Department for
Business, Energy
& Industrial Strategy

Market Study on Statutory Audit Services

Summary of responses to the 2019 consultation

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1 Introduction

1.1 In July 2019, the Department for Business, Energy and Industrial Strategy launched a consultation, which sought views on a study published by the Competition and Markets Authority (CMA) in April 2019.[1] Commissioned by the then Secretary of State, The Rt Hon Greg Clark MP, the CMA's study was a broad and ambitious analysis of the statutory audit market, which made a series of proposals to increase choice, competition and resilience so that the market better served shareholders and other users of audit services. The CMA's central recommendations were to:

- enhance regulatory oversight of audit committees;
- mandate 'joint audits' of FTSE 350 companies;
- give the regulator powers to design an 'operational split' between the audit practices and non-audit practices of the 'Big Four firms; and
- require a five-year review of progress by the new regulator.

1.2 The Government's consultation on these proposals closed in September 2019 and the Government is grateful to the companies, audit firms, trade associations and individuals who took the time to offer a response. The purpose of this document is to summarise those responses.

1.3 Importantly, this document should be read alongside a second Government publication[2] that places this response to the CMA's study within the broader context of Sir John Kingman's Independent Review of the Financial Reporting Council (published December 2018)[3] and Sir Donald Brydon's independent review into the quality and effectiveness of audit (December 2019).[4] That second document provides the Government response to the CMA's central recommendations and sets out a broader programme of reform to ensure that both audit and the wider corporate governance regime are fit for purpose as the UK seeks to recover from the effects of Covid 19.

Structure of this document

1.4 This document is divided into the following chapters, which briefly summarise the CMA's recommendations and provide an anonymised summary of stakeholder responses to the Government's consultation in 2019. We recommend that each section is read alongside the

[1] Statutory Audit Services Market Study - https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit_final_report_02.pdf
[2] Restoring trust in audit and corporate governance - http://www.gov.uk/government/publications/restoring-trust-in-audit-and-corporate-governance
[3] Independent review of the Financial Reporting Council - https://www.gov.uk/government/publications/financial-reporting-council-review-2018
[4] Independent review into the quality and effectiveness of audit - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf

CMA's full study, which provides additional detail regarding the design of, and rationale for, each recommendation.

- Chapter 1 focuses on the CMA's proposals for enhanced regulatory oversight of Audit Committees.[5]
- Chapter 2 focuses on the CMA's proposals regarding mandatory joint audits of FTSE 350 companies, as well as proposals for peer reviews of audits conducted for companies who are not within the scope of the joint audit proposals.[6]
- Chapter 3 focuses on the CMA's proposals to mitigate the effects of the distress or a failure of a 'Big Four' firm.[7]
- Chapter 4 focuses on the CMA's proposals to mandate an operational split between audit and non-audit practices of 'Big Four' firms.[8]
- Chapter 5 focuses on other possible measures that the CMA considered but were not included within its core package of remedies.[9]

Finally, a list of the organisations that responded to this consultation is provided in Annex A.

[5] Statutory audit services market study, pages 132-43
[6] Statutory audit services market study, pages 144-76
[7] Statutory audit services market study, pages 177-86
[8] Statutory audit services market study, pages 187-98
[9] Statutory audit services market study, pages 142, 175, 203

2 Audit Committee Scrutiny

This section of the consultation explored the CMA's analysis of the role of the audit committee when tendering for and overseeing audit engagements. It also sought views on the CMA's recommendation to give the new regulator powers to scrutinise audit committees in relation to both the appointment and oversight of auditors.

CMA Proposals

2.1 The CMA proposed audit committees should come under greater scrutiny by the new regulator in order to increase accountability of audit committees and to ensure that audit committees' selection and oversight of auditors is focused on audit quality.

2.2 The CMA recommended that the government legislate to ensure:

- The regulator should have the power and a requirement to mandate minimum standards for both the appointment and oversight of auditors.
- The regulator should have the powers and a requirement to monitor compliance with these standards, including the ability to require information and / or reports from audit committees, as well as placing an observer on a committee if necessary.
- The regulator should take remedial action where necessary, by for example issuing public reprimands, or making direct statements to shareholders in circumstances where it is unsatisfied with an audit committee.

Summary of Responses

Question 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? *(67 responses)*

Question 2: What comments do you have on the ways the regulator should exercise these new powers? *(61 responses)*

2.3 Audit firms and investors were broadly supportive of more regulatory scrutiny of audit committees, but there was less support from companies. Some respondents felt the regulator should have a limited and proportionate involvement, as audit committees understand the needs of the business in greater detail than the regulator would and are already responsible to shareholders in their capacity as directors. However, respondents did acknowledge that there should be greater transparency in reporting to shareholders about the work of audit committees. They also felt there should be improved engagement between the regulator and

audit committees. Respondents believed any increased requirements should avoid greater cost burden, bureaucracy, and delay to the audit process.

