

Mr Guy Jubb
Standard Life Investments

From: Dipen Gadhia
Inquiry Manager

Direct line: 020 7271 0162

By email only: guy_jubb@standardlife.com

4 April 2012

Dear Mr Jubb

Statutory Audit Market Inquiry

The Competition Commission (CC) is an independent public body established by the Competition Act 1998. It conducts in-depth inquiries into mergers, markets and the regulation of the major regulated industries. Under the Enterprise Act 2002, in most merger and market references the CC is responsible for making decisions on competition questions and for making and implementing decisions on appropriate remedies.

The CC is currently undertaking a market investigation into the supply of statutory audit services to large companies in the UK.¹ We are not investigating any particular companies, but investigating whether any particular features of the statutory audit market have anti-competitive effects.

As part of this investigation, we are considering whether the role of audit and the identity of the auditor affect your investment decisions. We have drafted some specific questions with respect to both equity and fixed income (debt) investments (Annexes A and B) and we would be grateful if you could provide a response to these questions as relevant by **Friday 20 April 2012**, keeping your response to each annex separate. If this date presents a problem please let us know.

If this request raises issues of commercial confidentiality for you, please note that Part 9 of the Enterprise Act 2002 makes it a criminal offence for the CC to make unauthorised disclosure of the information you provide. Annex C to this letter gives more information on the C's power to gather, handle and disclose information.

Please also note that the Enterprise Act 2002 gives the CC power to impose a requirement on persons to provide information by giving formal notice under s109 of that Act. If you are unable to provide the information we seek on a voluntary basis (for instance, for reasons of client confidentiality), please let us know by Thursday 12 April 2012.

If you would like to discuss any aspect of this letter, or our inquiry more generally, please do not hesitate to contact me.

Yours sincerely

Dipen Gadhia
Inquiry Manager
Dipen.Gadhia@cc.gsi.gov.uk

¹ http://www.competition-commission.org.uk/assets/bispartners/competitioncommission/docs/2011/statutory-audit-services/statutory_audit_market_inquiry_terms_of_reference.pdf . Please note that we are publishing details of our investigation on our website.

Annex A – Equity Investments

Introduction / about your investments

1. Which companies' equities do you own? (If numerous, please describe in categories, and indicate approximate holdings)

We manage investments in a wide range of equity investments, mainly listed on major global stock exchanges. The total value of assets under management as at 31 December 2011 was £154.9bn of which £50.4bn was invested in equities.

2. Would you describe yourself as an active or passive investor?

Active.

Role of audit

3. In making investment decisions, what information do you use from the audited accounts? How do you use this information? To what extent do you rely on it?

We use information derived from audited accounts to assist us in evaluating and monitoring existing and potential investments.

4. Do you require a clean audit opinion in order to pass investment decisions / internal controls?

No but in the normal course the vast majority of our investments are in companies whose financial statements have a clean audit opinion.

5. In your opinion could the audit report provide more information that would be useful for investors than is currently the case?

Yes

6. If yes, what information would that be?

More information to highlight and signpost aspects of the audited financial statements that have a sufficiently high degree of uncertainty that merit emphasis and/or where the accounting treatment, whilst appropriate, may merit special consideration.

7. Would you be willing to see an increase in audit fees for such additional information?

Preferably not.

Identity of auditor

8. Does the identity of the auditor affect your willingness to invest?

Possibly.

9. In particular, do you rate differently audit opinions issued by different audit firms?

Sometimes.

10. If so, which do you rate most highly and which less highly? Why? On what basis do you differentiate?

We should prefer not to name names. The criteria that can make a difference include the reputation of the firm, brand recognition, the appropriateness of the firm for the entity concerned.

Changing auditor and investor influence

11. Is a change in auditor a concern to you? Does your response differ depending on whether or not the auditor in question is in the 'Big Four' (ie Deloitte, Ernst and Young, KPMG, or PwC)?

Yes. It is a concern insofar as the circumstances associated with a change can be relevant to understanding the governance risk of the company concerned. Our response is not dependant on whether the auditor in question is one of the 'Big Four'.

12. Do you think a change in auditor has an effect on the cost of equity for the company concerned? Please cite specific examples where this has been the case.

It is not a change in auditor that has an effect on the cost of equity per se – rather it is the context of a change in auditor. For example, the last change of auditor at Mitchells & Butlers, and the fact that the out-going auditor was not going to participate in the competitive tendering process arguably contributed to the perception of increased equity risk, which implies an increase in the company's cost of capital.

13. Are there any barriers to a company changing auditor switching within and outside the Big Four from an investor's perspective?

Yes. The perception of the proportional size and reputational significance of a major company switching to a small auditor creates in practice a barrier. Also, there are perceived issues of competence when it comes to firms outside the Big Four auditing major financial services companies.

14. What influence do you have on the choice of auditor? (Eg, have you met with company management or Audit Committee chairs to discuss audit issues?)

We probably have more influence than we exercise in practice. We regularly include audit matters in our governance & stewardship engagements with companies, which are usually with the Chairman of the Board, not the Chairman of the Audit Committee. Most express satisfaction with their auditors and the focus of the engagement dialogue is around governance processes, non-audit services and audit committee disclosures. In very exceptional circumstances we have encouraged consideration of a change of auditor. It is very unusual for us to be asked for our view on which firm(s) should be included in a tender.

