Response to Competition & Markets Authority Statutory Audit Market consultation

2 November 2018

Grant Thornton UK LLP ("Grant Thornton") welcomes the opportunity to provide the Competition and Markets Authority ("CMA") with its responses to the Invitation to Comment ("ITC") in relation to its Market Study into the Statutory Audit Market published on 09 October 2018.

Introduction

Grant Thornton UK is a member firm within a leading international network providing independent advisory, tax and audit services. As the fifth largest such firm in the UK, we have a particular viewpoint and interest in the structure of competition in the UK audit market. We agree with the CMA that competition in the audit market for large companies and public interest entities ("PIEs", or a "PIE") is not functioning well and that the measures introduced following the last Competition Commission investigation have not been as impactful as would have been desired. Having made significant investments to further grow our presence in the market for audit to FTSE 350 companies, we are well placed to understand and articulate the barriers that face firms outside the Big 4 attempting to provide innovation and competition to the UK market, which remains dominated by the Big 4.

We think that serious failings in competition and regulation remain within the UK's statutory audit market, substantially in the form identified by the Competition Commission ("CC") in 2013. Recent corporate failures have highlighted the limitations of the audit market in its current form. We see these as prominent examples of a wider failure fully to achieve a robust and independent audit sector and to protect shareholders' and other stakeholders' interests in the UK's large companies and PIEs.

Given the complexities of the UK audit market, we think it is understandable and appropriate that a number of specialist reviews are considering different aspects of the market in parallel. We are fully involved with and supportive of the Kingman review and the Audit Quality Forum's 'Project Flora' initiative. We welcome a joined-up approach between these projects. A properly-functioning market will be a product of good competitive conditions, but also well-designed audit 'scope' and effective regulation. Some of the necessary changes may be of a regulatory and technical nature, but measures that promote effective competition are also essential: in particular, to prevent auditor incumbency and engrained relationships from inhibiting auditor challenge and incentives to innovate and ultimately undermining audit quality.

We are proud to be the largest provider of audit and related services to the UK public sector, where we work with over half of local authorities and the NHS. We are committed to promoting a UK that is collaborative, open, trusted, connected and prosperous. We see this CMA study as a chance better to align audit services with core public interest considerations and think we have a useful perspective to contribute. We will, as part of this process, further reflect on what we as a firm can do to contribute to an effective audit market and will welcome any opportunity to discuss this with the CMA. However, many concerns identified stem from buy-side behaviours and we encourage the CMA to focus upon corresponding reforms around audit procurement. Even though we may be considered to be potential beneficiaries of reform, we support the objective of reducing the concentration in the FTSE 350 audit market because we believe in the principles of effective competition and the consequent benefits on audit quality.

Executive Summary

- Grant Thornton agrees that competition in the supply of audit services to PIEs in the UK is still not working well. The remedies adopted at the end of the market investigation carried out by the CC (the "CC Remedies") may have resulted in some increase in companies tendering for and sometimes switching their auditor on a more regular basis. However, any increase in switching has been limited to switching between the Big 4. It has not resulted in non-Big 4 audit firms winning a large number of FTSE 350 audit mandates.

- This lack of effective competition was a central factor in Grant Thornton's decision, taken earlier in 2018, to withdraw from future tendering for the provision of audit services to FTSE 350 companies. We felt that buyers' predisposition to the Big 4 meant that we were not being permitted to play on a level playing field and so took a commercial decision to stop investing in what were very high cost tenders that offered little possibility of success.

- These are problems specific to the UK large company audit market, which must be the focus of remedial measures. Grant Thornton shares the view of the CMA that there is unlikely to be one complete solution. The issues identified in the ITC are multi-faceted and a range of measures to address them is likely to be required. We welcome the CMA's caution with regard to potential unintended consequences. In particular, mid-sized and smaller (and particularly privately-held) companies operate in a different market context to large PIEs. The CMA should not impose measures which disturb that well-functioning market or act as barriers to expansion for mid-size and smaller companies.

- Reform must focus on strengthening the independence of auditors of UK PIEs and on removing the biases in favour of the Big 4 that are not driven by quality. This will better serve stakeholders and the public interest. We consider that, in larger companies, "stakeholder" should extend beyond management and shareholders, also to cover pension holders, employees, customers, suppliers and local communities served by the company.

- Grant Thornton has the technical capability, scale and capacity to undertake and deliver high quality audits for many FTSE 350 companies today including those with wide international operations. Nevertheless, we recognise that the largest and most complex companies, which may have systemic importance on an international scale, will require an auditor that can match that size and complexity, or two or more auditors acting under a shared mandate.

- Grant Thornton does not consider that separating the audit and non-audit practices of the Big 4 would be an effective remedy. Audit quality is enhanced by the broader resources and insights that are available to support the audit function on an "as needed" basis in a multi-disciplinary firm. Simply splitting out audit is unlikely to solve all the concerns: rather it would create a group of Big 4 audit-only firms, with the same level of market concentration and the same buy-side biases in play. Some mid-tier firms may leave the market, rather than split their business to compete for PIE audit mandates. Although splitting out audit from non-audit business would partially address conflicts of interest and independence, we support simpler solutions.

- While Grant Thornton benefits commercially from providing both audit and advisory services to clients, we see value in prohibiting firms from receiving non-audit fees from PIE audit clients. Regulatory changes which have tightened controls over the selling of both audit and non-audit services to PIEs have reduced the practice, but auditors continue to provide non-audit services to their PIE audit clients, often to the value of around 40 per cent of the audit fee (and up to a limit of 70%). Importantly, there is a perception that sales of non-audit services create conflicts of interest: a clear ban may serve the public interest by providing wider stakeholders with reassurance and promote trust in the industry. However, there are certain services which are currently defined as 'non-audit', but are compatible with and, indeed, complementary to, the provision of high-quality audit (as outlined in our response to question 18, below). Any 'ban' on firms receiving non-audit fees from such clients would need to be carefully defined to ensure that these positive services are allowed to continue. It would be unfortunate if any action by the CMA resulted in firms only being able to offer audits which were less effective.

- Grant Thornton does not consider that the introduction of a market share cap in relation to the percentage of audits of FTSE 350 companies carried out by the Big 4 is, by itself, a useful tool for dealing with the concerns that have been identified. In particular, it is not clear to us how this would be made to operate without allowing the Big 4 to cherry pick the most attractive and profitable audits. Grant Thornton does consider that there may be some benefit in setting an aspirational market share target for an independent auditor appointment body (see below) to aim for.

- Grant Thornton does consider that there are advantages to joint or shared audits. This mechanism is used in countries such as France, where there is better market stability, with fewer high-profile failures and greater public trust in auditing. It offers the ability to draw on a wider range of technical knowledge and experience, promotes better quality outcomes, ensures a higher level of rigour and independence and generally results in a more dynamic market in terms of the number of firms able to provide effective audit services. Joint audits could be set up in a number of ways – we support a 'shared' audit model. We acknowledge that joint audit has been criticised and resisted in the past by the buy-side, but we look forward to discussing this again with the CMA. In particular, Grant Thornton considers that the introduction and use of joint audit is something that could be supported by an independent auditor appointment body with a public interest duty (see below).

- Grant Thornton has previously called for an independent auditor appointment body[1]. We note that the use of an independent auditor appointment body has been embraced in the UK public sector. An equivalent mechanism for the appointment of auditors to certain FTSE 250 companies could have a positive effect in terms of promoting independence and addressing potential bias in the procurement of audit by large companies in the UK. Although a significant change to the current system, this would send a clear signal that the UK is serious about market reform and ensuring that the firm (or firms) appointed to audit a large company is the firm (or firms) that will carry out that role most effectively, balancing the interests of all the various stakeholders and placing the public interest at the heart of the selection process. Such an arrangement could also deal with non-audit service procurement in a fully independent manner addressing current concerns over conflicts of interest in this area (a prohibition on selling non-audit services to PIE audit clients may also address this). We do think that private audit firms will provide the best quality audit in a well-functioning market: Grant Thornton does not support the nationalised provision of audit services.

- Effective reforms that increased competition and auditor independence in relation to PIEs would be strongly supported by Grant Thornton and would encourage more non-Big 4 firms to tender for audit for FTSE 350 companies. We consider that a successful outcome to the CMA's current market study would be one where:

  - audit quality overall in the FTSE 350, as measured by the FRC, improves consistently;

  - 10-20% of the companies in the FTSE 350 are being audited by non-Big 4 firms within three to four years;

  - there is wider stakeholder engagement with audit;

  - auditor independence (and the perception of independence) is strengthened; and

  - public trust and confidence are restored.

- Grant Thornton sets out below its responses to the specific consultation questions contained in the ITC. We look forward to discussing these further with the CMA.

Responses to the CMA's consultation questions

1. ***How well is the audit sector as a whole serving its stakeholders?***

Differing stakeholder interests

1.1 Stakeholder interests are currently defined by the fact that an audit must serve a business and its shareholders. For PIE audits, in particular, we consider that the definition of 'stakeholder' should reflect the public interest and encompass a range of interested parties: extending to pension holders, employees, customers, suppliers and local communities. This differs from mid-sized, private and smaller companies. Wider societal interest considerations are less relevant for these businesses, which have smaller corporate footprints; for these companies an auditor's duty should be owed primarily to the business and its investors. Non-PIE clients look to Grant Thornton as a trusted advisor when we act as auditor. This is a role that we value, that we think serves these businesses well and that should not be constrained unnecessarily by regulation (albeit we fully respect the importance of Ethical Standards).

1.2 As the CMA (and the CC before it) has rightly identified, different stakeholders have varying expectations and requirements of audit. Most notably, a company's managers may value lower pricing over a rigorous audit process, whereas a company's shareholders will be more focused on quality. In light of these misaligned incentives and expectations, some stakeholder interests are better served by the audit sector than others. In

[1] Grant Thornton provided the Kingman review team with a detailed proposal on the "Independent appointment of auditors", and invite the CMA to obtain and consider this document.

relation to large companies and PIEs, we believe that the balance is currently tilted away from the interests of shareholders and wider stakeholders. Audit serves neither their interests nor, by extension, the public interest, as well as it could.

1.3 There are various metrics that could be used to determine how well the audit sector is serving its stakeholders, which we discuss further below, including: technical audit quality; whether audit generates confidence and trust amongst stakeholders; whether audits meet the expectations of stakeholders (including whether auditors adequately challenge management and contribute to a company's sustainable growth); and whether audits are conducted at reasonable cost.

A high-level view

1.4 Overall, we think that the UK sector generally delivers high quality audits. The UK takes pride in a financial and regulatory environment which gives confidence to people to start new businesses, invest and attract inward investment. The UK has a strong international reputation as an attractive venue for investors, underpinned by reliable financial reporting. UK auditors are highly skilled and qualified, and are held to some of the highest standards worldwide. That the UK is regarded so highly as a location for investment endorses audit quality.

1.5 For most audit appointments (with c. 100,0000 statutory audits conducted in the UK each year), this service has been delivered as the product of a competitive environment. However, as has been identified by regulators, this is less true at the level of the largest companies, with a quadropoly of firms auditing the FTSE 350.

Audit quality

1.6 On a technical measure, we suggest that audit quality is broadly high. In terms of determining whether published accounts represent a 'true and fair view' of a company on a relatively tightly-defined 'going concern' basis, we are confident that most audits are carried out to a very high standard, within this limited scope. We note that the Audit Quality Review findings of the FRC in recent years suggest that overall audit quality is good.

