

UK Shareholders Association

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UK Competition Commission inquiry into Statutory Audit Services

A submission by The UK Shareholders' Association

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1 Introduction

The UK Shareholders' Association (UKSA) is a leading body representing the interests of private shareholders in listed companies. As a part of that work UKSA addresses matters which affect the interests of its members and so seeks to comment on the Commission's (UKCC) Notice of Possible Remedies issued 22 Feb 2013. We have had the advantage of reading the submission of the several institutions led by the Universities Superannuation Scheme (USS) and support that submission in all fundamental respects. There are, however, areas where we would place a different emphasis and accordingly this submission will refer to the above USS submission with comments from our own perspective. Our paragraph numbering follows that of USS and a copy of their submission is attached.

2 Competitive tenders and a cap on audit firm tenure (Remedies 1 and 2)

2.1 Our Proposal

We strongly agree with the USS proposal that there should be a maximum tenure period for the holding of audit appointments. The advantage of this is that there would be a completely new "pair of eyes" looking at a company's accounts. In our opinion, there is no acceptable substitute for this.

We are, of course aware of the requirements for partner rotation. We do however believe that these requirements, in practice, do not provide a reliably fresh approach. It is, for example, the very reasonable policy of audit firms to ensure that any contentious points on an audit are referred to their technical departments, but this will not change on the change of partner, thus no really new thought is applied. It is also very difficult for a member of a firm to challenge the decisions of his predecessors.

As for audit quality reviews, the UKCC itself notes that the Financial Reporting Council's team is only resourced to review audits at infrequent intervals. We must also note, however, the recent surge in cases against audit firms where they have been accused of negligence. It is therefore our opinion that the checks made by this team, whilst welcome, are not adequate.

2.2.3 Length of tenure

We note that it is accepted that an independent director is considered to have lost his independence after 9 years. There is, of course, no absolute logic in this view as it wholly depends on the character of each director and his relationship with the executive. However, it does appear to us that use of this benchmark is a reasonable approach to measuring the period over which an audit firm could be seen as maintaining its independence, so it is UKSA's policy to seek a maximum period of tenure lasting no more than 9 years. We note that the EU Commission have put forward proposals for a 6 year limit.

2.2.4 A possible waiver:

Once a cap is in place, UKSA would not support a waiver of this cap whatever the circumstances. We believe that auditors and audit committees should be able to plan for and manage any required changes.

3.1.1: AQRT

UKSA explicitly supports the comments made here. We particularly note and agree with the point that it is strange that shareholders, who are the people who pay for the audit and to whom the auditor reports, do not see the company specific reports made by AQRT on the performance of their auditors. We called for publication of these reports in our submission to the FRC in early 2011 during its consultation on audit practice at that time and strongly stand by that opinion.

3.1.2 Remedy 6 : Enhance shareholder engagement

The UKCC suggests a number of ways in which auditors and shareholders could come closer together. UKSA has a long standing policy aim to see the establishment of private shareholders' committees which, when in place, should certainly have the right to a dialogue with the auditors. Others propose more widely based shareholder committees, which to be fully effective should include elected individual shareholders who do not have any fees from or employment with the company.

Discussions with the auditors would not be the only purpose of such committees, of course. For example, the European consortium of shareholders bodies called 'Eurofinuse' is advocating the use of 'candidate committees' to appoint board members. Small shareholders, such as those represented by UKSA, do not normally have the opportunity to meet directors during the year and the two functions described here are typical of those a shareholder committee could undertake.

3.1.3 Remedy 7: Extended reporting requirements.

UKSA is interested to assist with the consideration of, and feels there could be benefit from, extended reporting, particularly by the Audit Committee (AC). We are aware of practical difficulties in this area and will seek to contribute to the debate.

4 The Audit Committee as a check on auditors. (remedy 5)

The relationship between auditors and audit committees should be strengthened. In particular, we believe it should be a requirement that the auditor can have direct access to the AC and not have to approach the finance director first, regardless of what might be the usual arrangement.

5 Remedy 4: "Big 4 only clauses".

We agree that these should be prohibited.

6 Limits on non-audit work by the audit firm.

UKSA appreciates the arguments for not restricting this type of work. It may or may not be true that non audit work is more profitable than audit work. It is, however, additional work and therefore attractive. A restriction on the total value of work that can be undertaken by the incumbent audit firm would not prevent the use of other firms where appropriate. Thus non- incumbent firms would still have the opportunity to gain exposure to the company being audited and become potential candidates to take over when tenure expires. UKSA wishes to see a limit set on the value of non-audit work that auditors may undertake amounting to no more than 50% of the audit value.

7 Conclusion:

It is clear to UKSA that action needs to be taken to enhance auditing. We believe that retendering with a mandatory cap on the length of tenure is the right way forward. Simply requiring retendering, as envisaged by the Financial Reporting Council is not enough. A major insurance company, requiring a very specialised audit, has recently changed its auditor and since reported that the changeover went smoothly and without major problems. We believe that the cost of changing auditors is sometimes exaggerated and should not be a major hindrance.

Greater disclosure and reporting to shareholders will help. Limits on non-audit work will provide more chances for non-incumbent firms to gain knowledge of companies in question.

Any questions on this submission should be addressed to enquiries@uksa for onward transmission to the author.

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