MARKET STUDY ON STATUTORY AUDIT SERVICES

Initial consultation on recommendations by the Competition and Markets Authority

RESPONSE FROM ICAS TO THE DEPARTMENT FOR BUSINESS, ENERGY AND INDUSTRIAL STRATEGY

13 September 2019
Background

ICAS is a professional body for more than 22,000 world class business men and women who work in the UK and in more than 100 countries around the world. Our members have all achieved the internationally recognised and respected CA qualification (Chartered Accountant). We are an educator, examiner, regulator, and thought leader.

Almost two thirds of our working membership work in business; many leading some of the UK's and the world's great companies. The others work in accountancy practices ranging from the Big Four in the City to the small practitioner in rural areas of the country.

We currently have around 3,000 students striving to become the next generation of CAs under the tutelage of our expert staff and members. We regulate our members and their firms. We represent our members on a wide range of issues in accountancy, finance and business and seek to influence policy in the UK and globally, always acting in the public interest. ICAS was created by Royal Charter in 1854.

Key comments

We welcome this opportunity to respond to the BEIS ‘Initial consultation on recommendations by the Competition and Markets Authority (CMA)’ following its audit market study.

Our overriding point is that there is a need to ensure that the proposals from the various audit related views are coherent and consistent in their approach. Given that the Brydon Review is still ongoing we welcome that BEIS highlights that this is an initial consultation on the CMA’s proposals, implying that there will be a further consultation at a later date. We believe this is a sensible approach as one cannot properly assess the needs of the marketplace until proposed changes to the audit product have been determined.

We also remain to be convinced by the package of recommendations proposed by the CMA and harbour concerns over their potential impact on audit quality. Additionally, we believe that the CMA has not produced sufficient and appropriate evidence to support the likely impact of its proposals.

We would also highlight that the Government has to consider the potential impact of such measures on the competitiveness of UK plc and that of the London capital markets. Corporates may consider why they should list in London, or indeed remain listed there, with all of these potential additional burdens being introduced.
Responses to the Consultation Paper Questions

1. Do you agree that the new regulator should be given broad powers to mandate standards for the appointment and oversight of auditors, to monitor compliance and take remedial action? What should those powers look like and how do you think those powers would sit with the proposals in Sir John Kingman’s review of the Financial Reporting Council?

2. What comments do you have on the ways the regulator should exercise these new powers?
   • For instance, do you have any comments on the conditions that should be met for the regulator to exercise its powers to take remedial action?
   • Are there particular events (such as a poor audit quality review, early departure of an auditor or a significant restatement of the company’s accounts) which should trigger the regulator’s involvement?

3. How should the regulator engage shareholders in monitoring compliance and taking remedial action?

4. What would be the most cost-effective option for enabling greater regulatory oversight of audit committees? Please provide evidence where possible.

Response to Questions 1-4

As we set out in our response to the Kingman Review, we are supportive of a new stronger regulator covering governance, reporting and audit. However, we are not supportive of the proposal to grant broad powers to the new regulator to mandate standards for the appointment and oversight of auditors, to monitor compliance and take remedial action.

The extent of this proposal calls into question the UK corporate governance system and the functioning of the unitary board model. If an audit committee cannot be trusted to appoint an auditor to act in the best interests of the company, then this questions whether such directors can be trusted to do so when making strategic corporate decisions.

We would highlight that we stated the following in our response to the CMA in February:

“The focus of the CMA review and its ultimate conclusions, along with the associated proposed remedies, appears to rest primarily on their judgement that the “principal/agent” structure has inherent issues of poor or perverse incentives and thus action needs to be taken. We do not see any compelling empirical evidence in the report that this is actually the case in practice. We cannot share the view that the proposed regulatory oversight of audit committees is the necessary way forward. In our experience, the vast majority of audit committees fulfil their role diligently and conscientiously, in an objective way which seeks to maximise the quality and effectiveness of the audit in the interests of the shareholders. Regulatory intervention in the work of one sub-committee of the Board could undermine the UK’s unitary board model under which all directors carry the same level of overall responsibility for the success of the company. This would be inconsistent with other aspects of UK corporate governance.