2.4 Other respondents suggested that there is a lack of evidence to support the need for broad powers and highlighted that many audit committees exercise their duties diligently and appropriately. Some respondents disagreed with the CMA's characterisation of "cultural fit" and "chemistry" and felt it was legitimate for audit committees to seek an auditor who could have an open and positive relationship with the company's management. Some respondents proposed that the regulator mandate minimum standards on auditor appointment and oversight but should not be overly prescriptive and should allow for discretion and judgement by audit committees.

2.5 Finally, the majority of the respondents felt that the regulator should take a proportionate risk-based approach when monitoring compliance with standards. Some respondents raised concerns about the proposal that the regulator should attend audit committee meetings. Others thought public remedial action should be a matter of last resort with the regulator engaging first with the audit committee and the company.

Question 3: How should the regulator engage shareholders in monitoring compliance and taking remedial action? *(48 responses)*

2.6 The majority of respondents felt that direct shareholder engagement in monitoring compliance and remedial action would be neither appropriate nor practical and should primarily be a matter between the new regulator and the relevant company. However others noted issues could be escalated to include shareholders in more serious instances, and suggested investors should be encouraged to raise concerns in relation to a company where the company is unwilling to engage or respond appropriately to valid concerns.

2.7 A number of respondents agreed there should be mechanism through which shareholders should be able to raise concerns or offer feedback to the regulator on the audit committee of the entity that they are invested in, which would be considered by the regulator when deciding whether or not to undertake more detailed observation.

2.8 While many commented that, in general, the regulator must operate independently, a small number of respondents believed the regulator should engage with shareholders on this issue. Suggestions included; the regulator should follow up with the shareholders after remedial action is taken; the regulator communicating to the shareholders the results of their reviews on Audit Committee effectiveness; and the regulator meeting shareholders to understand their concerns should stakeholders initiate a serious complaint. A small number of respondents highlighted the importance of keeping findings confidential until finalised and only published if there is a proportionate need to publicly reprimand the directors or auditors.

2.9 Many respondents commented that increased regulatory scrutiny needs to be coupled with robust disclosures that put shareholders in a better position to assess auditor selection, work quality, and board oversight of the auditor. A number of respondents made proposals as to how shareholders could be more engaged with auditing and accounting issues as a whole. Some respondents referenced the role of the Stewardship Code, noting that while it already

encourages engagement it could be strengthened to require active engagement and could require major investors to report any issues or concerns to the regulator.[10]

Question 4: What would be the most cost-effective option for enabling greater regulatory oversight of audit committees? Please provide evidence where possible *(42 responses)*

2.10 Around a quarter of respondents commented on this, with broad agreement that the regulator should take a risk-based approach to ongoing oversight. Respondents proposed the regulator use audit committees' existing records to avoid duplication of effort. Respondents also suggested increased transparency and engagement between the audit committee and shareholders could reduce the need for extensive regulator involvement.

[10] UK Stewardship code 2020

3 Mandatory Joint Audit and Peer Review

This section of the consultation addressed the CMA's recommendation to require two audit firms to jointly sign off the accounts of an audited entity (a 'joint audit'). It also sought views on the CMA's proposal that the regulator should have the power to appoint peer reviews of audit engagements of companies not subject to the joint audit requirement.

CMA Proposals

3.1 The CMA recommended that the Secretary of State legislate to give the regulator flexible powers to implement a joint audit regime and adapt it over time. The key elements of this proposal were that most FTSE350 companies should be required to appoint joint auditors of whom at least one should be a non-Big Four firm. The CMA recommended no changes should be made to the existing UK audit liability framework, meaning that the joint auditors would have joint and several liability for the engagement.

3.2 When making this recommendation, the CMA acknowledged potential difficulties with challenger firms taking on parts of the audits of the very biggest companies and that some companies should therefore be exempt from the requirement to tender for a joint audit. In doing so, the CMA recommended that the regulator should have the power to appoint peer reviewers, from outside the Big Four, for a selection of companies that were not included in the joint audit remedy.

Summary of Responses

Question 5: Do you agree with the CMA's joint audit proposal as developed since its interim study in December? *(72 responses)*

Question 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? *(36 responses)*

Question 7: Do you agree that challenger firms currently have capacity to provide joint audit services to the FSTE 350? 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 FTSE 350? *(49 responses)*

Question 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? *(45 responses)*

Question 9: Do you have any suggestions for how a joint audit could be carried out most efficiently? *(38 responses)*

Question 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? *(41 responses)*

3.3 The majority of respondents did not support the CMA proposal for joint audit. Multiple respondents felt it would not increase audit quality and could in fact negatively impact quality, due to issues 'falling between the cracks' of two audit firms and a perceived dilution of the accountability that a sole auditor brings. A number of concerns were also raised about how the measure would work in practice, including, for example, how disagreements between the two audit firms would be resolved, particularly on matters that involved subjective judgement. There was also an expectation of duplication and inefficiency that would add to the time and cost of an audit for what was commented on as limited discernible benefit.

