COMMENTS ON COMPETITION COMMISSION PROPOSALS ON AUDITOR TENDERING

I have chaired many diverse Audit Committees and currently chair two FTSE 250 committees and an AIM listed company committee. I have worked with each of the Big 4 as auditors and one of the next Two. I believe that each of the auditing companies pursue and have high quality and ethical standards. I also believe that they do not behave in an anti-competitive manner between themselves, to other participants and to their customers. They do not have an overly cosy relationship with their clients, including agents such as in particular audit committee chairs. To assert that they do displays an ignorance of the practical realities of relationships with major service suppliers. I wonder how many Commission members have actually sat in an audit committee meeting?

I believe that the Commission's proposal that audits should be tendered every five years would have seriously damaging and perverse consequences and should be abandoned. In my view the recently promulgated FRC approach to audit tendering should be implemented as it has more practical and sensible foundations. Through engagement in many peer group gatherings I am confident that my views are shared by a large number of audit committee chairmen in companies of diverse size and in diverse sectors. I, like many (all?) of my peer group, have not been approached by the Commission for our views on their draft Proposals. By contrast the FRC consulted widely on their draft Proposals in their recent Guidance. I am well aware that political pressures from Brussels have some sway, but the bad should not drive out the good (so fostering another application of Gresham's Law).

I will apologise for repeating my strongly held view that audit committee chairs take their responsibilities seriously and put their personal reputations at stake. If as a group they thought that mandatory tendering every five years would better support them in their responsibilities then they would be the first to step forward. No one could be more eager to ensure that auditors are independent, ready to challenge what they are told by management and quick to alert the committee to areas of controversy or disagreement. No audit committee chairman wants to be publicly pilloried or indeed sued.

My own reasons for opposing the Commission's proposal are shared with many:

1. **It takes time for an audit firm to gain the deep understanding of a group which a quality audit requires, particularly if complex and /or operating internationally. The bulk of most large audits do not relate to UK based operations, a fallacy held by many UK Regulators. Auditor performance is monitored internally, not least as part of the fee negotiation process, and unless there is a specific reason for complaint I cannot imagine a company or its audit committee choosing to**

change auditors on a regular basis. Change involves a huge time and cost investment and diversion of energy by management and, to a lesser degree, by the audit committee (especially the chairman), to enable the new audit firm to function effectively and deliver a quality audit. I am well aware of this from personal experience of tenders. By itself this effort distracts from the management of the business and in itself can give rise to the opportunity for fraud particularly in smaller and less well-resourced companies.

2. **The effort the management, often around the world, and the auditors would need to make inevitably adversely affects audit quality. There is a well understood "first time through" effect. The new auditor would not immediately be able to judge where in a complex group the major issues reside and judgements made. Similarly it takes time to judge management. The new auditor is not a superior all seeing being (or team) and whilst "new" eyes can have value, they can also be blind. My preferred approach is close to the current position of rotating lead partners, but retaining the experience of the team. Changing the entire team frequently would be fraught with risk.**

3. **The economics clearly imply that the direct and indirect costs of audit would be bound to rise and risks increase. This is not a sensible cost benefit equation. The company's costs in carrying out the tendering process and inducting new auditors on a regular basis would be very significant. And even if the proposals engendered greater price competition amongst those audit firms qualified to take on a complex audit, the additional costs they would bear in regular competitive tendering would have to be recouped somehow, or they should / would withdraw from the audit business and focus on unregulated and more profitable non-audit activities. Hence auditor choice could well diminish. Perversely this could also impact smaller audit firms the hardest.**

4. **In the light of these objections the proposals, if implemented on a mandatory basis, would be complied with by companies resentfully and with no real intention to make a regular change of auditor. So the process would be wasteful, frustrating, ineffective and damaging to the reputation of the Competition Commission.**

5. **The Commission and indeed the Regulators in the UK (and in Europe) seem blind to an obvious fact. The centre of corporate governance and underlying economic wealth creation is no longer in these regions of the world. The US is more aware of these global realities. The centre of gravity has already moved**

East, as witnessed by recent governance actions and audit attitudes in China. Indeed the Big 4 and Next 2 are much more engaged by what is happening in China than elsewhere. I would argue that the Commission's Proposals, whatever they eventually turn out to be, are unlikely to have more than a limited relevance to the wider world. If they are misdirected then they could propel the decline of the UK's influence on governance. The UK has been punching above its weight for many years on governance leadership, but this position is under increasing pressure. It would be most unfortunate if the Commission were to play an unwitting part in the shift in influence.

You will have many comments from varied interest groups, but my final plea is that practical common sense will prevail in the Commission's final report as this will impact the effective governance and efficient management of our UK based companies.

Jeff Hewitt

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(Chair of Audit Committee of Vesuvius plc, Foreign & Colonial Investment Trust plc, Cenkos Securities plc: but all remarks reflect my personal views.

Past Chair of Audit Committee of John Lewis Partnership plc and numerous small AIM companies.

Past Deputy Chairman and Finance Director of Electrocomponents plc and Finance Director of various other international companies.

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