

STATUTORY AUDIT SERVICES

Summary of calls held with Company W

CC note

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

Company W is an insurance and pensions provider that operates in 18 countries around the world. It is a FTSE 100 business (ranked in the top 50).

It was formed about 12 years ago following the merger of [X]. [X], one of the Big 4, was former auditor of [X] and another ([X]) was auditor of [X]. Following the merger, the former auditor of one of the merged companies ([X]) was selected auditor for the merged group. It had been the company's auditor for ten years.

The company had completed an audit tender process in 2011, following which it switched its auditor to another Big 4 firm, from [X] to [X] ([X], the new auditor, completed the audit for 2012).

Views of the Chief Accounting Officer

Tendering

1. The Chief Accounting Officer (CAO) noted that Company W had retained the incumbent auditor for ten years, following formation of the company from the merger between [X] and [X]. At that point, there had been an exercise to determine which of the two incumbent auditors should be retained for the merged company. Company W considered that after ten years it was appropriate to review the provision of its audit services. At the time that it was contemplating the tender, Company W expected regulatory changes concerned with Solvency II and IFRS phase 2 to be implemented imminently and it wanted to complete its tender process before any changes came into force. There had not been any concerns with the quality of audit service or actual or perceived independence of its incumbent auditor and this had not been a consideration in its decision to go to tender.
2. Having made the decision to go to tender, Company W wanted the tender process to be short and sharp. Many of the company's personnel in the finance team that were involved in managing the tender had previously worked at a Big 4 firm. From their experience, they considered there was no benefit from having a longer process. Company W engaged the services of Boston Consulting Group (BCG) to assist with running the process.
3. To meet requirements of the SEC, Company W needed to build in sufficient time in any change of auditor process to allow any new auditor to make itself sufficiently independent.
4. Company W invited all of the Big 4 firms to tender. It did review the capabilities of the Mid Tier firms and concluded that they did not have sufficient actuarial experience around the globe to be able to provide the service it required. One Big 4 firm, [X], decided not to participate in the tender because of a preference to maintain its ongoing consulting work for which it had been engaged by the company. Company

W accepted this decision and was pleased that this firm had made it quickly and transparently.

5. Company W took two to three weeks to prepare its Request for Proposal (RFP) documents and provided a similar time frame to receive responses. Regional CFOs then held two to three meetings with local audit partners around the world; each meeting lasted between 1 and 2 hours. This involved six to seven regional CFOs and their respective finance teams. Contact by the firms was strictly controlled, and Company W was careful to ensure that all participating firms had the same information and access. Information was provided via data rooms and if firms requested additional information this was provided to all firms. Feedback from regional CFOs was evaluated centrally alongside formal tender documents and then presented at a meeting with the Audit Committee (AC). As part of the assessment exercise, dinners were also held with each of the firms, to assess informal relationships.
6. BCG's role was one of project management: formulating the RFP; identifying the legal entities of the company around the world which would require an audit; assembling and collating all relevant information; and providing analysis of feedback. The cost for engaging BCG was less than £500,000 and Company W considered it had received good value for money.
7. In terms of management time costs, Company W noted that significant time was spent by each of the CFOs in meeting the respective firms in their regions. They also had to attend the final presentation meetings which were held in London. In addition, Company W had some of its reporting accountants working on the project with a total workload approximately equivalent to the work of two full-time employees for the (approximately eight-week) duration of the project. The CAO did not think that he would make any changes to the tender process and the way it was managed. He noted that the Finance Department had coped well with the process.
8. The CAO considered that he may still have achieved a robust process had there only been the option of two firms capable of competing, but his preference was to have three competitors as a minimum.