3.4 The CMA's proposed exemption for the most complex companies received a broadly positive response, although several respondents considered that the need for the exemption should reduce over time. The proposed exemption for investment companies and single entity companies was also broadly supported, although an argument was made that these entities should still be required to consider and promote the use of challenger firms when tendering their audit.

3.5 Multiple respondents raised doubts that challenger firms would have the capacity and capability to audit large and complex firms. Several challenger firms expressed reservations that they currently have capacity to provide joint audit across the FTSE 350. Although most indicated that the shortfall could be overcome through a gradual rollout, they highlighted that there would be a challenge in recruiting the necessary number of experienced auditors to tender for, and deliver, the additional work. The majority of respondents, across all stakeholder groups, commented that a gradual and phased rollout of joint audit would be important to reduce risks to audit quality or the resilience of the challenger firms.

3.6 Those in favour of joint audit saw it as a potential way to enhance market resilience and increase competition, due to the added incentives for challenger firms to invest. However, the majority of respondents felt that a mandatory joint audit regime would require reforms to the liability regime for the measure to be effective.

3.7 Many respondents noted that the CMA's predicted 25-50% increase in audit fee would not include the indirect time and costs borne by audited companies and audit firms that would not be passed on through the audit fee. Several others thought that this figure could be higher, in some cases substantially, particularly during the transition to the new regime.

Question 11: Do you agree with the CMA's assessment of the alternatives to joint audit, including shared audit? *(49 responses)*

Question 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? *(46 responses)*

3.8 In general, those respondents that disagreed with the CMA's mandatory joint audit recommendation expressed preferences for one of more of the alternative measures the CMA considered but discounted. Some respondents advocated shared audits instead of joint audit, as they considered that this avoided several of the risks identified with joint audit. However, other respondents agreed with the CMA that shared audit would result in a second tier of smaller firms and do little to increase choice across the FTSE 350 audit market.

3.9 Some respondents were in favour of a market share cap, as they felt it would avoid the duplication and audit quality issues perceived to undermine the joint audit proposal and would be simpler and less intrusive to implement. On the other hand, some respondents shared the CMA's concerns that share caps would blunt competition, encourage larger firms to "cherry pick" the most lucrative contracts, and could lead to challenger firms taking on audit contracts that they did not have the capacity to perform.

3.10 A small number of respondents proposed that peer review be introduced to the FTSE 350 as an alternative to joint audit, rather than an accompaniment to it.

3.11 In some cases, respondents disagreed with the CMA's fundamental approach to market opening measures and expressed a view that more market-led approaches were preferable to regulatory measures.

3.12 Respondents were equally split in their views on whether the CMA's proposal would improve competition in the wider audit market. Respondents commented that challengers would need extra support to develop their capacity if joint audit was introduced and highlighted the risk that the measure could lead to more audit firms being conflicted when the company next tendered its audit, reducing choice. Several respondents also cautioned that any evaluation of the measure should focus on whether it maintained or improved audit quality, rather than competition as an outcome.

Question 13: Do you agree with the CMA's proposals for peer review? How should the regulator select which companies to review? *(59 responses)*

Question 14: Are any further measures needed to ensure that the statutory audit market remains open to wider competition in the long term? *(49 responses)*

3.13 Those respondents in favour of peer review felt it would give challenger firms the opportunity to gain experience and would add greater scrutiny and increase quality of audits. Some suggested peer review could be an alternative to joint or shared audit. However, many expressed reservations, with some noting that it could delay the publication of the audited accounts and distract the audit firm and company's audit committee from finalising the accounts. There were also concerns over who the peer reviewer would be accountable to, if

the review would be published, and how it would work alongside the regulator's Audit Quality Review (AQR) regime and the main auditor's own internal quality assurance function.[11]

3.14 Others completely disagreed with peer review as a measure on the basis that if challengers did not have the capacity and capability to conduct a joint audit, there was little confidence that they could effectively review the audit. In addition, respondents highlighted that the challenger firm who undertook the peer review would be conflicted when the company next tendered its audit, thereby reducing choice in the market further.

3.15 One respondent suggested it would be preferable for the regulator's own AQR function to be expanded rather than set up a parallel process, potentially with staff seconded from challenger firms.

[11]The FRC's Audit Quality Review team monitors the quality of the audit work of statutory auditors and audit firms in the UK that audit Public Interest Entities (PIEs) and certain other entities within the scope retained by the FRC (these are currently large AIM/ Lloyd's Syndicates/Listed Non-EEA)

4 Measures to Mitigate the Effects of the Distress or Failure of a Big 4 Firm

This section of the consultation addressed the CMA's recommendations which proposed to give the regulator new powers to monitor the health of audit practices, and to intervene when a firm fails or appears likely to fail.

