COMPETITION COMMISSION

STATUTORY AUDIT SERVICES MARKET INVESTIGATION

[Company F]

Background

1. [Company F] (the company) was a FTSE 250 manufacturing business [✂]. The company reported revenues of £[✂] million and operating profit of £[✂] million for 2011.

2. KPMG had been the company auditor since [✂] when it replaced a Mid Tier firm following a competitive tender. KPMG audited all of the company's subsidiaries. The audit fee for 2011 was £80,000 to £90,000 (including the pension scheme audit).

3. The Directors and other private individuals held a significant number of shares ([✂] per cent and [✂] per cent respectively) [✂]. The majority of shareholders were institutional investors.

4. The FD trained in industry, qualifying as a Management Accountant (CIMA). He then worked at Coopers & Lybrand as a management consultant for two years. He worked for a private company as Financial Controller, Supply Chain Director, then MD of a subsidiary before being appointed to the main Board as Finance Director. He spent five years as Finance Director there before joining the company as FD.

5. The FD had worked with [✂] as auditors during his career.

Relationships

Auditors

6. The FD explained that the auditors were onsite for three weeks during the final audit, two weeks for the half-year review and to perform controls tests in between reporting periods. The FD attended the planning meetings where KPMG presented its work plan and management stated areas where it thought focus was needed. The audit plan was then presented to the Audit Committee.

7. The FD was clear that the auditors reported to the Audit Committee and not to him—it was the Audit Committee that appointed the auditors and directed their work. The auditors were there to check the FD's (and his team's) work.

8. The company also had an Internal Audit function which was outsourced to PwC. The FD had a very different relationship with the internal auditors in terms of looking at management controls.

9. KPMG's approach was to focus on the balance sheet and then consider how this translated to the income statement. In the first week onsite the audit team interacted with the finance team. During this week the only interaction the FD had with the auditors was at the end where he received an update on progress and any potential issues. During the second week he would meet the Audit Manager and AEP to discuss how the work was proceeding. The FD estimated that his input to the audit process during the three weeks of the final audit was approximately six hours.

Audit Committee

10. The Audit Committee members were all NEDs and so the FD saw them at the nine Board meetings a year as well as at the three Audit Committee meetings. He attended the Audit Committee meetings but was not a member. The Audit Committee meetings tended to include items on external audit, internal audit and business risk (on which management tended to present). At certain points, the FD and management team left the room to allow the Auditors (both internal and external) to speak directly to the Audit Committee. The FD thought there was a 'healthy tension'.

Shareholders

11. The FD had had no discussion with shareholders about the audit or choice of auditors. No one questioned the change of auditor in [✄]. The FD noted that he saw approximately 60 per cent of shareholders on a six-monthly basis.

Resolution of issues

12. The business was fairly straightforward and there had been no serious disagreements over accounting treatment. Some areas of judgement required healthy debate. At the planning stage management gave a business update so the auditors were aware of trading issues. For example, when the company had outsourced its distribution network the auditor looked more closely at the inventory controls at the third party distributor.

13. Regarding one area of judgement in the accounts, the Audit Committee asked the auditors to do a separate piece of work (within the scope of the audit) looking at the underlying profitability of the business. The Audit Committee wanted to ensure that the judgements did not materially impact the underlying profitability.

14. There was some judgement required around valuation of brands the largest brand which was acquired soon after the FD joined the company. The company had impaired some brand value over the last two years. When making a judgement on this type of issue it was a case of coming to an agreement which involved compromise from both sides.

Auditor selection

Switching Auditors

15. The FD had no relationship with KPMG before joining the company. His predecessor had started a tender process which the FD stopped as (i) the company was about to embark on a Class 1 transaction [✄] and (ii) he wanted to reflect on the business and understand the experience with the incumbent auditors.

16. In the meantime, the FD received a lot of interest regarding the status of the company's audit, and used the potential audit firms for pieces of non-audit work to obtain experience of working with them. For example: Deloitte undertook Corporate Finance work on the Class 1 transaction [✄], PwC undertook project work on the reporting in the financial statements and KPMG undertook work on the tax basis for capital allowances.

17. The main reason for the tender process was capability. The Company achieved strong growth over a period of time, becoming a FTSE 250 business about four months after the FD joined. The FD experienced the previous Mid Tier audit firm [✄]

performing the half-year and full-year reporting and his assessment was that there 'were a couple of good people' on the team but it had been involved in the audit for a very long time (see paragraph 101). When the partner rotated, the new partner and the audit team were based in different cities and the company was one of only a limited number of listed clients. The FD and Audit Committee saw this as a risk for the company: there were concerns about the capability and depth of capability of the audit team.

