Dear Chairs,

Thank you for your letter dated 19 September regarding audit fees. The audit fee idea which I referenced in my letter to you of 14 September comes from the Government Chief Commercial Officer (GCCO), and is based on his experience as a plc CEO. He has also suggested it to the Kingman review, having discussed it with a number of auditors.

In the case of Carillion, they failed to unearth their problems in time, and the auditors also failed to adequately flag the issues. Carillion was a very complex business, possibly over-complex. A question is whether the audit scope and fee was commensurate with the complexity of the business. I attach a note (Annex A) from the GCCO which I hope is helpful.

GCCO and his team would be very happy to come to brief your clerk to answer any further questions you might have on what is a complicated area where it might be more efficient to discuss face to face. Please contact them through my office if this would be of interest to you.

Rt Hon Frank Field MP
Chair, Work and Pensions Committee
Rachel Reeves MP
Chair, Business, Energy and Industrial Strategy Committee
House of Commons
London SW1A 0AA

27 September 2018
Annex A

Management will always try to reduce whatever costs they can, in order to improve profit; this includes audit fees. Taken beyond a safe level, however, that may mean that shareholders and wider stakeholders interests are not best served, in that poor practice may not get surfaced and not reported to the audit committee.

It could therefore be useful for audit chairs, and shareholders, to have an easy way of comparing different businesses and to see whether their company is spending an appropriate or comparable amount on audit as other businesses from their or comparable sectors, or of comparable complexity, as a way of pushing back on pressure to spend less. This could be achieved by asking companies to publish both their internal and external audit costs in relation to easy measures such as Sales, Ebit, Net Assets, and number of legal entities, being simple proxy measures of complexity and risk.

External audit costs already have to be published, so a comparison of external audit costs would be simple to do. Adding 'internal audit' costs would give the full picture of what a company is spending on internal control; all that adding 'internal audit' costs would require is a commonly accepted definition of internal audit costs, something that I understand is being worked on anyway.

Please note that there are already rules as to what other non audit areas the auditor can work on (for instance, they cannot give tax advice), and the maximum that can be spent with the auditor on those areas is normally capped at 30% of the audit fee. It is also important to recognise that 'high costs spent in total with firms that do audit', ie the Big 4, is not the same as 'high costs of an audit'.

The onus will still be on audit chairs to ensure their business is getting value for money for their audit fee, and while this would not avoid the rare instances of incompetent audits, or I hope even rarer cases of audit chairs deliberately hiding poor behaviour; the result is likely to be wider scopes of audit in those companies presently spending less than the benchmark, leading to more issues being revealed, rather than encouraging wasteful spend in the way you are concerned about.

As regards the Big 4, at the moment they have a large share of the FTSE350; partly because they are the only ones able to do, or take on, international audits. If more money ends up being spent on audit, then more of the smaller audit companies would feel it was worth gearing up to bid for that work, thus also reducing the concentration problem, particularly if the Big 4 as has been reported in the press, do not take on more than a fixed market share of the FTSE350 work.