1.7 The CC previously identified (a) scepticism, (b) objectivity, (c) integrity, and (d) independence as aspects of audit quality. We agree that these are each important elements of a high-quality audit that will serve both stakeholder interests, and the public interest. In respect of (c) integrity, we have little concern that these are features of all audit work in the UK. However, we are concerned that long audit tenures, a misalignment of incentives (as recognised by the CC and the CMA) and delivery of audit and non-audit services to the same PIE, may erode scepticism, objectivity and independence. We consider that high-quality audit is characterised by management challenge – a product of all three factors – whereas increased familiarity between auditors and management reduces the likelihood or possibility of an auditor challenging management assertions, thereby undermining audit quality. Lack of management challenge has been a common feature of FRC criticisms of audits to the UK's PIEs[2].

1.8 As we will explain further below, the current appointment process for UK large company audits does not adequately protect the public interest, in particular by failing to safeguard auditor independence. Measures should be taken to strengthen both the independence and scepticism of a company's auditors and the public *perception* of auditor independence. The FRC's definition of 'High Quality Audit' acknowledges the significance of this: "[…] *Auditors carrying out high quality audit act with integrity and objectivity, are demonstrably independent and do not act in a way that risks compromising stakeholders' perceptions of that independence* […]" (emphasis added). Long audit tenures also undermine the independence of auditors and the perception.

Meeting stakeholder expectations

1.9 One concern in the UK audit market is that wider-stakeholder impressions of audit quality are misinformed as a result of the 'expectation gap', which the CMA has rightly identified at paragraph 3.15 of the ITC. To the extent that audit sign-offs do not provide the assurances that stakeholders believe are being provided in respect of a business (in particular, identifying fraud, expressing a view as to the viability of a business as a going concern (beyond the 12 months required by the going concern assessment) and making assurances regarding the

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[2] See, for example, the FRC's paper '*Development in Audit 2018*', p.8.

narrative aspects of an annual report), then we suggest the audit is not satisfying stakeholder and public interests.

1.10 We acknowledge that a review of whether the current audit scope should be realigned better to match wider-stakeholder understanding of an audit sits more happily within the remit of the Project Flora review and the Kingman review, who will also consider the consequent implications on the cost of providing this level of assurance and the impact on auditor liability. However, we also suggest that stakeholders expect that auditors will be selected on the basis of rigorous tenders designed to appoint the auditor best placed to deliver audit quality. Our experience suggests that factors beyond quality or capability are influencing the outcomes of tenders for FTSE 350 audits. As the CMA has identified, FTSE 350 audits are almost universally performed by the Big 4, despite the fact that for many FTSE 350 companies, non-Big 4 firms (including Grant Thornton) would be capable of performing an audit. Investors and other stakeholders, meanwhile, are not properly engaged in the appointment process.

Generating confidence in business and fostering trust

1.11 Part of the role of an audit is to foster trust, creating an environment of confidence that serves the interests of businesses, shareholders and the wider economy. We noted in our June 2017 paper, *Shaping a Vibrant Economy: A blueprint for the UK* (reproduced as Annex 1 to this response):

> *Trust and integrity are the heart of a vibrant economy. They provide the basis for adoption of innovative products and services, higher productivity, investment and a 'licence to operate'.*
>
> *We need a systemic approach to restoring trust. In the short term, corporate governance can help by strengthening engagement, accountability and transparency.*

1.12 The collapse of Carillion, and the consequences for suppliers, pensioners, employees and customers, seems to have reduced trust in audit from investors, regulators and the wider public.

1.13 These concerns are particular to the UK. We consider that there are issues that should and can be addressed primarily by UK-only measures, where circumstances require, such as:

- the independent appointment of auditors to PIEs by a body with a public interest objective;
- the prohibition on provision of non-audit services to PIEs by their appointed auditor;
- an expansion of the definition of a PIE to capture the largest private UK companies (for example, all those with more than 5,000 employees);
- the use of joint or shared audits; and
- refining the scope of an audit to focus on viability and fraud-detection, review of narrative elements of accounts with reporting retargeted towards forward-looking assurances addressed to a wider range of stakeholders (with attendant reforms to audit-liability, as discussed below).

1.14 In principle, we agree with the suggestion that effective competition will create positive outcomes for each of these stakeholders. In much of the audit market this is already the case. However, we do not think it is working for PIEs.

2. ***How well does the audit framework support the interests of both direct shareholders and also wider stakeholders in the economy?***

2.1 We have addressed a number of the issues of relevance to this question in our response to question 1, above.

Lack of auditor independence and scepticism

2.2 We have noted above that there is a UK-specific concern as to how the public perceives audit and particularly auditor independence. This is exacerbated by the high degree of judgement and estimation uncertainty in a set of accounts. Shareholders and stakeholders understand that there is an element of subjectivity and scope for manipulation in the presentation of an accounting position. Shareholders and wider stakeholders therefore rely more heavily upon the auditors' professional scepticism. UK measures that are taken to strengthen independence and scepticism in relation to PIE audits (for example, through changes to the appointments model) would reduce concerns arising from the audit framework.

Failure to meet stakeholder expectations

2.3 Audit must protect stakeholders, who should understand what assurance they can take from an audit. Whilst professional investors are well informed as to the assurances provided by an auditor's report, wider UK stakeholders (including non-professional shareholders) are not. We think that this is a particularly significant problem in respect of large companies (such as the FTSE 350) because of the greater societal impact related to their prospects.

2.4 Although fundamental audit standards are agreed on an international level, we support a number of changes to the UK framework better to serve wider stakeholder and public interests. These include:

- simplifying the audit language so that non-specialist audiences can understand it;
- providing broader annual reporting 'in the public interest' for PIEs, driving assurance;
- including the identification of any instances of fraud and collusion within the ambit of an audit (under the current scope it is not always possible to identify fraud);
- enabling auditors to provide forward looking insights as to future resilience and viability of organisations; and
- including a focus on improving governance and scrutinising the narrative aspects of accounts and non-financial disclosures.

2.5 We suggest that in rescoping the audit framework, regulators (and ideally the Project Flora team, once established) should consult with wider PIE stakeholders to ascertain their views as to what will be the most helpful and impactful changes.

2.6 If the scope of an audit is expanded (as we suggest it should be for UK PIEs), a review of the current model of auditor liability must form part of that review. In particular, consideration should be given to potential 'safe harbour' defences in respect of liability for forward looking statements of belief or judgment made by UK auditors.

2.7 Although related to international standards of accounting and the wider audit framework, the changes that we have proposed are measures that could be adopted on a UK-only basis. The 'Project Flora' review of the audit framework is an opportunity more generally to modernise the role of audit in the current international business environment; though we welcome a joined-up approach between the CMA, the Kingman review and Project Flora.

3. ***To what extent do the decisions made by audit committees support high-quality audits, whether through competition for audit engagements or otherwise?***

3.1 As we have noted above, we do have concerns that the current process for appointing auditors to PIEs may undermine high-quality audits:

- through inherent biases and management involvement in appointment processes, which may result in (i) auditor scepticism and propensity to challenge management being undervalued in the tender process, and (ii) incumbent auditors who hope to be reappointed being disincentivised from challenging management; and
- through lack of effective competition for individual audits. This may be caused by the factors identified in paragraph 3.25 of the ITC. Additionally, for many FTSE 350 companies, tender processes are not as competitive as they might be, because perceptions of bias and unwillingness to replace an incumbent

auditor discourage non-Big 4 firms from responding to tenders (particularly in light of significant tender costs).

3.2 The FRC broadly reports high quality and that the number of audit failures is relatively low. However, the FRC has identified a weakness in challenge from auditors, a key component of audit quality. This reflects the difficulty of raising challenging questions with a company that effectively employs and pays for the auditor. This is linked to the auditor appointment process and the powers of audit committees:

- audit committees and directors are not always incentivised to ensure that audits are robust, and there is little evidence of audit committees holding auditors to account for a lack of management challenge;
- management remains influential in auditor appointments;
- there is limited oversight of the audit committee's role[3].

3.3 Following appointment and despite mitigation of high professional standards, risks to auditor independence increase as:

- the professional, financial or personal relationships between audit committee, Chief Financial Officer and auditor deepen;
- a lengthy tenure means that an auditor may have to identify its own previous oversights; and
- an auditor seeks reappointment.

3.4 In our experience audit committees and company management also focus keenly on accounts being filed in time, potentially to the detriment of audit quality.

3.5 The audit procurement process for UK PIEs (and particularly the FTSE 350) can be better designed to foster competition between auditors and encourage high-quality audit. This can be achieved on a 'UK-only' basis:

- we would support measures to improve the independence of decision-making in relation to auditor appointment (in particular through the creation of an independent appointment body with a public interest duty);
- we would also support more regular tendering – between five to seven years with reappointment permitted once. Increasing the frequency of tendering and the rotation of auditors would create greater auditor independence and a more free-flowing marketplace, outbalancing the costs of the time needed to get up to speed for a new client's business. Alone, it may not reduce market concentration;
- audit committees should seek to put in place performance metrics and incentives for auditors that directly encourage scepticism and the challenge of management: with contractual recourse where auditors under-perform;
- audit committees should report to shareholders on auditor performance.

4. ***How has this changed following the Competition Commission's intervention?***

4.1 The CC Remedies included measures designed to increase separation between the appointment of auditors and management, as well as to address the problem of misaligned incentives. In our experience, the enhanced powers of the audit committee have not had the desired effect. The CC took the view that an audit committee itself was at sufficient remove to provide 'independence' in decision making. However, we have found that management and particularly the Chief Financial Officer of UK PIEs remain influential, with incumbent auditors likely to be successful in retaining mandates. This also increases tender costs for auditors, as it is understood

[3] Grant Thornton's Corporate Governance Review 2018 reported a decline in the quality of reporting of audit committee's decisions about their auditor. 61 per cent of the FTSE 350 provide basic or general disclosures, limited perhaps to stating they had retendered their audit contract. Grant Thornton's Corporate Governance Review 2018 is available at https://www.grantthornton.co.uk/globalassets/1.-member-firms/united-kingdom/pdf/documents/corporate-governance-review-2018.pdf

that auditors must invest in relationships with company management (including travelling to meet with management in international locations) in order to have a realistic chance of securing a mandate. We also find that many Chief Financial Officers and the Chairs of FTSE 350 audit committees are former Big 4 employees.

4.2 The mandatory tendering of audit contracts has increased the rotation of auditors working for FTSE 350 clients[4]. However, such rotation has been between the Big 4, leaving market concentration unaddressed. As the CMA has identified, the proportion of FTSE 350 audits undertaken by the Big 4 has in fact increased since 2013.

4.3 Revisions to the Ethical Standard have had some impact upon the contemporaneous provision of audit and non-audit services. We are less convinced that the CC's measures – reserving to the audit committee the authorisation of non-audit service provision by a company's audit provider – have had the full effect desired. In our experience, many decisions are made by management and ratified by the audit committee, rather than the audit committee driving the process. In any case, auditors continue to provide non-audit services to their PIE audit clients, often to the value of around 40 per cent of the audit fee[5]. We also think it significant that there remains a perception, amongst wider stakeholders, that auditor independence is undermined by a desire to cross-sell advisory services to audit clients. As we noted in response to question 1, above, this is contrary to the public interest where it undermines trust in audit.

4.4 Although the CC Remedies are relatively young, in our view there is already good evidence that the interventions did not go far enough in encouraging competition in the market for FTSE 350 audits, reducing market concentration or promoting auditor independence.

