Securing the future of pensions

UK COMPETITION COMMISSION STATUTORY AUDIT SERVICES MARKET INVESTIGATION

NOTICE OF A FURTHER POSSIBLE REMEDY

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.

We welcomed the provisional findings of the UK Competition Commission's (UKCC's) inquiry into the statutory audit services market along with the Commission's proposed remedies. We support measures to strengthen independence and improve competition in the audit market and believe it is vital to continue to strengthen the role of the audit committee and its relationship with and oversight of the. We agree that no one solution will achieve the change needed, but rather what is required is the combination of a package of measures which:

- Increases transparency 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.

If such a package is introduced we are hopeful that the environment will evolve towards one where there is a clearer line of transparency and accountability between "client" and "customer" with more trusting and constructive relationships and increased truer competition in the audit market.

Further proposed remedy

The NAPF does not object to the further proposed remedy, namely that to give the FRC a secondary duty to promote competition between firms providing audits to FTSE 350 companies, with the objective of increasing the transparency of AQR reports.

As we set out in our initial response to the UKCC's proposed remedies, we believe that a more tailored set of publicly available results regarding the performance of all audit firms in the market would be helpful. Providing 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, in devising a secondary objective for the FRC, it is important that the emphasis is on competition to improve the quality of audits at a reasonable price, rather than on price alone. Investors would be very concerned if there was any trend or encouragement towards lowest price at the detriment of quality. Competition should be seen as a means to an end and not an end in itself.

There is a danger of an inherent tension being created between the monitoring of quality and of competition if such an 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.

Aside from the comments above, we should also stress that this proposed remedy should be considered in addition to the other proposed remedies and not considered as a sufficient condition on its own. The proposed remedy will assist investors with gaining more insight into 'quality' different audit firms and provide them with hooks for dialogue with auditors and audit committees. However, as recognised in the UKCC's own analysis, it is the relationship between auditors and management that is more of an issue; many of the other proposed remedies around tendering and rotation will help change this relationship for the better.

Finally, in providing the FRC with a secondary duty to promote competition, 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 this objective to the satisfaction of its stakeholders.

Conclusion

We continue to welcome the UKCC's rigorous and balanced analysis of the UK's statutory audit services market.

We endorse the analysis presented by the UKCC and support many of the proposed remedies. We believe that no one solution will achieve market correction, but rather a combination of greater more open tendering, a legislative back-stop for audit firm tenure, fostering of more transparency and dialogue between auditors, companies and shareholders, greater transparency around the performance and qualities of the audit firms in the market; and reform of exclusionary practices should go a long way towards a healthier FTSE 350 audit market. These remedies have all been identified by the Commission and we look forward to working the Commission and others going forward.

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