Investment Management Association
ima

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Denis Kelly
Audit Market Investigation
Competition Commission
Victoria House
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Dear Denis

Provisional remedies - Statutory Audit Services for Large Companies

The IMA represents the asset management industry operating in the UK. Our members include independent fund managers, the investment arms of retail banks, life insurers and investment banks, and the managers of occupational pension schemes. They are responsible for the management of £4.4 trillion of assets, which are invested on behalf of clients globally. These include authorised investment funds, institutional funds (e.g. pensions and life funds), private client accounts and a wide range of pooled investment vehicles. In particular, the IMA's members manage holdings amounting to 34% of the domestic equity market.

In managing assets for both retail and institutional investors, the IMA's members are major investors in companies whose securities are traded on regulated markets. Therefore, we have an interest in the requirements governing the audit of these companies' accounts and the auditor's report to our members as users.

Accounts provide investors, the holders of ordinary shares, with information for the purposes of making investment decisions and fulfilling their responsibilities as owners, i.e stewardship. That accounts are subject to a quality audit is pivotal to this and is a key element of a robust investor protection and stewardship framework and, potentially, in maintaining and protecting shareholder value. It also helps bridge the information asymmetry between a company's board and its external shareholders.

The IMA welcomed the OFT asking the Competition Commission to investigate the supply of audit services to large UK companies and whether there are features of the market that prevent, restrict or distort competition. The IMA agreed with the final report's conclusion that the audit market is not serving its shareholders. In particular, the Big Four dominate the audits of practically all companies in the FTSE 350 which is not healthy. Nor is it likely that there will be a naturally developed

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competitor in the medium term and the situation could be exacerbated should one of the Big Four fail. In this context, we do not believe that the Commission's provisional remedies necessarily address this issue as set out below.

- *Mandatory tendering every five years.* We agree that increased tendering should provide greater opportunities for "non-Big Four" firms, but question the extent to which it would be successful and whether the suggested remedies would lead to firms developing the necessary expertise and resource. It is more than likely that changes would be between the Big Four - we understand that 97 per cent of all switches made by FTSE 350 companies in the last five years have been to or within the Big Four.

  Nevertheless, a reduction in average tenure represents a well-founded public policy objective. However, whilst a minority of investors supports tendering every five or seven years, for the majority this is too frequent. The latter support the Financial Reporting Council's measures such that FTSE 350 companies tender the audit at least every ten years. In general tendering should be on a comply or explain basis and something that audit committees decide in consultation with shareholders. To mandate it disenfranchises both. Moreover, recently in response to market pressures there has been an increase in the frequency with which large UK companies/groups tender their audits, for example, Barclays, BG Group, RSA and HSBC Group. This questions the need for mandatory measures.

- *Audit quality review.* The real perceived value of an audit is in the process itself and yet this is largely opaque to investors. For some the best insight with respect to the audit process comes from reviewing AQRT reports, PCAOB reports and anecdotal evidence from audit firms and we believe more frequent audit quality reviews will help ensure a continuous focus on improvements to audit quality. However, we do not consider that this will necessarily result in increased choice. In fact requiring the AQR to review and report on the larger Mid-Tier firms annually could create extra costs for them and be a barrier to entry.

- *Loan agreement provisions*. IMA does not consider there should be any documents that contain clauses that limit choice to the Big Four firms. We believe to do so may be anti-competitive and support them being prohibited. Moreover, sometimes it can be implied that a Big Four firm should be appointed and a statement to the effect that appointments should be open to all audit firms would help address this.

- *Advisory vote on the audit committee report.* IMA does not consider that a vote on the audit committee report would have any benefit in that investors already have sufficient powers in respect of their oversight of audit matters at Annual General Meetings in that they vote:

  - on the annual report and accounts, which includes the Audit Committee Report;
  - on the annual re-election of members of the Audit Committee;
  - to approve the external auditor's fees; and
  - to approve the appointment of the external auditor.

  Nor are we clear what a vote against would mean in practice.

- *Strengthening the accountability of the auditor to the AC.* There can be a perception that the auditor is accountable to executive management which

controls the relationship and to whom services can be sold. Strengthening the auditors' accountability to the Audit Committee of Non-Executive Directors would help address this. Investors would also welcome more transparency over how the Audit Committee had discharged its responsibilities.

We trust the above is self-explanatory but please contact me if you would like clarification on any of the points in this letter, or if you would like to discuss any issues further.

Yours sincerely

Liz Murrall
Director, Corporate Governance and Reporting