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14 August 2013

Dear Sirs

Statutory Audit Services Market Investigation- Provisional decision on remedies

1 Introduction

Mazars, the leading integrated international audit and accountancy organisation with over 13,500 professionals in 71 countries and a turnover of approximately 1bn euros, is pleased to submit its views on the Competition Commission's 'Provisional decision on remedies'.

2 Overall view

Our overall view is that whilst we support the proposed remedies and the proposed means and timetable for implementation we believe that they are insufficient to bring about the change needed to address the AEC identified by the Competition Commission and, in particular, to deal with the barriers to entry faced by firms seeking to enter the FTSE350 audit market.

We continue to believe that in order to secure the necessary change there should be a package of remedies that includes at least a significant encouragement of joint audit and much stronger restrictions than currently apply on the provision of non-audit services by the incumbent auditor.

We are also not convinced by the reason given for dropping the proposal for the mandatory rotation of audit firms.

3 Concern that reforms are not sufficient to address deep-seated market issues

We believe an important opportunity is being foregone to address longstanding issues related to institutional prejudice against 'challenger firms' and, in particular, that arising from the influence of the Big 4 firms, directly and indirectly, on the FTSE350 audit market, on regulatory and standard-setting issues and on the profession.

We consider the causes of the AEC are deep-seated and have serious concerns that the relatively modest reforms proposed are unlikely on their own to create a competitive market driven naturally by

market forces. If our concerns are well founded, the reforms proposed by the Competition Commission would join a long list of previous efforts, including those advocated a few years ago by the FRC's Market Participants Group, that have failed to reach their intended goal.

The remedies are only likely to be sufficient if the reforms proposed, such as those related to strengthening the role of audit committees and investors in auditing matters, have substantial impact within a relatively short period of time. We would doubt that this is likely to happen.

4 The need for the implementation of reforms to be monitored

We also perceive a risk that with decisions on audit appointments being made on a company by company basis the desire for investors to see a less concentrated market will not be realised leaving the current oligopolistic situation - with firms 'too big too fail' and 'too big to regulate' - unchanged.

To mitigate the above risk we believe it is essential that the implementation of the reforms be monitored to consider whether they are having the planned effect in reducing the AEC identified. We believe that for monitoring to be effective it would be helpful for the Competition Commission to indicate the extent of change they would expect to see by a given date and that a monitoring body be identified.

The likelihood of the necessary change not occurring is increased by the change in proposal relating to the FRC whereby its new responsibility to promote competition will not be a separate secondary objective but has been downgraded to the need to have regard to it in the undertaking of its primary role.

If the FRC is not to have the necessary powers and responsibilities to monitor the effective implementation of the reforms we believe this role should be undertaken by the Department for Business, Innovation and Skills.

The need for a monitoring body to be appointed to oversee the implementation of reforms to the FTSE350 audit market is of the utmost importance given that the Competition Commission is relying to a very substantial degree on market based reforms and previous efforts at market-based reform, such as through the FRC's Market Participants Group, as discussed above, have been notable for their lack of success.

5 Surprised at the FRC's views on the annual review of firms

We are most surprised at FRC's views generally on the proposed remedies and especially by their desire only to review six firms on an annual basis. This hardly seems to augur well with regards to their proposed commitment to have regard to competition in undertaking their primary role. We believe there is a need for a substantial change in mindset at the FRC on their approach to promoting competition given its role in enhancing quality in auditing

In giving the reason for their views as the fact that we, along with other firms, currently do not audit any FTSE350 companies they are rather missing the point of your proposed reforms, ie to provide a more level playing field so that those currently not auditing FTSE350 companies might be given a fair chance to do so. The FRC's views also overlook the fact that we audit businesses within their remit and which are of a similar size and complexity to that of companies within the FTSE350.

In addition to the need for more non-Big 4 and less Big 4 people being involved at senior levels of the FRC, there is a need for a review of its committee structure in order for it to be able to deal

appropriately with competition issues, A particular focus of the review should be on how to increase the role of investors in the FRC's work related to auditing

We also believe it is vital for the Competition Commission to agree with investors how they will undertake the enhanced role envisaged for them including how they will act collectively as well as individually in order to bring about the desired change in the FTSE350 audit market.

