

20 March 2013

Inquiry Manager
Audit Market Investigation
Competition Commission
Victoria House
Southampton Row
LONDON
WC1B 4AD

Dear Sir

**SAICA SUBMISSION ON THE UK COMPETITION COMMISSION FINDINGS -
AUDIT MARKET NOT SERVING SHAREHOLDERS**

In response to your request for comments on UK Competition Commission Findings - Audit market not serving shareholders, attached is the comment letter prepared by The South African Institute of Chartered Accountants (SAICA).

We thank you for the opportunity to provide comments on this document.

Please do not hesitate to contact us should you wish to discuss any of our comments.

Yours sincerely,

Ashley Vandiar
Project Director – Assurance and Members’ Advice

Commentary of specific paragraphs in the UK COMPETITION COMMISSIONS FINDINGS report dated 22 February 2013, from a South African perspective

Paragraph	Extract	Comments
2	“Additionally, although auditors are appointed to protect the interests of shareholders, who are therefore the primary customers, too often auditors’ focus is on meeting the needs of senior management who are key decision takers on whether to retain their services. This means that competition focuses on factors that are not aligned with shareholder demand.”	<p>Research concluded in 2008 found that the following factors may have a strong influence on the audit expectation gap. They have identified the following factors in their research which will contribute to this perceived gap:</p> <ol style="list-style-type: none"> 1) The complicated nature of the audit function 2) The conflicting role of auditors in terms of the provision of non-audit related advisory services as well as the attest function 3) Retrospection evaluation of the auditors’ performance by means of quality reviews being conducted by regulators 4) The shareholder’s unreasonable expectations of the audit function. (Please refer to Table of expectations noted) <p>The perception that the audit profession is currently not addressing the demands of shareholders, may not necessarily be solved through increasing the competitiveness of the audit profession, as the root causes of the expectations gap will not be addressed through increasing the competitiveness of the market.</p>
6	“auditors tend to focus on management interests over those of shareholders. For example, management may have incentives to present their accounts in the most favourable light whereas shareholder interests can be quite different.”	<p>ISA 220 par 9 to 11 requires that “The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement.” This ISA requires that the engagement partner as well as the engagement team should be independent and not favour management’s interest above that of shareholders. Compliance with ISA 220 will mitigate the risk that the engagement partner and engagement team will be bias towards management. EQCR reviews (based on ISQC 1) should mitigate this risk even further.</p>
7	“Shareholders play very little role in appointing auditors compared to executive management”	<p>Based on par 90 of the Companies Act No. 71 of 2008 in South Africa, the shareholders will appoint the external auditors at the Annual General Meeting (and not management)</p>
11	“Mid Tier firms face experience and reputational barriers to expansion and selection in the FTSE 350 audit market.”	<p>Based on research conducted by Dr Dirk Steyn (2006) the following factors may be barriers to entry for mid tier firms in South Africa:</p> <p>The rotation of audit practitioners as required in the IFAC code as well as the Companies Act no 71 of 2008, section 92.</p> <p>The prohibition of non-audit services provided by auditors to their clients based on the Companies Act requirements as stipulated in section 90(2).</p>

		<p>Pricing considerations during the engagement decision process, for example:</p> <ul style="list-style-type: none">• Increased training costs and resource requirements due to a lack of qualified chartered accountants.• Greater use of specialists needed relating to matters such as post retirement benefits, decommissioning provisions, environmental matters and sustainability reporting.• Other studies have concluded that firms in medium audit practice do not always use the same level of audit automation due to cost vs. benefit considerations. <p>The risk of ever-increasing litigation that has impacted significantly on audit fees and the pricing of high risk audit assignments.</p>
--	--	---

RESPONSES

Possible remedies

Our views on the seven possible remedies are as follows.

1. Mandatory tendering

The commission considers that a greater frequency of tendering may be required to address effectively the adverse effect on competition and, for the purposes of the consultation, has suggested periods of five or seven years.

Our view: We are supportive of the new corporate governance code that has introduced 10-year tendering for FTSE 350 companies on a 'comply or explain' basis. We have no concerns about increased tendering activity and are not concerned of competition. However, we do not think that there is one specific defined time period in which a tender takes place that makes sense for all companies in all circumstances. It is for this reason we support the FRC's 'comply or explain' approach which has a long and successful tradition in the UK – indeed the FRC found in 2012 that over 95% of boards complied rather than explained. In this respect the commission's proposed timescales of 5 and 7 years do not in our view strike the right balance between costs and benefits for the largest companies (and their shareholders) and could lead to a straitjacket. The suggested approach contrasts with the FRCS measures. 'Comply or explain' has worked very well in a number of other areas of corporate governance and in our view will work well in this context too.

2. Mandatory rotation of audit firm

Mandatory audit firm rotation for FTSE 350 companies after a specified period of time - seven, ten and 14 year periods have been suggested by the commission.

Our view: By making it mandatory for firms to rotate, the knowledge and understanding acquired by that firm would be lost and a whole new process would be started afresh when the new firm takes over the audit. Audit firm rotation would eliminate audit efficiencies that could be passed on from year to year which can be argued to affect audit quality. Further, this will undoubtedly increase costs. We also think it undermines extending accountability of the auditor to the audit committee if the audit committee is precluded from potentially choosing the firm they think is best for the job.

3. Expanded remit and/or frequency of Audit Quality Review Team (AQR) reviews

This remedy might involve changes to both the scope and frequency of the model and would be subject to further consultation.

Our view: We think that AQR reviews are valuable tools for audit committees. However, increasing their remit or frequency will have to be weighed against the costs of doing so.

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

Our view: We support the removal of such clauses however; there is a risk that this clause may be replaced with another clause which still excludes the medium tier firms. It should be the exclusion of any clause that limits the company to appointing an audit firm from only a select group of firms.

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

This remedy would require the audit engagement partner to report directly to the audit committee chair such that only the audit committee would be able to negotiate audit fees, initiate audit tenders, require a replacement of an audit engagement partner, authorize the external audit firm to carry out any non-audit work or conduct any other major aspect of the external audit relationship. The audit committee chairman would also be the first point of contact if a material audit issue arose rather than only being consulted after the finance director.

Our view: We agree that the role of the audit committees is fundamental, and we've argued consistently that audit committees are performing their job effectively. It is impractical, however, for a significant audit issue to be first discussed with the audit committee since it is probably only through dialogue with the finance director (or other senior accounting staff) that it will be clear if there was a material audit issue or not.

6. Enhanced shareholder-auditor engagement

Remedies might include requirements for: a vote on holding an audit tender; 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; audit engagement partners to present directly to shareholders at the AGM on the conduct and outcome of the audit; and audit committee chairs to have a dedicated AGM Q&A session.

Our view: We welcome dialogue with shareholders, although we note that audit committees are effective in our view in protecting shareholders interest. The problem with this remedy is the fact that shareholders are generally not interested in operational matters and shareholders generally do not even attend AGM. Further, this may not add or strengthen the audit quality, independence or ensure that all audit firms obtains a fair chance at being appointed. It may just be another level of interaction that would drive up audit costs without adding any benefit.

7. Extended reporting requirements

The commission supports the broad view for enhanced disclosure being led by regulatory bodies such as the FRC and IAASB, but has not, as yet, formed a view as to the most effective means of providing such information.

Our view: While this appears to be a positive remedy, one would need to be careful to ensure that the additional reporting requirements add benefit to the user / reader and justify

the additional costs involved. We are unclear how this will open up the market to allow the medium tier firms to perform more audits of the larger companies.