Switching

9. The CAO accepted that there would be risks and costs associated with switching auditors, including managing any transition. In his view, tendering was about identifying the best firm to provide audit services to the company. Any transition would need to be managed and this included ensuring that everyone collectively bought into the decision at a global level.
10. The transition created additional work which included educating the new auditor about systems; processes; products; and people—knowledge the firm would build up over time. This was done through a series of detailed briefings by finance teams, handover by the outgoing audit firm, and review of the audit files. Briefings took place from the CFO level downwards. This process was started very quickly after the decision to switch was made. The new auditor shadowed the incumbent on its final audit for the 2011 year end. The new auditor made this investment and mobilized its team around the world to ensure that this took place. Company W needed to make time to educate the new auditor's team.
11. The handover was carefully managed by the company's internal staff. All staff time costs were absorbed in usual running of business activities. Company W could not say how many internal staff hours were utilized in the transition.

12. The largest risk of a switch of auditor is a lack of familiarity of new auditor with the process and risks of the organization to enable them to plan and deliver their audit work efficiently and effectively. This familiarization process involved resources from both company and auditors. To assist, the new auditor seconded resources into the company, at its expense, which had the benefit of these staff increasing their familiarity with the business.
13. All tendering parties were required to state how they would manage the transition in their response to the RFP. There was a good handover by the incumbent auditor and, as required by regulations, the new auditor had full access to incumbent auditor's audit files.
14. The benefits of the switch included a lower audit fee and a fresh set of perspectives on the business. Unsurprisingly the audit had not been radically different, since Company W had a strong internal finance team. The quality of the product was different in some respects but broadly similar to that from the incumbent auditor.
15. The CAO did not think the transition could have been managed much better. He noted that both the interim and first full year audit by the new auditor went smoothly, indicating that the transition process was well managed.

Other remedies

16. The CAO considered that if tendering was required more frequently than every seven to ten years this may create large costs. At seven to ten years, companies should be able to manage the process around other developmental work. Too frequent tendering, say less than every five years, would lead to inefficiencies with too great a proportion of time spent on handover and familiarization.
17. With respect to enhancing the role of the AC, in the CAO's view, the auditor was already accountable to the AC. There were lots of opportunities for direct communication, and the audit partner had private meetings with the ACC on a monthly basis. The CAO considered that the day-to-day management of the audit, which was more about managing the audit process, was better handled by management. At Company W, the ACC could have as much information about the audit process as he wanted.
18. In relation to the remedy of more frequent AQRs, the CAO indicated that in his experience audit firms tended to conduct the audit on the basis that it would be reviewed by the AQR anyway, so the possibility of more frequent AQR reviews would not change behaviour.

Views of the Audit Committee Chairman

Tendering

19. Company W decided to tender in [redacted] on the basis that auditors were suppliers of services and it was good practice, as well as good governance, periodically to review all service contracts to ensure the best service available. The decision to tender had nothing to do with independence. However, a contributory factor was that, with the current audit partner coming to the end of his rotation period, Company W did not feel that the new partner being put forward by the previous auditor was the best person for the job and that better partners may be available at other firms.
20. In total, the tender process took about ten weeks. The process was completely managed by the Group CAO and his team. The ACC considered that it did not take

up too much additional time for him. He must have attended three to four additional meetings.

21. The AC had decided that [X] was an opportune moment to hold a tender because of impending changes under IFRS and US listing requirements. The AC did not see another window of opportunity for several years. One member of the AC was against going out to tender because of the potential disruption to management.
22. Company W had invited all Big 4 audit firms to tender. However, one firm ([X]) had decided not to participate because its preference was to retain the substantial non-audit work contract with the company. The ACC attended presentations from each of the three bidders which lasted between one and one and a half hours each. The final decision on who to appoint did not take very long after all the bidders had been seen.
23. It was the ACC's view that if the incumbent auditor had been unable to participate because there was a requirement to rotate auditors, having a competition between just two providers would not have been sufficient. His preference was for there to be more choice of audit firms than currently existed, particularly for large multinational companies such as Company W.
24. In relation to the Big 4 firm that had decided not to participate in the tender, the ACC noted that it was the firm's decision not to do so. Company W had not viewed this decision negatively because the firm was involved in ongoing work in relation to Solvency II requirements. The ACC did not consider that he could have compelled this firm to participate in the tender.
25. During its pitch, the incumbent auditor emphasized the risks of changing auditor, including the loss of history and knowledge that it had as its incumbent auditor. Company W accepted many of the risks but believed they could be managed.
26. The ACC considered the tender process was completely manageable, although he noted that the company had hired a third party firm to help project-manage the process, and to maintain a level of discipline and fairness across all bidders so that no one party was favoured over others. In his view, the tender process had gone very smoothly.
27. The ACC said that there had been no engagement with shareholders concerning the tender process.
28. The only cash cost was the cost of hiring an external consultant to advise on the tender process and provide some logistical support to the finance team. The other main cost was that of management time, globally, to meet with the partners of the tendering firms, in local jurisdictions.