CMA Proposals

4.1 The CMA recommended that the regulator should be given powers to obtain the information that it needs to monitor the health of audit practices, and to intervene where an audit firm is at a risk of a sudden collapse.[12] With these powers, the regulator would aim to maintain market competition in the event of failure of a major audit firm. While the regulator currently has voluntary arrangements with audit firms to do this, the CMA proposed that the regulator should be given statutory powers and associated duties to carry out these responsibilities more robustly.

4.2 The CMA also recommended that the regulator should obtain timely and periodic submissions from the Big Four firms and possibly the large non-Big Four firms on their financial health to assess a firm's viability. The regulator should then review the contingency plans from large audit firms, which should encompass their turnaround plans in the event of distress. The CMA recommended that the regulator should work with non-Big Four firms to draw up plans to assess their capacity to take on migrating auditors and/or audit clients from a distressed Big Four firm. The regulator should also require audit committees to inform them of any upcoming tenders and other relevant information that it considers necessary to monitor firms' financial health.

4.3 In addition to these proposals, the CMA recommended that the regulator should have flexibility to determine what action to take once it has identified signs of distress. The CMA suggested a range of options that the regulator could deploy depending on the circumstances of the failing firm. These include requiring the audit practice to identify the source of the problem and to modify their contingency plans accordingly – this could involve the regulator proactively discouraging audit committees from automatically transferring audit contracts to the remaining Big Four firms and, instead, encouraging audit clients and staff of large audit firms to move to a non-Big Four firm.

4.4 Finally, the CMA also proposed, that in the event of a failure, the regulator should consider the possible benefits of requiring large audit practices to ringfence a proportion of audit partners' equity; and consider whether and how a power to intervene in executive decision-making could be used, possibly through a special or modified insolvency regime that would be applicable to large audit practices.[13]

[12] Statutory audit services market study, page 177
[13] Statutory audit services market study, paragraph 7.25

Summary of Responses

Question 15: What factors do you think the regulator should take into account when considering action in the case of a distressed statutory audit practice? *(74 responses)*

4.5 The majority of respondents agreed that a further contraction within the audit market, resulting from a firm failure would be detrimental to choice. They proposed that the regulator should be aware of firms' financial situations and the regulator should take pro-active measures to decrease the likelihood of a firm collapse. When assessing the potential causes of a collapse, some respondents also suggested that reputational damage suffered by an independent member firm could have a knock-on effect on the whole of the international network. To mitigate this risk effectively, some respondents noted that the regulator should take targeted action to isolate the firm or individual where the damage had originated.

4.6 When considering how the regulator should prevent a firm failure, some respondents suggested that firms should be mandated to hold sufficient capital to withstand shocks. In doing so, multiple respondents drew comparisons with the prudential regulation of the financial services sector, where capital maintenance requirements are mandated under PRA and FCA rules. A number of respondents also warned that the regulator may be less likely to impose sanctions in a heavily-concentrated market where a firm is considered 'too big to fail' and may face financial distress as a consequence of the sanction.

Question 16: What powers of intervention do you think the regulator should have in those circumstances, and what should be their duties in exercising them? *(49 responses)*

4.7 The majority of respondents supported the proposals for new and enhanced regulatory measures that the CMA recommended, with some noting that interventions should be proportionate, prompt and targeted to circumstances of a specific distress scenario. Some respondents stated that the regulator should intervene to ensure that staff from a failed firm are incorporated into other successful firms. By contrast, others suggested that challenger firms should be encouraged to boost their capacity and expertise like their larger competitors. A minority of respondents argued that, in the immediate aftermath of a Big Four failure, it might be necessary to allow staff to move to the remaining large firms to maintain the health and quality of the audit market. They proposed that, with a sudden firm failure, challenger firms would struggle with audit expertise, even with an influx of new staff, particularly with the larger and more challenging audits.

4.8 Finally, a few respondents also proposed that the market required no intervention, as in the case of Arthur Andersen, where the market adjusted itself following their failure. Others suggested that new powers of intervention would be less important if market-opening measures were successfully implemented to create a more populous market, as this would directly address issues of resilience within the audit market through increased choice and competition.

5 Operational Split Between Audit and Non-Audit Practices

This section of the consultation explored the CMA's recommendations to require an 'operational split' between audit and non-audit practices within firms.

CMA Proposals

5.1 In its Market Study, the CMA considered whether the multidisciplinary nature of audit firms has a negative impact on audit quality and behaviours within firms. It concluded that tensions can arise between a firm's non-audit and audit functions, with the result that the greater revenue and profits accruing from non-audit work may have a detrimental impact on auditor incentives and working culture.

