

28 August 2014

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Denis Kelly
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Dear Denis

Statutory Audit Services Market– Consultation on Draft Order

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 £5 trillion of assets, which are invested on behalf of clients globally. In particular, IMA's members manage holdings amounting to 30% of the domestic equity market.

In managing assets for both retail and institutional investors, 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 in ensuring that the markets trust the information reported.

IMA welcomed the OFT asking the Competition Commission to investigate the supply of audit services to large UK companies and whether features of the market prevent, restrict or distort competition. IMA supported the final report's conclusion that the audit market is not serving its shareholders and many of the suggested remedies. Our observations on the draft Order which is now subject to consultation are set out below.

- ***Part 4, Mandatory use of Competitive Tender Process.*** The Commission considered companies would benefit from tendering the audit every five years. Thus Part 4 requires that when a company has not undertaken a competitive audit tender in five consecutive years it should set out in the annual report which

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year it will next tender and why this is in the members' best interest.

Investors have been concerned that the long periods auditors hold office can materially impact their independence and objectivity, which are vital in ensuring audit quality. They would welcome a reduction in average tenure.

Whilst a significant minority of investors support tendering every five or seven years, for the majority this is too frequent. The latter agree with the EU's requirements that Public Interest Entities should change their auditor at least every ten years which can be extended to 20 years provided retendering takes place every ten years. In general, they believe tendering should be something that audit committees decide in consultation with shareholders.

In this context, the transparency proposed is welcome. We believe companies should disclose their intention to tender a year or more ahead of the process. Giving sufficient advance notice gives institutional investors the opportunity, should they wish to do so, to be consulted on the envisaged tender process.

- **Part 5, Audit Committee responsibilities.** Part 5 specifies that only the audit committee, acting collectively or through its chairman, should negotiate and agree the audit fee and audit scope, undertake the tender process, and make recommendations to the board.

Investors welcome the enhanced role of the audit committee in relation to the audit and the appointment of the auditor. However, we are concerned that, as drafted, the Order allows the chair of the committee to agree matters on his/her own. These matters should be for the committee as a whole. In particular, whilst the audit committee chair may well negotiate the audit fee, we would be concerned if the chair was to agree the fee on his/her own in that it should be the committee as a whole. This should be addressed.

- **Part 7, Monitoring and compliance.** Part 7 requires auditors of FTSE 350 companies, when requested by CMA, to notify the CMA:

- when the audit was last tendered and if it has not been tendered in five years, when the next tender is proposed; and
- whether the company has made the statements required by the Order.

We believe it may be more appropriate for the FRC as opposed to the CMA to be responsible for ensuring the appropriate disclosures and tendering activity. The FRC is essentially the auditors' regulator.

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

Yours sincerely



Liz Murrall
Director, Stewardship and Reporting