COMPETITION COMMISSION

STATUTORY AUDIT SERVICES MARKET INVESTIGATION

[Company H]

Background

1. [Company H] (the company) was a FTSE 250 business that discovered, developed and produced oil and gas assets globally. [✂]. The company had recently sold the majority of its Indian investment.

2. It was currently ranked at 157 in the FTSE index. It was in the FTSE 100 until the second quarter of 2012 when it moved to the FTSE 250—following a return of capital to shareholders and resulting reduction in market capitalization. The company had net assets of $6.9 billion at 31 December 2011.

3. The company's major shareholders were institutional investors. [✂]

4. Ernst & Young (EY) had audited the company for a number of years. The company held a tender in 2003 where EY was retained as auditor. The company recently introduced a policy to hold a tender every ten years. The audit fee for 2011 was $984,000.

The Finance Director's view

5. The Finance Director [✂] (FD) qualified as a Chartered Accountant with KPMG in 1990 and as a Chartered Tax Advisor in 1992. She moved to Deloitte for a short period in 1997 where she was headhunted by the company for the role of Group Tax Manager. She became Financial Controller in 1999 and FD in 2006. EY had been the auditors since she joined the company.

Relationships

Audit Engagement Partner

6. The FD's deputy ran the audit process from the company's side and knew more about the auditor's work than the FD. The FD could know about all of the audit work if she wanted to. The FD interacted mainly with the AEP to agree the audit plan, review levels of materiality, and discuss the approach to the audit (a controls-based audit or a substantive audit). The audit plan was then taken to the Audit Committee for approval. An important part of the relationship was that the auditors could speak to the Audit Committee without management present, and management could speak to the Audit Committee without the auditors present.

7. The FD became involved at the planning stage if there were any significant issues that arose. The year in which the FD was most involved was in her role as Financial Controller during the company's transition to International Financial Reporting Standards (IFRS) accounting standards. There were no clear written guidelines on oil and gas extraction industries and what the guidelines required from the accounts. The company talked to peers in the industry and other audit firms as to how the guidelines should be interpreted.

8. During the rest of the audit process, the FD was involved if there were other significant issues. Otherwise the FD left the team to get on with the audit. She attended the

close-out meeting and reviewed Audit Committee papers for completeness and accuracy before going to the Audit Committee.

Audit Committee

9. The main questions asked by the Audit Committee of management were where management had made commercial decisions. The Audit Committee asked the auditor about its approach to agreeing judgements with management and its approach to technical judgements.

10. The company had had two different ACCs during the FD's tenure. The FD rated the current ACC (a former Audit Partner) as very good. This was in part because the ACC was based in the same city as the FD, and was recently retired so was very accessible and able to talk about issues at very short notice. The former ACC was also an FD at the same time and was therefore very busy which made making contact harder.

11. The FD noted a difference in approach between a current FD and former Audit Partner with respect to the ACC role. A former Audit Partner had more in-depth understanding of the auditor requirements and had more ways to challenge the auditor. Any ACC needed to have necessary experience to identify where management had made commercial judgements, and whether management could explain the use of technical accounting for particular items.

Shareholders

12. The FD had very little contact with equity investors concerning the audit of the financial statements (in the company's case shareholders were only interested in the amount of cash on the balance sheet which could be invested). The FD had more contact with banks on matters relating to the audit. Banks lending to the company had asked questions of the relationship with the auditor, the audit process, internal audit and risk management, and occasionally wanted direct contact with the auditor. They did not ask questions about the choice of auditor.

13. The FD saw management's role to be one of stewardship, but she accepted that the audit gave shareholders assurance.

Resolution of audit issues

14. The FD expected the auditor to challenge areas of judgement as part of the technical review process. The company had a technical 'guru' who debated 'quite hotly at times' with the audit team the correct accounting policy for certain items. It was important that in cases of disagreement a written review was completed explaining what the accounting standards said and why there was a disagreement so the Audit Committee could make a judgement. This had only happened a couple of times and generally issues were clarified during the technical review process.

15. The FD thought that IFRS could be counter-intuitive. For example, in one year's results two-thirds of reported profit was derived from foreign exchange movements for intra-group loans. It was technically correct to report this as profit but did not feel as if it should be the correct result for shareholders, because intra-group trading was normally eliminated. The FD was persuaded through several meetings with the ACC, the AEP and the reviewing Technical Partner that this was the only correct way to present the item. IFRS could cause some unintended results and it was very important that the ACC, the AEP and management had an open and informed debate about

the issue before making conclusions. The treatment of this particular issue was made clear in the press release and accounts.