5.2 In response to these issues, the CMA recommended that the Government mandate an "operational split' in firms, with the regulator responsible for designing specific elements of the separation and refining it over time. The CMA recommended that this proposal would initially apply to the 'Big Four' firms and that the regulator should consider extending elements of the operational separation principles to certain challengers. The key features of this recommendation included the creation of a new board for the audit practice (which would be responsible for remuneration decisions and developing and maintaining audit quality standards) and a requirement to produce separate financial statements that would reflect the costs of services from the non-audit part of the firm.[14] In addition, the CMA recommended that profits should not be shared across audit and non-audit partners.

5.3 When making these recommendations, the CMA opted against an alternative proposal that would have mandated a full structural separation between audit and non-audit functions. However, it also noted that a re-examination of the merits of a full structural split may be necessary if operational separation does not deliver the expected improvements.

Summary of Responses

Question 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? *(57 responses)*

Question 18: What are your views on the manner and design of the operational split recommended by the CMA? What are your views of the overall market impact of such measures? *(64 responses)*

[14] Statutory audit services market study, page 192

Question 19: Are there alternative or additional measures which would meet these concerns more effectively or produce a better market outcome? *(34 responses)*

5.4 Respondents offered a range of views regarding the CMA's analysis of the tensions between audit and non-audit services. Several institutional investors some audited companies shared the CMA's concerns, with one observing that a 'one firm' culture within large firms runs contrary to the distinct set of values which are required to conduct a high-quality audit. However, other respondents disagreed with the CMA's analysis, noting that tensions have been largely or wholly resolved through recent reforms and regulatory measures. Others also highlighted the benefits of a multidisciplinary model, which allows auditors to draw on the knowledge and expertise of colleagues elsewhere in a firm, especially when auditing clients where specific specialisms are required. Finally, one respondent questioned the proposition that the sharing of profits between audit and non-audit partners results in a decline in audit quality in practice.

5.5 There were also a wider range of views in response to the CMA's proposals to remedy the tensions it had identified. Several respondents disagreed with the element of the CMA's proposals to require separate 'profit pools' for audit and non-audit partners, suggesting this could lead to firms breaking up, less resilience within firms and lower investment in systems and processes that could lead to higher audit quality. However, respondents broadly agreed with the other elements of the CMA's proposals, deeming them a sensible 'middle way' between a full structural split and the current situation. It is also important to note that, since the consultation window closed, the Big Four firms have agreed to take forward many elements of these proposals on a voluntary basis, working with the Financial Reporting Council.

5.6 Finally, most respondents did not offer further comment when invited to offer alternatives proposals to the CMA's operational separation recommendations. Some explained that further measures are not necessary, while one took the opportunity to comment on the CMA's alternative proposal to introduce a "cooling off period" in which firms could not bid for non-audit work for a period of years following an audit engagement.[15] This respondent suggested that this measure would be undesirable as it would limit choice in the market.

Question 20: Do you agree with the CMA's proposal to keep a full structural split in reserve as a future measure? *(53 responses)*

5.7 A significant proportion of respondents disagreed with the CMA's proposal to keep a full structural split in reserve as a future measure. Some respondents observed that it would be practically difficult to achieve a full separation in the context of the wider global structure of the biggest firms, while others suggested that a full separation could lead to duplication in functions, increased costs and a decline in audit quality due to the difficultly accessing specialist expertise during 'busy seasons'. However, other respondents agreed with the CMA's proposal, observing that this proposal could be reconsidered after there has been opportunity to assess the impact of the operational separation. One respondent also supported the

[15] Statutory audit services market study, page 203

proposal on the basis that they thought it unlikely that a culture based on professional scepticism could flourish while audit and non-audit functions remain within the same firm.

Question 21: What implementational considerations should Government take into account when considering the operational split recommendations? Please provide reasoning and evidence where possible. *(41 responses)*

5.8 Although many respondents did not comment on this question, those that did focused their attention on the possible implications for the partnership model if economic separation were required within firms. In doing so, some respondents observed that firms may find it difficult to access the expertise of non-audit specialists, while others noted that regular communication with the regulator would be important to deliver these measures effectively. One respondent also observed that, while economic separation within firms would be a complex matter that requires detailed consideration, the CMA's proposals regarding the governance and oversight of a firm's audit practice could be implemented comparatively quickly.

6 Other Possible Measures

This section of the consultation explored the CMA's recommendation to review progress after five years of full implementation. It also consulted on several additional measures that the CMA suggested may merit further investigation, but which did not form part of its core package of proposals.

CMA Proposals

6.1 To supplement its main proposals, the CMA recommended setting a specific point at which progress can be reviewed, and the effectiveness of the overall package of remedies can be assessed.[16] It suggested that the regulator should be required to do this five years from full implementation, in addition to its continuing oversight of the implementation and maintenance of the remedies. In doing so, the CMA recommended that the review should consider the merits of moving to the independent appointment of auditors by the regulator and the merits of a requirement for a structural split between audit and non-audit services.

