

**Iain J Mackay**  
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2 August 2013

Dear Sirs,

## **Statutory Audit Services Market Investigation**

We are writing in respect of your summary of provisional decision on remedies notified on 22 July 2013.

We have announced today the result of our audit tender process, which has helped inform our views on the market for statutory audit services, and we would be happy to meet with you to discuss our recent observations in more detail. We note you propose several remedies; however our main concern is in respect of the proposal for mandatory tendering and more specifically the five year tendering period recommended.

We tendered our audit in response to the 2012 UK Corporate Governance Code's "comply or explain" approach. We note that we are among several FTSE 350 companies to have commenced an audit tender process since the code was updated. We believe the UK Code has the potential to have a significant impact on audit competition and should be given time to work before considering additional remedies. Whilst by its nature voluntary, the market discipline of "comply or explain" should not be underestimated.

In respect of the five year tendering period there are a number of more detailed considerations noted below.

- Notably with respect to audit of banks it is likely that a change in audit firm would require the incoming firm to make changes to financial arrangements for both the firm and individual partners and staff. Although mandatory rotation is not proposed, frequent tendering engenders significant disruption to the provision of financial services to the audit profession.
- Significant changes to non-audit services contracts in order to comply with the rules on independence may entail a heightened degree of operational complexity for FTSE 350 companies.

**HSBC Holdings plc**  
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Incorporated in England with limited liability

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*Group Finance Director*

- Allowing sufficient lead time to enable a well-planned tendering process to be implemented and in the event of auditor change allowing sufficient time to effect smooth transition of auditor is vital, particularly with regard to ensuring robust audit quality of large, multi-jurisdiction companies.
- In HSBC's case we have allowed approximately six months to run the tender and eighteen months to enable our new audit firm to complete the complex process of achieving independence and to enable thorough transition of audit responsibilities. Management and the Audit Committee considered continuity of robust management challenge and conduct of high quality audit as being vital to effective transition. Accomplishing this requires significant lead time.

Taking these factors into consideration it is our opinion that a 5 year mandatory tender cycle may therefore involve commencing the next tender process approximately three years after appointment. This, we believe, creates unintended disincentives to audit firms, companies' management teams, audit committees and shareholders and poses unnecessary risk to ensuring sufficient investment in achieving high quality audit outcomes.

The role of the audit committee with respect to the appointment of auditors and maintaining audit effectiveness is vital; management plays an equally vital role. We believe that the objectives of management and the audit committee should and can be aligned. In this respect it is important that audit committees oversee and approve audit fee arrangements, approve a framework for non-audit services, oversee the tender process, and throughout the audit engage regularly with auditors.

Management plays an equally important role; to not involve management in a tender process or fee negotiation may deprive the selection and negotiation processes of important skills and insight and would, we believe, be a detriment to ensuring audit quality.

To illustrate: HSBC's recent tender process, although initiated by management (subject to approval of audit committee and board), was overseen and approved by the audit committee; the selection panel was formed comprising finance and non-finance executive management and non-executive directors; the recommendation of the selection panel was reviewed by our audit committee; and it was the audit committee that submitted the selection recommendation to the board for approval. Our Finance team provided the resources for the day to day running and co-ordination of the process. We believe this process was robust, and of high quality.

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We welcome that you are not pursuing mandatory switching; our process indicated that there were few firms we could realistically select from, and eliminating the incumbent would have significantly limited our choice.

Yours faithfully,

A handwritten signature in blue ink, appearing to read "Iain J Mackay", with a large, sweeping flourish underneath.

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