16. One example of materiality discussed was the divestment of a large part of the business (equal to 100 per cent of turnover and profit). The FD talked to the AEP about how the reduced market capitalization affected the audit approach and what level of detail was required.

17. The FD did not think that debates on judgements could be characterized as management wanting a higher level of materiality and the auditors wanting a lower level. She wanted the audit to be as efficient as possible, but thought she was 'pretty aligned' with the auditors on the appropriate level of materiality.

18. The FD ultimately wanted to ensure that the books were correct. The FD explained that the income statement and balance sheet were relatively unimportant for the capital market's assessment of how the company was doing, and she therefore focused on having as clean a balance sheet as possible—profit levels were irrelevant.

Accounting issues for extractive industries

19. Much of extractive industries accounting was driven by technical reporting. The oil and gas reserves reports gave the position of the oil and gas reserves under the ground available to the company. The reserves determined depletion charges, abandonment charges, and informed company valuation.

20. Many of the issues that had 'hit the press' in the sector had been due to a lack of understanding on the part of either FDs or audit partners about what drove the reserves reports. In the reports, one of the key issues to understand were methods of extraction and whether what remained under ground was accessible.

21. There were both technical and commercial aspects to these issues. Examples of technical factors included different extraction techniques and the quality of reservoirs, and how this impacted the 'recovery factor' (the proportion of barrels underground that could be extracted). Commercial factors related to the structure of contracts with the host government. The way revenue was shared between the company and the host government changed over time depending usually on the pattern of extraction.

Auditor selection

Tender in 2003

22. The company last held a tender in 2003, when EY retained the audit. The company had been faced with audit partner rotation and thought that it was a suitable time to hold a tender. Three firms, EY, KPMG and PwC, were invited to tender. Deloitte and mid-tier firms were not invited as they did not have a compelling presence in India at the time.

23. The FD said that she had good awareness of the audit firms' presence in India as at the time she was spending much of her time there and so was able to meet the individuals. She explained that whilst the firms could impose standards and processes across the world she needed to know the skill of the individual partners in the territories and make sure that they were independent, understood the industry and understood IRFS reporting as well as local standards.

24. The bidders submitted written submissions at the first stage of the tender. In preparation, the bidders were offered access to whoever they wanted at the company. PwC dropped out at this stage as the company felt that KPMG and EY demonstrated a deeper understanding of the company's business and issues.

25. EY and KPMG made presentations to the Audit Committee, the other board members and some members of the finance team at the second stage of the tender. Each gave a presentation of two and a half to three hours. The decision was very close but EY retained the audit.

26. The Audit Committee's prime concerns were:

(a) 95 per cent of the company's business at that time was in South Asia and the audit firm needed to have coverage of this area as well as the UK.

(b) Assurances that the auditor understood the technicalities of the industry.

27. There was no formal scoring matrix for the tender. The FD thought that KPMG was better in terms of coverage but EY was better in terms of technical understanding, which was considered the more important factor by the Audit Committee. EY retained the audit as it demonstrated both a deep technical understanding along with good coverage in South Asia. The fees proposed were similar for each audit firm.

Annual reappointment

28. The company floated its Indian business in 2006. The company was advised by the book-runners Merrill Lynch, ABN Amro, Morgan Stanley and Citibank that the Indian market would find it strange if the auditor that signed the prospective accounts was not in place for at least three years after flotation. Therefore any decision to tender the audit was put on hold.

29. The company had introduced a new policy of tendering every ten years in March 2012. The policy had been discussed between the FD and ACC for about six months and would be included in the annual report. The company faced auditor partner rotation and thought that this was a natural break point. [✂] The FD thought that the most feasible time to conduct a tender was after the year-end audit or after the interim review. The FD noted that changing auditors whilst conducting a major transaction would not be feasible.

30. The company produced a full written report on the auditor every year. The audit committee members, FD and members of the company's finance team that liaised with the auditor for the relevant year were asked to review the ICAS 'Reviewing your auditor' guidance and complete the 'Possible Trigger Points from Ongoing Auditor Review' and 'Annual Audit Assessment' questionnaires in that document, in respect of the auditor's performance for the relevant year-end process. The questionnaires covered: changes in relationship, changes in independence, changes in competence, communication, independence and objectivity, financial stability and risk profile of the firm, audit strategy, communication of adverse or unexpected findings and finalization of the audit.