Investors are not close enough to each investee company (nor can they be – practically or legally) to provide any detailed oversight of the audit processes including the selection of auditors. They do however approve the proposed choice of auditors and their reappointment each year at the annual general meetings. They are also free to engage with Boards and their audit committees at any time during the year on this and other matters. Public listed companies in the UK and their boards of directors are required to apply the UK Corporate Governance Code. Under the unitary board structure in the UK, the board has a majority of independent non-executive directors. The audit committee must be wholly made up of independent non-executive directors. Each director is also up for election each year allowing shareholders to remove any director who does not meet their standards.

As the CMA highlights, evidence from experienced audit committee chairs suggested that they were clear on their duties to shareholders, were focused on audit quality and not price and that overall the system works well. The CMA also states that “overall, the balance of views from audit committees and investors was that audit in the UK is generally of a high quality. Many stakeholders pointed to the fact that the UK has a high reputation internationally for the quality of its audit firms”. The CMA should reflect on whether adequate prominence is given in its conclusions to this evidence (as provided by the individuals who are closest to this subject matter).
We would envisage the following matters of an audit quality nature.

Committees report directly to the regulator during and after a tender selection process (CMA Report, Para 4.16a). This solution, along with the suggestion of an "observer", presupposes that any regulator would have sufficient expertise and time to invest in understanding the specific audit needs of the company concerned to avoid a non-value-added exercise. Our concerns in this regard also apply to the proposed requirement that audit committees report directly to the regulator throughout the audit engagement – demonstrating how they are monitoring quality. At a practical level, we question how the regulator will find the necessary executives and staff who have the experience and expertise necessary to perform the oversight, and who are free from conflicts of interest relating to the company and its audit committee members and potential auditors. Nevertheless, such a proposal ought not to be for the CMA but rather for ARGA to explore in due course, within the context of future revisions of the Corporate Governance Code."

We do, however, believe that there is scope for improving the current framework. As we set out in our recent response to the Brydon Review, we are supportive of enhanced transparency of the audit committee’s activities. The most important aspect of these needs to be to encourage greater engagement of investors with audit committee chairs. We believe that such discussions would prove to be beneficial for both the audit committee chairs and the investors. Indeed, it would be an ideal opportunity to discuss matters of an audit quality nature.

We would envisage the following enhancements to the current framework:

- Increased transparency over the audit tender process. This would include better disclosures regarding the recommended process, selection criteria and disclosure requirements in the annual report and accounts for audit tenders.
- The new regulator should issue enhanced guidance on best practice on how audit tenders should be undertaken and this should be covered by the 'comply or explain' principle. This should clearly establish the extent to which management can have an involvement in the process. It should also encourage shareholder communication in the process from the outset with the objective of increasing the level of shareholder engagement.
- The new regulator should be given the power to review a company’s audit tender process if concerns are made public around the appointment or if on reappointment of the auditor more than 20% of shareholders vote against.
- Enhanced guidance should be published to better demonstrate what is seen as best practice in relation to an audit committee’s oversight of the effectiveness of the external audit process and how this can be best demonstrated and communicated.
- Shareholders should use their existing powers to engage with audit committees and we would welcome shareholders being more proactive in this regard. We also see this as a two-way process and encouragement should be given to audit committee chairs to engage with key shareholders.
- Increased engagement between the regulator and audit committee where the company’s audit has been inspected by the regulator’s audit quality review team.
• Consideration could be given to better promoting the content of reports by audit committees on how they have fulfilled their obligations over the year. Again, this could provide a basis for shareholders to engage with audit committees of investee companies.

However, whilst we would support such enhancements as to how audit committees operate, we are not convinced as to the merits of providing broad powers over their role to the new regulator. There is an undoubted risk that such a regime would be unduly burdensome for both the regulator and companies. Additionally, consideration would need to be given as to how such a proposal would work alongside existing oversight requirements of the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) in the financial services sector. The regulator would also need to recruit staff with the capabilities to perform such a role. We question whether they would have sufficient expertise to properly assess a wide range of corporate entities. We also have concerns over commercial sensitivities especially where the regulator was in attendance at an audit committee meeting.

