

STATUTORY AUDIT SERVICES

Summary of call held with Company G (*Case studies 2*)

CC note

See: www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/case_study_cover_note.pdf.

Company G is a worldwide banking group, providing personal, corporate and investment banking services as well as wealth management and credit card services.

Views of the Audit Committee Chairman

1. The Audit Committee Chairman (ACC) said that no decision had yet been taken on when to hold a tender for the company's audit engagement, which had been held by the same firm for many years, but, in line with FRC recommendation, this decision would be taken in due course. [✂]
2. The decision to announce a tender in due course had been taken by the ACC, with the support of the Audit Committee (AC). There had been no pressure on this issue from the company's shareholders.
3. The Audit Engagement Partner (AEP) was rotated every five years and a change of audit firm would normally be considered at that point. [✂] The company reviewed the quality of the auditors every year.
4. The rules in different jurisdictions requiring the independence of auditors made it extremely difficult for a bank to change auditor. There were also specific challenges associated with the auditing of a bank. Some firms had therefore sometimes declined to bid for bank tenders in the past.
5. The first action the bank would take in running a tender would be to find out which firms would be able and willing to act as its auditors. This would involve establishing how the firms are positioned in relation to their independence. [✂]
6. Having assessed the possibilities for firms being able to fulfil the role of external auditor, a process to enable those firms to familiarize themselves with the company—and the company to get to know the firms—would be set in train.
7. A proposal for a tender would probably follow [✂].
8. The company was expecting that disruption of its work would be substantial and involve staff around the globe. Several thousands of hours would be likely to be spent on the tendering process over the course of two years—both by the audit firms (not least on ensuring that they could meet the independence requirements) and by the company.

Switching

9. The ACC considered that the main risk inherent in switching auditors was the knowledge gap of the incoming team. The reliance the company could place on the

quality of the new firm was its pre-eminent concern. The change in auditors inevitably aroused considerable anxiety for this reason.

10. A high-quality service involved:
 - an open and direct relationship between the AEP and the AC, with the AEP communicating with the AC in a clear and straightforward manner;
 - rational and relevant recommendations from the auditor;
 - the provision of a consistent service around the world; and
 - compliance with all local regulatory requirements. (The ACC said that regulatory requirements were resulting in escalating costs every year. The environment was complex and unforgiving.)
11. The ACC said that careful and rigorous planning of the transition from one audit firm to another was important so as to try to ensure that the incoming firm had as much knowledge of the bank as possible. A long, intense tendering process could be seen as part of the induction process.

Mandatory tendering

12. The FRC guidance apart, holding a tender was a healthy discipline, allowing a company to cross-check the provision of audit services. This was unrelated to any general concerns a company might have about the quality of the audit service it was receiving. It was right for the company to test the market, but having made the investment in this beneficial process, it would want to keep the appointed auditor in place for at least ten years.
13. The ACC feared that one problem that could result from mandatory tendering would be that, with several firms going for several tenders around the same time, fewer well-qualified firms and teams would be available for new engagements.

Mandatory rotation

14. The ACC saw merit in the mandatory rotation of AEPs but favoured doing so every seven years rather than every five, as proposed. But the mandatory rotation of firms was not desirable in the banking sector.

Other remedies

15. The ACC considered that the FRC had not gone far enough in restricting the provision of non-audit services (NAS) by the auditor to a company. Further movement in this direction would not only direct the audit firm's focus on audit but would also enable firms other than the auditor to establish relationships with companies and to give the other firms the opportunities to develop the right skills for working with the sector concerned, eg with bankers. The ACC did not think this would heighten the risk that firms would not be considered as independent when audit tenders arose, because NAS could be terminated rapidly if necessary.
16. The ACC hoped that the CC report would emphasize the primacy of the AC's relationship with the audit firm, while recognizing the practicality that the auditor had to maintain a day-to-day relationship with the finance management. The role of the AC had changed markedly since the Enron scandal and it was uniquely placed to

interface with the auditors independently of the executive management. There should be general acceptance that the external auditors meet ACCs on a one-to-one basis and that part of the role of the ACC should be to protect the auditors from undue pressure from management.