happens to be the incumbent auditor

who can deliver the best audit, it makes no sense to appoint an alternative especially given the length of time and resources required in the early years following a new appointment.

This proposal also undermines the role of the Audit Committee which as noted above has developed hugely in recent years and which now is the dominant influence in tendering decisions and the final arbiter in appointing the auditor.

For a Company of GSK's size, complexity and global reach, there are a limited number of audit firms who could be considered for appointment as the company's auditors. Firstly, we would need to be certain that the proposed auditor has the expertise, experience, size and international scope required to handle the particular audit. However, there are other considerations, which are also very relevant. We would not wish to appoint an external auditor who:

- Currently undertakes extensive non audit services for the company because of the need not only to tender and change the provider of audit services, but also to tender the non-audit services provided by the new auditor. It would also be necessary to check that none of the non-Audit work that they had completed would prejudice their ability to take on the audit. For example auditors cannot audit their own work. This could greatly reduce the participants in a tender process or could require the process to be undertaken over a very long timeframe.
- Have close links with a key member of financial or executive management, or the Audit Committee.
- Preferably does not act as auditor to a major competitor.

We believe that mandatory rotation of audit firms diminishes the authority of the Board to manage the Company's affairs.

There is no evidence from the very limited application of automatic tendering in other countries that it has done anything for audit quality or to increase the participants in the market. In fact it could well undermine quality because of the lack of motivation in later years of the appointment and because it takes time for a new auditor to get up to speed particularly in a complex Group like GSK.

3. Expand remit and/or frequency of Audit Quality reviews

We do not see the need to expand the role and frequency of Audit Quality Reviews although we would note that the current 1 year data gap for information on mid-tier firms is not conducive to opening up the audit service market to mid-tier firms. We understand that the Financial Reporting Council has inspected the Big 4 firms on an annual basis, whilst the mid-tier firms are only inspected on a three yearly basis. Perhaps this is something that could be reviewed when the inspections are delegated to the professional bodies subject to oversight and supervision in April.

4. Prohibition of "Big 4" clauses in loan documentation

We would not object to the removal of "Big 4" clauses in loan documentation, although we do not see that this would necessarily make a significant difference in whether or not a company will decide to appoint a mid-tier firm. The decision to

appoint a mid-tier firm will depend on their ability to conduct an audit of the complexity and scope required. This would create a learning curve for mid-tier firms to climb quickly to be able to provide such a service.

5. Strengthened accountability of the external auditor to the audit committee

We would refer back to our response to Provisional Finding 6 above. Like GSK, most Audit Committees do hold regular meetings with the external auditors without management present and have strict policies in place regarding the provision of non-audit services by the external auditors. A responsible Chairman of an Audit Committee is actively involved in the relationship with the external auditor, as described in your paper.

However, we do not understand how further strengthening the accountability of the external auditor to the Audit Committee addresses the issue of expanding the audit service market to mid-tier firms.

6. Enhanced shareholder-auditor engagement

We do not support the recommendations within this remedy.

Shareholders appoint the members of the Board and delegate to them authority for running the company in the long-term best interests of shareholders as a whole. This includes deciding whether and when to tender audit services. In turn, the Board select members of the Audit Committee, who are responsible for overseeing, amongst other things, the audit.

It is not appropriate that more than a simple majority be required for re-electing an auditor beyond any period of mandatory tender, when a simple majority is all that is required for appointing a director.

We see little purpose in requesting the audit partner to be present at the AGM. Auditors are currently present at all AGMs and in practice, are rarely required to answer questions. Requiring auditors to make a presentation would further extend the AGM unnecessarily.

We would also be concerned to further raise the profile of our engagement partner. We currently obtain shareholder approval each year to enable us not to print the engagement partner's name in our Annual Report and to keep it confidential to prevent him and his family from attracting the attention of animal rights activists.

Shareholders already have the right to raise questions on the audit and financial reporting at the AGM and this right is rarely exercised.

7. Extended reporting requirements

We see no need to extend reporting requirements further. Every other consultation on narrative reporting exhorts companies to "cut the clutter" and requiring additional disclosure runs counter to the current trend, particularly as we have seen little demand from shareholders for further information. We suspect that any further disclosure requirements would merely lead to unhelpful boilerplate disclosure.

We do not understand how extended reporting requirements would serve to facilitate greater use of mid-tier firms.