5. Do you agree with the CMA’s joint audit proposal as developed since its interim study in December?

Response to Question 5
The CMA does not appear to have given careful and detailed consideration to the potential implications of the introduction of mandatory joint audit on:
• audit quality;
• costs;
• auditor accountability and liability; and
• practical implementation issues, including: how the auditor selection process and auditor inspection process would work under a joint audit regime; and how the challenger firms will manage this huge potential increase in their business in such a way that quality and service levels are not impacted.

Furthermore, for effective implementation of a mandatory joint audit regime, it would need the full support of all key stakeholders. From a review of the responses to the CMA’s proposed remedies it is clear that this is not the case. An overwhelming majority of respondents to the CMA’s December consultation were not supportive of this proposed remedy. Those expressing concerns include, not just most of the corporate respondents but, also significant investors such as Schroders. Indeed, the comments made by the Association of British Insurers very much echo the views of ICAS:

“However, we are not convinced that there is clear enough evidence about the issues driving these concerns on which to base substantial structural changes to the market. In particular, we would not support any structural remedies whose ability to deliver the benefits intended is unclear and yet which impose significantly higher costs or may have adverse unintended consequences.”

We also do not believe that the CMA has produced sufficient and appropriate evidence on which to support this proposal. Joint audit is not commonly used around the globe therefore it would be a major risk at a time of economic uncertainty to introduce such a requirement. There is a real risk that it would disadvantage the UK capital markets.

Despite our opposition to this proposal we welcome that the CMA did take on board our suggestion that its scope (if introduced) should be:
(a) limited to the FTSE 350; and
(b) specifically exclude extremely complex business operations that require very specialised knowledge.

However, consideration would need to be given to how, and over what time frame, such a regime would be introduced and whether any transitional provisions would be necessary. It is unlikely to be a quick solution. It will require legislative change, particularly in relation to the implications for auditor liability. It will also require regulatory involvement, at a time when the regulator is itself undergoing a fundamental change.
6. Do you agree with the CMA’s proposed exemptions to the joint audit proposals? How should the regulator decide whether a company should qualify for the proposed exemption for complex companies?

Response to Question 6
If this remedy was to be introduced, we believe that there would be a need for various companies to be exempted from the requirement to appoint joint auditors. Given the lack of supporting evidence that has been provided by the CMA, as per the recommendation in the BEIS Parliamentary Committee Report, there would be a need to undertake a pilot test in the first instance. Additionally, clarity would also be required in relation to what specific companies would be exempt i.e. the CMA proposes exempting:

(a) The very largest and most complex FTSE 350 companies, as determined by the regulator; the regulator should instead have the power to commission a periodic peer review of the audit engagement;
(b) Investment trusts and companies that do not prepare consolidated accounts;
(c) Any FTSE 350 company that appoints a challenger firm as its sole auditor; and
(d) FTSE 350 Companies that need an exemption on a limited basis as determined by the regulator.

This illustrates one of the problems of this proposed solution in that a considerable number of companies in the FTSE 350 will be exempt. This by itself will hinder the ability of the challenger firms to gain the capacity and capability to audit entities of this nature.

In terms of (a) above, it is also not clear how many companies would be subject to this exemption, but the number is likely to be sizeable. The CMA refers to the views of the audit firms at paragraph 2.15 of its final report, quoting 30/40 such companies whilst at paragraph 6.89, it refers to 50 companies.

With regards to (c) above, somewhat paradoxically given the role and objectives of the CMA this proposal could be construed as being anti-competitive, as a FTSE 350 company that appoints a Big Four firm would be subject to joint auditors whereas one that appoints one of the challenger firms would not. This proposal by its very nature creates a competitive advantage for a challenger firm should they be appointed.

7. Do you agree that challenger firms currently have capacity to provide joint audit services to the FTSE350? If a staged approach were needed, how should the regulator make it work most effectively? If not immediately, how quickly could challenger firms build sufficient capacity for joint audit to be practised across the whole of the FTSE350?