15. Have you ever voted against the company recommendation on auditor selection at an AGM? If so, what was the outcome?

Not in recent memory. We have abstained in exceptional circumstances to convey our concerns regarding the recommended arrangements. These tend to pertain to perceived conflicts that may impinge on auditor independence. The vote is

accompanied by appropriate engagement. Our experience is that the perceived issue is addressed following engagement and/or voting.

16. Have you ever liaised with other institutional investors over managing your voting on a particular issue related to auditors?

In certain situations we have been aware of the voting intentions of other institutional investors. However, we reach our voting decision independently, having regard for what we believe to be in our clients' best interests.

Annex B – Fixed Income (Debt) Investments

Introduction / about your investments

1. Which companies' listed debt do you own?

We manage listed debt in a wide range of companies. The value of corporate fixed income debt under management is £71.3bn as at 31 December 2011. The value of total assets under management was £154.9bn as at 31 December 2011.

2. Would you describe yourself as an active or passive investor?

Active.

Role of audit

3. In making investment decisions, what information do you use from the audited accounts? How do you use this information? To what extent do you rely on it?

We use information derived from audited accounts to assist us in evaluating and monitoring existing and potential investments.

4. Do you require a clean audit opinion in order to pass investment decisions / internal controls?

No but in the normal course the vast majority of our investments are in companies whose financial statements have a clean audit opinion.

5. In your opinion could the audit report provide more useful information for investors than is currently the case? If yes, what information would that be?

More information to highlight and signpost aspects of the audited financial statements that have a sufficiently high degree of uncertainty that merit emphasis and/or where the accounting treatment, whilst appropriate, may merit special consideration. Also, if there are unusual aspects that may influence cash flow or the valuation of assets, especially when they provide security for lenders.

Identity of auditor

6. Does the identity of the auditor affect your willingness to invest?

Possibly.

7. In particular, do you rate differently audit opinions issued by different audit firms?

Sometimes.

8. If so, which auditors do you rate most highly and which less highly? Why? On what basis do you differentiate?

We should prefer not to name names. The criteria that can make a difference include the reputation of the firm, brand recognition, the appropriateness of the firm for the entity concerned.

Changing auditor

9. Is a change in auditor a concern to you? Does your response differ depending on whether or not the auditor in question is in the 'Big Four' (ie Deloitte, Ernst and Young, KPMG or PwC)?

Yes. It is a concern insofar as the circumstances associated with a change can be relevant to understanding the governance risk of the company concerned. Our response is not dependant on whether the auditor in question in the 'Big Four'.

10. Do you think a change in auditor has an effect on the cost of debt for the company concerned? Please cite specific examples where this has been the case.

It is not a change in auditor that has an effect on the cost of debt per se – rather it is the context of a change in auditor. For example, the last change of auditor at Mitchells & Butlers, and the fact that the out-going auditor was not going to participate in the competitive tendering process arguably contributed to the perception of increased debt risk, which implies an increase in the company's cost of capital.

Annex C

The CC's procedures and powers to gather information and the handling and disclosure by the CC of information

1. Information about the CC's procedures and powers to gather and disclose information is contained in the series of publications listed on the CC website, in particular [Chairman's Guidance on Disclosure of Information in Merger and Market Inquiries, CC7](#). This annex is only a summary.

Information-gathering powers

2. Our information-gathering powers under section 109 of the Enterprise Act 2002 (the Act) include the power to require persons to give evidence to it, to produce specified or described documents that are within that person's custody or under their control and, in the case of a person carrying on a business, to supply estimates, forecasts, returns or other information as may be specified.
3. In the event of late provision or non-provision of information required by notice under section 109, the CC has the power to impose a penalty.
4. Usually requests for information are made without formally exercising our section 109 powers. However, in the event of delay or failure to respond to our requests, we may decide to issue formal notices under section 109.

Disclosure of information

5. We aim to be open and transparent in our work while respecting the confidentiality of information that we obtain during inquiries.
6. The Act imposes a general restriction on the disclosure of specified information that we have obtained in connection with the exercise of our functions. (Specified information means information which relates to the affairs of an individual or to any business of an undertaking.)
7. However, the Act also sets out the circumstances in which we may disclose such information, including when disclosure is made for the purpose of facilitating the CC's functions or is made to a public authority exercising certain defined functions for the purpose of that authority's functions.
8. Depending upon the circumstances of any disclosure by us, restrictions may apply to any further use or disclosure of the information. If information is disclosed for the purpose of facilitating our functions but is not made available to the public, the person to whom the disclosure is made may not further disclose the information other than with our agreement and for the purpose of facilitating the functions of the CC. For more information, see paragraphs 2.1 to 2.5 of CC7. For more information about disclosure to public authorities, see [Disclosure of information by the Competition Commission to other public authorities, CC12](#).
9. We are very sensitive to the need to protect commercially sensitive information we receive from parties. Whenever we consider whether or not to disclose specified information we must have regard to three considerations set out in section 244 of the Act:

- (a) the need to exclude from disclosure (so far as practicable) any information whose disclosure we think is contrary to the public interest;
- (b) the need to exclude from disclosure (so far as practicable):
 - (i) commercial information whose disclosure we think might significantly harm the legitimate business interests of the undertaking to which it relates; or
 - (ii) information relating to the private affairs of an individual whose disclosure we think might significantly harm the individual's interests; and
- (c) the extent to which the disclosure of the information mentioned in (i) or (ii) above is necessary for the purpose for which the CC is permitted to make disclosure.

It is not at all uncommon for our published reports to excise such sensitive information.