18. There was no external pressure to change the previous auditor. The biggest pressure came from the FD himself who was surprised that the company had the Mid Tier firm as auditor. His experience of [✂] at his previous company, and comparing this to the previous auditor's performance, motivated the tender process.

19. The initial tender process (in [✂]) had included a number of firms from the Big 4 and second tier. EY was not invited as they audited [✂], two of the company's main competitors.

20. Two years later the FD decided to omit one Mid Tier firm from the process, since in his opinion it had taken no opportunity to engage with him since he joined the business He had the benchmark [✂] and saw no benefit in including [✂] as well. He considered that as a FTSE 250 business the company should be looking to the 'premier league' of audit performance.

21. The previous auditor was invited to tender and was taken seriously. If it had come up with a compelling proposition it would have been given serious consideration. It was an opportunity for it to show improvement on what the FD described as 'lack lustre' performance and non-existent pro-activeness of advice on the tax provision. The FD thought that the firm's partner was strong but his location in a different city [✂] was an issue.

22. The choice of auditor was determined using a scorecard which assessed:

(a) team competence;

(b) communication;

(c) service approach; and

(d) commitment and pro-activity.

23. Fees were reviewed as an underlying factor. All four quotes were in a range of £120,000 to £132,000. This meant that fee was not a deciding factor. The FD said that discounting fees, the other factors were weighted 30 per cent on team competence, 25 per cent on service approach and the remaining 45 per cent weighted evenly between communication and commitment/pro-activity.

24. The FD expected sector experience as a given; with the level of investment the larger firms put in this was not an issue and they all had the capability to perform the audit. The specific questions asked of the audit firms were:

(a) Did the team have the appropriate experience and expertise?

(b) What tax experience could they bring?

(c) Were the roles and responsibilities of each team member clear?

(d) How would they fit with the company's culture (was this a 'clipboard approach' or would they communicate effectively to understand the business)?

(e) Had management met the team who would actually do the work?

25. Four individuals at the company were involved in the selection process (the FD, CEO, ACC and GFC). The FD considered that the process was competitive. At the outset he had an idea of who would be successful and it was not KPMG, so the outcome of the process was different to his initial expectation. He also took comfort that the company had not chosen the cheapest bid. He said there was a significant amount of interaction with each firm and that they had all tried to win and those not appointed expressed disappointment in not succeeding.

26. The FD thought there were 'real issues' with Mid Tier firms. It boiled down to the quality of the individuals. He would 'never say never' but would need to meet the team to understand what support they could provide and what depth they had behind them. He received a 'distinct level of competence and support from a top four audit firm'.

Switching costs and tender triggers

27. The FD thought that transitioning to a new auditor was hard work but fairly straightforward. The tender process required each firm to set out its transition plan. The costs of switching were internal time costs, ie the FD's, Audit Committee's and finance team's time spent bringing the audit team up to speed.

28. The FD said that just because he had changed auditor in [✂], it did not mean that in five years time he would be looking to change again. He would only consider changing if there was a question around independence or if he felt that the company was not receiving value for money. If the process was working well, he would not seek a change. Running a tender was a valid process but was not something he would do every three years.

Fees

29. The ACC agreed the audit fee. When considering the fees proposed during the tender, the company focused on value for money, ie what seniority of staff it was receiving for the hours charged. The FD said that 'there was no point in getting a cheap fee and junior audit experience'. The Company looked at the partner time offered by each audit firm and the credentials of the rest of the team.

30. In agreeing the fee with KPMG, the tender fee was not altered but the company requested more partner hours. The fee was agreed on a fixed basis for three years (subject to inflation and scope changes). KPMG offered the fee fix but it was attractive to the company as it meant that there was some certainty. A significant concern for the company was that it might get a 'rock bottom' price for the audit in the first year and then see increases in the following years. Agreeing a fee based on inflationary changes was fair, as the audit firms really only incurred staff costs.

Quality

31. Partner input was important for the review of more judgemental areas as partners would 'lift the drains a bit harder'. In the first week of an audit, the focus was on transactions, in the second week there were questions asked by the manager and in the third week the AEP was involved and the level of questioning went up further.