We further consider that there is a need for a thorough multi-stakeholder review, again with the strong involvement of investors, of AQR's approach to its task. This would include a review of its staffing, its methodologies, and its means of reporting its findings and of measuring its impact on audit quality. The banking crisis perhaps provides pause for thought in this area.

6 Reason for abolishing the proposal to require mandatory firm rotation not persuasive

We are not persuaded by your statement that 'our provisional view is that while mandatory switching would address concerns expressed by investors about very long tenures, our proposed remedy package addresses the AEC more effectively whilst delivering similar benefits' (paragraph 18).

We are surprised by this as mandatory tendering will not necessarily lead to very long tenures ceasing and secondly a strong body of investors has indicated they regard unduly long tenures as a real cause of concern to them.

The absence of a requirement for mandatory rotation also leaves open the risk of some change in the near future not being maintained in the years ahead once the spotlight is reduced on the FTSE350 audit market.

We were surprised by your statement that 'Given a preference for Big 4 firms by many institutions, it appears rational for a company to appoint a Big 4 firm. Further, the tendency to prefer a Big 4 auditor indicates some risk for a listed company in switching from a Big 4 firm to a Mid-Tier firm' (paragraph 3.265). Given the absence of rational grounds for such a preference it would be helpful if the Competition Commission were to make very clear in the interests of creating a level playing field that it disassociates itself from such views. We would make a similar point with regards to the comment that 'Our position remains that there are significant costs for companies and firms associated with switching and that for some companies these costs may be substantial (for example, where the audit is complex)' (paragraph 4.64). In this case it would be far more helpful for the Competition Commission also to emphasise the benefits that can arise from switching and the risks of unduly long tenures.

7 Support for five-yearly mandatory tendering

We support the proposal for five-yearly mandatory tendering, in line with the length of period between audit partner changes, and believe your proposals are balanced given that they allow for this period to be extended to seven years in exceptional circumstances. Your approach offers greater certainty that tenders will take place at all FTSE350 companies than the FRC's current 'comply and explain' basis.

We believe, however, that the Order should require companies to publicly indicate in advance of when they are going out to tender so that any firms which believe they have the necessary capabilities and interest may submit an expression of interest. The openness of some companies to non-Big 4 firms submitting tenders has been disappointing in some recent high profile instances of companies tendering their audit, a continuation of a very clear trend identified by the Competition Commission in your own research on the issue.

For Mazars, we are pleased to confirm:

- we will be pleased to participate in at least 10-15 significant tenders a year; and
- we are willing to bear the cost of responding to such tenders.

We also note that in considering the costs incurred by companies in putting their audits out to tender these need to be weighed against the benefits derived from an increase in market competitiveness and in audit quality from more regularly testing the service offered by the incumbent auditor against that offered by alternative suppliers.

8 Taking proper account of investors' views on auditor independence

We note the comment that 'we place significant weight on the views of investors in this regard [ie re quality and professional scepticism]. A coalition of investors said that audit quality (and ultimately trust in capital markets) depended on real and perceived auditor independence' (paragraph 1.32).

In view of the above, we are surprised that you have moved away from calling for mandatory rotation after a period of, say, around 15 years as proposed by the coalition of investors and that you are not introducing a cap on the extent of non-audit services, again as proposed by them (at a level of 50%), as we understand they regard both issues as having a significant bearing on independence and/or the perception of it.

Limiting the extent of non-audit services provided by the auditor, not only enhances independence but also provides competition incentives as it opens up the possibility of 'challenger firms' providing more such services to FTSE350 companies thereby enabling audit committees and finance directors to gain knowledge of their capabilities thus making them more effective competitors in audit tenders.

With the above in mind, we are puzzled by the partial nature of the logic in paragraph 4.80.This records that 'some parties thought that the sharing of NAS across Big 4 firms would therefore effectively restrict a company's choice if ACs were not encouraged to consider a wider range of firms'. Firstly, this would not necessarily be the case if the restriction took the form of a cap on the quantum of non-audit services rather than increasing the list of prohibited services. Secondly, the very point of such a measure would be, as discussed above, to increase the range of providers of non-audit services beyond the Big 4 in order to enhance competition. It would be in management's hands as to whether they restricted the range of auditors by the way they selected non-audit service providers and if this were given as a reason for limiting auditor choice one would trust this matter would be of interest to the audit committee and investors.