Response to Question 7
We believe that the challenger firms could currently provide joint audit services to a small number of FTSE 350 entities. However, it would take time for them to build the necessary capacity etc, to be able to undertake a sizeable number of audits of such entities.

8. Do you agree with the CMA’s recommendation that the liability regime would not need to be amended if the joint audit proposal were implemented?

Response to Question 8
We do not agree with the CMA’s recommendation. In our response to the CMA in February we stated the following:

“Should the CMA continue to propose mandatory joint audit we would encourage the CMA to emphasise to BEIS the need to revise the existing auditor liability provisions. We believe that the introduction of a proportionate liability regime would be essential if joint audit is to be introduced. We have long been supporters of the need for reform of auditor liability as the current “joint and several” approach is not proportionate. The existing ‘joint and several’ auditor liability regime is unfair whereby one audit firm may only perform a percentage of the audit but could end up being liable – at least in law - for the full amount of any loss incurred as a result of an audit failure by the other auditor. Both firms should only be responsible for their own respective failings. If not addressed, this could be a significant deterrent to challenger firms wanting to compete in the FTSE 350 audit market.”
Looking at the various responses to the CMA’s December consultation it is clear that the challenger firms would appear to share our view. For example, Mazars stated:

“On grounds of fairness and in order not to create unreasonably barriers to entry to the FTSE350 audits by challenger firms, there should be a proportionate regulatory system with an emphasis on promoting improvement through the stakeholders in the PIE audit market working together constructively. A proportionate liability regime should be introduced on similar grounds.”

Additionally, Grant Thornton stated:

“In our view proportionate liability is an essential feature of joint audit if the non-Big 4 firms are to be encouraged to participate otherwise an unintended consequence could be a failure to attract and retain the numbers of firms required.”

Therefore, we believe that a change in the auditor liability regime would be an essential pre-requisite to the introduction of a joint audit regime.

9. Do you have any suggestions for how a joint audit could be carried out most efficiently?

Response to Question 9

We have no suggestions in this regard.

We would highlight that in our opinion a shared audit would logically enable a more efficient approach to be adopted with only one firm being responsible for the group audit opinion. Such an approach is less likely to present a risk to audit quality whilst it would also start the process of addressing the structure of the audit market.

10. The academic literature cited in the CMA’s report suggests the joint audit proposal would lead to an increased cost of 25-50%. Do you agree with this estimate?

Response to Question 10

We believe it would be very likely to result in an increased cost. However, the extent of this would vary from entity to entity, depending on factors such as: the nature, geographical spread etc of the audited entity’s operations and on the split of the audit work between the respective joint auditors.

In 2012, ICAS commissioned an independent academic literature review on joint audit. One of its key findings was that “There is some empirical support for the frequently stated argument of joint audit opponents that joint audits lead to additional costs.”

11. Do you agree with the CMA’s assessment of the alternatives to joint audit, including shared audit?

Response to Question 11

We do not agree with the CMA’s assessment of shared audit. We believe this would provide a basis for challenger firms to further develop their capacity on more complex entities, further promote their respective credentials in the FTSE 350 audit market and act as a stepping stone to them getting greater access to this market. Consideration could also be given to changing the areas of the audit that the challenger firm is to be involved in, on an annual or other basis, to help broaden their experience. Over time, this should help to address the concentration issue.

12. How strongly will the CMA’s proposals improve competition in the wider audit market, and are there any additional measures needed to ensure that those impacts are maximised?

Response to Question 12

In most instances there already appears to be sufficient competition although generally this relates to competition between the Big Four firms. The underlying objective is to increase the level of choice in the audit market and reduce the current level of concentration. Regardless, of whatever measures are introduced, including joint audit, this will take time.

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1 What do we know about joint audit? (ICAS), 2012, Nicole Ratzinger-Sakel, Sophie Audousset-Coulier, Jaana Kettunen, Cédric Lesage: https://www.icas.com/technical-resources/publication-what-do-we-know-about-joint-audit
13. Do you agree with the CMA’s proposals for peer review? How should the regulator select which companies to review?