4.5 We note that the CC's Notice of possible remedies, published on 22 February 2013, envisaged mandatory retender between five and seven years. This would strike a better balance between the cost of the tender process and the benefit of the greater competition that comes with more regular tenders. We acknowledge that there is some benefit accrued from an auditor's familiarity with a company, its terminology and methods, but absolutely think that increased independence would outweigh the time, risk and cost of auditors 'getting up to speed' with the business and relationships. We note that for each high-profile event such as BHS and Carillion, the familiarity of the auditor with the sector/company did not serve to prevent failure.

5. ***Is competition in the audit market working well? If not, what are the key aspects hindering it?***

5.1 As we have suggested above, competition in the large statutory audit market remains heavily restricted by buy-side barriers to entry and expansion. The market positions of the Big 4 are testimony to this. Mid-tier firms do possess the requisite capacity and quality to deliver quality audit services to all but the largest companies: as is borne out in the FRC's public reports.

5.2 Furthermore, what competition does exist is not sufficiently focused around audit quality. In spite of an increase in tendering and auditor rotation the FRC has reported a reduction in the quality of audit amongst the Big 4.

5.3 A number of barriers to non-Big 4 firms in the large statutory audit market lay at the heart of our decision not to continue seeking mandates within the FTSE 350, as of March this year. Our concerns included:

- demand-side barriers, including an appointment culture that:
  - shows significant inertia and unwillingness to explore options outside of the Big 4. Although the CC Remedies included banning 'Big 4-only' provisions in loan agreements, there remains a legacy view that the Big 4, or their premium positioning, represent a 'safe' option. Audit committees have little incentive to make anything other than a conservative choice of auditor (i.e. Big 4), and we find that a Big 4 appointment retains some element of prestige; and

[4] Evidence gathered for Grant Thornton's Corporate Governance Review 2018 suggests that this remains limited. Only 8 of 29 FTSE 350 companies that had tendered their audits in the preceding year had then changed auditors. It also appears that the CC Remedies have not been fully reflected in industry practices. Our Corporate Governance Review 2018 revealed that 18 FTSE 350 companies do not disclose their last or next audit tender and six are in breach of the 10 year tender requirement.
[5] It is not always clear how these conflicts are managed. Our Corporate Governance Review 2018 reports that whilst most FTSE 350 firms report how they safeguard auditors' objectivity and independence while providing non-audit services, 45.2 per cent still provide only 'some' information. Further consideration of the interaction between advisory and audit services for large companies is included in our Corporate Governance Review.

- maintains a bias towards Big 4 firms; as a result of the professional background of audit committee and management alumni, incumbent relationships with Big 4 firms, or familiarity with the brands.

- supply-side barriers, including:

  - tender costs that are, in our view, too high for non-incumbent non-Big 4 firms to justify. These are more easily absorbed by the larger firms because of their inherent scale, incumbency and their greater likelihood of securing a mandate. In addition to direct tender costs, firms must invest in relationship-building activity with company managers who are influential in auditor appointments;

  - the relative infrequency of tenders, with few chances to win business and little return from investments in bidding processes;

  - an emphasis during tender processes upon experience in auditing large companies, resulting in a self-reinforcing cycle of Big 4 appointments;

  - greater regulatory, financial and reputational risk involved in conducting audits for larger companies; to the firm and the responsible individual. This is a more serious concern for non-Big 4 firms, as potential sanctions imposed by the FRC are not proportionate to the size of the sanctioned firm; and

  - the risk that in securing audit work, conflicts of interest will bar a firm from securing more lucrative advisory work.

5.4 Grant Thornton felt unable to compete effectively in this market, despite the fact that we carefully selected and responded only to tenders which we were well placed to win. We sought mandates that were aligned with our technical and geographical strengths and sector expertise, but found that the current UK FTSE 350 audit market was not viable for a non-Big 4 firm. While we can focus our operations elsewhere to good effect, we suggest that the public interest would be better served by a more dynamic UK market for PIE audits with more than four credible firms.

5.5 Notwithstanding our recent decision not to tender for FTSE 350 companies, since audit tendering became a requirement we have not sought to compete for audits for the very largest companies within the FTSE 100, which, in the absence of shared-audits, may genuinely require the extended global network of the Big 4 firms. For these very large companies, we think the CMA has correctly identified the key market features that may limit their choice of auditor.

6. ***In particular, how effective is competition between the Big 4 and between other firms and the Big 4?***

6.1 We are not well-placed to comment upon competition between the Big 4. However, in terms of the UK market for audit to large companies there is effectively no meaningful competition between the Big 4 and other firms. For reasons touched upon above, which are both structural and behavioral in nature, the Big 4 and other firms simply do not compete on a level playing field; to our view many tenders are conceived as 'Big 4-only' processes, or, if non-Big 4 firms are invited to tender there is no realistic prospect of their appointment.

7. ***How has this changed following the Competition Commission's intervention?***

7.1 We are aware that there has been an increase in tender processes following the CC's intervention. However, we consider that this has done nothing to address levels of concentration in the market, as the CMA notes in the ITC: the Big 4 auditors accounted for 97% of FTSE 350 audits by volume in 2016/17, compared with closer to 95% at the time of the CC's report.[6]

[6] FRC report, '*Developments in Audit 2016/2017*', p.6

7.2 Even more importantly, we note that the FRC has expressed concerns that audit quality within the Big 4 last year fell, particularly in respect of FTSE 350 companies[7]; whilst at the same time the four mid-tier firms which the FRC reviewed showed improvements in quality[8].

7.3 The largest of the companies can have severely reduced choice of auditor (among the Big 4) by explicit or implicit conflicts of interest which the CMA outlines. The CC did not introduce any measures to promote joint or shared audit, which may help correct this issue.

8. ***What is the role for competition in the provision of audit services in delivering better outcomes (i.e. consistently higher quality audits)?***

8.1 Competition is a very important part of ensuring an effective UK market for the provision of audit, including provision of audit to large firms and PIEs.

8.2 Auditors of PIEs should be competing for the benefit of the public interest. However, auditors are appointed, reviewed and paid by the companies which they scrutinise. This distorts the aims and the results of the competition. It is important that there is robust and effective competition between firms offering the provision of audit to ensure that the PIE company – and its various stakeholders – obtain the best outcome.

8.3 Competition could help achieve high quality audits through:

- ensuring that a large number of audit firms are available to companies seeking to appoint a firm; and that, if one of those firms does not deliver what that company needs, there are sufficient options to switch;
- modernising tendering and creating contractual incentives to strengthen professional scepticism, promote independent challenge of management and value quality as part of the appointment criteria;
- introducing innovation through constantly evolving new technology and good practice; and
- introducing fresh perspectives and diverse professional opinions.

8.4 All of the above should contribute to audits being carried out effectively and to the highest quality.

9. ***In practice, how much choice do large companies and PIEs have in the appointment of an external auditor?***

9.1 UK PIEs do not have enough choice in terms of the appointment of an external auditor. Even where supply side barriers to entry are not present and an auditor from a wider group than the Big 4 is available and capable to provide audit services to a company, demand side barriers to entry mean that a company is unlikely to appoint them.

9.2 Moreover, for the UK's largest companies seeking to choose an auditor from the Big 4, the explicit and/or implicit conflicts of interest (which have been identified by the CMA in its ITC) mean that the number of firms from which a company can choose may actually be fewer than four. This is a concern as the largest companies, from a public policy perspective, should have access to the best quality audit.

9.3 This is very unlikely to lead to the best outcomes in terms of robust and high-quality audit processes.

[7] For 2017/18, 73% of FTSE 350 audits reviewed by the FRC required no more than limited improvements against 81% in the prior year; as announced in the FRC's press release '*Big Four Audit Quality Review results decline*', 18 June 2018, available at https://www.frc.org.uk/news/june-2018/big-four-audit-quality-review-results-decline

[8] The results of the FRC's reviews of individual audits for Grant Thornton in 2017/2018 showed improvement from 2016/17, whilst the FRC also reported progress in revisions to Grant Thornton's policies and procedures in response to the revised Ethical and Auditing Standards; see the FRC's paper '*Developments in Audit 2018*', p.49

10. ***What are the key factors limiting choice between auditors?***

10.1 We agree with the CMA's description of factors which limit the choice of auditors to a UK PIE. We note that mid-sized and smaller UK companies have a much greater (and we think sufficient) choice of auditors.

10.2 The range of companies is wide and diverse and so the choice available to different PIEs varies:

- the very largest companies in the FTSE 350 currently have the least choice available to them. They are likely to be the companies which may require the scale and geographical reach which only the Big 4 can offer. However, because some of the Big 4 may already provide these companies with (more profitable) advisory work, in reality, their choice of possible auditor may actually be less than four firms. In certain cases, there may be only one firm to which they can turn for audit services; Carillion was an example. We will be interested to understand the extent to which this observation is supported by data that the CMA gathers;

- we consider that there is a real opportunity to increase choice in relation to smaller FTSE 350 companies. This is because these companies have opportunities to access non-Big 4 auditors and, intuitively, would have fewer conflicts with Big 4 firms. Appointing a non-Big 4 firm in these circumstances is realistic and we believe this is where the most impactful market interventions should be targeted. Currently options available to these companies may be limited by the fact that, although capable of serving these companies, mid-tier audit firms may be deterred from responding to invitations to tender due to the cost of those processes and the perceived unlikelihood of securing a mandate.

11. ***What are the main barriers to entry and expansion for non-Big 4 audit firms?***

11.1 A number of barriers in the UK market restrict the ability of non-Big 4 firms to expand into and compete for FTSE 350 audit appointments. A number of these buy-side barriers may, we suggest, be addressed by an 'independent appointment' remedy.

Scale

11.2 These include:

- tender costs are very high and difficult for non-Big 4 firms to justify, based on historical success rates;

- infrequent tenders give non-Big 4 firms limited opportunity to penetrate the market and recover the costs of building capacity;

- firms are exposed to the risk of failure and resulting sanctions, which are not proportionate to firm size and have an outsized effect on non-Big 4 firms;

- mid-tier firms seeking to grow by acquisition may struggle to maintain audit quality derived from firm-specific knowledge or processes, whereas organic growth is slow;

- providing audit services to larger companies requires additional specialisms;

- if a large company has sudden difficulties, it may need the capacity of a Big 4 firm to meet short, unplanned, deadlines; and

- recruitment and retention of audit staff including responsible individuals who take personal risk is more difficult for non-Big 4 firms, who cannot consistently match the levels of remuneration offered by Big 4 firms.

Opportunity cost

11.3 These include:

- engaging in expensive and unsuccessful FTSE 350 tendering processes represents an opportunity cost to the firm, as the time and cost of tendering could have been invested in winning mid-market audit mandates or advisory work in all markets; and

- audit firms may be put off competing for FTSE 350 appointments as this can exclude a firm from potentially securing more lucrative and potentially lower risk (though more uncertain) advisory work.

Bias towards Big 4 firms

11.4 These include:

- Big 4 firms have greater brand awareness and reach (via other services and pre-existing relationships);

- Big 4 alumni dominate audit committee Chair and Chief Financial Officer positions;

- there is a perceived 'prestige' in retaining a Big 4 firm; and

- a focus upon large audit experience in tender processes creates a cycle of Big 4 appointments.

12. ***Is there a significant risk that the audit market is not resilient? If so, why?***

12.1 Grant Thornton considers that there is a significant risk that the audit market is not resilient. The most significant risks to the PIE audit market lie at each end of the FTSE 350.