6.2 The CMA also highlighted other proposals that had been brought to its attention that might merit further consideration. [17] These include:

- **Remuneration deferral and clawback**. Whereby awards to partners could be deferred, with a portion of the award vesting in subsequent years. The retained amounts could be subject to a clawback provision, giving the option to the Audit Board to reduce payment. This would aim to discourage irresponsible risk-taking, lack of effective oversight and short-termism, in a similar way to the framework introduced in the financial services sector in 2015.
- **Audit firm ownership rules.** This suggestion involved reconsidering the requirement for audit firms to be majority owned by qualified auditors. Liberalising the ownership rules could encourage greater capital investment allowing entrants and challengers to scale up more quickly, but would need to be weighed up against potential impacts on independence.
- **Technology licensing**. Cross-industry technology licensing, potentially facilitated by the regulator, could remove barriers to competition in the future. The Big Four firms could be required to share their audit technology with challenger firms, for example.
- **Measures to improve information for shareholders, and increasing transparency of audit committees, especially during tendering.** Possible measures include disclosing audit staff hours and fee breakdowns, and a requirement to provide a public database of audit partners and firms. This database could be similar to the one

[16] Statutory audit services market study – final summary report, page 18
[17] Statutory audit services market study – final summary report, pages 18 -19

maintained by the US regulator, the Public Company Accounting Oversight Board to make it easier to identify all audits for which a partner was responsible.[18]

- **Notice periods and non-compete clauses.** The CMA received suggestions that barriers to the growth of challenger firms could be reduced if notice periods for partner and senior staff in Big Four firms were reduced, and non-compete clauses were limited in scope. In response, the CMA suggest that the regulator should consider whether Big Four firms should limit their notice periods to six months.
- **Requirements on tendering and rotation periods**. The current requirement on Public Interest Entities is to carry out an audit tender at least every ten years and to change audit firm at least every twenty years.[19] The BEIS Select Committee recommended revisiting this, moving to a fixed term of seven years, in order to disrupt the 'familiarity' that can arise between auditor and audited company.[20]

Summary of Responses

Question 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? *(27 responses)*

6.3 Although many respondents did not offer views on this question, those that did generally supported the CMA's proposal for a review to assess the efficacy of its proposals. Respondents also noted that the proposals will take several years to take effect and that sufficient time should be allowed to assess their impact. However, respondents did not give clear views on whether five years or a different timeframe might be more appropriate. Nor did they offer firm views on the scope and content of the review, although some respondents disagreed with the CMA's proposal that the option of a full structural split should be included, given the variety of concerns cited in response to question 20.

6.4 Only one respondent took the opportunity to highlight the issue of auditor appointment, which the CMA suggested should feature in a future review. This respondent suggested auditor appointment should be performed by a specialist body, probably the regulator, in order to reduce the perceived or actual commercial allegiance between an auditor and the management of the company it is auditing.

6.5 Responses to the CMA's other possible measures are summarised in detail below.

Question 23: Do you agree with the CMA's suggestions regarding renumeration deferral and clawback? *(27 responses)*

[18] Auditor Search is a public database of engagement partners and audit firms participating in audits of U.S. public companies, run by the PCAOB
[19] The Statutory Auditors and Third Country Auditors Regulations 2016
[20] BEIS Select Committee, 'Future of Audit', page 51 - https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf

Question 24: How would a deferral and clawback mechanism work under a Limited Liability Partnership Structure? *(26 responses)*

6.6 In general, respondents did not feel that a renumeration deferral and clawback mechanism was a workable or desirable proposal. Some respondents supported the idea in principle, noting that similar arrangements had been put in place in the financial services sector and might discourage short-term risk taking. However, others warned that the auditing and financial services sectors operate in different contexts, and that concerns around short-term risk-taking are far more relevant in the financial services sector where significant investment decisions are involved. In addition, some respondents noted that auditors are already subject to regulatory fines when the regulator identifies failings in audit quality.

6.7 Importantly, many respondents raised concerns about how these proposals would operate in practice, noting that they would require very detailed guidance, regulatory oversight and design. As a result, one respondent felt these proposals were disproportionate and time-consuming compared to the 'problem' they were trying to address. Others also highlighted tax complications that might arise, with one noting that these issues would be particularly acute within Limited Liability Partnership structures.

Question 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? *(30 responses)*

6.8 Several respondents agreed that, in theory, a liberalisation of ownership rules could have a positive effect on the audit market by attracting new capital and encouraging challenger firms to grow. One respondent drew a comparison with changes brought about by the Legal Services Act 2007, which attracted new entrants to the market following the introduction of alternative business structures.

