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THE BIG PICTURE

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Audit firms called to account for cosy tenures

Madison Marriage

Caterpillar, General Electric and P&G, the makers of Pantene shampoo, have all been using their auditors for a very long time

A lot has changed in the past 125 years.

Since 1890, the year in which Shredded Wheat, the popular breakfast cereal, was created and the fire alarm was invented, modern society has been transformed completely, from the discovery of antibiotics to the development of aeroplanes, television and the internet.

But one thing has remained stubbornly constant: the accounting firm used by Procter & Gamble, the consumer goods company behind products such as Pantene, the shampoo, and Gillette, the shaving brand.

P&G's relationship with Deloitte is coming under increasing pressure to end.

A number of the world's largest investors are becoming concerned about the remarkable length of some of these relationships and the ability of audit firms to deliver independent advice when they have worked for the same company for decades, if not centuries.

"[Auditor tenure] at P&G is completely ridiculous. I am shocked," says a corporate governance expert at one of the UK's biggest fund houses, speaking on condition of anonymity.

He adds: "From an investor perspective, I think we have been spending far too much time speaking to remuneration committee chairmen and not nearly enough time talking to audit committee chairmen. I do not think you would find anyone who would think having the same auditor for 100 years is a good thing."

Investors have intensified their focus on auditor independence in the aftermath of the financial crisis. Questions were raised about why the big four accounting firms (PwC, Deloitte, Ernst & Young and KPMG) either failed to spot or failed to highlight mounting problems in the banking sector.

Worryingly for some investors, P&G is by no means alone in its decision to stick with the same auditor for a substantial length of time. General Electric, one of America's best-known conglomerates, has used KPMG for 106 years, according to figures compiled for FTfm by MSCI, the data provider.

Caterpillar, the heavy equipment company, has used PwC for 90 years, while Goldman Sachs, the investment bank, has employed PwC for the past 89 years.

Bram Hendriks, senior corporate governance officer at NN Investment Partners, the $227bn Dutch fund house, is concerned. "An excessively long association between the auditor and [its] client may constitute a threat to independence. Auditor tenures of 50 years plus are considered excessive," he says.

Peter Lundkvist, head of corporate governance at AP3, the Swedish national pension fund, adds: "The independence of auditors from the company and its management is critical for maintaining investor confidence. In some cases companies have had the same audit firm for more than 100 years. It is very difficult for auditors to claim that they are independent in these cases."

There could be many more companies with extended auditor relationships, but it is difficult to tell. MSCI estimates that only 56 per cent of all S&P 500 companies disclose how long they have used the same auditor, although this is an improvement on 2012, when just a quarter of companies volunteered this information.

In the Russell 3000 index, meanwhile, there are 114 companies that have used the same auditor for between 50 and 99 years, according to Calstrs, the $193bn Californian pension fund. Another five companies in the Russell 3000 index have had the same auditor for more than 100 years.

Calstrs says it expects companies to change auditor every seven years. "Regular rotation is seen as necessary to maintain external auditor independence and to avoid the types of cosy relationships that could lead to conflicts of interest," a spokesperson for the pension fund says.

Although the issue of lengthy auditor tenure appears to be of growing concern to a number of investors, there are no examples of shareholders rejecting the reappointment of an auditor among the 3,000 largest US companies in the 2014 voting season.

Institutional Shareholder Services, the proxy adviser that helps investors decide how to vote at company meetings, says that of the 17,810 votes held on auditor nominations at large companies globally last year, only 16 failed. This means that investors approved auditor nominations on 99.9 per cent of occasions.

Asset managers are not only reluctant to reject auditor reappointments, many of them, particularly those based in the US, are also unwilling to discuss their views on appropriate auditor tenure.

FTfm asked 30 of the world's biggest asset managers to comment for this article. Of the eight that agreed only one was US based: Calstrs. The remaining seven were UK asset managers Hermes, Aberdeen and Sarasin, as well as Nordea, the Nordic fund house, France's Amundi, NN Investment Partners and AP3.

Among those that declined to comment were BlackRock and Vanguard, the world's two biggest fund houses by assets, as well as Franklin Templeton, Dodge & Cox, T Rowe Price, Pimco, Legg Mason, JPMorgan Asset Management, Schroders and Standard Life Investments.

BlackRock, JPMorgan and Franklin Resources are also among the companies that do not disclose their auditors' tenure, according to MSCI.

One of the asset managers, who did not want to comment on the record, says she believes the problem may lie in the fact that investors simply are not aware of how long some auditors have been in place. "There is a complete and utter lack of awareness around this issue," she says.

This lack of awareness could be resolved soon. The US Securities and Exchange Commission is planning to consult investors this summer on whether large companies should be forced to disclose how long their auditors have been in place, according to Joseph Carcello, a member of the regulator's investor advisory committee.

Mr Carcello, who is also executive director of the University of Tennessee's corporate governance centre, adds that the regulator is keen to see companies publish better-quality audit reports.

Pirc, the shareholder advisory group, has adopted a policy of recommending its clients oppose the reappointment of auditors when they have been in place for more than a decade. Pirc believes the impact of this policy could be substantial, given that its clients account for £1.5tn of assets and are estimated to hold approximately 1 per cent of the shares of S&P 500 companies collectively.

Paul Lee, head of corporate governance at Aberdeen, believes more US investors will begin to question auditing arrangements at the companies they invest in.

He says: "If additional transparency alerts people to the fact that many companies have had the same audit firm in place for upwards of 50 years, then that can only be a good thing. Auditors are the independent eyes and ears of shareholders within the corporate reporting process and we need them to be free to do that to their best ability."

General Electric defends KPMG's tenure

Many of the companies that have had the same auditor in place for close to a century did not want to comment for this article.

General Electric, the conglomerate that has used KPMG as its auditor for 106 years, was the exception. It said: "The board of directors annually reviews KPMG's independence and performance in deciding whether to retain [the accounting firm].

"The board considers KMPG's audit performance, their ability to handle the breadth of our worldwide operations, an analysis of their known legal risks, the audit quality and efficiency benefits of having a longer-tenured auditor, and controls in place at GE and KPMG to mitigate against any potential independence concerns.

"In our engagement with investors, they generally have not had an issue with KPMG's tenure — they are more focused on disclosure. As a result, over the past few years we have significantly enhanced our proxy disclosures around the auditor engagement process."

Procter & Gamble, Caterpillar and Kimberly Clark all pointed FTfm in the direction of their proxy statements — documents they must send to their shareholders containing relevant information ahead of an annual meeting.

P&G said that "the retention of Deloitte to serve as the company's independent external auditor is in the best interest of the company and its shareholders".