12.2 At the top end of the FTSE 350:

- there is limited audit competition, as only the largest audit firms can respond, some of the Big 4 may be conflicted and joint or shared audit solutions that might serve to mitigate those concerns are not being used;

- there are risks to auditor independence arising from appointment models in the UK, overlong audit tenures and potential conflicts arising from sales of non-audit services; and

- any Big 4 firm withdrawing from the market would have an outsized effect, as the largest companies require large human resource to perform audits. Particularly where other Big 4 firms may have conflicts issues, we query whether the market would have the capacity to take up the slack, following a Big 4 firm exit.

12.3 If a Big 4 firm exited the audit market, the remaining three would be unlikely to prioritise less profitable audits at the lower end of the FTSE 350, particularly where taking on that appointment might exclude the firm from securing an audit mandate from a higher value competitor.

12.4 There may also be positive market outcomes following the exit of a Big 4 firm, including:

- more open-minded audit committees, who are more willing to consider non-Big 4 appointments and may take a more positive view of joint and shared audit; and

- greater urgency to seek reforms that build capacity within non-Big 4 firms.

13. ***What is the appropriate balance between regulation and competition in this market?***

13.1 We think that the market for audits to PIEs currently requires relatively high levels of regulation, in part for the public interest nature of the work and in part to compensate for the ineffectiveness of competition (as discussed above). An independent appointments body for a section of the UK FTSE 250 could focus more closely and consistently on quality at the appointment stage. In this scenario, we suggest that competition between auditors could serve to drive higher levels of audit quality.

13.2 Regulation is important in maintaining minimum standards for audit, and we think has an important role in relation to UK PIEs, where public interest considerations should come to bear on the auditor's remit. Stronger competition (with quality as an effective parameter of that competition) would further promote high standards. We consider that a more competitive market for large company audits would be characterised by:

- rotation of auditors, recognising the value of fresh perspectives and diverse professional opinions;
- innovations, in both technology and working practices, as auditors seek to stand out from a wider group of credible competitors; and
- competitive pricing, but not driven to artificially low levels through cross-subsidisation by advisory work and overlong appointments.

13.3 Whilst we think that greater competition will improve outcomes for the range of stakeholders in UK PIEs, regulatory reforms are also needed to improve quality and the audit market's resilience. We have set out some recommendations for reform to the UK market in our response to the Kingman review to protect the public interest. These included proposals that:

- the FRC should be able to sanction company directors and audit committee chairs;
- while sanctions are important for accountability, the regulatory regime must drive learning and improved practice. Sanctions should have some proportionality to the size of the auditor firm;
- the regulatory regime should explicitly recognise that audits of PIEs serve a wide range of stakeholders: including employees, pensioners, suppliers and customers. A public interest objective should be at the heart of an independent appointment process; and
- the regime should disincentivise elements that might compromise independence, by restricting non-audit fees[9] from PIE audit clients and increasing the frequency of tendering and rotation of audit contracts.

14. ***Please comment on the costs and benefits of each of the measures in Section 4 and how each measure could be implemented.***

15. ***Are there any other measures that we should consider that address the issues highlighted in section 3? If so, please describe the following: a) aim of the measure, b) how it could be designed and implemented, and c) the costs and benefits of each such measure.***

15.1 For responses to questions 14 and 15, please see Annex 2, attached. This considers the costs and benefits of the measures in Section 4 of the ITC and suggests further measures that the CMA should consider to address the issues highlighted in Section 3 of the ITC.

Joint and Shared Audits

15.2 Further to the analysis provided at Annex 2, Grant Thornton considers that joint audits for UK PIEs would help to address certain CMA and public interest concerns, particularly if implemented in conjunction with other remedies such as independent appointments.

15.3 We acknowledge that joint audits have been resisted by industry in the past. Common criticisms have included that previous efforts to implement joint audits in the UK have been ineffective and that joint audit can lead to a duplication of audit work (and cost).

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[9] 'Non-audit' and 'audit' services must be appropriately defined. Certain services which are currently defined as 'non-audit' are complementary to the provision of high-quality audit. Any 'ban' on firms receiving non-audit fees from such clients would need to be carefully scoped to ensure that these positive services are not proscribed. We would happily engage further with the CMA in developing a definition of 'audit' that captures the relevant attendant services.

15.4 Nonetheless, joint audit has a number of positive aspects. In particular, joint audit can create better quality audits by combining the complementary technical expertise, sector insight, experience and geographical reach of two or more audit firms. Joint audit could also create options for the largest companies, who, for reasons discussed above, may otherwise have very restricted choice of auditor. Joint audit may also create opportunities for non-Big 4 firms by challenging supply-side barriers to entry and giving firms more experience of large company and PIE audit work, making them more competitive participants in future FTSE 350 audit procurement. In sum, these positive aspects of joint audit may also improve resilience in the market.

15.5 We are of the view that costs related to the use of joint audit can be outweighed by these benefits and mitigated or eliminated through design. Concerns around duplication of work and cost stem, we think, from a view of joint audit consisting of two firms conducting an audit and jointly signing-off group accounts. A more effective model (and one that is closer to the model operated to good effect in France) might be termed 'shared audit'.

15.6 A shared audit model enables work to be divided and shared. This can be organised in a sensible way depending upon the audit requirements, including by risk area, subsidiary and geography etc. However, there is scope for overlap where useful, for example in relation to particularly complex matters or operations for which an entity might seek a contribution from each joint auditor. During an audit tenure there can be periodic rotation of audit procedures, meaning that some elements can be approached with 'fresh eyes' and an audit is not reliant upon an auditor identifying their own past oversights.

15.7 A shared audit model has been implemented successfully in the French market. There is no clear empirical evidence that this has led to any increase in costs to business. The French audit market is, however, the least concentrated in Europe, with Mazars and our French affiliate firm acting as credible competitors to the Big 4. We understand that public perception of and trust in audit is greater in the French market, whilst there are fewer instances of significant company failures. Overall, the system appears to serve the public interest well.

16. ***One way to create audit-only firms would be through separate ownership of the audit and non-audit services practices of the UK audit firms. Could this be effective, and what would be the relative scale of benefits and costs?***

16.1 As noted above, Grant Thornton does not support the separation of ownership of audit and non-audit service practices of UK audit firms. We think that there are a number of positive features of having firms with both capacities and are sceptical as to whether there would be any material benefit in splitting out the firms, whilst we suggest it would be difficult to achieve on a UK-only basis.

16.2 Benefits of firms offering both audit and non-audit services include:

- efficiencies being generated across full-service firms, whereby access is gained to non-audit sector and field specialists, who may be required infrequently for audit mandates, but are able to contribute valuable skills and knowledge where relevant; and

- the ability for firms to offer a wider range of professional opportunities to attract greater talent, as well as enhancing the breadth of the training provided to individuals.

16.3 On the other hand, we do not think that the creation of audit-only firms would solve the systemic issues in the market. It is unlikely that separating UK ownership would improve competitive conditions in the market; the concerns we have outlined above, which prompted our withdrawal from the audit market for FTSE 350 companies, would remain, but in respect of an 'audit-only' Big 4.

16.4 Some issues may be exacerbated by an 'audit-only' market. With firms entirely dependent upon audit revenue, independence and incentives to challenge audit clients may be further eroded (and the principal-agent concern more entrenched). There may also be unintended consequences for businesses outside the FTSE 350. Mid-market and smaller companies benefit from looking to auditors for a more holistic service that encompasses wider services and advice, while separate procurement of audit and non-audit services may also be commercially unrealistic and onerous for these companies.

16.5 The full separation of UK audit and non-audit companies would be costly and time-consuming to implement. It would also be excessive in light of the more moderate (but arguably equally effective) remedies available to address 'conflicts' issues, such as banning advisory sales to PIE audit clients.

16.6 Ring-fencing of the audit business as a separate economic entity within firms that audit PIEs has been proposed as a solution to conflicts of interest. We see this as challenging to implement and monitor, as well as being a weak response to the concern around conflicts; one that is also unlikely to mitigate the perception of conflict. A simple ban on selling properly and carefully defined non-audit services to PIE audit clients would be more effective and transparent. In addition, whilst Big 4 firms may receive sufficient PIE audit business to justify a ring-fenced audit practice, we consider that such arrangements could have the consequence of excluding non-Big 4 firms from the PIE audit market. This is because the audit portfolios of Non-Big 4 firms more heavily reflect non-PIE companies who benefit from full-service teams and whose ability to prosper would be diminished if they could only access the ring-fenced audit services of a firm. The likely exit of non-Big 4 firms as a result of ring-fencing requirements would protect concentration and undermine competition in the PIE audit market.

17. ***How do the international affiliations of member firms affect the creation of audit only firms? What is the extent of common ownership of audit firms at the international level?***

17.1 The creation of an audit-only UK firm within our international network would be difficult to operate. Grant Thornton is part of a global network of affiliated companies. That network is sustained through common practices, standards and interests. Our management and leadership structures would need to change to account for an audit-only practice in the UK.

17.2 However, there is no global holding entity for Grant Thornton. Ownership of each member firm is entirely independent. Although it would be difficult (and, for reasons set out in response to question 16, undesirable) to adopt an audit-only model in the UK, we think it would be possible. Our international network is already accustomed to serving audit markets with diverse regulatory and competitive environments.

17.3 Other large international networks may have greater corporate integration. An audit-only carve out in the UK may be more challenging for those firms to implement.

17.4 However, as we state above, we do not consider that the creation of audit only firms is necessary. Such a remedy might have unintended consequences in terms of the effectiveness of audit that firms are able to offer; and the issues of conflict which such a remedy would be seeking to address can in our view be resolved through other less excessive measures.

18. ***What should be the scope of any measures restricting the provision of non-audit services? For example, applying to the Big 4 only, the Big 4 and the mid-tier audit firms, or any firm that tenders for the audits of large companies and PIEs?***

18.1 We recommend restricting the provision of services to PIE audit clients in the UK, other than those that are strictly necessary to complete an audit or that closely complement the audit. Services currently defined as 'non-audit', but which it is in the interests of stakeholders for auditors to provide, are[10]:

- reporting required by law or regulation to be provided by the auditor;
- reviews of interim financial information;
- reporting on regulatory returns;
- reporting to a regulator on client assets:
- reporting on government grants; and
- reporting on internal financial controls when required by law or regulation.

18.2 In the event of a restriction on non-audit services, these could be reclassified as 'audit' services. We do not consider that "*Extended audit work that is authorised by those charged with governance performed on financial information and/or financial controls where this work is integrated with the audit work and is performed on the*

[10] These points are drawn from a list of 'audit related services' set out at paragraph 5.41 of the Revised Ethical Standard.

same principal terms and conditions" should be carved-out from any ban (this is currently regarded as an 'audit related service'). This allows discretion and may undermine the effectiveness of a general prohibition.

18.3 As noted in response to question 16 above, we consider that full separation of audit and non-audit firms would not create positive outcomes, and, as a measure designed to reduce conflicts of interest in relation to audits to the largest companies, may have negative outcomes for mid-sized and smaller companies.

18.4 We suggest that few mid-tier firms would be willing to adopt the costlier 'audit-only' operating model for the purposes of serving some PIE clients. A likely outcome would be an increase in UK market concentration as mid-tier firms withdraw from the market for audit to large companies and PIEs.