Response to Question 13
We do not agree with the CMA’s proposal. As we stated in our response to the CMA:

“We do not believe the case has been made for the benefits of peer review as described by the CMA, against a background of a potential joint audit regime, and the increased role of the AQR audit inspection process set out in Sir John Kingman’s Report. Furthermore, the CMA may not have fully considered the impact this may have on audit firms and companies.

Peer review is ordinarily a regulatory condition imposed by a Recognised Supervisory Body (RSB) and only where there are concerns about audit quality. The definition of peer review presented by the CMA could present considerable obstacles to its introduction. Such obstacles include, but are not limited to, the other firm’s capability to undertake this task prior to the audit report being signed and confidentiality.

Notwithstanding the real practical difficulty of any regulator sourcing a team of independent auditors to carry out such reviews in any scale (especially if alongside any joint audit regime), the use of such a team would further reduce the choice for companies when a tender for new auditors is required. This goes directly against the desired intention of the CMA to increase the choice for companies when tendering for auditors.”

Furthermore, the CMA proposes that the peer reviewer would be accountable solely to the regulator. What duty would therefore be owed by the regulator to shareholders should something of a material nature be discovered during their engagement? Such a process would also add to the reporting cycle as companies subject to such a review would be likely to take longer to publish their preliminary announcements and annual report. The regulator should be focused on making sure that all of the audit firms have the right internal policies and procedures to minimise the risk of poor quality audits rather than having another firm of auditors, audit the auditor appointed by the shareholders.

The impact on the audited entity also needs to be considered. Being subject to audit is an important element of corporate governance but it is very time consuming. The ultimate objective has to be to ensure that an audit firm overseen by the audit committee and supported by the regulator provides a high quality audit in the first instance. Care needs to be exercised to ensure that this key responsibility is not abdicated by having an audit of the audit.

As we do not support this proposal, we do not believe there is a need to comment on what companies should be subject to this measure.

14. Are any further measures needed to ensure that the statutory audit market remains open to wider competition in the long term?

Response to Question 14
We do not believe that any further measures are required at this time.

15. What factors do you think the regulator should take into account when considering action in the case of a distressed statutory audit practice?

16. What powers of intervention do you think the regulator should have in those circumstances, and what should be their duties in exercising them?

Response to Questions 15 and 16
We believe that primarily this is a matter for the new regulator to discuss with the audit firms.

We do, however, agree with the CMA’s conclusion that failure of one of the large auditors would be very likely to materially worsen the current choice problems in the market and weaken competition. We also agree with the comments made by the FRC that reputation is the overriding factor:
We would however highlight that we disagree with the CMA in its assessment of the resilience of the Big Four firms and believe that they would be significantly more vulnerable to adverse events without the support of their non-audit businesses.

We have commented on how we would mitigate the underlying tensions between audit and non-audit parts of the firms in our response to question 18. Our proposals would also help to ensure that the voice of the auditors within the firm remains strong, as under our proposals they would have a duty to report directly to the regulator if they had due cause to do so.

We are supportive of the FRC’s Audit Firm Monitoring and Supervision (AFMAS) which requires the six biggest audit firms to draw up contingency plans in the case of distress and Sir John Kingman’s recommendation that the regulator should be given statutory powers to carry out this monitoring work and welcome that BEIS has proposed bringing this forward via legislation.

Whilst there appears merit in the substance of what the CMA is seeking to achieve, the lack of clarity from the CMA as to how this could be achieved illustrates that this is a complex area.

17. Do you agree with the CMA’s analysis of the impacts on audit quality that arise from the tensions it identifies between audit and non-audit services?

Response to Question 17
We recognise that there is an undoubted perception that the provision by auditors of non-audit services to their FTSE 350 clients impairs their independence and by implication, audit quality. That is why we favour a prohibition on auditors providing non-audit services (subject to certain specified exemptions) to such audit clients.

