Think Ahead ACCA

Statutory audit market

A public consultation issued by the Competition & Markets Authority

Comments from ACCA to the Competition & Markets Authority
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www.accaglobal.com

Further information about ACCA's comments on the matters discussed here can be requested from:

Maggie McGhee
Executive Director, Governance

ACCA
+44 (0)20 7059 5000
info@accaglobal.com
www.accaglobal.com
The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

SUMMARY

ACCA welcomes the opportunity to comment on the proposals issued by the Competition & Markets Authority (CMA).

In addition to our responses to the specific questions asked by the CMA, we have suggested a number of additional areas that the CMA may wish to consider as it progresses its review. These are outlined below:

- Whether there should be a “cooling-off” period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity. This may help to allay public concerns that the auditor’s judgement in the final year of the audit relationship could be affected by the firm’s desire to sell consulting services to that entity in the following year. A cooling-off period of two years might be an appropriate balance between protection of independence and choice of service provider [Ref: CMA paragraphs 4.8(a) and 4.8(b)].
- Considering a prohibition on management from firing their auditors during their terms of service [Ref: CMA paragraph 4.31(b)].
- Whether there are non-regulatory ways of encouraging best practice among audit committees in ensuring auditor independence and audit quality [Ref: CMA paragraphs 4.31(a) and 4.31(c)].
- Whether an NAO-style national auditor could serve as auditor for certain Public Interest Entities or large unlisted companies and what it would take or this to be implemented [Ref: CMA paragraph 4.46(b)].

In order to avoid unintended consequences of action taken in haste, we would encourage that the CMA use its unique position to collect sufficient data and evidence to form a view of the market impact, cost and efficiency of proposals before concluding.

ACCA is currently undertaking a global study of public expectations of audit. The UK component of this work is being finalised and has collected the views of over 1,000 members of the public. We would welcome the opportunity to discuss the emerging findings and our response to the consultation with you in due course.

Our responses to the individual questions posed by the CMA are outlined below.

AREAS FOR SPECIFIC COMMENT:

A) Issues

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

We note that globally, rates of corporate failure are not substantially different to those in the UK. However, in most countries we do not see corporate failure being blamed on the audit profession. On a global basis, we conclude that the audit sector serves its stakeholders very well.

Within that, there are some very public cases of situations where audit has not functioned as well as stakeholders, including the general public, expect. It is right to enquire how audit quality can be improved in these cases. And it is right to explore how other elements of the financial reporting and corporate governance system can be improved too.

Theme 1: The audit framework

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

Taken as a whole, the audit framework appears to support the interests of direct shareholders and wider stakeholders. However, many stakeholders – auditors, company managers, board directors, audit committee members, investors, employees and others – contribute to the audit framework operating effectively. When considering options for change, it is important to consider the system as a whole.

In the vast majority of cases where audit has disappointed either direct shareholders or wider stakeholders, this has been as a result of a failure to follow the audit framework, rather than due to inherent weaknesses of the audit framework itself.

The FRC, as audit regulator and audit standard-setter, has taken action to improve the audit framework where it determines that this is in the public interest. In addition, changes can arise due to the actions of other parties, such as government, the European Commission/European Union or international standard-setters such as IESBA or the IAASB.

This is an area where further research into how audit committees interact with external auditors and with investors might help inform the CMA's views.

Theme 2: Incentives and governance

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

The European Union's changes to the EU Audit Regulation and Directive, which took effect from June 2016, gave audit committees of Public Interest Entities a central role in monitoring the quality and independence of external auditors. They were also given responsibility for managing the process for regular retendering of the company's external auditor.

The CMA should obtain evidence on the effectiveness of audit committees, through interviews with audit committee members and examination of audit tender documentation. As the competition authority, the CMA has privileged access to information and it should exploit this to obtain the information it needs. This information is likely not to be available to others. There may also be relevant data among the findings of the CMA's predecessor, the Competition Commission, during its 2011-2014 investigation into the statutory audit services market.

