

August 2013

PIRC response to provisional decision on remedies

We welcome the Commission's work in the area of audit services. It is our view that there is an effective oligopoly in place, and that this does not serve the interests of our institutional shareholder clients. It is striking that in other sectors of the economy there are simple limits on the market share any one provider can amass. The CC has, in our view, taken a very market-focused approach to seeking greater competition in the provision of audit services.

Mandatory tendering

As you may be aware PIRC believes that mandatory rotation of audit firm would be the most effective market solution to the dominance of a limit number of accounting firms. However, given that the Commission's summary of provisional decisions on remedies indicates that this will not be taken forward, we believe that mandatory tender after five years is the minimum that should be introduced.

Our support for this policy is based on our belief that the clearly dysfunctional market for audit services needs a jolt. The number of tenders of audit services from large PLCs is still tiny. Our concern is that the overall result of the current approach of the Financial Reporting Council (FRC), set out in the UK Corporate Governance Code, of requiring firms to tender after ten years, will be a market for audit services that is little changed in a decade's time. We believe that a ten-year tendering cycle will simply "kick the can down the road", and assuage any immediate pressure for change. In our view this will fail to significantly increase competition in the market.

PIRC therefore urges the Commission to pursue the proposed remedy, and require FTSE350 constituents to tender audit work every five years.

We do not underestimate the extent of lobbying that is underway to prevent an effective intervention in the market for audit services, something we discuss further below. Therefore, if the Commission is not successful in introducing such a remedy, PIRC believes a more direct approach, such as a straightforward cap on market share, may be required.

Competition duty for the FRC

We also support, with reservations, the CC's proposal that the FRC be given an explicit competition duty. Regrettably, we are not convinced that the FRC has proven itself to be an effective regulatory body in this area, and we are concerned that it is too close to the firms that are within its ambit. We were extremely disappointed that the FRC itself

lobbied the CC against proposed remedies such as mandatory rotation or more frequent tendering given that it has done little to address the concentration of the audit services market itself. In our opinion it is a regulator that takes action only when forced to by pressure from elsewhere. When not forced to act, its regulatory instinct, in our experience, is almost always to defend the status quo.

Our principal reservation about giving the FRC a competition duty is that, because of conflicts, it may struggle to give the duty practical application. However, on balance, and in combination with a five-year tendering requirement, we believe that the remedy should be introduced.

Nature of evidence submitted to the Commission

Finally, it is also clear to us that there has been some effort to co-ordinate lobbying against the CC's proposed remedies in relation the audit market. We would draw your attention to the similarities in the text of submissions made by the GC100, SABMiller and GlaxoSmithkline in response to the CC's provisional findings and notice of possible remedies. There are also similarities between the submissions of the GC100 and GlaxoSmithkline in response to the provisional decision on remedies. We also note that a number of submissions from individuals share a similar format.

This is also not the first time that such activity has been undertaken in relation to the market for audit services. The Auditing Practices Board consultation on the provision of non-audit services, undertaken in 2009/2010, also saw corporate submissions which contained passages of text that were identically worded.

In our view generic text is used to provide an easy way for more corporate submissions to be sent in, to give the impression of a position that is widely shared. We therefore wish to make the Commission aware that there may have been an attempt to orchestrate responses in opposition to the proposed remedies in order to dissuade you from taking action.

Kind regards

A handwritten signature in black ink, appearing to read 'Alan MacDougall', written in a cursive style.

Alan MacDougall

Managing Director
PIRC Limited