We appreciate that this does not fully resolve any perceived conflict that is seen to exist within the firm itself and the importance placed on audit. Therefore, we believe that greater separation of the audit practice from the non-audit is required, however, we do not believe that any move towards an operational split needs to go as far as the CMA has proposed. We welcome certain aspects of the CMA’s proposal including that the audit part of the firm should have a separate board and that this should contain independent non-executives. However, as we explain in our response to question 18 below, we are not supportive of the need for:

- No profit-sharing between the audit practice and the non-audit practice, with audit partner remuneration linked to the profits of the audit practice only.
- Transparent transfer pricing, checked by the regulator, particularly for the use of non-audit specialists on audits.

18. What are your views on the manner and design of the operational split recommended by the CMA? What are your views on the overall market impact of such measures?

Response to Question 18
We are not supportive of the CMA’s proposal in its current form. We believe that there is a strong economic argument for not doing so. With a much-reduced profit pool there will be less investment by the audit firms in people, systems, audit processes and, more importantly as a consequence, quality. The need to introduce transfer pricing between the audit practice and the other areas of a firm will also reduce profitability in the audit practice. The strain on profitability will be exacerbated by an enhanced regulatory fine regime and the ever-increasing costs of tendering as companies change their auditors more frequently. All these pressures will make the auditing profession less attractive to high quality people and potentially have a negative impact on audit quality. It may also discourage the use of “expensive” specialists at a time when there will be more need for them as business gets more complex. The attractiveness of the middle tier firms and their inability to invest in these areas is an example where lower profit pools are an inhibitor in the development of those firms. Audit is a relatively low profit margin function which reflects its role as a public good role therefore the audit practice benefits from its ability to develop via the contribution made from other areas of the firm.
We do however believe that steps could be taken to better separate the audit practice from the other parts of the firm. Indeed, some of the audit firms are already taking steps in this direction. The first step would be to introduce a prohibition on the audit firms providing non-audit services to audit clients (FTSE 350). Secondly, the audit practice should have its own separate board that is accountable to the Regulator. We are not supportive of transfer pricing as this could inhibit the need for increased availability of specialists to ensure audit quality is enhanced.

19. Are there alternative or additional measures which would meet these concerns more effectively or produce a better market outcome?

Response to Question 19
As we suggest above, a prohibition on audit firms providing non-audit services to their FTSE 350 audit clients and greater separation of the audit and non-audit services parts of the firm. However, this should not remove the economic benefits that being a single firm provides. We have highlighted the implications of this above. To do so would remove the ability of audit firms to invest in the same level of technological advancements and hence potentially result in a negative impact on audit quality.

20. Do you agree with the CMA’s proposal to keep a full structural separation in reserve as a future measure?

Response to Question 20
Such a measure will always be available to the CMA. However, we would caution that such a measure would need to be agreed at a global level to ensure its effectiveness. Of course, reaching agreement at the global level will be fraught with difficulties.

21. What implementation considerations should Government take into account when considering the operational split recommendations? Please provide reasoning and evidence where possible.

Response to Question 21
We have provided these above. We believe that the potential costs (qualitative and quantitative) of the CMA’s proposal as stated outweigh any potential benefits. This is before any consideration is given to any potential unintended consequences.

22. Do you agree with the CMA’s other possible measures? How would these suggestions interact with the main recommendations? How would these additional proposals impact on the market?

Response to Question 22
The most important of these relate to measures to improve information for shareholders, and increasing transparency of the role and work of audit committees. We have included further comments on this in our responses to questions 4 and 27.

23. Do you agree with the CMA’s suggestions regarding renumeration deferral and clawback?

Response to Question 23
This is a matter that would be best discussed with the firms themselves and with investors who are the ultimate client.

24. How would a deferral and clawback mechanism work under a Limited Liability Partnership structure?

Response to Question 24
This is a matter that would be best discussed with the firms themselves.

25. Do you agree that liberalising the ownership rules for audit firms would reduce barriers for challengers and entrants to the market?
   • What positive and negative impacts would this have?
   • Do you have any specific proposals for a reformed ownership regime?
Response to Question 25
We responded to the CMA as follows on the possibility of liberalising the ownership rules for audit firms.