18.5 Although we acknowledge concerns that some large companies face a limited choice of auditor due to other auditors being 'conflicted out', we consider that, for most of FTSE 350 companies and PIEs, this problem can be remedied by improving competitive conditions so that mid-tier firms provide credible audit alternatives. If the Big 4 were forced to split, their audit and advisory businesses would be freed of their respective conflicts of interest. This would simply reinforce their collective dominance of the relevant markets. As we explain at paragraph 16.4 above, creating 'audit-only' firms may also exacerbate the existing 'principal-agent' problem.

18.6 We think that concerns around conflicts can be better resolved through restrictions on the provision of audit and non-audit services to a single client (save for non-audit services that are necessary to perform the audit). We also believe that the creation of an independent audit appointments body, described below, could be used to authorise non-audit services, which would have the further benefit of addressing the inherent conflict within current arrangements.

18.7 We do, however, recommend that the definition of a 'PIE' is reviewed and potentially widened in the UK (as noted above). This should include whether the largest private companies should fall within the definition (based on size – say greater than 5000 employees – nature of an undertaking or number of employees etc.). This would reflect the reality of those companies' influence on a wider range of stakeholders. However, such a definition would have to be very carefully defined to capture companies with clear public interest implications (such as systemically important privately-held global businesses), without impinging upon the freedom that is deliberately afforded to support ambitious privately-owned companies.

19. ***How should the market shares be measured? - number of companies audited, or audit fees or some other measure?***

20. ***Could the potential benefits (greater choice, and resilience) of a market share cap be realised?***

21. ***What do you consider to be the relative scale of the costs of a market share cap, such as increased prices and potentially reduced competition, and potential benefits?***

22. ***What should be the appropriate level of such a cap, collectively for the Big 4 for the measure to achieve its objective? For example, 90%, 80%, 70%?***

23. ***Could a joint audit be an effective means of implementing a market share cap?***

23.1 We will take questions 19 to 23 together. As noted in the introduction to this response, we are sceptical as to whether a market cap will address the concerns that the CMA has identified in the UK audit market, at least when used in isolation, while it would be difficult to implement in an effective way.

23.2 We acknowledge that a market cap would necessarily reduce concentration in the large company audit market and the dominance of the Big 4. This may also allow non-Big 4 firms to invest in capacity and gain experience; enabling them to present themselves as more credible alternatives to the Big 4 in future tenders. However, a market cap would not address auditor independence (in a way that independent appointments, for example, might).

23.3 A cap would need to be very carefully implemented to avoid a scenario where the Big 4 take on the more attractive audits (with greater profitability and lower audit risk), leaving non-Big 4 firms to take on only risky, costly, complex and reputationally difficult clients.

23.4 We suggest that a market cap would require careful and graduated implementation. The following points should be considered:

- most non-Big 4 firms have particular areas of strength and specialism. A cap should be implemented in a way that would enable these firms to build upon their existing specialisms (organically or through acquisitions), with targeted investment enabling firms to provide effective competition in their preferred sectors. Investment could then be made in audit staff (including specialist staff) and key international locations;

- in order to be practicable and transparent, any cap should be designed by reference to volume rather than value of audit. Although this will not result in an effective distribution of audit income (the top 175 firms on the FTSE account for 94% of all FTSE fees), we think this would be more realistic to implement;

- for a cap to work, Big 4 firms will have to buy into its implementation. For non-Big 4 firms, say, to take on 20% of the market by the summer of 2019 there would need to be some assistance from the Big 4 in supporting the transfer of staff to undertake the work: but we do see this as being possible without destabilising audit quality; and

- based upon existing capacities and capabilities, we think it is currently realistic that non-Big 4 auditors could audit c. 40-50 of the FTSE 350 firms within a three- to four-year period.

23.5 We do support consideration of joint audits, as a supportive or stand-alone measure. Further explanation as to how these might be structured is included at paragraph 15.2 onwards, above. Joint audits offer more technical knowledge, quality, independence and a more dynamic market. We think joint audit can be particularly effective where auditors are selected by reference to their complementary specialisms. As noted above, joint audit is common in France and is encouraged by the regulatory regime. This does appear to have created a more dynamic and less concentrated market (the top four firms have only c. 47% of the market).

23.6 A shared audit remedy would be complimented by 'independent appointment' measures. We think an independent appointment body would be more willing to depart from current (conservative) audit procurement practice; and would be more open to joint-audit.

24. ***Should the auditors and those that manage them (e.g. audit committees, or an independent body as described in section 4) be accountable to a wider range of stakeholders including shareholders, pension fund trustees, employees, and creditors, rather than the current focus on shareholders?***

24.1 Yes. As we have noted above, we consider that PIEs have a wide range of stakeholders, and this should be engrained in auditor accountability.

25. ***If yes, should audit committees (in their current form) be replaced by an independent body that would have a 'public interest' duty, including for large privately-owned companies? Should this body be responsible for selecting the audit firm, managing the scope of the audit, setting the audit fees and managing the performance of the audit firms?***

26. ***Please describe the benefits, risks and costs of such an independent body replacing audit committees.***

26.1 Grant Thornton supports the creation of an independent body that would make audit appointments – particularly auditors to FTSE 250 companies. This, we think, is an important measure that would resolve a number of UK-specific buy-side issues that restrain effective competition in the large company audit market, whilst also addressing concerns around the independence of auditors; ultimately promoting audit quality and serving the public interest.

26.2 For PIEs, we suggest that the independent body should both appoint auditors and set audit fees. We agree that, in doing so, the body should have a public interest duty. However, audit committees need not be replaced in their entirety. Audit committees should instead have an enhanced role in continuing auditor performance management.

26.3 There are many models for how independent appointment might work. Our illustrative proposal was set out in a paper that was produced for the Kingman review**,** which the CMA may wish obtain and review. However, we think that there are various ways in which an independent appointments body could be successfully structured, with Public Sector Auditor Appointments Limited (the body that appoints auditors to local public bodies, including councils, police and crime commissioners) providing a useful case study. We think that this would be a particularly successful remedy when combined with shorter auditor terms (c. 5 years), mandatory switching after 10 years and initiatives such as shared auditing, as discussed above.

26.4 Risks and benefits are laid out at point 13 of Annex 2.

26.5 The consultation presents two further options: a new insurance model related to share price; and the creation of an independent 'NAO-style' national auditor which could replace the auditors of some or all of the large companies and PIEs (i.e. nationalise large company audit). Grant Thornton does not support either measure:

- there are many factors that inform share price and it would be exceptionally difficult to accurately link stock market performance with the quality of an audit, even when supported by judgements of the regulator. We consider that this insurance remedy would be unworkable for this reason, though we also suspect that audit costs would increase significantly if auditors were to be expected to provide a level of assurance that insured a company against deterioration in its share value; and

- we essentially agree with the each of the concerns raised against an NAO-style auditor, as set out at paragraph 4.51 of the ITC. We do not think that this is a realistic solution, nor one that stakeholders would support.

27. ***Should companies be required to tender their audits and rotate their auditors with greater frequency than they currently are required to do? What would be the costs and benefits of this?***

27.1 Yes. As discussed above, we consider that tendering is too infrequent to create a competitive market for audits to large companies in the UK market context, while overlong appointments undermine auditor scepticism and independence. Companies should be required to tender at least every five or seven years (as originally suggested by the CC), with mandatory switching after two consecutive terms.

27.2 The enhanced objectivity and independence of auditors, as created by such a change, will far outweigh the concern as to time needed to fully understand a client's business.

27.3 The consultation is mindful of increased costs presented by more frequent tender processes. We are of the view that these costs will be outweighed by the benefits:

- lengthier contracts may, over time, result in poor value for a client. Costs may be saved by more frequent reviews/appointments;

- the benefit of increased independence and higher quality audit, although more difficult to quantify, is likely to outweigh the cost of audit procurement; and

- we consider that reduced tender costs would be one of the advantages of independent appointment.

Grant Thornton looks forward to discussing these points and working with the CMA to take the necessary steps to increase competition and improve quality in the provision of audit to FTSE 350 companies in the UK and beyond. If the CMA has any specific questions on this submission and the responses given to the consultation questions, it should contact Jon Roberts, Grant Thornton's Head of Assurance, by email to Jon.Roberts@uk.gt.com.

THE FOLLOWING ANNEXES ARE ATTACHED AS SEPARATE DOCUMENTS:

ANNEX 1 – SHAPING A VIBRANT ECONOMY

ANNEX 2 – COSTS AND BENEFITS OF POTENTIAL MEASURES

ANNEX 1

VIBRANT ECONOMY

Grant Thornton
An instinct for growth™

Shaping a vibrant economy

A blueprint for the UK

June 2017

Contents

Section	Page
Our approach	04
What is a vibrant economy?	07
Trust	08
Growth	12
Place	16
The Vibrant Economy Index	20
What now?	22

The UK is at a pivotal point in its history

There are big macro issues to address. Technology is transforming industries, the nature of work is changing, we have to support an ageing population and transform our public services to meet changing needs. There is a growing trust deficit in society and many feel left without a voice. Thrown into the mix is the task of negotiating our future relationship with the European Union and new trade deals across the world.

There is also huge opportunity. Our economy has long-standing strengths: an innovative service sector, thriving creative industries and advanced manufacturing expertise. We are recognised for the integrity of our independent judiciary, the resilience of our financial institutions and regulators that enable us to play an important global role. As the fifth largest economy in the world we have longstanding, deep connections across the globe. These give us durable foundations upon which to build our future.

As we embrace these challenges and opportunities we need a clear vision of the UK's place in the world – where are our strengths and what will stimulate sustainable growth?

Over the past 18 months, Grant Thornton has brought together communities and leaders from across the UK to share their aspirations. We found that people from different sectors and places, of all political persuasions, have a common vision of an inclusive economy – one that is collaborative, open, trusted, connected and prosperous – where markets, businesses and places rediscover their purpose. We also found that people want to work together across traditional boundaries to achieve this.

Recent political events show that government and politicians, nationally and locally, must work together to reshape our economy as happened post-war where cross-party collaboration produced solutions that lasted for decades. Government cannot, and should not, do it alone. Businesses and other organisations have a big role to play and the ability to make a difference.

The ideas that follow draw from face-to-face engagement with over 1,000 leaders at our Live Lab events and numerous other constructive and insightful conversations. We have sought to bring to life the key components of a vibrant economy in the UK. In this blueprint, we have also described what we, in collaboration with others, are doing to make this happen, and have set out what we think government can do to help fulfil this vision.

By taking these first steps together, we can help build a positive future and a society that creates opportunities for all.

Sacha Romanovitch
CEO, Grant Thornton UK LLP

Our approach

Over the past 18 months we have been exploring how we can shape a vibrant economy in the UK.

We have convened discussions across the country, listening to people from the public, private and not-for-profit (NFP) sectors. Together, we and other participants have shared our appreciation of what is already working, our dreams for the future and our ideas about how we can collectively make change happen.

Reflecting on what we have learned, we believe that it is up to all of us to create our shared future. This is not something that could – or should – be the sole responsibility of any one organisation or person. Making this vision a reality means we will need to work together, drawing on all of our strengths.

Inspired by our discussions, we propose actions for both ourselves and for government to help shape a vibrant economy, focused on the three key areas of: trust, growth and place.

Our vision is of a UK that is collaborative, open, trusted, connected and prosperous. Our journey starts now.

We have engaged with

Our clients including...

Businesses (large and small)

56%
Advising over half of the FTSE 100

Leading independent nominated adviser to AIM listed companies

The public sector

>50%
Working with over half of local authorities and the NHS

The largest provider of audit and related services to the sector

Not-for-profits

1000+
NFP clients

Working with universities, charities, housing associations and colleges

With a combined workforce of over six million people

The broader community including...