31. The company had not decided who it would invite to any future tender. An important aspect for the company was that had yet to decide in which territories it would operate in the near future. Therefore any potential auditor had to have broad international strength. For this reason, the FD thought that it was possible that only the Big 4 firms would be invited to tender, although this was a decision reserved to the Audit Committee. The FD did not feel limited within the Big 4 firms as IFRS for extractive

industries was now more established and there was a reasonable spread of extractive industries clients among the Big 4 firms.

32. The FD had informal discussions with mid-tier firms but did not think they were interested in the company's audit, although she did think they could do the work. The FD had discussions with other firms below the ranks of the Big 4 and had gained the impression that they were reluctant to move into FTSE 100 auditing and take on the burden of professional indemnity insurance which accompanied these audits. The company dropped out of the FTSE 100 but the FD did not know if this would make the company more interesting to mid-tier firms.

Switching costs

33. The FD considered that it was not unusual for fees to be more competitive following an audit tender process. Often these were held for a period of up to three years.

34. There was a significant amount of management time involved in any tender process. The FD thought there was no point in undertaking a tender unless the process was meaningful, and to do this the auditors needed access to a broad range of management within the company (probably 25 to 30 individuals), across the finance, reserves reporting, risk management and internal audit teams, and the company secretarial.

35. The FD was less concerned about the risk associated with a new auditor getting to know the business and the technical issues. As part of the tender process the company took into account the ability of prospective auditors to get to grips with technical issues. The FD knew the client lists of the Big 4 firms in extractive industries so expected them to have an understanding. She said that Deloitte had expanded its client base since the previous tender. The FD did not mind incurring the additional management costs in bring a new auditor up to speed as it was valuable to the company to ensure that the accounts were thoroughly scrutinized.

36. The FD expressed the importance of transparency to shareholders in incurring tendering costs and that tendering gave them a chance to share opinions. The FD was strongly against mandatory rotation of auditors.

Fees

37. The FD's deputy led on fee negotiations. At the time of the tender the audit fee for the first year and the inflation rate for the next three years were agreed. The company's structure had changed significantly (with sales of major assets in India), therefore the audit fee was very different and hard to reconcile with previous years.

38. The audit fee was agreed annually since the tender in 2003. The fee depended on the number of subsidiaries audited and the number of territories where the audit was coordinated. The auditor provided a fee to audit a particular number of subsidiaries rather than an individual fee for each subsidiary.

39. The company did some benchmarking against other companies in extractive industries and companies with overseas requirements but it was of limited use as the company was not typical.

Quality

40. The FD liked to think that the auditor gave the accounts a 'reasonable scrub' and checked for any control issues. She would be foolish to rely wholly on this and also

needed an internal audit team and internal processes to do this. The FD also wanted to ensure that the company was interpreting IFRS standards correctly and there was not a long history to look back at.

41. The focus was on technical expertise. Other aspects related to service were taken as given. The relationship partner would be told if the company could not work with certain individuals.

42. It was very embarrassing if a technical part of the accounting was wrong. The company had to restate its earnings per share figure in March 2012. [✂] The restatement did not result in any share price movement as it was not material, but having noticed it the company needed to correct it.

43. Restatements were the sort of issue that, if they happened regularly, would raise issues about auditor quality. In this particular case the FD said it was an obscure point so she did not blame EY. There had been no other such incidents since the company converted to IFRS.

44. The company received a letter in January 2007 based on the 2005 accounts. A further letter was received in July 2010 based on the 2009 annual report. The points raised were issues about industry reporting and only one of the company's responses was not accepted. [✂] The amounts involved were not material. Amendments were made through the 2006 year-end results.

Non-audit work

45. The FD was very strict about giving the auditor non-audit work in general.

46. The company produced many working capital reports, generated for sponsoring financial institutions. The FD thought in general that it was more efficient if the company's auditors did this work. She did not think it would be possible to produce the reports without the same level of understanding the auditors had of the company. The FD also added that sponsoring institutions for which this work was done would generally believe that the auditor was best placed.

47. For other work such as tax advisory, due diligence and other general advisory services the FD preferred to give the work to other firms. The FD thought that it was inadmissible to give internal audit work to your external auditor. With regards to tax the FD thought that it made better sense for another firm to do the work. The company benefited from one firm examining the tax work which in turn was checked by the auditor in the normal course of the audit.