32. As well as the partner, it was important for the company to be able to access the technical expertise of the audit firm. The company liked the Audit Manager to present to the finance team on accounting regulation changes once a year. This was something the FD saw as low cost to the audit firm but of high value to the company. The FD did not think there were any other examples of value added that the company could benefit from through the audit.

Non-audit services

33. The FD was very keen on auditor independence. He preferred to instruct another firm to undertake non-audit work. This restriction did not cause the company any issues. The other Big 4 firms were all capable of providing the non-audit work to a high standard.

34. The previous FD was at the company for 20 years and had very few external relationships. When the FD joined and sought funding for the Class 1 transaction many people said ‘we do not know the company’. Accordingly he felt it was important to establish relationships and internal audit, external audit, pensions and life assurance work was put out to tender. This resulted in a change for the better as there was a better quality of supply of these services under the new providers.

The ACC’s view

35. The ACC [✄] was appointed to the company board in 2010. He was a Scottish Chartered Accountant and qualified with Arthur Andersen in 1991. He remained there until 1997, working in audit and undertaking some corporate finance work, when he joined another FTSE 250 business [✄] as Business Development Director. He was appointed Group FD of that business [✄] in 2000, a position the ACC still held. He was also on the board of a small listed recruitment company called [✄].

36. In accepting the role, the ACC said it was important to the board of his main employer (the other FTSE 250 business) that he obtained experience of another company. His full time employer had not made any time formally available for him to undertake his ACC role (although he was allowed to attend meetings).

Relationships

Auditors

37. The ACC saw the auditors at Audit Committee meetings three or four times a year. He expected to catch up with the AEP and the FD at least on the telephone before meetings to understand what work had been done and what had been found. The AEP also contacted him as and when issues arose. The AEP always had access to him.

38. The ACC received verbal feedback at each stage of the audit. The planning document told him about the audit approach, the risks, how the auditors would get comfortable with the risks, the makeup of the team and when certain bits of work would be done. At the half-year and full-year meetings the ACC got an insight into the approach taken to support any written opinions and would be taken through the detail.

39. When agreeing the audit plan, the ACC would not try to second guess the work plans or identify areas where he wanted more work done. For example, there had been a good discussion about the quality of earnings on the income statement. There were a

number of items which were treated differently in previous years and therefore might have affected the audit. The ACC wanted to check the treatment of these items. It did not create more work but it focused attention on these issues.

Management

40. The ACC spoke to the FD regularly throughout the year. There were ten Board meetings as well as Audit Committee meetings. The most important thing was having an ongoing dialogue with the FD and CEO to understand what was going on in the business and to keep the ACC updated on the state of the business before the audit. The ACC also expected the FD to brief him on the issues at the start of the audit process and to give him views on issues before speaking with the auditors.

Shareholders

41. The ACC had no interaction with shareholders. Typically, the CEO and FD had most interaction with shareholders. It was unusual to have contact with shareholders outside the AGM. He had not received any question from shareholders about the auditors.

Resolution of issues

42. The ACC thought the company audit was reasonably straightforward. While accounting generally had become more complicated, the areas of judgement at the company were well known and were not as complex relative to other industries or businesses. The main issues were a large inventory, large trade receivables and payables, investment in brands and promotional activity.

43. The ACC thought that it was a ‘failure of everyone’ if issues only came to light for the first time at the Audit Committee meetings. At that point it was too late to do any more work or make changes. To make the process work, it was important there was good planning and regular communication between all relevant parties.

44. The ACC thought that while the auditors were responsible to the Audit Committee, it was very important there was a proactive relationship between management and the auditors, as the audit work was dependent on this relationship. He expected them to discuss anything that affected the financial statements.

45. The ACC expected the FD and the AEP to talk to one another without him present. He had not experienced any case of issues being pre-agreed without the opportunity for the Audit Committee to debate the issue.

46. There had been no significant disagreements since his appointment. The ACC would always speak with the auditors in private to check if anything had been contentious with management or they had been pushed to adopt a certain judgement.

The role

47. Audit Committee meetings tended to last one to two hours and the ACC allowed approximately two hours reading time in preparation. The documentation provided for the meetings consisted of reports from the internal and external auditors, management issues on accounting, interim and final reports and the associated press releases and analyst presentations. There was also a rolling agenda to look at

reports on tax, treasury and internal controls. The company risk register was also reviewed and updated for any changes in risks the company faced.