Switching costs/benefits

29. When the new auditor was appointed as the new audit firm, the incumbent auditor was six months into the current year audit. The remaining six months were used to educate the new auditor and bring it up to speed, which meant that Company W's finance team were dealing with two auditors during this time.
30. Once the decision to switch had been made, a plan was put in place to manage the risks of the changeover. The ACC saw the changeover as something that had to be done as part of doing business. The risks were not technical risks, rather they concerned senior staff time and relationships. Senior staff time was managed to ensure that other work did not slip; the risk that relationships did not work well was managed by ensuring that good audit partners were put in place around the world.

31. The ACC already spent 50 to 60 days a year in his role. He considered the change in auditor possibly added a couple of extra days to that, and did not have a significant time implication for him, and that this extra work load was spread over his ongoing duties at Company W. He met once a month with the new audit engagement partner to ensure that everything was running smoothly. The change did not have any time implications for the rest of the AC.
32. The scope of the audit did not change much. In the ACC's view, Company W's audit was a good audit to win, so all firms had put their best people up for the job. In addition, the ACC considered that Company W also had good people who managed the change well.
33. The costs from switching key members of the audit team within the same firm were not the same as when switching the entire audit firm. Firms were generally good at getting replacement people to shadow into a role before taking it on.
34. In terms of benefits, the ACC considered that it was good to have a fresh set of eyes that might challenge judgements and have slightly different ways of working (accepting that there had been no significant changes as a result). His view was that it had been a constructive and positive process. He noted that the audit fee had also decreased from in the region of £[~~30~~] million to £[~~20~~] million, although the total amount paid to the auditing firm had remained more or less the same, in the region of £[~~30~~] million. He noted that Company W did not set out to get a reduction in the audit fee. Its objective was to get the best audit, with the fee to be negotiated secondarily.
35. In terms of the market, the ACC was most concerned to ensure that there was a greater choice of audit firms. At the moment, all the Big 4 provided extensive consultancy services to the industry, which meant that there was always a risk of firms being conflicted out. In his view, all big multinational companies were limited to the Big 4 because of the global resources required to audit such companies.
36. The ACC did not favour mandatory tendering or rotation. He would like to allow more time for the FRCs to comply or explain requirements to take effect to see if they had any impact. In his view, auditors already had strong accountability to the AC.
37. He questioned how more engagement with shareholders might be implemented whilst also treating shareholders equally. He noted that very few institutional shareholders attended AGM meetings. Such meetings were not generally occasions where constructive debate took place.
38. With respect to creating an enhanced role for the AC and the ACC, he thought that there was some scope for more discussion of issues but saw a risk that the AC would not know enough detail. At the moment it acted as an 'oversight' committee, reviewing and debating the conclusions of management and the auditors. Requiring the AC to be more involved risked a loss of its non-executive status. This may cause more friction within the board as to who was actually running the company on a day-to-day basis. In the ACC's view, these issues were already occurring on the regulatory front where non-executive directors were being given more responsibilities.
39. Overall, the ACC saw the process of changing auditors at Company W as a beneficial one, which had not been particularly onerous. He did not understand why some CFOs were so reluctant to change auditors, but accepted that there could be a perception of high costs. In his view, it was a good practice to review the relationship on a periodic basis.