Over 1000 participants
With leaders from businesses, entrepreneurs, the public sector and NFPs.

By initiating Live Labs in seven regional cities
Live Labs bring communities together to collectively suggest practical steps to address the big issues affecting their region.

- Sheffield
- Reading
- Manchester
- Leeds
- Bristol
- Cambridge
- Birmingham

We have also...

Published new insights
Developed with partners including **FiftyThousandHomes, SOLACE, the RSA** and **Social Market Foundation**

Established an advisory board of leaders – the Vibrant Economy Commission
Who are passionate about building a vibrant economy

Hosted roundtables and events on issues including...

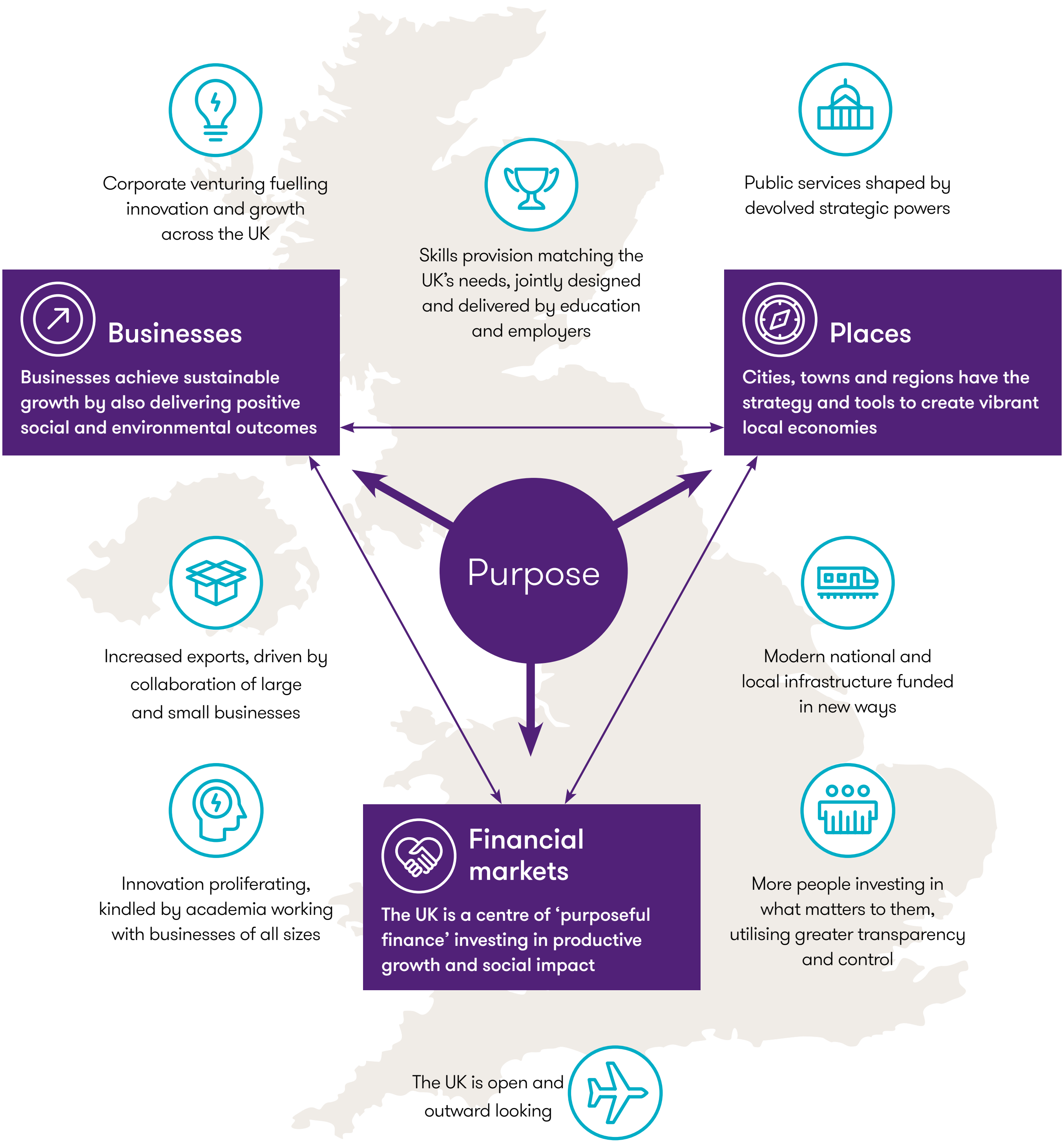
- Brexit
- Skills
- Health
- Fintech
- Trust
- Housing

“We have brought together communities and leaders from all sectors throughout the UK to share their dreams of a vibrant economy.”

Sacha Romanovitch, CEO,
Grant Thornton UK LLP

What is a vibrant economy?

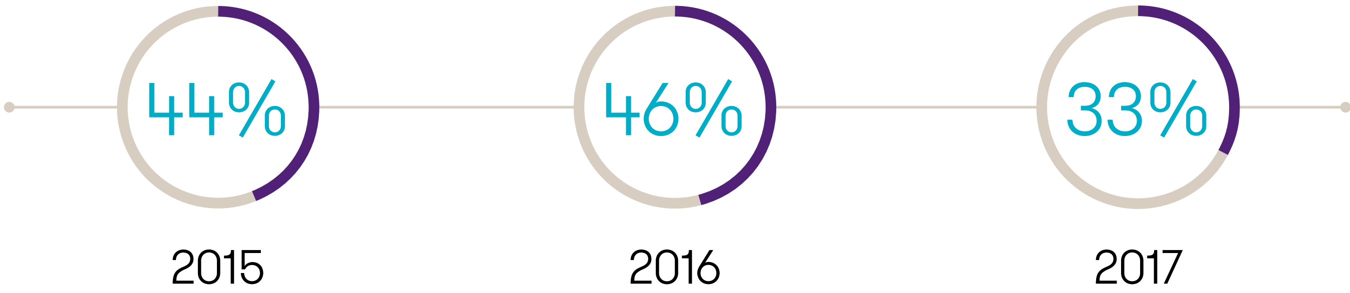
Collaborative. Open. Trusted. Connected. Prosperous.



Trust

UK snapshot

Trust in business is falling



Source: Edelman Trust Barometer

A growing role for 'profits with purpose'

46%

of people would like their pensions invested in organisations that reflect their social and environmental views

Source: Big Society Capital

£130bn

additional corporate value could be created by putting 'visionary purpose' at the heart of British business

Source: The Big Innovation Centre

The importance of business

31.95m

Provides work for 31.95 million people

Source: Office for National Statistics

£205bn

Contributes 30% of the UK's tax receipts

Source: Confederation of British Industry

Unleashing purpose in business and financial markets

Trust and integrity are the heart of a vibrant economy. They provide the basis for adoption of innovative products and services, higher productivity, investment and a 'licence to operate'.

We need a systemic approach to restoring trust. In the short term, corporate governance can help by strengthening engagement, accountability and transparency. Reform of our tax system is also essential. We need to tackle the complexity and anachronism that make it harder for people to know how to do the right thing and easier for aggressive, artificial tax avoidance schemes to operate.

In the longer term, we need a shift in business models from:

- the primacy of profits to a focus on achieving a wider purpose
- regulatory compliance to sustainable business culture
- a focus on speculative investment to a financial system where UK savers invest in line with their values.

Business is part of a reinforcing system where all prosper

This is a shift from delivering shareholder value solely through profits. This means moving to a model where value is realised through a combination of profits and the benefits the business brings to the complex social, economic and environmental system in which it operates.

An increasing number of businesses (including Ella's Kitchen and ATKINS) recognise that business success and societal progress go hand in hand. Addressing society's wider challenges is a very effective way for a business to stay relevant to customers, **delivering profits with purpose**. This helps to provide long-term shareholder value and to mitigate future risks in the business environment.

People want to use their savings to support this. The UK financial services sector already has strengths in impact investing (generating a social or environmental benefit as well as financial return) and scaling up this approach could consolidate the UK as a global centre of excellence.

Government has a unique opportunity to champion this trend, transforming financial markets and business models in a way that drives sustainable growth and reconnects society and business.

Recommendations

Champion profits with purpose as the new normal

Government's aim should be to move to a situation where the majority of businesses in the UK deliver wider social and environmental outcomes, as well as profits. This would be supported by impact investing becoming a mainstream retail product, allowing UK savers to decide what societal or environmental outcomes they want their savings to achieve in addition to providing a financial return. To accomplish this government should:

- **fully utilise the Social Value Act and public procurement** to ensure all government contracts are with businesses that actively make a positive contribution to society
- **promote full understanding and application of existing directors' duties under Section 172 of the Companies Act** (to have regard to employees, suppliers, customers, the community and environment)
- **support continued development and adoption of integrated reporting** and other tools for business to report in a comparable and verifiable way on social and environmental as well as financial outcomes. This in turn will support the development of mainstream impact investing
- **scale up impact investing** by supporting upcoming reports by the UK National Advisory Board on Impact Investing and by Elizabeth Corley, on how individual investors can be given more choice to invest their savings in businesses and organisations with purpose
- **work with institutional investors to identify and tackle regulatory and other barriers** to investing in UK businesses and infrastructure (such as investment risk profiles and restrictions on pensions investing in private companies).

"This very much aligns to Pukka Herbs' vision of improving the quality of people's lives, rather than simply making money. I very much agree that we all have a duty to contribute to society and the environment, using business as a positive force for good."

Edward Gardiner, Pukka Herbs Ltd

"Most of the $75 trillion global savings that fuel capital markets are owned by ordinary citizens. Those savers are workers and consumers, who depend on public services. The gains they make from their fund manager focusing on financial returns can be eroded if their savings are invested in corporations that maximise profits by minimising their tax obligations, wages and consumer value and fail to tackle climate change. The opportunity is for financial markets to redefine themselves as a way for savers to control the companies that control their destiny."

Saker Nusseibeh, CEO
Hermes Investment Management

Grant Thornton will work with others to...

Continue to celebrate businesses with a purpose, through our Faces of a Vibrant Economy and the work of our Vibrant Economy Commission.

Develop open-source tools, with not-for-profit organisations, to support businesses who want to adopt 'profits with purpose'.

Develop ways in which business can measure and report on impact. This includes working with Future-Fit (futurefitbusiness.org) and their development council (including Eileen Fisher, De Beers, Novo Nordisk and The Body Shop) to help develop their framework for reporting on social and environmental impact (linked to the UN Sustainable Development Goals). We will also develop an assurance process to enable Future-Fit progress and data to be incorporated into company reports.