9 Disappointing that existing restrictions in loan covenants are not to be outlawed

We are disappointed that you 'do not propose that the prohibition on [choice of auditor in loan covenants] should apply to loan agreements already in place on the date on which the Order came into force, again to avoid unnecessary disruption to the market' (paragraph 3.295). We are not clear what the disruption would be especially if the Order required the restriction to be lifted the next time the company was required to tender their audit. Our view is reinforced by your statement that 'We do not expect the proposed remedy to impose significant incremental costs on lenders. We would expect that in the majority of cases, a company's choice of auditor would not present concerns for lenders and individual negotiations would be required in isolated instances only' (paragraph 3.304).

10 The real barriers to firms investing in further building capabilities

You state that 'It is our view that one of the main barriers to firms [Big 4 and Mid Tier firms alike] investing in the capabilities required to compete for certain audit engagements is the infrequency with which engagements are put out to tender' (paragraph 3.123). Our view is that this is but a preliminary barrier. The main barrier is confidence that there is a level playing field such that 'challenger firms' will be invited to tender and then selected on their capabilities rather than the selection being made on factors unrelated to quality or price as can currently happen as there is not at present, as you recognise, a level playing field for 'challenger firms' seeking to enter the FTSE350 audit market.

11 Concern on discussion on joint audit

We note there is a certain lack of specificity in your discussion of shared or joint audit. For example, you state that 'We have not been able to quantify what the potential cost of imposing shared or joint audit on the market would be, however we believe that across the market these costs would be potentially significant, particularly if the risk of a reduction in audit quality was to be avoided' (paragraph 4.109). We would be pleased for more information on the means by which you have arrived at this conclusion. There is no reason to believe that joint or shared audit would involve significant extra cost especially when account is taken of the overall impact on prices given that as you recognise it would have some benefits in relation to entry and expansion though you 'were not convinced these benefits were significant or certain, and did not justify the potential costs of such a remedy' (paragraph 4.110).

Joint audit would also have the merit of potentially enhancing audit quality. Both joint auditors, assuming there were two, would have joint and several liability for the opinion offered and therefore it can be argued that investors would have more confidence in the opinion and quality would be enhanced by each of the joint auditors reviewing the work of the other, an important consideration given the complexity and inherent subjectivity of the financial statements of many leading FTSE350 companies especially where there are significant amounts determined by reference to valuations. We are also surprised by your comments on quality given that joint audit is currently an option allowed to companies.

Moreover, we would point out again that it is the only remedy that has been adopted in practice in a major economy that has succeeded in creating a more level playing field between firms.

Joint audit is the only remedy that, in the medium term, would enable 'challenger firms' to play a significant role in auditing the companies at the very top of the FTSE100 where the share of the total of FTSE350 audit fees is very heavily concentrated and where the implications would be greatest on the economy were one of the dominant players to leave the market unexpectedly, an issue which the FRC has indicated is a source of concern to it.

You went on to add that you placed considerable weight on the views of investors who were almost universally opposed to such a remedy on the grounds of additional costs and risks to quality (paragraph 4.111). It would be helpful to understand the experience of the investors offering a view on joint audit especially as regards how it works in the country where it is currently widely adopted. We remain willing to provide further information to the Competition Commission, investors and others on issues related to the practical implementation of joint audit. We also cannot help avoid the observation that there seems a more ready willingness to listen to investors' views in this area than in others, eg on mandatory rotation of firms and the provision of non-audit services, where those of a very significant group of investors have been sidelined.

It is also noticeable that your comments in relation to cost and other factors relate to compulsory joint audit rather than to providing an encouragement for it.

We are also concerned at the campaign of misinformation surrounding joint audit. We find Deloitte's comments disingenuous in referring to shared, not joint audits, which failed. None of Polly Peck, Parmalat or BCCI were joint audits. Moreover, the fact that Enron was a sole audit and that the FRC has made numerous findings against firms undertaking sole audits does not mean that sole audits should be regarded unfavourably.

For the reasons stated above we urge you to reconsider your views on joint audit as a potential remedy.

12 Further discussion

If you would find it helpful to discuss any issues covered in this letter please do not hesitate to contact David Herbinet on 0207 063 4419 or Anthony Carey on 0207 063 4411.

Yours faithfully

Mazars LLP

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