“...This approach has been adopted in relation to other sectors, most notably in relation to the provision of legal services. It is not without its challenges, and whilst it might enable firms to invest for the future, it might also pose risks to firm culture and behaviours.

Questions of ownership also arose in the context of the EU Green Paper in 2010. At that time, ICAS believed that there was merit in consideration being given to allowing audit firms further access to external capital. Currently, although audit firms are able to access external capital they are presently required to be owned and controlled by a majority of individuals who hold the audit qualification, and are therefore members of a professional body, subject to meeting the highest level of technical, ethical standards and behaviours. At the time ICAS advised that further consideration was required because we have no evidence as to whether investors would merely seek to invest in the larger firms or would be willing to invest in smaller entities which would clearly be the aim of this proposal. Such a proposal would also need to be considered further in a global context.

Care also requires to be taken as the traditional partnership model entails proven benefits regarding auditors’ independence, audit quality and firms’ capacity to attract and retain talent. It is critical that any alternative ownership model is equally conducive to the profession’s long-term sustainability and the delivery of high-quality audit services. External investors only invest money where the investment offers attractive profit perspectives based on a reasonable risk/reward ratio.

ICAS members are trained to behave according to a well-established set of values and principles and commit to acting in the public interest and conducting themselves with integrity, objectivity and courage, and in accordance with the high ethical standards of ICAS.


There is a risk that these values and principles, and therefore auditor independence, could be weakened if the restrictions around audit firm ownership are removed. To dilute the influence on the firm would need very careful consideration. The CMA could not consider this initiative without close involvement of the Financial Reporting Council, as the Competent Authority for audit in the UK.”

26. Do you agree with the CMA’s suggestions regarding technology licensing?
• What changes would you like to see made to the current licensing framework?

Response to Question 26
We responded to the CMA as follows on this matter:

“...Technology is undoubtedly currently a barrier to the challenger firms. If, however, challenger firms are in effect to be given access to the FTSE 350 audit market then they may be willing to invest increased resources in new and innovative technology.

Regardless, the ability to facilitate access to technology platforms and related operation knowhow would appear to be a pre-requisite to undertaking an effective and efficient joint audit. It may facilitate the use of a single audit methodology which is likely to aid audit quality.

However, it is only fair that the firms which have made the investments in such technological innovations should be properly rewarded for their use by other audit providers. That in our view is a matter to be discussed by the CMA and the respective audit firms.”

27. Do you agree with the CMA’s suggestions to provide additional information for shareholders? Do you have any observations on the impact of the Public Company Accounting Oversight Board’s database on the US audit market?

Response to Question 27
We welcome better transparency, not necessarily increased disclosure. Based on that principle our assessment of each of the suggestions made by the CMA is as follows:
(a) working with proxy agencies that provide research for investors to help them assess the performance of Audit Committees and auditors;

We question what expertise proxy agencies have in this area. Additionally, we have concerns that the proxy agencies’ objectivity might be impaired by conflicts of interest. Proxy agencies are making recommendations on how to vote at companies’ general meetings whilst also selling advisory services to some of the same companies. In seeking to address perceived issues with audit quality and independence, we would suggest that the CMA should be wary of recommending a wider role for proxy agencies, where there are also perceived issues of quality and independence.

(b) increasing transparency for shareholders around the audit process. For example, the regulator could consider:

(i) disclosing tender documents to shareholders once the Audit Committee has selected an auditor, but before the selection is put to a shareholder vote at the AGM;

(ii) disclosing certain aspects of the audit contract to shareholders – this should be subject to confidentiality and at a minimum it could disclose the commitments to audit quality made by the auditors so that auditors could subsequently be held to account for their underperformance;

We would welcome increased transparency around the audit process. However, we believe this could be covered in the proposed enhanced guidance on audit tendering that we refer to in our response to questions 1-4.

(c) maintaining and publicly disclosing a database of audit partners and firms of current and past audit engagements, similar to that maintained by the PCAOB in the USA;

The impact of this in the US has yet to be assessed and it may be beneficial to wait to see how this plays out. That said, our preliminary thinking is that there may be merit in adopting a similar approach. This would primarily benefit investors and audit committees who would then not just be able to identify the audit partner signing the opinion audit firm issuing the opinion, but also other auditors who were used by the primary auditor in reaching its conclusion on the financial statements. This information is now available to investors on the PCAOB’s Auditor Search database by company name or ticker symbol.

