STATUTORY AUDIT SERVICES

Summary of call held with Company V

CC note

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

Company V is a consultancy, engineering and project management group. It was formed in 1982 as a result of a merger. The company has offices in 40 countries and employs 29,000 staff. Over half of its revenue comes from North America and nearly a third from Europe (including the UK). The company initiated an audit tender process in 2009 following which it switched its audit from a Big 4 firm to another Big 4 firm ([✂] to [✂]). The incumbent auditor had been in place for many years.

Views of the Chief Financial Officer

Tendering

1. The Chief Financial Officer (CFO) joined the company in September 2008. At the start of his tenure he conducted a review of the company's advisers and professional services suppliers and about one year after joining he initiated the audit tender. He felt the company would benefit from a reduction in fees and a fresh approach but did not begin the tender process with the intention of switching, rather he wanted to test the market. The CFO had a feel for the market from his previous posts and estimated that the company was paying 25 to 30 per cent more than it should. Accordingly, he wished to test the market.

2. The CFO requested Audit Committee (AC) approval for the tender, which in turn put the issue to the full board. The tender process ran between September and December 2009. The final decision on auditor appointment was made in January 2010. The CFO did not raise concerns with the incumbent auditor before taking the decision to tender. There was no dissatisfaction with the incumbent auditor's service level.

3. The company invited two Big 4 firms ([✂] and [✂]) to tender: the incumbent and one other. It did not consider one Big 4 firm ([✂]) as it felt this firm did not have the relevant sector experience. It did not consider the other Big 4 firm ([✂]) as this firm was involved in tax advisory work for the company at the time. Though not an ongoing piece of work, the fee for this was likely to be higher than the audit fee. The CFO did consider the Mid Tier firms but ultimately did not make contact with them. The company needed an auditor with sufficient global scale.

4. The company issued formal scoping documents to the two audit firms asked to tender. Both firms had discussions with the CFO, other senior finance management, members of the board and members of the AC. The firms also made hour-long presentations to a panel comprising the AC, the CFO and senior finance management.

5. The AC made recommendations to the board following this. [✂] the board decided to change audit firms.

6. The amount of time spent by the CFO was ‘non-trivial’ but not enormous and was absorbed into day-to-day workloads. The CFO thought that the tender process was not a major burden on any one individual’s time. The disruption to the company had been limited by the fact that the tender process was a two-horse race and for this reason had also not been an overly burdensome process. This had been a deliberate strategy.

7. The CFO thought that two participants in the tender was sufficient, given the company’s objectives—to reduce costs and obtain a fresh approach—and this meant that there would not be too much disruption to the company. However, the CFO felt he may have invited one other Big 4 to tender if he had deemed it to have sufficient sector experience.

8. The tender process was also loosely timed to avoid any unnecessary disruption (for example, after the half year results) and no external costs were incurred by the company. In view of the company’s international reach, it sought views from its overseas divisions which fed back into the tender process. The tendering firms were asked to submit who their proposed teams would be in various regions. Once the new auditor was appointed, each of the company’s subsidiaries immediately switched to the firm, rather than switching over the course of a number of years.

9. No external costs had been incurred during the tender, and the company had no plans to retender (beyond the obligations contained in the UK Corporate Governance Code).

Switching

10. The CFO accepted that there would be risks and costs associated with switching auditors, including managing any transition. However, in his view the company was in a good control shape and the disruption, though ‘non-trivial’, was ‘manageable’ and a modest price to pay for the benefits of switching. Any disruption did not last beyond the first year.

11. The CFO believed that only a ‘modest’ amount of extra time was spent with the new auditor after the switch both for himself and the Finance Team. The company had anticipated extra work and prepared for it. No work of the Finance Team was put on hold as a result of the switch.

12. In comparison, AEP rotation in his experience was almost seamless, but did provide a fresh approach and insight. Partner shadowing prevented awkward disruption. A change in CFO would cause greater disruption than a change in auditor.

13. The CFO stated that if there had been a major piece of work for the Finance Team (such as a large Class 1 transaction) at the time of the switch, then it might have been necessary to ‘juggle’ the conflicting demands on Finance’s time.

14. There was no substantial change in the scope of the audit in the first year after the switch. However, some aspects of the company’s business not included in the audit by the previous auditor were included after the switch. The new auditor had changed the audit approach and emphasis and this is what the company was looking for. The audit fee was reduced by 30 per cent also. The CFO felt the company obtained a cheaper, more efficient and higher-quality audit as a result of the switch.

15. The CFO felt the quality improved year on year as the new auditor became more familiar with the company. The audit fee rose slightly as a result of the company expanding, both organically and as a result of acquisitions.

Remedies

16. The CFO fundamentally disagreed with the CC's provisional findings. He did not believe the reference market was uncompetitive. He thought that there were no barriers to switching and that there were no misaligned incentives between management and shareholders. The CC's provisional findings did not take sufficient account of the Chair, the SID and the AC. He had never witnessed any lack of scepticism and if he had, he would have put the audit out to tender. He wanted auditors to be a robust sounding board.

17. The CFO did not feel that mandatory tendering was essentially different from the FRC's new 'comply or explain' tendering requirements. 'Comply or explain' leads to compliance in the vast majority of cases.

18. The CFO thought that mandatory rotation was based on a flawed premise, as longevity did not of itself compromise independence. Also, it would lead to reduced choice and ultimately to lower quality. Shorter tenures would increase costs and could reduce quality, as audits could become commoditized.

19. In respect of extending the remit or frequency of the AQRs and of strengthening shareholder–auditor engagement, the CFO did not object in principle but did not know how these remedies would work in practice. In the CFO's experience, auditors were never questioned at AGMs. In his view, shareholders were not unhappy with auditors and took their reports at face value.

20. He agreed that 'Big 4' clauses should be prohibited.

21. With regard to enhancing AC accountability for external audit, he thought that there was already a very strong link.

22. He agreed in principle with measures to enhance shareholder engagement in the audit process; however, shareholders rarely expressed any concern regarding audit. The CFO assumed that this was because shareholders thought that auditors were doing a good job and accepted audit reports at face value. He spent perhaps 10 to 15 per cent of his time talking to investors and they did not ask about audit.

23. In respect of extending reporting requirements, the CFO did not believe that this would add any value in practice.