



Department
for Business
Innovation & Skills

1 Victoria Street
London
SW1H 0ET

Tom Wood
Inquiry Manager
Audit Market Investigation
Competition Commission
Victoria House
Southampton Row
LONDON
WC1B 4AD

T +44 (0) 20 7215 6858
E enquiries@bis.gov.uk

www.bis.gov.uk
Our ref:

Date: 13 Aug 2013

Dear Tom,

It is important that audit market operates effectively and I support your work to ensure this. Thank you for the opportunity to comment on the Commission's provisional remedies.

As you know, we are negotiating a new European Directive and Regulation with the aim of boosting auditor independence, creating a vibrant audit market, increasing audit quality and avoiding unnecessary costs. I am sure you will agree that changes to the regime being developed in the UK and those in development across Europe should work effectively together.

Negotiations have yet to be completed at European level. But I hope it might be possible at this stage to consider the fit between these two packages of changes, particularly those you propose to implement by Order. It might help if I discuss those remedies first. I refer to them by the lettering used in the summary of the provisional decision on remedies published on 22 July.

(a) Mandatory retendering of auditor appointments

I agree with the observation in the Competition Commission's summary report (para 7) that it is a matter of judgement as to the appropriate interval between tender processes.

The Financial Reporting Council (FRC), following consultation, settled on 10 years on a comply or explain basis; the Competition Commission has proposed 5 years on a comply or explain basis with 7 years applying on a mandatory basis. Meanwhile in their

negotiations in the European Council, EU Member States have frequently discussed 10 years on a mandatory basis, with the Parliament at 14 years. However the Council position is not finalised and the final EU period will then be the subject of a negotiation between the Parliament and the Council.

In this context, we hope it will be possible to retain some level of flexibility for the final Order to include both comply or explain and mandatory periods that fit with the EU framework that emerges. It is also worth bearing in mind that the final Order will take effect in the context of other EU measures to outlaw some (and to cap other) non-audit services, which also have competition effects.

(d) Loan agreements

We welcome the Commission's support for a measure here and the development of the Commission's thinking as to its form. However we have a query about the sanction applicable and how it will interact with EU proposals. Where a prohibited term is included in a loan agreement, the effect of the EU proposals would be to render the relevant term ineffective. It is not clear to us how the implementation of this requirement in the UK would interact and operate alongside the civil sanction that would apply under a Commission Order.

(f) Audit related board functions reserved for approval of the audit committee and additional auditor reporting obligations

Consistency with principles of company law

There is a particular problem which we fear the Commission will have to consider if it makes an Order in this area. Where it is a subcommittee of the board, the Audit Committee's role is to act on behalf of the board as a whole. The Companies Act also does not distinguish between executive and non-executive (ie independent) directors. The FCA's Disclosure and Transparency Rules would also allow the members of the board as a whole to fulfil the role of the audit committee provided the conditions in the Rules were met.

In this context it is not clear to us that the audit committee can have certain actions reserved to itself, which the board itself cannot take. This legal point may require further consideration in particular in relation to the manner in which this proposal is taken forward in the proposed Order. We understand you intend to follow the approach of Rule 7.1 of the FCA's Disclosure and Transparency Rules, which we would support.

There are also more detailed legal points which will need to be considered in the assembly of an Order of the type proposed. Matters such as the fixing of the audit fee by the company and the determination of the scope and staffing of the audit by the firm will require careful drafting for consistency with company law, which BIS will wish to comment on in due course. Also we think this proposal is intended as a governance measure to clarify responsibility. As such we assume you will not want it to have the effect in practice of requiring entirely separate staffing or management support to the audit committee.

Auditor reporting and auditing standards

We understand it would be possible to deliver this part of the proposal by FRC auditing standards, which we would favour. There are at least two possible advantages to this approach in that it could ensure that the auditor's obligations are consistent with one another, as they will be located together. It would also ensure appropriate sanctions are applicable in cases of non-compliance.

General points - Recommendations for action to be taken by the FRC

We note that there are a number of proposed remedies in the form of recommendations for action by the FRC. We hope it will be possible to form the final recommendations so as to give the FRC the flexibility it will need to implement them in a way that works from their perspective and in the context of the consultations they will need to conduct in order to take them forward.

This is consistent with the proposal that the FRC should have a secondary responsibility for competition in the audit market. We support this proposal as it is currently formulated. However, we would like to suggest an alternative approach to implementation. This could be done via an amendment to Schedule 13 to the Companies Act 2006. It contains supplementary provision on any body that is the subject of a Delegation Order under Part 42 of the Act. The FRC is the subject of such an Order.

Advisory vote on audit committee report

Finally we wish to comment on one specific recommendation that you propose to make to the FRC, on the inclusion in the corporate governance code of an advisory vote on the audit committee report. It is not clear to us how valuable shareholders will find this vote and what this will add to the other votes already put to shareholders on:

- reappointment of directors (including audit committee members) under the corporate governance code; and,
- on accepting the annual accounts and reports.

In this context, we would not want the Government to come under pressure now or in the future to introduce this vote into company law either as an advisory vote or as a more substantive matter. We hope it will be possible for the final recommendation to ask the FRC to consider both whether and how any requirement for a vote of this kind might be introduced.

I hope that these comments are helpful. Audit policy officials at BIS would be more than happy to discuss them further should this be necessary.

Yours sincerely,



BERNADETTE KELLY CB
Director General, Markets and Local Growth