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Statutory Audit Investigation
Competition Commission
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Dear Sirs

Response to Competition Commission – Statutory Audit Services Market Investigation

I am writing on behalf of SABMiller to respond to the Competition Commission's recent investigation into the Audit Services Market. SABMiller plc is one of the world's leading brewers, with more than 200 beer brands and some 70,000 employees in over 75 countries. In the year ended 31 March 2012 the group reported earnings of US$5,634 million and group revenue of US$31,388 million. SABMiller plc is headquartered in the UK and listed on the London and Johannesburg stock exchanges, with a market capitalisation of some £55.2 billion (US$84 billion).

General observations

We have set out below our comments on your provisional findings and on the possible remedies, but we have three general observations:

- First, 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 these changes should be allowed time to take effect before introducing any further changes.

- Secondly, we believe that your findings and proposed remedies do not take account of the importance and strength of the audit committee, which acts on behalf of shareholders in this area.

- Thirdly, while we note the provisional finding about the difficulties which companies may experience when assessing the quality of work and service levels from an incumbent supplier against that of an alternative supplier (which is true across a whole range of suppliers, not just audit firms), we do not understand how the proposed remedies are intended to address this finding.

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**

   While it may be easier for companies to compare the service levels provided by an incumbent firm with those of alternative suppliers, this is also true of many other service providers engaged by companies, and is not unique to the audit market.

   In any event, even if management are more familiar with the service levels provided by the company's auditors, companies use a range of other professional services firms, including accounting firms which audit other companies, and as a result are quite well able to form a view on the relative qualities of the work done. In addition, FTSE 100 audit committees typically consist of experienced directors who are familiar with other audit firms used by other companies where the directors hold executive or non-executive positions. In that respect, the audit committee is in an excellent position to assess and compare service levels provided by non-incumbent firms.

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

   Again this is the case with any other service provider, and overlooks the experience which management and the audit committee members are likely to have 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**

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

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

   The biggest disincentive to the appointment of a new auditor is not the management time involved (although that will inevitably be significant) but the risk of a reduction in the quality of the audit service as a result of the change process.

   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, as the new firm needs time to build up a comprehensive understanding of the company and its issues. The risks associated with mandating audit change at every company in the FTSE 350 over too short a timeframe are therefore high. These risks are likely to far outweigh those of the current situation where it appears a few companies have governance failings. We believe that these failings can be addressed by the Financial Reporting Council's changes already in place.
   In any event, even if a company has not recently put its audit out to tender, it is likely that audit committee members will have experience of tenders in other circumstances, either as non-executives elsewhere or from previous careers as executives or professional advisers or auditors. In practice well planned tenders need not be unduly expensive or disruptive for all parties.

The main reason long lived audits exists is because of satisfaction with the service provided, just like any other service.

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

In our view, the biggest barrier to selecting a mid-tier firm as an external auditor is their ability to provide the services that would be needed by a large complex multi-national company. In our case, we have operations in over 75 different jurisdictions, and, especially in emerging markets and second tier cities, we would have concerns about the ability of smaller firms to have the international expertise, scope and resources to handle such large audits on an international basis.

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 simply not the experience of our audit committee, or, we suggest, of any FTSE 100 audit committee. What is described is something of a caricature of the process, which might have been the case some years ago, but audit committee competence and authority has developed significantly and we do not today recognise the description you give.

The role of an effective audit committee is to prevent this situation. There are a number of safeguards in place to ensure that the auditors are independent of management:

There are strict rules in place about the ability of the external auditors to undertake certain non-audit services. The company's auditors give up the opportunity to provide more lucrative non-audit services in order to comply with these rules to ensure that independence is maintained.

Most significant non-audit services above a specified monetary threshold require the pre-approval of the audit committee or its chairman.

Audit committees typically hold regular private sessions with the external auditors without management being present. 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 in our material subsidiaries and at group level 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 highly sensitive to the need to protect their reputation and independence and therefore highly incentivised not to risk that reputation by failing to fulfil their role properly. Such failings may lead to professional disciplinary proceedings and serious sanctions, which may include withdrawal of the right to practise.

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

This is just not the case. In our experience, we have received very little interest from shareholders for further information relating to audit work undertaken. Ahead of our Annual General Meetings, we receive very few comments or questions relating to the nature, scope or quality of the audit work itself, as opposed to the usual questions about the level of audit fees paid or the length of tenure of our auditors. Shareholders rarely ask to meet with the Chairman of the audit committee or raise questions about the audit in meetings with management.

The quality of audit reporting to shareholders is not principally driven by the reluctance of management to permit greater detail. In fact, much of the audit reporting is driven by prescribed wording in auditing standards. Reluctance to go beyond this is therefore less about management than about audit firms seeking to mitigate risk by adhering precisely to what they must say – rather than making subjective statements. It is highly unlikely that mid-tier firms would approach this challenge any differently. If it is felt that there is an information gap in terms of disclosures, this could be better deal with by amending the relevant auditing standards.

Response to Possible Remedies

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

The recently revised UK Corporate Governance Code requires that the external audit contract should be put out to tender at least every ten years on a comply or explain basis, and we believe that this new regime should be allowed to operate for a few years before any further changes are made.

We also believe that it is very important that the "comply or explain" basis is retained as there could always be some intervening event that makes it inadvisable to tender the audit at the end of the ten year period, such as, for example, when there is a new chief financial officer, a new chairman of the audit committee or if a company has recently been involved in any major corporate activity.

We do not however understand how tendering the audit every 10 years necessarily increases the likelihood of more mid-tier firms being appointed auditors to FTSE100 or FTSE350 companies, if they do not have the international reach and resources required both during the tendering process 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 the company having completed its necessary review. If the outcome of a tender process confirms that the incumbent auditor is best qualified for the role, it makes no sense to appoint a second best alternative given the length of time and resources required in the early years following a new appointment.

The proposal also fails to give due recognition to, and 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.

Like other large FTSE 100 companies, there are a limited number of audit firms who could be considered for appointment as our company's auditors. First and foremost, a company needs to be certain that the

proposed auditor has the expertise, experience, size and international scope required to handle the particular audit. However, there are further considerations, which are also relevant. A company would typically not wish to appoint an external auditor which:

already 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 previously provided by the new auditor);

has close links with a key member of financial management or the audit committee; or

(in some industries) already acts 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. In fact, we believe that it is more likely to undermine quality because of the time which it takes for a new auditor to get up to speed, particularly in complex groups.

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. We understand that the Financial Reporting Council already inspects the "Big 4" firms annually.

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

We do 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.

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

We refer back to our response to Provisional Finding 6 above. Our audit committee holds regular meetings with the external auditors without management present, and has strict policies in place regarding the provision of non-audit services by the external auditors. A responsible chairman of an audit committee will already be actively involved in the relationship with the external auditor, as described in your paper.

Also, while we recognize the importance of the points made in your paper, we do not understand how 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 these recommendations.

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 selects 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 make a presentation 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 extend the AGM unnecessarily.

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. There are multiple initiatives on narrative reporting exhorting 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 believe that any further disclosure requirements would merely lead to unhelpful boilerplate disclosure.

Yours sincerely

John Davidson
General Counsel and Group Company Secretary