48. The ACC thought the Board was ultimately in place to protect shareholders. He thought his role was to take a step back and challenge as appropriate. It was very difficult from an Audit Committee point of view to examine in detail the work that the auditors had undertaken, as it did not assess the individual things tested or the auditors' working papers. This would not be practicable and it was not part of his role. The ACC felt qualified to have a sensible discussion with the auditors about their work.

Auditor selection

Annual re-appointment

49. In the annual review process, management and the Audit Committee reviewed the effectiveness of the Audit Committee, internal audit and external audit. The Company had a set questionnaire to evaluate the auditors which looked at quality of work, independence, timeliness of work, effectiveness of reporting, rigour and the relationship with management.

50. In the ACC's experience, management tended to be more critical than the Audit Committee during the review process, which he attributed to increased expectations of the overall service the auditors should provide. He wanted assurance on the approach taken and to know that enough work had been done to do a good job. Management wanted this too, but were also focused on getting value for money and added value in the form of management input, process reviews and internal control input from the auditor.

Switching costs and tender triggers

51. In the short term, the ACC thought switching auditors was a hassle. The process required considerable work and preparation, and there was time spent for the auditors to build up their knowledge of the business. However, this was not a reason not to tender. To do a really good job the auditors had to understand the fundamentals of the business. Overly rapid rotation risked losing this understanding.

52. The ACC would have the necessary time to conduct a tender alongside his full time role [✂] as the Audit Committee's role would be to oversee and understand the process. Management would be responsible for conducting the tender process and implementing the new auditors into the business.

53. There would be a time 'for fresh eyes' and after a certain point the company should look to test the market, even if the quality of the audit it was receiving was satisfactory. The ACC thought five years was too short a time period as the company could lose the benefit of the knowledge acquired by the auditors. Ten years would be more appropriate.

Awareness of other options

54. The ACC did not feel limited in the choice of auditor as there were the Big 4 firms. The ACC had limited exposure to Mid Tier firms and would only assess their capability if the company was minded to change auditors. Currently Mid Tier firms were not on the radar as able to add value to the company. He thought that as companies got bigger shareholders, lenders and investors expected to see a Big 4

auditor, but he had not experienced such pressure of expectation while at the company.

55. Reflecting on his experience in his executive director role with [✄] the ACC thought it would be more of a challenge for the Mid Tier firm to audit that company as it was more complex and an international business. The Audit Committee at his full time employer did not appoint [✄] for the [✄] audit in 2002 as they did not think it had the quality in [✄].

56. The ACC had only one approach in the last 24 months from a Mid Tier firm (in the context of the company). A meeting was arranged but was cancelled by the firm and had not been rearranged. He had no other meetings with other firms but this was partly as the ACC was not the type of individual who wanted to be courted. If he wanted something he would go and get it.

57. The ACC did know all the heads of audit at the big firms in [✄].

Fees

58. Management negotiated the audit fee but the ACC needed to be happy with it. As there had been a tender relatively recently, the ACC had a reasonable feel of whether the fee was fair. He had not seen any benchmarks on equivalent companies and tended to look at fee movement from year to year for the company and to examine the rationale for any fee changes.

Quality

59. The most important aspect of quality for the ACC was technical competence. He wanted to know and be convinced that sufficient work had been done so the Audit Committee could recommend to the Board that it could sign off on internal controls and the accounts. Any other factors, such as management recommendations, were secondary.

60. The ACC saw the audit as a service and as such it was important to get value for money. As well as technical competence, it was useful to receive qualitative inputs to business, for example recommendations on internal processes or controls, although these were mainly for the benefit of management. The ACC primarily looked for a good audit opinion which was timely and contained no surprises.

61. The ACC thought the audit should not be a loss leader, in the hope of the audit firm obtaining other work. It was not in the interests of the company or the auditor for the audit to be unprofitable.

Non-audit services

62. The Company had a threshold value for non-audit services above which the decision was taken to the Audit Committee. Below this value it was a decision for management to take on what was the best firm for the job. The Audit Committee was involved in making judgments about whether the value of the non-audit service could affect independence. Selecting the best firm for the job was the starting point. In some cases the auditor would be the best firm to do the work or it would be common sense for them to do the work.

The Audit Engagement Partner's view

63. The AEP [✄] joined KPMG (then Peat Marwick) in 1979 and had been a partner since 1990. The AEP had just completed five years as audit partner of one listed company and had just been appointed to the audit of another listed company after a competitive tender.