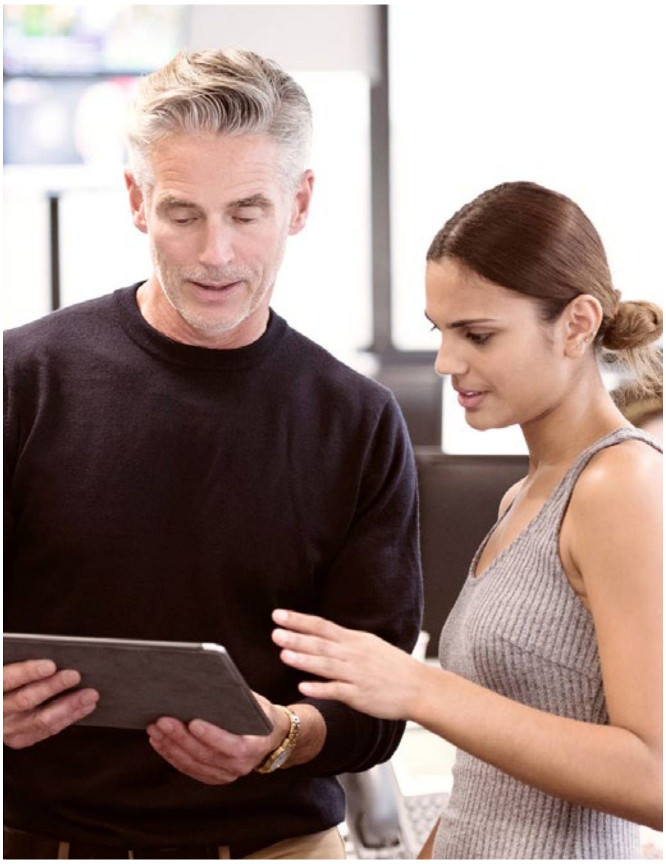
Champion tax simplification, which can build trust by providing greater transparency and certainty around corporate tax. We will also continue to support the Covi Responsible Tax Lab (covi.org.uk) and help develop the Future-Fit 'responsible tax' goal, to provide a benchmark for any company wishing to adopt an ethical and responsible tax strategy.

Our experience

We advise over 56% of the FTSE 100 and for the last fifteen years the Grant Thornton Governance Institute has conducted an annual, comprehensive analysis of FTSE 350 annual reporting.

In 2015 Grant Thornton UK adopted a clear purpose: to help shape a vibrant economy for the UK – explicitly recognising the role we have to play beyond simply achieving a profit.

We have also begun our journey to becoming a shared enterprise, where all our people have shared responsibility for the organisation and shared rewards.



Growth

UK snapshot

Approximately only
11%
of firms currently export

£543bn
total exports in 2016

Top global export destinations for UK goods in 2016 were:

15%	11%	6%	6%
USA	Germany	France	Netherlands
£47bn	£33bn	£19bn	£19bn

Source: Office of National Statistics

Young adults who had four or more interactions with employers at school are:

5×less
likely to be NEETs
(Not in Education, Employment, or Training)

and earn

16% more

Source: Education and Employers Taskforce

43%
increase in reported skills shortage vacancies since 2013

Source: FullFact 2016

£244bn
is the amount of cash the UK's largest corporates are holding on balance sheets

Source: Grant Thornton UK LLP

£3.6bn
is the total equity investment in UK firms in 2016

Source: Beauhurst

Putting collaboration at the heart of the UK's industrial strategy

In the face of ever-accelerating global and technological change, the government's industrial strategy should provide a long-term plan for domestic and international growth. This should aim to unlock the full potential of the UK as a positive contributor to a global economy.

Strong evidence exists that innovation and exporting deliver the improved business performance we need, enabled by workforce skills, investment and 'openness' to working with external partners (Enterprise Research Centre white paper, 5 April 2013). The government's industrial strategy should therefore focus on boosting these areas. Our discussions tell us that collaboration will be a powerful catalyst for delivering the results we want.

From our discussions it is clear that businesses see other businesses as their best allies to grasp this opportunity.

A 'Fourth Industrial Revolution' is taking place, where every part of the economy and society will transform through the application of technology and digital networks, fusing physical, digital and biological worlds. In this environment, collaboration can help smaller businesses to scale-up and larger businesses to innovate. Corporate venturing can boost this, with larger corporates investing some of their balance sheet in partnerships to scale-up smaller UK businesses.

Businesses and public services want skills gaps addressed as a matter of urgency. Technology is changing the nature of work, meaning that many of the jobs our children will work in do not exist today and we need to plan for this.

When we talk to employers about the actions needed to address skills shortages, they invariably focus on employer engagement with education and training, as well as immigration policies, being core to the solution.

Recommendations

Incentivise collaboration to boost exports, develop skills and unlock innovation

Government needs to champion a strengthening of our economic foundations for future growth. The core elements are the creation of a strong exporting culture, a healthy pool of skills and talent for businesses and public services, and innovation that puts the UK at the forefront of the 'Fourth Industrial Revolution'. Government should kick-start action to:

- **grow a new collaborative model of exporting** – that allows smaller firms to leverage the existing distribution channels and trade agreements of complementary larger exporters. This should be reinforced by introducing a new tax credit for the cost of researching and entering new markets
- **incentivise collaboration between employers and education** – including creating a new school performance measure for every pupil to have at least one interaction with an employer every year; and encouraging graduate-level apprenticeships, eligible for apprenticeship levy funding in universities with businesses involved in teaching courses
- **implement a sustainable immigration policy** – including post-study work visas, connected to local and sectoral needs for global talent and labour
- **support 'collab-innovation' activities** – that bring together universities, smaller start-ups, larger corporates and specific expertise to help commercialise and scale-up innovation. This should include a corporate venturing tax relief scheme, to incentivise collaboration, and the removal of tax and accounting disincentives.

"It is vitally important to develop an education system that prepares young people to drive a vibrant economy forward. UK business, large and small, needs to advise on their future requirements and help reimagine an education style that creates inquisitive, problem solving, team-playing, engaging young people."

David Wallace, Stratford Upon Avon School

"I believe exporting and doing business internationally have a direct impact on competitiveness and productivity. Matching a big company's experience with the ambitions of a first time exporter will lead to a win-win for both, and the economy as a whole."

Danny Lopez, Blippar

Grant Thornton will work with others to...

Further develop our centre of excellence in exporting, specialising in strategy, finance and operational delivery, connecting businesses to key trade destinations and promoting global opportunities. By 2020, at least 20% of our people will have expertise in international trade.

Roll out our School Enterprise Programme across the UK, enabling year 7 and 8 students to run their own business and develop financial literacy and entrepreneurial skills.

Work with Touchpaper, a new not-for-profit network promoting collaboration between large corporates and start-ups, alongside other founding members: Bristows, Capgemini, Digital Catapult, Google, Multiple, Nesta and Tech City.

Our experience

At Grant Thornton UK we work with over 40,000 privately held businesses, public interest entities and individuals nationwide.

Grant Thornton member firms operate in over 130 countries, linking our clients to advisers around the world.

We advise clients on how to unlock growth in domestic and international markets.

As part of the government's apprenticeship programme, we have led the development of a business administration and customer management apprenticeship framework and we have recently launched a graduate level MBA apprenticeship with Cranfield University.

Place

UK snapshot

Britain's ageing population is growing fast

9.2m	11.5m	16.2m	
1995	2015	2035	2037

22%

of the population will be pensioners by 2037

Source: Office for National Statistics

The NHS budget has doubled

£54bn
1994

£96bn
2014

Source: NHS, Department of Health

Average London house prices as a multiple of average earnings

9.5×
in 2004

15.7×
in 2014

Source: Centre for Cities

Global ranking of infrastructure quality 2015–16

1. Hong Kong
2. Singapore
3. Netherlands
4. UAE
5. Japan
6. Switzerland
7. France
8. Germany
9. UK
10. Korea
11. USA

Source: World Economic Forum 2016

Equipping towns, cities and rural areas to create vibrant local economies

The UK economy has grown as we have recovered from the financial crash, but not evenly.

As we unlock sustainable growth, taking advantage of the benefits of globalisation and new technology, we must share this growth across the UK and give every place the tools to shape their own vibrant local economies.

The challenge is how to do this when current models of public services appear unsustainable. People are living longer, and an ageing population is putting increased pressures on local government (which spends 35% of its total funding on adult social care) and the NHS.

In order to achieve more for less, public services and infrastructure need to be looked at in the round: exploring issues from a place perspective and developing joined up strategies across traditional 'silos' to deliver integrated public services. This calls for much greater collaboration across the public, private and not-for-profit sectors – and we know from our Live Lab events that this is a priority.

Collaboration can provide the basis for innovation. For example at the moment, only 4% of the NHS budget is spent on prevention (70% is spent on treatment of long-term conditions). There is an opportunity for communities to address this imbalance by taking a holistic approach to health (creating healthier spaces and workplaces and tackling air quality) and using technology to provide more accessible, cheaper diagnosis and treatment for many routine issues.

Our Live Lab discussions identified infrastructure as one of the main priorities in every city. Local priorities include broadband, airport capacity in the North, housing in London, east-west transport links, and linking smaller towns to big urban centres. People are keen to find alternative ways of raising capital to invest in local projects alongside national infrastructure programmes.

Our work with clients has also identified that immigration and skills are central to the development of public services, infrastructure and strong communities. Debate on immigration in the UK is increasingly polarised. This is affecting individuals who have seen a rise in hate crime, employers who face increasing skills shortages in sectors like agriculture, care homes, the NHS and construction; and the communities who feel most impacted by immigration. The UK's approach to immigration needs to reflect local economic needs, community views and to reinforce our tradition as a tolerant society that strengthens our place in the world.

Recommendations

Continue to devolve powers from Brussels and Westminster to local areas, in ways that encourage innovation, collaboration and trust

Government should give cities and shires across the UK powers and frameworks to support collaboration on strategic issues and raise the finance for investment in their infrastructure priorities. These should include:

- **greater flexibility for local experimentation in models of leadership, governance and delivery of public services** – supporting different ways of enabling strategic decision making in and across shire counties as well as city regions; and collaboration between public, private and not-for-profit sectors
- **devolution to strategic local bodies of services and policies** – including immigration, skills, health and social care, housing, local and regional transport – with freedom to develop holistic solutions across these areas
- **giving local bodies the flexibility and freedom to support innovation and infrastructure investment** – including local bonds, borrowing and tax raising powers and the ability to experiment with alternatives to business rates.

“The more powers and budgets that are devolved from the centre, the better equipped the regions will be to successfully tackle the long-term complex challenges we face. Future investment must be driven by local priorities, collaboration and need. This is also crucial if we are to effectively deliver on the promises of the government’s forthcoming Industrial Strategy.

Greater collaboration and flexibility will empower the cities and regions to deliver a devolution dividend for the whole of the UK economy. In particular, greater control over the revenues generated by locally raised taxes – such as property and council taxes – would give local institutions greater incentive to drive investment and growth, and the means to fund it.”

Emma Degg, Chief Executive, The North West Business Leadership Team

Grant Thornton will work with others to...

Create a Place Based Leadership Academy, in partnership with Collaborate CIC and others, providing a platform for people to share information and work together to develop public services and shape cities, towns and communities. This will bring together public sector leaders with not-for-profit and private sectors, to support local strategies, financial management, data insight and leadership and culture development to deliver results.

Bring together public, private and not-for-profit sectors to uncover new ways to work collaboratively towards delivering solutions to London's housing pressures. This will include developing new analysis to better understand the areas that hold the greatest opportunity to increase housing supply.

Our experience

We work with over half of the local authorities and NHS bodies in England and Wales and more than 80 housing associations.

We advise on a wide range of infrastructure investments, including HS2 and the Welsh rail franchise.

Our Place Analytics are used by a wide range of organisations to understand the characteristics of local economies and support decision making.

Our offices in locations across the UK have been engaging dynamic organisations in debate about their local economies.

The Vibrant Economy Index

What gets measured gets done

Gross Domestic Product (GDP) has been the traditional measure for judging whether or not government interventions have delivered a successful economy. Policies are crafted to encourage higher rates of growth, and if GDP increases, this is applauded as a success.

This measure of progress oversimplifies entangled issues, masks regional differences and may allow governments to ignore actions where they could make a significant difference to the quality of our society.