48. There was always a benefit of other firms having an understanding of the business. If the company wanted to change auditor it was beneficial to have people who had that understanding and had established creditability with the company's employees.

49. The company would only deviate from its approach if the level of service required for non-audit work could best be provided by the auditor firm. The company had experienced this in one territory where it had operations.

50. EY was aware of the upcoming tender work. It was aware of the strict policy on non-audit work going to other firms but indicated a strong preference to be included as a candidate for the audit tender.

The ACC's view

51. The ACC [✂] trained as a Chartered Accountant at KPMG (then Peat Marwick Mitchell). He spent a couple of years in industry before returning to KPMG and spent the majority of his career there as an Audit Partner. He covered all sectors except financial services. He specialized in oil and gas, house building and construction and new technologies.

52. The ACC joined the company's board on 1 July 2008. He was also a non-executive director at a private oil company, four investment trusts and a local development agency (Scottish Enterprise).

Relationships

Auditors

53. There were four Audit Committee meetings per year attended by the auditors. Two were for audit planning (in July and January) and two were for reviewing the interim and full-year reports (in August and March respectively).

54. The auditors presented their plan to the Audit Committee after discussions with management. These discussions were particularly important when the business entered new territories. For example, when the company first operated in Greenland there were discussions about how evidence would be collected and whether a team needed to be on site or if it could be managed from the UK. One of the Audit Committee members had previously managed an oil company and was able to provide a practical perspective when questioning the audit plan.

55. The ACC had a high-level overview of the auditors' work, established through the Audit Committee meetings and speaking with the AEP (without management) before each reporting event (interim and full year). The ACC wanted to understand what had been done, what issues there were and the AEP's strength of feeling on any of these. The ACC contrasted the AEP's views with management's views, about which he was much better informed.

56. The ACC estimated that he spent around 10 to 12 days per year on Audit Committee matters of a total of 30 to 35 days spent on the company (in his non-executive director role and on the risk committee).

Shareholders

57. The ACC had very little interaction with shareholders. From his experience at the company and as an Audit Partner he thought that shareholders took a clean audit opinion as a given and had little interest in speaking with the ACC.

Resolution of audit issues

58. The company's accounts were technical in nature; they used accounting standards developed specifically for oil companies and necessarily relied on third party reports (with regard to matters such as reserves etc). Expert reports were provided to the company as a whole and he received them as a Board member. The ACC's past experience in auditing oil and gas companies had built his knowledge of this area.

59. From a financial reporting perspective, cash to exploit the oil reserves was what mattered for a company in this sector. The analysts focused on what was under the ground but this was not reported on the company's balance sheet at its market value.

60. In general, the ACC received a very full report from the auditors which described discussions between management and the auditors on significant accounting issues. The company provided the Audit Committee with forecast accounts in January and reconciliation to the final results as agreed by the auditors in March. The auditors also provided a report on how any adjustments were dealt with.

61. The ACC considered resolution of audit issues to be a tripartite discussion. There were some issues on which he needed more convincing, particularly given his experience as an ex-auditor. The rigour applied was driven by the number of issues and their nature. There were not many issues discussed during the previous audit as the company had sold its Indian business—it had been largely straightforward.

62. There was one contentious issue around the accounting treatment of the company's functional currency. [✂][1]

63. Generally, the ACC did not face a joint approach from management and the auditors when a complex issue arose. During his tenure not many issues had to be debated at the Audit Committee. However, the issue described above (see paragraph 62) was discussed between management and the auditors before being presented to the ACC, [✂].

64. The Audit Committee combined accounting skill with an understanding of oil company operations and so discussion could be held from first principles. The Audit Committee needed to ensure that the relevant standards were applied and that the auditors were satisfied with the final decisions. For example, when agreeing the appropriate useful life of a pipeline, the technical expert was able to advise on the technology and the business contracts relating to this (the technology lasted longer than the right to extract although the extraction rights were often extended, see paragraph 100).

Auditor appointment

Annual reappointment

65. The company had a policy to tender the audit every ten years (see paragraph 29). However, the auditors' performance was assessed annually on a formal basis. The ACC spoke with the auditors and management separately to understand how the process had gone from each point of view. He said that the Audit Committee took a keen interest where the service from EY was not as expected, and that EY was not in place for ten years irrespective of its performance. Reappointment was not taken for granted and the Audit Committee was 'on their case'.