(d) encouraging greater dialogue between shareholders and the Audit Committees outside of the formal AGM;

It is incumbent upon shareholders to engage with audit committees of their investee companies. Many board directors have commented that while investors engage on matters relevant to the remuneration committee, there is little or no engagement on the matters addressed by the audit committee, which arguably go to the heart of the quality of their investments. We have highlighted this point in our response to the Review of the FRC and to the CMA. Likewise, audit committees need to be mindful of their wider role and responsibilities. From discussions with investors it is clear they would like to communicate more with audit committees but there are barriers in terms of resources to enable them to do this and we have to accept that, with the rise of passive and very short term investors many will not see this as a good use of their time. This leaves audit committees without any feedback as to whether what they are reporting is appropriate and helpful. It is therefore hard for audit committee chairs to know what best practice is. In order to raise the standards across all audit committees, thematic reviews on subjects like assessing audit quality etc would be extremely helpful.

(e) requiring Audit Committee Chairs to participate in live Q&A sessions at the AGMs;

We have no objections to this proposal. However, given the low levels of attendance by institutional investors at AGMs we question the benefits of doing so. In any event chairs are always present at AGMs to answer any questions from the shareholders.

(f) publishing the time spent by key members such as the partners and the hourly rate charged;

We question the benefits of doing so.

The most important possible measure of these is undoubtedly (d) above, i.e. encouraging greater dialogue between shareholders and the audit committees outside of the formal AGM.
28. Do you agree with the CMA’s suggestions regarding notice periods and noncompete clauses? Do you agree that the regulator should consider whether Big Four firms should be required to limit notice periods to 6 months?

Response to Question 28
We do not have any comments on these suggestions.

29. Do you agree with the CMA’s suggestions regarding tendering and rotation periods?

Response to Question 29
We agree that the introduction of mandatory tendering and rotation has done nothing to reduce the level of concentration in the FTSE 350 audit market. This has not come as a surprise to us. We had previously indicated, prior to their introduction, that this was the most probable outcome of these measures.

Reducing the period of the maximum audit tenure would not be a solution to this issue. We therefore see no merit in making changes to the current UK tendering and rotation regime at this point in time. This will obviously need to be kept under review as the EU undertakes its implementation review of its 2016 audit regulation and directive (depending on how close the UK wishes to remain with the EU audit regulatory regime). In this regard this should be looked at post 2026 when the ten year retendering peak has passed to see what has arisen from these measures.

30. Do you have other proposals for measures to increase competition and choice in the audit market that the CMA has not considered? Please specify whether these would be alternatives or additional to some or all of the CMA’s proposals, and whether these could be taken forward prior to primary legislation.

Response to Question 30
We have no other such proposals.

31. What actions could audit firms take on a voluntary basis to address some or all of the CMA’s concerns?

Response to Question 31
Some of the audit firms are already moving towards greater separation of their audit and non-audit services practices. Additionally, the firms are also putting in place measures to restrict the extent to which they supply non-audit services to their FTSE 350 audit clients. Of course, in relation to the latter the FRC has already issued proposals to prohibit audit firms from providing non-audit services to a wider range of clients than just those in the FTSE 350. We will be responding separately to that consultation.

32. Is there anything else the Government should consider in deciding how to take forward the CMA’s findings and recommendations?

Response to Question 32
The Government has to consider the potential impact of such measures on the competitiveness of UK plc and that of the London capital markets. Corporates may consider why they should list in London, or indeed remain listed, with all of these potential additional burdens being introduced. Additionally, the impact on audit firms and the attractiveness of a career in auditing also needs to be considered. There is a danger that a specialist audit firm might lose elements of the broad business experience that helps a good rounded professional accountant to carry out a high-quality audit, exercising professional scepticism and probing the problem areas that their business acumen steers them towards.