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

The 2013 Competition Commission intervention has largely been subsumed by the 2016 changes to the EU Audit Regulation and Directive. For example, the EU's 2016 changes were more wide-reaching in the obligations they placed on audit committees.

Theme 3: Choice and switching

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

Competition is a broad issue with many elements. We share the CMA's views on the nature of pricing in the audit market. While we do not see evidence of price-fixing in the audit market, nor are we aware of audit committees of Public Interest Entities either finding insufficient firms to compete in their tendering processes or prioritising low price firms over higher quality firms, we are conscious of the difficulties faced by non-Big Four firms in accessing the audit market for large listed companies.

An issue here is the impact of non-audit services on the independence of the incumbent auditor and future candidates for external auditor. The EU's regime of mandatory rotation has only been in place since 2016. As such, it may be too early to conclude how audit committees ensure there are sufficient candidate audit firms to run a meaningful audit tendering process. Over time, best practice may develop and become more widespread.

As referenced by the CMA, we believe the opinions of non-Big Four firms held by audit committees are important in affecting competition in the audit market. The apparent absence of pressure for change from investors is also a factor.

We also recognise that in some sectors of the economy, for instance banking, there may be a more limited choice of suitable firms who can audit certain companies, particularly at the larger end of the market. Concerns of criticism from a regulator – whether justified or merely perceived – may also influence companies to select from audit firms with a demonstrable track record (such as the Big Four) rather than smaller firms that may find it more difficult to prove their competence.

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

Competition between the Big Four remains high. However, there is clearly a perception, real or perceived and supported by the concentration of listed company audits among the Big Four, that other audit firms are not able to compete in the listed company audit market.

The cost of tendering for audits combined with a lower-than-expected success rate has led some other firms to state that they will no longer compete for FTSE 350 audit contracts. This is unlikely to be reversed unless opinions of audit committee members change and/or investors intervene more proactively in auditor appointments.

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

There have been no substantial changes to the regulation of Public Interest Entity audits following the Competition Commission's 2013 intervention. As noted above, the 2016 changes to the EU Audit Regulation and Directive have largely subsumed the Competition Commission's 2013 intervention. We do not believe this is enough time to determine whether the measures introduced by Competition Commission's 2013 intervention or the EU Audit Regulation and Directive have been effective.

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

We do not see a role for competition in the provision of audit services in delivering consistently high quality audits. We believe that much bigger factors in underpinning audit quality are the audit inspection regime of the FRC and its associated penalties, and the public opprobrium that follows company failure.

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

Large companies and Public Interest Entities have sufficient choice in appointing an external auditor. In practice, this choice may be limited by:

- The decision of the EU Audit Regulation and Directive to require mandatory firm rotation at least every twenty years. As a result, periodically the incumbent auditor will become ineligible for reappointment.
- A lack of independence of certain firms, as a result of having provided services to that entity which make that firm not independent for the purposes of the financial statement audit.
- The scope and reach of the audit firm's international network in comparison to the entity's international scope.
- A lack of specific sector expertise or resources in an audit firm or its international network.
- Commercial decisions taken by firms to not bid for a specific engagement or a category of engagements.
- The preconceptions of audit committee members about the scope, reach and expertise of a particular audit firm or its international network.

We are not aware of any UK-listed Public Interest Entity failing to attract sufficient bids for an audit tendering process.

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

As noted in paragraph 3.26(a), audit committee chairs of FTSE 350 companies view mid-tier firms as lacking the scale and/or credibility to be their company's auditor.

While some investor groups have expressed the view that they would like to see a wider pool of audit firms being used by FTSE 350 companies, this has not translated into action: either by pressurising audit committee chairmen to choose from non-Big Four firms or by exercising their vote in Annual General Meetings. This might indicate a revealed preference for other factors, such as scale and credibility, over having a wider pool of potential audit firms.