Relationships

Management

64. The AEP interacted with a number of the management team: the FD, the CEO, the Group Controller, several other members of the finance team and IT personnel. The most time was spent with the FD and Group Controller, meeting every day during the fieldwork for the mid-year report, interim reporting and the final report.

65. The AEP also met the CEO ahead of the planning stage of the audit to get an update on the business. He also had similar monthly meetings to catch up on the business.

66. The most intense period was in the lead up to fieldwork at the half-year and year-end reporting stage.

ACC

67. The AEP had much less contact with the Audit Committee than with management. The current ACC was the third since KPMG's appointment, and the level of contact had been the same with each one. The AEP spoke with the ACC ahead of Audit Committee meetings to get comments and observations on the auditor's paper. This allowed any issues to be clarified before the Audit Committee meeting. The schedule of audit committee meetings is set out below:

    (a) June: Audit plan and audit strategy was presented. The audit fee was proposed.

    (b) September: Preparation for half-year reporting.

    (c) January: Approved final audit plan for year-end reporting—confirmed the areas of focus and update the plan in light of the work undertaken at the half-year.

    (d) March: Final meeting where year-end accounts were approved.

68. The AEP thought that the ACC was diligent very professional, [✄]. The AEP had never felt a long relationship with company individuals had prejudiced a decision. The AEP felt that knowing someone well helped resolve awkward issues when they arose. For example, tensions arose when bonuses and remuneration were affected by a decision, and knowing the individuals well made it easier to have tough discussions. However, he also felt partner rotation was a good thing for obtaining a fresh look at the business. He considered that familiarity with the business was more of a risk to objectivity than familiarity with individuals—a partner's level of scepticism was likely to be lower after ten years than after five.

69. The AEP considered that a good ACC should challenge management and the auditors. [✄]

Shareholders

70. The AEP had no contact with shareholders (apart from the directors who were also substantial shareholders). He attended the AGM in an observer capacity. No questions had been asked about the audit. Shareholders tended to ask questions around operational matters of the business.

Resolution of issues

71. When scoping the audit, it was important to know what the key risk areas in the business were. It started with understanding the business, focusing on the risks and assessing the controls in place.

72. One of the key issues KPMG faced at the company was the treatment of money spent on sales and promotions [✂]. The accounting for brand support was a 'soft' area as agreements would be made for cash-back payments at the end of the year. Sales and marketing teams had control over spend in their regions. An improvement in the documentation of these agreements benefited the company during a dispute [✂] as it had documentary evidence [✂].

73. When KPMG first started the audit, the AEP spend time understanding the accounting for stock. The company had been using standard costs measures rather than actual costs (so they did not account for changes in the cost of raw materials [✂]) and it appeared that this was not an area the previous auditors had investigated.

74. The auditors needed to ensure that treatment was consistent year to year and to make sure items were properly classified as one-offs and disclosed appropriately. It was important to know the bonus triggers for individuals in the business.

75. Other areas of focus included the pension scheme audit. There was a large defined benefit pension scheme which had to be accounted for on the balance sheet and disclosed appropriately. There were also complexities around intangible assets such as goodwill accounting for acquisitions and brands.

76. The company had not asked the AEP to reduce the scope of the audit.

Auditor selection

Switching auditors

77. The company had been a target for KPMG for many [✂]. The AEP was firmly rebuffed every time he tried to approach management. KPMG provided some transaction support to the company which brought KPMG and the company closer together and enabled the AEP to meet the then CEO [✂] face to face. He asked on more than one occasion if the company could be persuaded to switch auditors and was told the company was not prepared to switch. At this stage the company had a long-standing relationship with its then auditor [✂].

78. The CEO changed a couple of times in the mid-2000s and the AEP could not get him to agree to a meeting. The AEP only obtained a face-to-face meeting using another client who was a supplier to the company. He asked the client to invite him to an event at which the company's CEO was also attending. Following this meeting the CEO was more amenable to meeting again.

79. The tender process began in 2007 when the company decided to test the market. [✂] were issued with a request to tender. [✂] were not invited as it was the auditor for [✂], a close competitor of the company. The bidders had a fact finding site visit and met the FD and Financial Controller. They were asked to provide a tender document and present to the CEO and FD. The plan had been for the company to then shortlist three firms to present to the Audit Committee.

