

Inquiry Manager
Statutory Audit Investigation
Competition Commission
Victoria House
Southampton Row
London WC1B 4AD
auditors@cc.gsi.gov.uk

20 March 2013

Dear Ms Carstensen,

Response to Competition Commission – Statutory Audit Services Market Investigation

Smith & Nephew plc welcomes the opportunity to respond to the Competition Commission's recent investigation into the Audit Services Market. 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. Smith & Nephew plc is a UK FTSE 100 company, with a secondary listing on the New York Stock Exchange. We have around 20,000 registered shareholders and operate in over 30 countries across the world.

We have been actively involved in the response submitted by the GC100 Group to this consultation and would wish to endorse the points made in that submission as well as the submission from the Hundred Group of Finance Directors. The Smith & Nephew response will therefore be confined to a few key points rather than repeating points made elsewhere:

General Points

- 1) 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.
- 2) We note the provisional findings from your review, many of which are very similar to the experience companies have when assessing the quality of work and service levels from an incumbent supplier against that of an alternative supplier. The difference however is that members of the Audit Committee with their experience in executive or non-executive roles at other companies are well placed to assess service levels and audit quality in firms other than

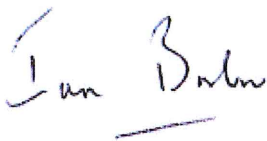
the incumbent firm, which is not always the case with other service providers. In addition, there is actually more information published by regulators such as the Financial Reporting Council and the Public Company Accounting Oversight Board on audit service levels than is generally available for other service providers.

- 3) We do not understand how the proposed remedies are intended to address the findings. For example, enhanced shareholder-auditor engagement would not impact our decision whether or not to appoint a mid-tier firm as our auditor. The real issue is the ability of mid-tier firms to provide the services that are needed by a large complex international company such as Smith & Nephew. We have operations in many different jurisdictions and would have concerns regarding the ability of smaller firms to have the international expertise, scope and resources to handle such a large audit on an international basis.
- 4) We believe that your findings and proposed remedies do not take account of the importance and strength of an effective Audit Committee, whose role, amongst other things, is to ensure that the auditors are independent of management. Our Audit Committee and the Chairman of the Audit Committee hold private sessions with the external auditors without management present where they can raise any matters of concern. Any non-audit services are controlled within tight parameters. Any non-audit services that management proposes to be undertaken by the auditors require prior approval from the Chairman of the Audit Committee. The Audit Committee, led by a financial expert, evaluates the capabilities and delivery of the auditors both informally through their regular interactions with the audit partners throughout the year and in the formal assessments made at year end. Our audit partner and senior members of the audit team are rotated at least every five years and the Audit Committee is actively involved in the appointment of the new audit partner together with the assessment of the effectiveness of the external Auditor. In the event that there were any problem with the auditors, the Audit Committee would be prominent in determining whether and when to test the service through tender. Your findings do not reflect the level of independence and responsibility found in the modern Audit Committee
- 5) Whilst recognising the need to tender the provision of audit services within the next few years, we are mindful of the disruption likely to be caused and the significant management time required to carry out this process effectively. This is not something we would wish to address immediately following the very recent appointment of a new Chief Financial Officer. Were we to decide to change auditors, significant time would be required in managing the transition period from our existing firm to a new audit firm. During this period, there would be an increased risk of a reduction in the quality of the audit service, as the new firm would need time to build up a comprehensive understanding of the company and its issues.
- 6) As and when we do carry out a tender of our audit services, we recognise that there really is very little choice available to us. The Chairman of our Audit Committee is a former partner of one of the Big 4 firms and we therefore feel that it would be a conflict of interest were we to appoint that firm. We do not feel that the mid-tier firms would have the experience, scope and

range to handle an audit of our complexity, particularly on an international basis, although we would include them in our considerations. We have heard from other companies that the mid-tier firms have been withdrawing from the tender process once they see the scope of what is required for a FTSE350 audit. We have significant relationships for the provision of non-audit services with the remaining two Big 4 firms. If we were to select one of these firms, this would mean that we would re-tender these non-audit services, which extends the management time required. These are all practical considerations that will require us to make a considered decision before changing auditor. For these reasons, whilst supporting the move to more regular tendering of audit services we would not support mandatory rotation.

We would welcome the opportunity to discuss these issues with you further.

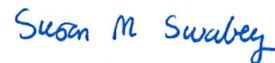
Yours sincerely



Ian Barlow
Chairman of the Audit Committee



Julie Brown
Chief Financial Officer



Susan Swabey
Company Secretary