Inquiry Manager
Statutory Audit Investigation
Competition Commission
Victoria House
Southampton Row
London WC1B 4AD

14th March 2013

Dear Madam/Sir,

The Financial Reporting and Analysis Committee (FRAC) of The Chartered Financial Analyst Society of the UK (CFA UK) welcomes the opportunity to respond to the remedies suggested by the Competition Commission for its Statutory Audit Services Market Investigation.

CFA UK represents more than 10,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

Statutory Audit Services Market Investigation

Financial Reporting and Analysis Committee (FRAC),
CFA Society of the UK

The FRAC welcomes the chance to respond to the proposed remedies by the competition commission.

1. Mandatory tendering

Overall, we believe that mandatory tendering would be positive for the industry.

(a) We think that **five years is too short a time period for tendering and that seven or even ten years would be better**. This would provide the auditor enough time to invest in auditing the company and not be subject to rotating teams so that the benefits of tendering are not lost.
(b) We are happy with mandatory implementation. We believe that having a fresh pair of eyes to look on auditing accounts may enable the new auditors to point out areas where management was wrong or to highlight differences in reports.
(c) We believe that an open book basis would be the best way to proceed.
(d) Clearly there would be costs in changing auditors both for the company and the auditor itself. However, if it were conducted on an open book basis, we do not believe that these costs would be so significant as to not pursue mandatory tendering.

(e) We have no view on the particular requirements of phasing.
(f) We believe that it is important to divide the auditing and consulting businesses of a company otherwise there could be a conflict of interest. Furthermore, when a tender is imminent, the incumbent auditor may not be as forthcoming in disagreeing with company management. This may make the auditor less likely to disagree with management if they believe this will help it win the business when the tender arises.

2. Mandatory rotation of audit firm

We have split views on whether mandatory rotation should happen.

(a) Like tendering, we think that **seven to ten** years would be the most appropriate amount of time if it were to happen. We are divided on whether there should be a back-stop date for mandatory rotation. The following reasons were given for: 1) Without such a limit, one firm could continually audit a company for decades – as often happens now. We are concerned that this results in a cosy relationship, leading to a lack of independence and scepticism. 2) A new auditor brings a fresh pair of eyes. Increased costs in year one can be mitigated, as the Commission suggests, and perhaps investors would not mind sanctioning a higher initial fee because of the benefit of fresh scrutiny. 3) Auditors may be less likely to disagree with company management if there were no mandatory rotation and a tender was coming up. The auditor would not want to lose the business and might bend to the client's will to win the tender again. The following reasons were given against: 1) The audit committee would not have the authority and flexibility to change auditor when it wanted to; 2) The audit committee would not have a full choice of auditors to choose from as the incumbent auditor would not be able to rebid. A key concern is whether audit firms outside the Big Four will enter tenders for large company audits. 3) As a step towards encouraging competition in the audit market, mandatory tendering would provide the main remedy without the disadvantages of **mechanical switching.**
(b) Even with only three firms competing, this should be enough. If there might be fewer potential candidates because of conflicts of interest over consultancy work, this argues for restriction of the latter.
(c) As above, we believe the tender should be on an open book basis.
(d) Same as above.
(e) No view
(f) We believe it would be better for **an independent body to appoint the auditor, such as a regulator or a body representing investors**. If listed companies and/or investors paid a proportionate levy to the body then it could distribute work amongst the firms. Its practice would include ensuring that no audit relationship lasted longer than 7-10 years.

3. **Expanded remit and/or frequency of Audit Quality Review team (AQRT) reviews**

   i) We do not believe that there should be a different set of rules for FTSE 350 companies and believe they should be reviewed at least every three years (in line with the SEC)
   ii) Yes, the AQRT should be able to publish FTSE 350 results separately so that there is greater transparency.
   iii) We wonder whether this would add any value. It may be better to get AQR to do a better job of challenging judgments rather than getting buried in audit evidence and sampling.
   iv) No view.

4. **Prohibition of 'Big 4 only' clauses in loan documentation**

   a) We agree that Big 4 clauses should be prohibited in all documents.
   b) The main benefit is that this would open tenders up to more firms. We don't see how it would add to costs.
   c) It is worth discussing this with the non-Big 4 firms. The clause would exist to open up the market to them, but this may not be enough to encourage them to compete for larger company audits. Other barriers should be investigated.

5. **Strengthened accountability of the External Auditor to the Audit Committee (AC)**

We agree that there needs to be strengthened accountability of the external auditor to the audit committee. Currently the direct line of communication between the auditor and the financial director is too strong.

6. **Enhanced shareholder-auditor engagement**

The most obvious public opportunity for engagement between shareholders and auditors is the AGM. However, there are a few problems with this: firstly, there are too many AGMs happening within a short space of time (some two hundred between March and June); secondly, companies often do not give meaningful answers to questions on numbers at AGMs. Consequently, such a meeting may not be held in a constructive manner. So other ways of enhancing shareholder-auditor engagement should be encouraged. These might include webinars, Q and As by email and thematic meetings, perhaps on a sectoral basis, between auditors and groups of investors.

7. **Extended reporting requirements.**

We are in favour of an enhanced auditor commentary and are responding to the FRC's consultation on ISA 700.

We look forward to discussing the issues raised in this response.

Yours sincerely,

Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Tom Haywood
Policy Adviser, Financial Reporting and Analysis Committee
CFA Society of the UK

Will Goodhart,
Chief Executive
CFA Society of the UK

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 10,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.