80. However, the tender was subsequently postponed for two years. A delay in agreeing the selection process (the proposal to recommend three companies to the Audit Committee was at the end of a Board meeting and time ran out and was delayed until a later meeting) did not leave enough time for a new auditor to start work before the year-end, and the FD was retiring which delayed the process for the second year.

81. The company used this time to engage with all the bidders. For example, KPMG did some work on capital allowance claims in relation to a new manufacturing facility and [✂] did some due diligence work on an acquisition [✂]. Having an existing relationship with the company was important but it was not unique as all the other bidders had existing relationships. The AEP thought that without the existing relationship KPMG would have been behind the competition.

82. The tender process recommenced in 2009 [✂]. KPMG had to demonstrate a commitment to the company's audit and an understanding of the business in winning the tender. The former CEO (now Chairman) had often mentioned in passing that he liked the management team to observe the day-to-day running of the business, which the AEP saw as an opportunity. As an example of their willingness and ability to understand the business the AEP and Audit Director participated in a 'day on the ground' in a division of the business. It also allowed the AEP to observe the related controls in place. The observations from this visit fed into KPMG's pitch. The AEP thought that he had demonstrated that he had listened and he had done something different to make his team standout.

Annual reappointment

83. Ahead of the AGM, the audit team and the company's finance team sat down and discussed what each party could do better. This was fed back to the Audit Committee to highlight the areas that could be improved. In addition, there was an annual review of KPMG carried out by the company and reported to the Audit Committee which the AEP did not observe.

84. As part of the feedback process, the FD commented that he did not have enough visibility of what was happening during the audit process. In response KPMG set up a status board for the various work streams to provide a real time view of what was happening. This was maintained in the audit room on site at the company during the final audit and updated daily to keep the FD better informed of progress.

Fees

85. In the 2009 tender process the feedback received was that all the proposed fees were close (within a £20,000 range). KPMG's fee was the second highest but similar to the average. The fee offered during the tender was exactly the same as the fee finally agreed for the first year audit. There was no further negotiation on the fee. Start-up costs were not included. The first year overrun in terms of getting to know the business was absorbed by KPMG. These extra costs included site visits and setting up systems and files.

86. The audit fee was derived from considering the number of hours required to conduct the audit on an ongoing basis. This was inferred from other proposals and comparing rates for other regions. A blended rate of about £[✂] per hour was estimated as competitive and sufficient to complete the audit. The AEP had been challenged by KPMG management when tendering to obtain as high a fee as possible. Indeed, the KPMG management had pressured him to tender with a higher rate but he decided that he would not win at that rate and submitted a lower bid. KPMG records for the year ending September 2010 show that the tendered audit fee translated in to a lower than average recovery rate [✂].

87. The fee was negotiated by the AEP and FD and presented to the Audit Committee for approval. There was a three-year fixed-fee subject to the scale of the business and inflation. The AEP thought that having a fixed fee was generally driven by clients rather than the auditors. He thought that companies liked the certainty. A concern with appointing new auditors, particularly if the fee was lower than the incumbent, was that it was a one-year discount which would increase to a higher fee in the future. Companies did not appoint an audit firm with the expectation of switching after two years so they wanted to make sure the fee was sustainable.

88. The AEP thought a fixed fee could be an advantage to the auditors as it prevented acrimonious fee discussions until the firm had demonstrated it was delivering on its promises and providing a good service, but generally it was client driven.

89. The AEP said that various Finance Directors [✂] shared information with one another fairly freely in relation to fees and how fee deals have been agreed. The AEP said an audit firm will not always undercut the incumbent audit firm in a tender. In one case, for a different client, where a tender had been issued following a service issue with the incumbent firm, the AEP had pitched at a higher fee than the incumbent and won. [✂]

Quality

90. There were a number of members of the audit team. As well as the AEP and the Audit Director there was an Audit Senior Manager who was on-site every day during the fieldwork. The main onsite team consisted of a qualified accountant who was supported by up to three assistants, who performed the detailed checks in relation to the audit. As the audit progressed the amount of junior staff time decreased and the amount of senior staff time increased as more reviews were done.

91. The team also consisted of several specialists. Actuaries looked at pensions, IT specialists looked at the computer systems and a tax manager provided input for the audit of the tax numbers. The AEP also had input from a KPMG [✂] expert in the Corporate Finance division to understand the perception of the company compared to its competitors and the market in general.