6.9 At the same time, many respondents were unconvinced that theory would translate into practice, suggesting that a lack of capital has not been a key driver in limiting competition and that the main barrier to competition within the market was the inability of firms outside the Big Four to win large audits in the FSTE 350. In addition, several respondents raised concerns about changes to incentives and working culture that might arise if rules were relaxed. For instance, one noted that that changes could result in a greater focus on profitability over quality – this respondent also observed that the sense of an audit 'profession' could be diluted if firms were increasingly viewed as a business enterprise.

6.10 Finally, one respondent noted that other proposals should be considered the priority and that Government and the regulator should focus on measures where there are more compelling arguments to justify action.

Question 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? *(36 responses)*

6.11 Respondents offered a wide variety of views when asked about the CMA's suggestions regarding technology licensing. On the hand, some respondents, including one challenger firm, favoured the proposal in principle, noting that challengers do not have the economies of scale to develop certain technologies and that the sector would benefit from a greater uniformity in the technologies it used with clients. One respondent who favoured the proposal noted that Big Four firms should be reimbursed at an appropriate commercial rate if compelled to share technology, while another suggested the challenger firms combine forces to develop and innovate new products.

6.12 On the other hand, many respondents claimed there was insufficient evidence to suggest that a lack of technology was a barrier to growth. This included several challenger firms, one of which suggested the proposal wrongly assumed that the technology of Big Four firms is better than that of the challengers'. In addition, several respondents raised the concern that a compulsion to share technology would stifle audit quality amongst larger firms, who would no longer be incentivised if required to share the outputs of their innovation with challenger firms. More practically, some respondents raised the concern that the technology used by Big Four firms is owned and licensed by a global network, with the result that it is difficult to know how this proposal could work in practice.

Question 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? *(38 responses)*

6.13 The vast majority of respondents agreed in principle that shareholders and other stakeholders should be provided with current, transparent and predictive information about a company's performance. However, many questioned the usefulness of additional disclosures and noted that the nature and quantity of that information needs further consideration to ensure shareholders are likely to engage with and understand the information provided. Respondents also flagged the risk that much information is highly dependent on the specific circumstances of the entity in question and could be misleading without in-depth knowledge of the area. There were concerns this could distract from the real drivers of audit quality.

6.14 Many respondents supported offering greater transparency for shareholders as an important element to enhancing oversight and accountability. A number agreed increased disclosures could encourage more open and informed discussions with the Audit Committee and provide more information to compare audit firms and encourage consistency. While different respondents supported various aspects of the CMA's suggestion, there was significant focus on information provided during the audit tender process being most beneficial.

6.15 Other respondents believe sufficient information is already reported to shareholders on an Audit Committee's activities, through the annual report, the AGM and under the ethical standard and therefore did not feel there will be significant benefit to increased disclosures.[21]

[21] Additional disclosures are required under the Revised Ethical Standard 2019, such as the requirement to disclose where audit fees are routinely lower than the full cost of the audit.

6.16 Only a small number of respondents provided views on the example of the Public Company Accounting Oversight Board**.** Of those many noted that a public database of partners and firms already exists, but did not oppose an expansion of the database if there was clear evidence it would increase accountability.

Question 28: Do you agree with the CMA's suggestions regarding notice periods and non-compete clauses? Do you agree that the regulator should consider whether the Big Four should be required to limit notice periods to 6 months? *(33 responses)*

Question 29: Do you agree with the CMA's suggestions regarding tendering and rotation periods? *(46 responses)*

6.17 On the CMA's proposals regarding notice periods and non-compete clauses, most respondents focused on the issue of notice periods, offering a wide variety of views. On the one hand, several arguments were put forward in favour of regulatory action to require consistent practice across the sector so that notice periods do not impede the movement of partners to challenger firms. One challenger firm stated that notice periods for partners can extend to two years, arguing that there needs to be greater movement of skilled people if the CMA's joint audit proposal was to work. Another respondent made a similar argument, noting that these proposals would usefully facilitate a reconfiguration of the audit market as competition measures take effect. The proposal also received support among some large firms. One agreed that restrictions to notice periods would help challengers build capability and capacity, but noted that a policy would require careful design as there as several factors to consider when determining the appropriate length of such periods. Another large firm noted that six-month notice-periods would be sufficient, allowing audit obligations to be delivered and handed over to colleagues in a way that would not undermine audit quality.

6.18 On the other hand, some respondents, including a challenger firm, were more sceptical of these proposals and did not believe that notice periods were a problem or hindrance when accessing senior staff. One respondent argued that there may be reasonable and legitimate reasons for long notice periods for equity partners, relating to the funding of the firm and its underlying tax arrangements. A second argued that regulation at this level was time-consuming and disproportionate to the perceived issue, while a third raised concerns that shorter notice periods may exacerbate the flight of staff in a scenario where a firm is in reputational or financial distress. Finally, several respondents also raised concerns that these proposals could cause disruption to companies being audited if they resulted in unplanned personnel changes during the course of an audit engagement.

