UK COMPETITION COMMISSION STATUTORY AUDIT SERVICES MARKET INVESTIGATION

PROVISIONAL DECISION ON REMEDIES

NAPF RESPONSE

Introduction

The National Association of Pension Funds (NAPF) is the UK's leading voice for workplace pensions. Our members have combined assets of around £900 billion, and operate some 1,300 pension schemes. NAPF membership also includes over 400 providers of essential advice and services to the pensions sector; these include accounting firms, solicitors, fund managers, consultants and actuaries.

We have an interest in ensuring the audit market serves the needs of our pension fund members. We believe the role of the auditor is of vital importance to investors in making assessments and investment decisions and the present level of audit quality and accompanying reporting could and should be enhanced.

General comments on remedies

We welcomed the provisional findings of the UK Competition Commission's (UKCC's) inquiry into the statutory audit services market. We support measures to strengthen independence and improve competition in the audit market in order to improve and safeguard audit quality. To achieve this we believe it is vital to continue to strengthen the role of the audit committee and its relationship with and oversight of the auditor and the accountability of both to shareholders. We believe there is no silver bullet solution to achieving the change needed, but rather what is required is a combination of a package of measures which:

- Increases transparency and accountability to shareholders from both the audit firm and audit committee;
- Enables and promotes increased and improved shareholder engagement with the audit process; and
- Corrects the currently identified misaligned incentives through increased tendering and a legislative tenure back stop.

Mandatory tendering every five years

We welcome the recognition that effective and rigorous tendering of the audit contract does not presently occur frequently enough. Whilst the introduction by the FRC of a comply-or-explain requirement for companies to tender every 10 years was a positive development, we do not believe that it goes far enough.

We do however, have apprehensions about a requirement to tender every five years. We would not like to see auditors being forced to devote excessive resource and attention to the practice of continually tendering at the expense of carrying out their primary role of auditing the accounts. Extending this proposed period to seven years, which is already suggested could be utilised in exceptional circumstances, would reduce the risk of any impact on audit quality.

Audit Quality Review (AQR)

The NAPF believes that more frequent audit engagement reviews of audit engagements will ensure increased focus on continuous improvement and audit quality. In addition, increased disclosure by the audit committee of the findings of the review and how they plan to respond is welcome and is an evolution of the current requirements of the Code.

It is not necessary however, to be so prescriptive as to require disclosure of the grade awarded as this runs the risk of being misconstrued as a judgement on the quality of the financial statements themselves. Although it should be clear that minimum expected disclosures would include when an AQR was undertaken, the key areas of focus and related responses. Best practice should then be left to evolve and will no doubt and the work being undertaken by the FRC's Financial Reporting Lab will help with this. It would be expected that investors will take a dim view of those audit committees which do not make appropriate disclosures.

Advisory vote

Shareholders already have a significant number of powers in respect of oversight of audit matters, these include votes on: the report and accounts; the re-election of relevant directors; the auditor's fees and the appointment of the auditor.

At this stage therefore, we see little merit in providing shareholders with an additional advisory vote on the audit report. However, with the changes to the Code and other reporting obligations of the auditor and audit committee, it is worth continuing to monitor whether these translate into the desired level of reporting. If they fail to do so, and we remain optimistic at this stage that they will, then at that stage there could be merit in providing shareholders with the additional vote.

Accountability of the audit to the audit committee

We continue to support the Commission's proposals to strengthen the accountability of the external auditor to the Audit Committee. Clarifying that it is the responsibility of the audit committee to set out the scope of the audit work, initiate any tenders, recommend reappointment of the auditor and approve any non-audit work will help alleviate concerns, whether perceived or real, that executive management has too influential a relationship with the auditor.

It is however, arguably too prescriptive and also unrealistic to require the audit committee to negotiate fees. It is not unreasonable for the audit committee to delegate such interactions to management, however, approval of and accountability for the fees would remain with the audit committee.

Given the Corporate Governance Code is expected to be revised again in 2014, these changes would be most appropriately introduced through the Code as an evolution of current practice.

FRC objectives

As we set out in our response to the proposed additional remedy, we believe that proposals to provide shareholders with more information as to the 'quality' of the different auditors can only help foster a more effective market and improve the understanding of the qualities and performance of the various audit firms amongst their 'client' base – the shareholders.

However, we explained that we have concerns about creating a secondary objective for the FRC, we continue to have concerns.

There is a danger of an inherent tension being created between the monitoring of quality and of competition if a secondary objective were to be introduced. As such while we support the objective of increasing and improving the transparency of AQR reports, it might be worth considering if this could achieved without the provision of a new secondary objective for the regulator.

In considering remedies to the identified problem, we would encourage the Commission to bear in mind that the entity that audits the incumbent auditor must be accountable to shareholders, hence a market-based solution would be preferable and more successful as opposed to a regulator driven solution.

The FRC itself will need to be minded of any conflicts it may itself have, perceived or actual, which may hinder its ability to fulfil any new or current objectives, to the satisfaction of its stakeholders.

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