92. The AEP described a number of aspects of quality:

    (a) the numbers had to be true and fair and the numbers must have no surprises;

    (b) there must be no criticisms of accounts (ie they must be compliant);

    (c) the auditor should be providing feedback to the finance team and Audit Committee on where they were on the scale of financial statement disclosures, corporate governance, director's report, risk report etc (a marginal position is unacceptable). The quality of financial reporting was important—the FRC checked this; and

(d) the auditor should also identify control issues and areas in the business where things could be done more efficiently.

93. The FRC had not reviewed the company's accounts. However, the company had provided input to a FRC survey on the tender process.

Non-audit services

94. KPMG provided some tax advisory services to the company. The FD's starting point was that he would rather use another firm for non-audit work. The Audit Committee had to sign off non-audit services provided by the auditor in excess of an agreed level [✂].

The former AEP's view

95. The former AEP trained with [✂] qualifying in 1976. He moved to a smaller [✂] firm which through a series of transactions became the previous auditor [✂]. He became a partner in 1981 and was an authorized listed partner working with listed companies and not-for-profit organisations.

96. [✂] The previous auditor (and its predecessor firms) had been the company auditors since the 1920s. [✂] It had a very strong relationship with the company's old management. More recently it had only provided the audit service to the company. It reviewed the tax work but did not prepare it.

Switching auditors

97. The former AEP was not involved directly with the pitch for the tender. He was involved on a peripheral basis as another partner had taken over from him as the lead AEP. The company was the largest single client within the office. There was a huge amount of preparation for the tender given the size of the business. It was necessary to check all the requirements of the company and prepare the proposal document.

98. The former AEP thought the reason for the tender was an issue of corporate governance given the previous auditor's [✂] long relationship with the company. He thought there was a degree of realization that [✂] was on the back foot because of the long relationship, but it was still a very important tender and every effort was put into it.

99. There were two main selling points for the previous auditor. First, as the existing auditor it had knowledge of the client and the main risks, therefore there would be no learning curve. Second, the company would be one of the firm's biggest audit clients and so could be confident that ample resource would be applied to the engagement.

100. In its feedback [✂] the previous auditors were not seen as offering anything new, although the former AEP did not know what 'new' was. He thought the FD was surprised that the company did not have a Big 4 auditor and that the previous auditor [✂] struggled against this preconception.

101. The company was not a difficult business to audit and as such there was no particular competitive advantage the previous auditor could have had over its competitors. The former AEP thought that audit was a competitive market place and the Big 4 firms could be very competitive on price. The previous auditor did not submit the lowest bid, and was in a difficult position being the incumbent. The former

AEP did not think he could make a significantly lower bid as this might raise questions about the fee in previous years.

Subsequent interaction

102. The previous auditor maintained contact with the company through invitations to seminars. It had scoped for one other piece of work related to the company's systems, but it did not think it had the necessary experience and therefore did not tender.

A potential bidder's view

103. BDO was contacted by [✂] the company's former FD in August 2007 to understand BDO's appetite for participating in a tender process for the company's audit. BDO responded with enthusiasm and subsequently received a formal invitation to tender and instructions.

104. BDO then confirmed appointments to meet with the relevant company individuals. Those meetings took place and it submitted a proposal in September 2007. This was followed up by further discussion and by an oral presentation to the company. In November 2007, the company deferred the decision. BDO wrote to the company in that month, following up on that decision, in an attempt to reopen discussion.

105. In December 2007 BDO invited the company's CEO and other executives to an event with the Speaker of the House of Commons. They declined. Later that month BDO received a letter from the former FD which said the process would restart in February or March of 2008, most probably, and that BDO would be contacted then.

The subsequent tender process

106. In March 2008, the former FD resigned and in May 2008, the current FD, [✂], was appointed as FD. BDO contacted him a number of times by telephone and understood that he knew BDO was there, and would contact BDO when the time was right, but that BDO should not bother him. In August 2008 BDO speculatively pitched for some IFRS 3 valuation work, but was unsuccessful.

107. The 2009 change in audit appointment was a surprise for BDO as, it was not invited to tender. BDO considered that it was able to carry out the audit but that the company did not want to engage it.

Subsequent events

108. In 2010 BDO wrote to the company three times regarding events, but received a negative response on each occasion. The BDO team broadly concluded that it was wasting its time and there was no benefit in making its presence felt where it was unwelcome. Their resources could be better employed on other opportunities.