We think that a successful economy is one that reflects more than just increased GDP – and that high prosperity levels are not a guarantee that the benefit will be felt across all parts of our society. A different approach is needed.

Last year, we developed the Vibrant Economy Index to try a new way of understanding progress in local authority areas in England.

The Index emphasises the local over the national, and recognises that different places will have different dynamics between the baskets (indicators). It clearly demonstrates that comparatively strong economic prosperity does not correlate to comparatively positive outcomes in other crucial areas.

We have discussed the Index at our Live Labs, and at other events across the country. Local authorities in particular have valued the greater insight into the economic and social dynamics of their area when considering their priorities.

This way of measuring performance gives a more nuanced understanding of where action needs to be taken, and whether it is having the desired impact. This approach could transform the way that areas shape their policies to drive progress, and measure whether they are on track to achieve it.

The Vibrant Economy Index is Grant Thornton's first step in systematically understanding the complex needs of local areas.

Grant Thornton will work with others to...

- refine the Index, taking advice from academics and others with the aim of giving a UK-wide picture
- develop a new way to understand what matters to people about the places where they live and work, refining our approach with input from the Vibrant Economy Commission and matching the responses with the reality measured through the Index.

The six baskets of the Vibrant Economy Index

Prosperity
We have an economy that is producing wealth and creating jobs.

Dynamism and opportunity
Our economy is entrepreneurial and innovative, with skill sets that can drive future growth.

Inclusion and equality
Everyone benefits from economic growth. The gap between richest and poorest narrows, regional disparities reduce and there are opportunities for all.

Health, wellbeing and happiness
People are healthy and active, leading fulfilling lives which provide individual prospects.

Resilience and sustainability
Our economy has a neutral impact on the natural environment and our built environments are resilient places we want to live in.

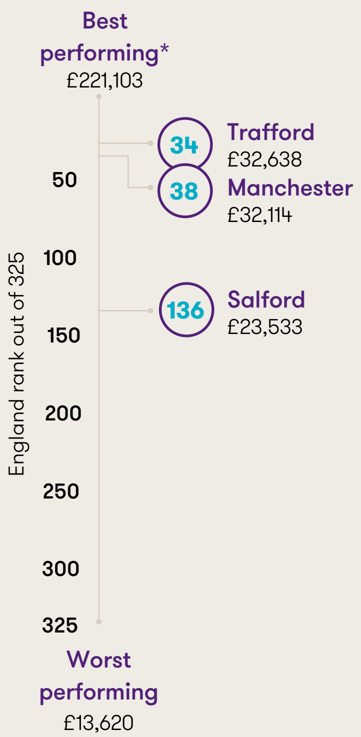
Community, trust and belonging
Vibrant communities have a lively and creative cultural life, and a clear identity that all its people are proud of.

Case study: Greater Manchester

The Greater Manchester region consists of ten local authorities, including next door neighbours Manchester, Trafford and Salford. Here we compare the different insights we have into how these three areas are performing using traditional measures of success (GDP/GVA) and the Vibrant Economy Index.

Current method: GVA/ GDP

GVA per head, 2015

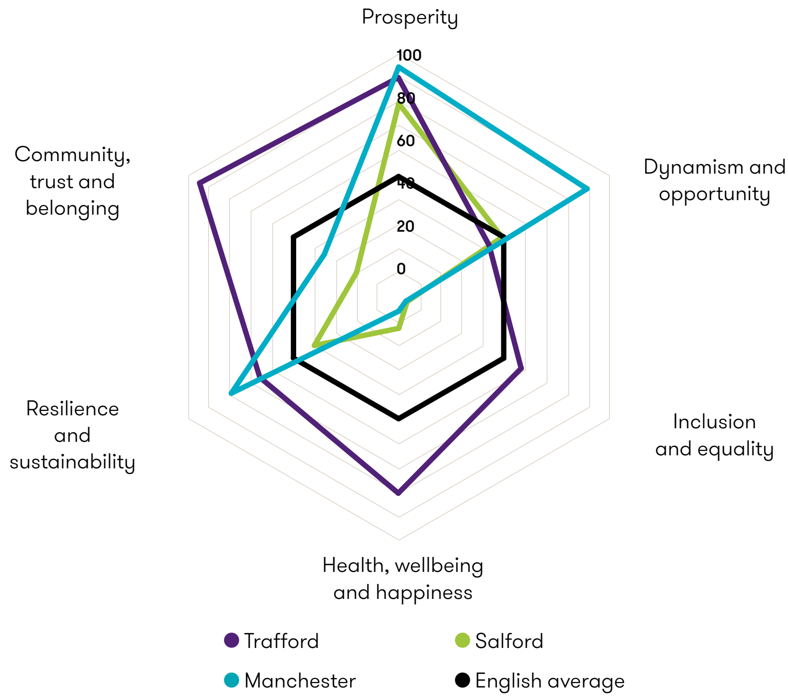


Looking at these three areas from a purely economic angle, using GVA per head, we can see that all three rank in the top half of all local authorities in the UK.

These results are mirrored in how each area scores against prosperity indicators in the Vibrant Economy Index, where each performs above the English average.

* We have excluded the City of London from this and the Vibrant Economy Index

Suggested method: the Vibrant Economy Index



When we introduce a broader range of metrics the full picture begins to appear.

This footprint shows that, although all three areas are doing well on the prosperity basket (which includes GVA), they have very different outcomes in others.

It is clear that high levels of prosperity do not generate consistently positive effects in other areas. Manchester and Salford contrast sharply with Trafford on almost all the other baskets.

This becomes even clearer when we make a comparison against the English average.

The dominant story in Manchester and Salford is that although prosperous, it is clear that significantly lower numbers of people than Trafford and the English average share equally in this wealth. In addition, people in these areas are less likely to live healthy and fulfilling lives.

The Index brings out the detail, supporting more sophisticated and focused policy.

Which do you think is better?

What now?

The next steps involve us working together

Have an idea you want to explore further?

Want to collaborate on any of our ideas?

Get in touch

Want to share your ideas more widely?

Join the conversation

@GrantThorntonUK
#VibrantEconomy

Sacha Romanovitch
CEO

Adam Jackson
Director of Public Affairs and Policy

ANNEX 1

An instinct for growth™

grantthornton.co.uk

EPI.1230

Annex 2 - Costs and benefits of potential measures

	Measure	Costs	Benefits
A	**Measures being considered by the CMA**		
1	Greater partial, or complete, restrictions on audit firms providing non-audit services to their audit clients	Clients would have to source non-audit services ("NAS") from alternative sources so costs could increase Loss of coordination between audit and complimentary NAS 'Partial or complete' would need careful definition and may lead to inconsistent practice	Promotes auditor independence Relationship is not distracted from audit issues Auditor judged only for audit quality – return to traditional approach where audit was valued
2	Prohibit audit firms from providing non-audit services not only to their audit clients, but also to any other large company or PIE	Firms will leave the market if they lose lucrative consulting work at large organisations Reduces the incentive for non-Big 4 to enter the large company audit market.	Audit is valued more by the audit firm – encourages investment in audit quality Non-Big 4 firms can grow into large corporate space if the Big 4 leave to concentrate on advisory work, potentially leading to less audit market concentration and more competition.
3	Split the UK arms of major accounting firms into audit-only and non-audit services practices	Complex for mid-market companies who value full service offering Big 4 audit firms remain so no impact to market concentration Non-conflicted Big 4 could dominate market even more than under current arrangements Difficult to achieve within global accountancy firms	Ringfencing could be a reasonable middle ground between banning NAS and splitting firms altogether but will lose some of the efficiencies of full-service firms All other benefits of 1 above

	Measure	Costs	Benefits
		Loss of access of some technical specialisms and restricting talent pool, potentially reducing audit quality. All other costs of 1 above	
4	Market share cap on the Big 4	The Big 4 would 'cherry pick' most lucrative/low risk clients Once caps have been reached by the Big 4 it would be difficult to hold meaningful competitions between non-Big 4 to ensure secured highest quality offer Non-Big 4 may not have the time to build requisite capacity	Quick and impactful way of changing market composition
5	Variations of joint and shared audits	Joint could be high cost and complex Non-Big 4 may not have capacity/skills to deliver joint audits at larger organisations Could lead to disputes over liability if audits are challenged	Works in other countries Effective at promoting independence Shared audits offer flexible alternative – easier for non-Big 4 to undertake and can avoid duplication of work/cost Takes advantage of complimentary specialisms
6	Direct support to the mid-tiers by the Big 4 and professional bodies	Buyers still likely to remain with Big 4 – little change to market Competition law issues could be complex Could lead to disputes over liability if audits are challenged	Longer-term improvements in quality anticipated

	Measure	Costs	Benefits
7	Reducing the barriers for senior staff to switch between audit firms	Remuneration levels are currently different so could destabilise arrangements at non-Big 4, making it easier for senior staff to exit Unlikely to address concerns around buy-side bias	Promotes knowledge transfer and builds capacity
8	Changes to the restrictions on the ownership of audit firms	Will be resisted by the firms Buyers still likely to favour Big 4	In the longer term could bring investment to support non-Big 4 to grow
9	Break up the Big 4 into smaller firms	Complicated to determine how the splits could be made – where would NAS sit etc? Difficult to achieve for global organisations – which organisation would be part of the group?	Immediate impact on market concentration
10	Improving the transparency around the tendering process	Unlikely to change anything as buyers content with current tendering arrangements	Blind tendering could address bias but tender details would be difficult to 'hide' whether the auditor was Big 4 or non-Big 4
11	Reforming mandatory tendering and auditor rotation	Buyers would still favour Big 4 More regular tendering may be more costly and potentially disruptive	More regular competition could free up the market over time and allow non-Big 4 firms to justify investments in capacity and capabilities Potentially strengthen auditor independence
12	Further strengthening audit committees and / or their links to shareholders	Buyers would still favour the Big 4 Less impactful than other measures	Improving independence. Giving shareholders greater involvement should help to align audit with stakeholder interests Compliments other measures suggested

	Measure	Costs	Benefits
13	Break the link between company management and auditors	Companies feel that only they (through audit committee) are best placed to appoint auditors and are likely to resist Procurement and monitoring arrangements could be complex and require an initial investment in national arrangements Requires mechanisms in case of disputes	Strongest solution to concerns over audit independence Works in other sectors Audit committee role is strengthened through greater independence Potential to take fee considerations away from companies to allow greater focus on quality and capacity of potential firms Audit Committee can focus on governance of the business as is not 'distracted' by lengthy and time-consuming tendering Approach can be applied flexibly to a proportion of the market Can work in tandem with other solutions – e.g. market cap, joint or shared audits Potential to consolidate tender processes may reduce sell- and buy-side tendering costs
14	An insurance-based system for audit	High cost Difficult to achieve with limited liability Amount of audit work increases to potentially unworkable levels Difficult to achieve when international arrangements are impacted	
15	An 'NAO-style' national auditor	Would take time to create organisation	Consistency of approach and standards

Measure	Costs	Benefits
	Loss of a competitive market could reduce incentives to compete on quality and price and therefore impair progress in both these areas Loss of partners and staff in the market who would leave for more lucrative employment and likely destabilisation of audit quality, particularly in very large companies	Accountability and 'public interest' credentials
16 Reform the audit framework	Will take time and international coordination to do properly Additional scope could be costly and would require liability concerns to be address	Essential that this is taken forward, to consider wider societal needs of stakeholders (beyond shareholder needs) and assurances around viability and fraud Would promote modernisation and development of technology