66. For example, the auditor agreed to second a manager from India to Glasgow for two years to provide a link between the Indian and UK audit teams—this did not happen and the Audit Committee challenged the auditor over this. Another example was when a director, who was held in very high regard, rotated off the audit team—the company demanded that the replacement had the appropriate expertise.

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[1] [✂]

67. The ACC said that he would have the final say on auditor selection but would be influenced by management's views.

Switching costs

68. A tender would be held when the AEP rotated off the audit (circa 2013). The ACC thought that the company was keen to be progressive in matters of corporate governance. Its policy on tendering tied in to this. In his broader experience, the ACC thought running a tender process involved a significant investment by the company, particularly if there were cross-border locations and complex arrangements. Audit firms would also seek as much access as possible to management and the key decision makers.

69. The ACC thought that he would double the number of days he spent on Audit Committee business during a tender year. He said that the company needed to ensure the investment in holding a tender was worth the return and that therefore a ten-year period was right. He might be persuaded that 15 years was also right, but he felt strongly that five years was not enough.

70. Another consideration when holding a tender was changes to the business. If there was a major change to the business, then this was not the time for the Audit Committee and the board to 'disturb the ship'. In this situation it was more important to have continuity of people who really understood the business.

Awareness of other options

71. The ACC thought it was 'almost inconceivable' that the external audit would go to a non-Big-4 firm, but internal audit might. This was because of the company's international presence and the fact that the locations of the company were unknown and changing. He noted that the mid-tier firms audited mineral extraction companies listed on AIM and therefore had sector expertise. It was international coverage and consistency that was the issue.

72. The ACC thought that mid-tier firms did not have a consistent presence in enough countries (he mentioned that in Bangladesh only EY could provide tax advice to a suitable standard). The ACC thought that the mid-tier networks were not as 'bedded' and the strength of the franchise was not as strong. In his experience as an Audit Partner the ACC had taken over some business from mid-tier firms where there had been issues. While he thought the mid-tier firms' networks might be strengthening, 'there was nothing like the sort of rigour of the Big 4, as I understand it, in terms of cross-border quality control'.

73. The ACC did not see it as his ongoing role to have knowledge of the capabilities of the other audit firms. He would need this when the company went through a tender and at that point he would need to address whether to invite all or just three of the Big 4 firms to tender and whether to include a mid-tier firm.

74. He said that he received no direct pitches for audit work; the firms wanted him to be aware that they were interested but did not make unsolicited bids.

Reputation

75. The ACC had not faced pressure from outside the company to continue using a Big 4 firm. Regarding bank covenants, the ACC thought the perception that there was pressure to use a Big 4 firm had been unfairly criticized. Given the uniform consist-

ency across the Big 4 firms it was easier for the bank to remove the hassle and risk by mandating one of those firms—'If something goes wrong, they have big enough insurance, you can sue them anyway'. The ACC thought that other audit firms could do the job but it was just easier to comply with the terms of a covenant by not considering other options.

Fees

76. The ACC thought that fees had become 'a little bit relaxed'. The company was involved in many transactions and the policy had moved to 'do the work and negotiate afterwards'. The ACC, however, thought that 'if you can produce a plan, you can cost a plan'. The ACC had challenged management and the auditor on this and established a more regimented system of fee planning two years ago. At the audit planning meeting, the auditor presented a reconciliation with the previous year's plan. The fee was itemized over the different areas the audit covered which the Audit Committee could review and challenge.

77. Management led the initial fee negotiations and the Audit Committee had the final say over any agreement. The Audit Committee had never challenged the fee but had made it clear that it was watching this closely. The Audit Committee asked management to undertake a benchmarking exercise which indicated that the company's fee looked high—although it was very hard to make comparisons. For example, the company's auditors had had to spend a large amount of time on the Indian business which made direct comparisons difficult.

78. Since the fee looked high, the ACC thought that the fee needed re-basing, and expected EY to provide a bottom-up fee proposal. He thought that tendering exerted pressure on the auditor not to be seen as overcharging.

79. Conversely, if there was one very low bid in a tender it would be questionable whether the bid was properly priced. The ACC's job was to 'get a proper audit done' and if this meant spending 10 to15 per cent more, it was worth spending it. The ACC thought that this would be the opinion in most boardrooms.