There is an urgent need for data here, to better understand what are the views of audit committee members, how those views are formed, how audit committees and investors interact and what drives investor (in)action at Annual General Meetings. The CMA should obtain any existing literature on these issues, including any evidence that may have been collected during the Competition Commission's 2013 intervention, and consider commissioning its own research where the evidence is insufficient.

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

Audit tendering processes are expensive, and are particularly expensive for non-Big Four audit firms, which tend to win disproportionately fewer of the audits they compete for than Big Four firms. In this context, we note that reducing the mandatory retendering or mandatory rotation period would be likely to favour Big Four firms and penalise other firms.

The opinions and preconceptions of audit committee chairs and investors are also major barriers to the appointment of non-Big Four firms. As in our answer to Q10, data is needed to inform any measures in this area.

Theme 4: Resilience

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

There is a risk that a firm's reputation becomes so tarnished that companies abandon it as auditor, as happened to the Arthur Andersen network. There is also the risk of firms withdrawing from the large listed company audit market, as Grant Thornton has done in the UK.

The best response to the risk of firm failure is to foster a culture of audit quality in audit firms. Audit regulation is important in supporting this culture – both negatively, through reporting on areas that need improvement, and also positively by encouraging and supporting proactive measures that improve audit quality.

Theme 5: Regulation

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

Audit is a regulated market, and will remain so. It is important that firms are incentivised through regulation to invest in and sustain quality in all their audit engagements.

As in our answer to Q12, we view audit regulation as crucial in supporting audit quality. We do not see that competition has a significant role in either supporting or undermining audit quality in practice.

B) Potential measures

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

4.8(a) – greater partial, or complete, restrictions on audit firms providing non-audit services to their audit clients

The FRC's Ethical Standard prohibits the provision of a wide variety of services by auditors to the entities they audit. These are consistent with the 2016 reforms to the EU Audit Regulation and Directive, which also contains a 'blacklist' of services which may not be provided by auditors to the entities they audit. The 2016 reforms also contain a non-audit fee cap, set at 70% of the audit fee (averaged across three years). This ratio excludes services which are required by law to be provided by the company's auditor.

In addition, the EU Audit Regulation and Directive requires all non-audit services provided by the company's auditor to be pre-approved by the company's audit committee.

With the EU Audit Regulation and Directive having become effective in 2016, the impact of these new measures, including the three-year impact of the non-audit to audit fee ratio should now be starting to become clear. The CMA should seek to obtain some initial data here to inform any potential measures in this area.

It's worth noting that the EU Audit Regulation and Directive only allows the fee for the year-end audit to be included within the 'audit fee'. Fees for related services, such as the half-year review or opinions on regulatory returns are not permitted to be included within the 'audit fee'. Any intervention by the CMA will need to be very carefully targeted to ensure that it does not exclude as a 'non-audit service' an engagement which common sense demands should be provided by the company's auditor. Otherwise, this measure could actually *reduce* competition by requiring such services to be provided by another firm, which would then be considered non-independent for the purposes of the company audit.

Preliminary findings from our research suggest that the general public, perhaps informed by poorly-worded media reports, tends to think of all non-audit services as ‘consulting’. This may fuel the perception that all non-audit services are deleterious to auditor independence, whereas more recently the provision of non-audit services of all kinds is dramatically reduced due to the 2016 changes.

An alternative proposal that the CMA could consider in the public interest is to introduce a “cooling-off” period after the end of an audit relationship during which the firm would be prohibited from offering any services to that entity. This may help to allay public concerns that the auditor’s judgement in the final year of the audit relationship could be affected by the firm’s desire to sell consulting services to that entity in the following year. A cooling-off period of two years might be an appropriate balance between protection of independence and choice of service provider.

