Statutory audit market study
7th floor
Victoria House
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21 January 2019

Dear Sir/Madam

Response to the CMA's Statutory audit services market study by 3i Group plc ("3i")

About 3i

3i is a leading international investment manager and investor focused on mid-market Private Equity and Infrastructure. Our core investment markets are northern Europe and North America. 3i was established in 1945, is listed on the London Stock Exchange and a member of the FTSE 100.

3i reports its results under IFRS and is audited by Ernst & Young LLP. This is a response on behalf of 3i and reflects our experience of our audit in 3i. It does not address our experience of audits in our portfolio companies.

General comments

We are supportive of any measures that demonstrably improve audit quality and welcome the chance to respond to the CMA's proposals. As a private investor ourselves, in a range of sectors and geographies, we recognise the value of a high quality audit that provides assurance and helps to preserve value.

The CMA update paper makes various references to the Kingman Review, and the question of the 'expectation gap', which is intended to be addressed by the Brydon Review into UK Audit Standards. The remedies proposed in the update paper rightly focus on the need to improve audit quality, with an implicit assumption that greater competition will assist this in the longer term. We recommend that any remedies are implemented:

i) after the Brydon Review is completed, so that there is shared view on the definition of audit against which quality can be measured; and

ii) after the recommendations of the Kingman Review (which we broadly support) are implemented, to ensure that there is a well-resourced and empowered regulator to oversee the audit sector.

We believe the benefit of a coherent, consistent and sustainable set of changes outweighs any benefit of immediate action.

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Our specific responses are attached and we would be happy to provide further background to them if that would be helpful. Please do not hesitate to contact me, or our Group Finance Director, Julia Wilson, if you do have any questions..

Yours faithfully

Simon Thompson
Chairman

Response to consultation questions

A) Issues

We agree that audit quality is an important protection for shareholders of, and other stakeholders in, a business. We accept that there have been some significant corporate failures, which call into question the quality of the audit in those particular cases, and that the resulting loss in public confidence means that some change is needed.

We make the following observations based on our recent experience of conducting a mandatory audit tender process:

- By planning ahead, we succeeded in running a competitive audit tender with three parties (all Big 4), notwithstanding their potential to lose significant non-audit services as a result.
- We considered firms outside the Big 4 but they did not have sufficient depth of sector experience (and one declined to participate).
- Audit quality was the principal focus of the Audit Committee throughout the tender process.
- We believe the existing rules on non-audit services (black-list and 70% cap) are generally effective in minimising conflicts and that, in practice and to the best of our knowledge, most FTSE 100 Audit Committees and the Big 4 typically operate limits on engagements that are materially more restrictive (and did so even prior to recent announcements from the Big 4).
- The quality of an audit is highly dependent on a firm's ability to access a range of non-audit specialists to provide input into areas of critical judgement.

B) Remedies

Remedy 1: Regulatory scrutiny of Audit Committees

We do not support this remedy, as we believe that the proposals would be unduly burdensome for both the regulator and companies. However, in principle, we support the recommendation of the Kingman Review to create a well-resourced and empowered regulator, capable of reviewing the work of Audit Committees more effectively, and would support greater interaction between such a regulator and the Audit Committee on audit related matters and, for example, complex accounting judgements.

We would not support regulation that is overly process focussed or, in the financial services sector, that duplicates the existing oversight of the PRA and FCA.

Remedy 2: Mandatory joint audit

We do not support the concept of mandatory joint audit, as we believe it creates a risk that audit quality will be diluted and costs increased. We have used firms other than our principal auditors for discrete, non-material parts of the group's audit. In our experience, without very careful management, it can lead to a confusion in accountability, and a risk of duplication or omission in scope.

We accept that there is a need to reduce the barriers to entry for challenger firms, and we would support secondments and technology sharing to achieve this.

Remedy 2A: Market share cap

We do not support a market share cap as it is likely to restrict choice for Audit Committees that require their auditors to have particular capabilities in specialist areas (i.e. 3i's requirement to have auditors who are able to value mid-market private investments), or large and complex international groups.

A cap based on the number of clients would be the most objective measure.

Remedy 3: Additional measures to reduce barriers for challenger firms

We are supportive of measures that are designed to reduce barriers to entry for challenger firms, and that both increase choice and quality for companies, and improve resilience in the audit market in general.

Remedy 4: Market resilience

We agree that the reduction of the Big 4 to 3 (including as a result of voluntary action) would be a poor outcome for choice and competition.

Remedy 5: Full structural or operational split

The quality of our audit depends on access to the non-audit transaction services teams who have significant experience of unquoted company valuation and a good understanding of current market conditions and practice. This is our most significant audit risk. We would therefore not support a full structural split of the firms.

Provided access to non-audit specialists is still available, we would support an operational split. We note that many corporates are capable of creating different incentive arrangements in their separate business segments to recognise the specific objectives, risks and markets in which they operate. We see no reason why this should not be achievable in a large international partnership structure.

Remedy 6: Peer review

We support the concept of peer review as a part of, rather than separate from, the FRC's existing AQR process, and as a way to increase the resources available to the regulator.

We do not support the proposal to conduct peer review in real time, as we believe this could confuse accountability, and create delays in coming to important judgements (without necessarily improving those judgements).

We would support peer review as soon as practicable after the audit is completed, so that lessons can be quickly embedded into the next cycle of planning.