80. The ACC was relaxed about fixed fees for a given audit. He was, however, happy to pay overruns if they were required to do a quality job. In terms of fixing a fee over a number of years, he had no issue with this as long as it was on an 'all things equal basis'.

Quality

81. The ACC measured quality by considering the consistency of service. The ACC looked for: consistency of staff from year to year, the quality of reporting and no surprises with issues coming up late and openness with the Audit Committee. The ACC did not want the auditor to be too friendly with the CFO but he did not want an adversarial approach either.

82. The ACC thought it was very difficult to tell whether the auditor had done enough to spot material misstatement. He had to trust them to do the job properly, and placed reliance on the auditing standards and the regulators, and also on the quality reviews that EY undertook internally. In addition, the Audit Committee could make its own enquiries at the meetings with the auditor.

83. The company had had two letters from the Financial Reporting Review Panel (FRRP). The company had to make changes in response to one letter and for the

second letter one reply was sufficient to deal with the questions. These reports got an 'ACC very excited'. The FRRP letters did not give the ACC a sense of the quality of an audit: they were usually to do with accounting treatment or disclosure. The EY Audit Inspection Unit (AIU) review was more helpful.

84. The ACC thought that the added value in an audit process was keeping management honest. He had no reason to doubt the integrity of management in the company but he had seen management at other companies under tremendous pressure to present accounts in a favourable light or adopt aggressive accounting treatments that would be easy to succumb to. Audit was a check and balance against potential management excess.

Non-audit services

85. The company had an internal policy that for work under £25,000 it could use the auditor, between £25,000 and £50,000 management needed to sign off the work, and for work over £50,000 the company needed to get a range of quotes and the ACC had to be informed if the auditor was to be used.

86. The company used mid-tier firms for non-audit work, for example Tenon was providing advice on iXBRL—the Inland Revenue requirement that all companies used a consistent general ledger layout.

87. The ACC said that Class 1 transaction work was given to the external auditor, and whilst it could be done by another firm there was so much overlap with the audit that it made no sense for another firm to do it—'they would have to re-audit the thing'. From his experience as an auditor the ACC had undertaken this work instead of the external auditor and thought it was extremely inefficient.

88. There were no non-audit services permitted within the ethical guidelines that give the ACC cause for concern.

The Audit Engagement Partner's view

89. The AEP, [✂], trained with EY, qualifying in 1983 and become a partner in 1994. He previously audited two FTSE companies (Weir Group and Dana Petroleum). The AEP audited companies in a broad range of sectors during his career, but more recently had broadly audited the energy sector. He first worked on the company audit in 2008.

Relationships

Management

90. The AEP had a strong relationship with the FD, the FD's deputy and other members of the finance team. He characterized the relationship as trusting with an open dialogue. The AEP would generally communicate with the FD at least once a month. When the AEP was first involved with the audit, he tried to speak to them every two weeks and as the relationship evolved this moved to an 'as needs' basis.

91. Management had a broad awareness of the audit team's work but not the details. At critical times the FD would become involved, but it was primarily the FD's deputy who had more detail around where and when the audit team was working.

Audit Committee

92. Interaction with the Audit Committee was not as frequent as with management, limited mainly to the four Audit Committee meetings and the AGM. There would sometimes be one or two other meetings during the year, for example the AEP and Audit Committee met on a visit to an oil field in India.

93. The AEP would have a discussion with the ACC in advance of most Audit Committee meetings, especially where audit results were to be discussed.

94. The audit plan (see paragraphs 101 to 109) covered the areas of audit risk. It was discussed with the FD before being presented to the Audit Committee. The AEP thought that the audit plan was fairly fully formed by the time it went to the Audit Committee.

Shareholders

95. The AEP had almost no contact with shareholders.

Resolution of audit issues

Most complex issues

96. There were a number of complex issues to consider when auditing the company. The AEP thought that the company's main driver from the very beginning was to get the right answer. While there had been discussions over the more complex judgements, there had not been disagreements.

97. Last year, the biggest issue was the [✂] which was very complex and required a number of judgements [✂].

98. Another complex issue was the carrying value of exploration assets—particularly in Greenland where the company spent a lot of money and there were issues around monitoring the success and accounting for the drilling. This was complicated because there were costs that were not 'well specific' and cut across a number of areas—this was a judgement taken to the Audit Committee.