4.8(b) – prohibit firms from providing non-audit services not only to their audit clients, but also to any other large company or PIE

In addition to the problems faced by measure 4.8(a), this measure would severely reduce choice for Public Interest Entities in commissioning a firm to provide several important audit-like non-audit services, such as the half-year review or opinions on regulatory returns. Measure 4.8(b) would mean that in future only firms that do not additionally provide audit services to other companies would be able to undertake this work. It is difficult to imagine that a regulator such as the PRA would be comfortable that such firms could undertake CASS engagements with sufficient skill. In addition, the severe lack of choice in the market would inevitably push up prices.

As noted in our response to 4.8(a), we propose that a “cooling-off” period after the end of an audit relationship during which the firm would be prohibited from offering any services to that entity might be an effective way of reducing the independence threats to the audit of providing non-audit services.

4.8(c) – split the UK arms of major accounting firms into audit-only and non-audit services practices

This measure also suffers from the problems faced by 4.8(a) and some of the problems faced by 4.8(b).

As noted in the CMA’s paper, this would impact audit quality by making it more difficult for audit firms to access specialist skills, such as in tax, pensions, IT or valuations, to support audit fieldwork. We would agree with the CMA’s comment that this would be expected to create more difficulties for smaller firms than for the Big Four.

It could also lead to cases of artificial compliance, where firms have separated their ownership but continue to collaborate closely due to historical ties.

4.12(a) – reducing the barriers for non-Big Four firms to build their capacity

4.13(a) market share cap on the Big Four

As noted, this proposal would directly reduce competition and choice in the audit market. As such, it would directly contradict the CMA's mandate to increase competition and choice in the market.

A market share cap would also impact negatively on the responsibilities of the audit committee to manage an audit tendering process.

It is unclear how a market share cap would be introduced in practice, and the CMA report does not propose a mechanism. Ultimately, to be workable, a cap will need to outline precisely which companies can and cannot appoint or reappoint a Big Four auditor at any point in time. The lack of detail in the CMA's proposal (and indeed in all other versions of this idea) masks the fact that it is an unfair imposition on audit committees, it reduces choice and it does not work in practice.

4.13(b) variations of joint and shared audits

While joint audit is frequently proposed as the 'solution' to improving audit quality, the evidence from academic research is mixed at best[i]. It does increase the cost of audit and there is no consistent evidence that it leads to higher quality audit or better choice in the audit market.

There are some examples of shared audits in the FTSE 350 already. However, these do not tend to be publicised widely and so may not be well-known to the general public. Our understanding is that such arrangements can work well, although it can also lead to problems over communication, transparency and quality. Their use is uncommon. so it would be inappropriate to conclude that they can make a consistent improvement in audit quality. And they do not appear to have made any meaningful impact on choice in the audit market.

Again, any proposals to introduce measures relating to either joint audits or shared audits would benefit from a full consideration of academic research and any data which the CMA can obtain.

4.13(c) direct support to the mid tiers by the Big Four and professional bodies

As the CMA report points out, "there are various questions of how this would work in practice". In particular, it is unclear how technology or intellectual property developed for use in one network's global methodology could easily be transplanted into a firm that already uses another network's global methodology and may be required to follow the policies and procedures of that global network.

This measure would do nothing to address the preconceptions of audit committee members, who see non-Big Four firms as lacking the scale and/or credibility to be their company's auditor.

4.13(d) reducing the barriers for senior staff to switch between audit firms

A major barrier to the appointment of non-Big Four firms is the viewpoint of audit committee members. This supply side measure does nothing to address that. In practice, partners and senior employees can and do move between firms. The CMA does not indicate how it would (and why it would be fair to) make existing employers pay more of the costs of their partners and staff leaving their organisation.

4.13(e) changes to the restrictions on the ownership of audit firms

In theory, a partnership model, in which the owners of an audit firm are directly involved in its management, ought to be effective in ensuring that every partner bears responsibility for the actions of every other partner. In other words, that every partner ensures audit quality on every audit engagement.

So rather than change the restrictions on the ownership of audit firms, which brings a host of unknown problems (as identified by the CMA), a better question is to determine why the partnership model appears ineffective in ensuring consistent audit quality. The CMA could determine what existing academic research there is on this issue and what further inquiry might lead to insight.