6.19 On the question of rotation and tendering periods, the vast majority of respondents disagreed with the reform proposals, arguing that the current requirements were introduced recently and that further time is required to let them take effect and to be assessed. On this basis, many respondents argued that there is insufficient evidence that the supposed benefits of a shorter rotation period would justify the increased tendering costs, time taken away from core activities, and time required to upskill new auditors that this proposal may involve. However, one respondent noted that a reduction to the current twenty-year requirement to change firm would be worthy of further consideration. Another also suggested these proposals

may be worth revisiting as part of the CMA's proposed 5-year review, once other recommendations have been implemented.

Question 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? *(26 responses)*

Question 31: What actions could audit firms take on a voluntary basis to address some or all of the CMA's concerns? *(27 responses)*

Question 32: Is there anything else the Government should consider in deciding how to take forward the CMA's findings or recommendations? *(39 responses)*

6.20 Most respondents did not offer new or alternative proposals to those mentioned in the CMA's central proposals or its list of other possible measures. However, one respondent wrote in favour of a 'market share cap' as an alternative to the CMA's proposals for joint audit, while another suggested that the costs of tendering should be borne by the company that goes out to tender – this respondent suggested that this proposal could lower barriers to entry and help to create a level playing field for smaller firms. A low number of respondents also discussed the BEIS Select Committee's proposal to require a 'cooling off period', whereby firms would not be able to provide non-audit services to a company in the three years immediately following the end of an audit engagement with that company.[22] One of these respondents suggested this proposal might allay concerns that an auditor's judgment might be impaired in the final years of an audit by a desire to sell consulting services afterwards. Another noted that that the proposal could limit competition and that one year would be the more appropriate time frame if a cooling off period were introduced.

6.21 When asked about measures that could be taken on a voluntary basis, one respondent observed that actions should be taken prior to legislation where possible, as it will take time to establish the new regulator. Several respondents also pointed to announcements that had already been made by larger firms. For instance, these announcements included a commitment by some firms not to undertake non-essential non-audit work for companies where they are engaged to carry out a statutory audit. They also included commitments regarding improved governance of the audit practice, which closely resemble elements of the CMA's proposal regarding operational separation within multidisciplinary firms.

6.22 Finally, some respondents offered general remarks when asked what else the Government should be considering when taking forward the CMA's proposals. Some observed that the CMA's proposals will need to be considered within the wider context of Sir John Kingman and Sir Donald Brydon's respective reviews, while one observed that the Government will need to make it clear which proposals it will implement via primary legislation and which it will implement through secondary legislation or through rules created by the new regulator. One respondent also noted that the Government should keep audit quality at the heart of its decision-making, while another observed that any reforms will need to consider the

[22] BEIS Select Committee, 'Future of Audit', page 52

international networks in which firms operate. Finally, one respondent noted that the Government should not discourage entities from listing in London and that any reforms should consider the overall attractiveness of the London capital markets as a listing destination.

Annex A – List of Respondents

Anglo American	Association of British Insurers (ABI)
The Association of Investment Companies (AIC)	Association of Chartered Certified Accountants (ACCA)
Association of Practicing Accountants (APA)	AstraZeneca
Audit Committee Chairs' Independent Forum (ACCIF)	Aviva
Baker Tilly International	Binder Dijker Otte & Co (BDO)
Brewin Dolphin	Cairn Energy
The Chartered Institute of Management Accountants (CIMA)	City of London Law Society Company Law Committee
The City UK	Confederation of British Industry (CBI)
The Corporate Reporting Users' Forum (CRUF)	Croda International
Crowe UK	Daily Mail and General Trust
Deloitte	Duncan and Toplis Limited
Ernst and Young	Fidelity International
GC100	GlaxoSmithKline (GSK)
Grant Thornton	G4S
Halma plc	Hermes Investment Management
The Hongkong and Shanghai Banking Corporation (HSBC)	The Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Chartered Accountants of Scotland (ICAS)	Institute of Chartered Secretaries and Administrators (ICSA)
Intermediate Capital Group (ICG)	Investment Association (IA)
JD Wetherspoon	Johnson Matthey

Johnston Carmichael	KPMG
Kreston Reeves	Landsec
Lloyds Banking Group	Luminate
Mazars	Moore Kingston Smith
National Express Group	Nationwide Building Society
Pensions and Lifetime Savings Association (PLSA)	PricewaterhouseCoopers (PwC)
Prudential	Quoted Companies Alliance (QCA)
Rio Tinto	Royal Bank of Scotland
Royal London	RSM International
Santander	Secure Trust Bank
Shell	Schroders
St. James's Place Wealth Management	United Kingdom Shareholders Association
Vodafone	Wellcome Trust
38 Degrees	100 Group

9 individuals also responded to the consultation directly, including academics and audit professionals. One company responded but asked to remain anonymous.