99. Other complex issues included goodwill impairment because of associated businesses and accounting for share-based payments.

100. One judgement that needed to be made was [✂]. The AEP and the company sought advice from third parties before taking a final view on this. [✂]

The audit plan

101. The audit plan was discussed with the FD before being presented to the Audit Committee, by which point it was usually fairly fully formed. The AEP took the Audit Committee through the plan, emphasizing the key risks and listening to any concerns it had. The plan was amended in light of these discussions as the audit process progressed.

102. The audit plan was a detailed document that set out the key audit influences, the key areas of audit emphasis, EY's audit process and strategy and the fee proposal.

103. The section of the plan on key audit influences looked at the drivers of financial reputation and the relevant factors for the audit, and the key business risks and significant risks for the financial statements. The key audit influences were identified as: [✂].

104. The section on key areas of audit emphasis addressed the areas of risk identified in paragraph 103 and described what EY's approach would focus on. The key areas of audit emphasis were: [✂].

105. The audit plan also set out the scope of the audit in terms of the subsidiaries that required full-scope audits and an overview of the process: procedures required by auditing standards, procedures required by company law, procedures required by the listing rules, EY's approach to materiality, the audit timetable, the senior members of the audit team and the proposed fee. The audit fee was also separately broken down to highlight changes from the previous year, highlight one-off fees and scope adjustment increases and decreases.

Auditor selection

106. The AEP started work on the company audit after another EY partner had rotated off. [✂] the AEP had been selected from a choice of three partners that EY had put forward. [✂] Each year there was a robust discussion with the company on what the auditor was doing and about the auditor's overall performance assessment.

107. The company issued a checklist to the finance team and the Audit Committee. There were also discussions between the AEP and Audit Committee, and the Audit Committee and the FD. These reviews had thrown up two important issues which the auditor had to address. [✂]

108. The AEP thought that it varied year to year as to who had the most influence over reappointment. It appeared to EY that management had the first say if there were issues around the quality of service. If there were concerns from a governance perspective then this would be driven by the ACC.

109. [✂]

110. The AEP thought that it was difficult to try to prevent a company from going out to tender as it often depended on what was driving the tender. For example, if there were issues with the quality of service then the audit team could be changed. If the fee was considered too high then there could be a discussion about the fee. However, if there was a governance reason to go out to tender the audit firm could do less about it. The AEP also added that it was hard to be sure what exactly was driving a tender—he had experience of taking part in a tender under the assumption that it was governance-related but subsequently discovered there were other underlying issues.

Fees

111. The ACC did not normally challenge the audit fee. [✂] Fee negotiations started with the previous year's fee and then took account of any scope changes and inflation.

112. The AEP had experienced instances where a client had categorically stated it would tender without a reduction in fee (for example, at the [✂], but this had not happened at the company. The AEP thought that the company was after the right value and quality and had conducted a peer group analysis, which showed that the audit fee was 'in the pack'.

113. The AEP did not think that pressure on fees compromised the effectiveness of an audit. Ultimately the AEP had to get the right answer as the costs associated with getting it wrong were much higher than costs on top of the audit fee to do the work.

Quality

114. When thinking about quality the AEP thought that fundamentally his job was to make sure the right risks had been identified and that he had applied the right level of scepticism to management judgements. It was important to understand a risk, understand the implication of the risk on the financial statements and to ensure the audit approach was properly aligned to the risk.

115. The AEP did not think that he had seen an audit he would describe as 'poor'. He thought there was a period when documentation of audit issues did not sufficiently demonstrate the evidence the audit team had understood. This had been addressed by both the regulators and the firm and led to the mantra 'if it is not documented it is not done.'

116. The most significant issue that arose from a performance review (see paragraph 107) was. [✂]

117. There were also concerns about [✂].

118. There had been one FRRP letter in the last couple of years. There was nothing that required restatement or correction: it was a request for enhanced disclosure in subsequent years. The company was investigated by the AIU in three categories. An AIU reviewer spent a week at the AEP's office reviewing the company audit files on these topics. [✂]

Non-audit services

119. The non-audit work that the auditor provided was associated with regulatory work, which the AEP thought would be very difficult for a firm other than the auditor to do.

120. [✂]

121. The AEP had occasionally been approached by other EY partners for an introduction for work, but his general response was to resist so as not to waste too much company or audit firm time as such pitches were unlikely to be successful (and might irritate the company). [✂]