We are particularly concerned that bringing in external investors may create pressures from those investors to prioritise commercial returns over audit quality. Another key flaw in the CMA's proposal is that a new entrant to the market may struggle to present itself as competitive against the established non-Big Four firms which are already unable to break into the FTSE 350 audit market for the demand-side reasons the CMA has identified.

4.12(b) – breaking up the Big Four into smaller firms:

This idea requires global consensus for it to be workable, and we do not sense that there is any global appetite to do it.

4.31(a) – improving the transparency around the tendering process

We would support better sharing of best practice in audit tendering, with a view to encouraging audit committees to make their tendering processes even better. Current disclosures in annual reports indicate that audit committees do take their responsibilities for managing the tender process and for overseeing auditor independence very seriously. So we do not see that this measure would deliver a step change in competition and choice in the audit market.

As an alternative, this transparency could be underpinned by regulation. For example, a change could be made to either the UK Corporate Governance Code or the Listing Rules to require more extensive disclosures around audit tendering so investors are better informed.

4.31(b) – reforming mandatory tendering and auditor rotation

Increasing the frequency of mandatory tendering and mandatory rotation would increase the cost of tendering as a proportion of audit fee income. As such, it would favour larger firms and penalise smaller firms. Given that there is evidence that non-Big Four already find the costs of tendering to be prohibitive, this would be expected to reduce competition and choice in the market by raising barriers to entry.

ACCA's report, *Tenets of a Quality Audit*[ii], identifies a tension between auditor independence and the 'closeness' to an entity that the auditor acquires through repeated involvement in the engagement. This builds upon existing academic research which finds that experience of the audit built up over several years can support a more effective risk assessment in accordance with ISA 315 ('Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment').

We have seen that some countries with short mandatory rotation periods, such as Turkey and Singapore (for banks), have now extended them to be more in line with global norm of 10-20 years, due to perceptions that a mandatory rotation period that is too short can harm audit quality.

The 2001 report of the US Public Oversight Board proposed prohibiting public corporations from firing auditors during their terms of service as a corollary to mandatory auditor rotation. We suggest that the CMA consider a prohibition on auditor on dismissal alongside its other measures, as it might provide audit firms with additional capacity to be independent. We note that the Public Sector Audit Appointments (PSAA),tries to avoid replacing an auditor within five years of their appointment.

4.31(c) – further strengthening audit committees and/or their links to shareholders

We support reinforcing the central role of the audit committee in supporting auditor independence and audit quality. We would prefer curating best practice to changes in regulation or legislation. In addition, it is unclear whether the 2016 changes have had time to fully bed in. The CMA should be cautious about changes in this area until it is clear that the full potential of audit committees to foster quality has been achieved. Again, this is an area where the CMA should seek to understand the root causes of any perceived issue through interviewing audit committee members and shareholders.

4.41(a) – transferring the powers to appoint audit firms and manage their performance to shareholders directly

Under the EU Audit Regulation and Directive, the audit committee is responsible for managing the audit firm tendering process, for proposing two potential audit firms to management and for stating a preference for one of them. Management then appoints an audit firm and must explain why it has not followed the audit committee's preference, if applicable. Shareholders then vote on the appointment/reappointment of the audit firm at each Annual General Meeting. In practice, management's decision receives the overwhelming support of shareholders

It is an interesting question as to why investors purport to want a wider choice of auditors when their revealed preference is to support the status quo. The CMA could usefully investigate this issue.

4.41(b) – transferring the powers to appoint audit firms and manage their performance to shareholders indirectly through shareholder groups

This measure suffers from the same problems as 4.41(a). Indeed, it is worse, as it puts the power in the hands of a subset of shareholders, who may hold views that are inconsistent with the membership as a whole. As noted above, the revealed preference of the membership as a whole is overwhelming support for management's judgements in respect of auditor appointments and auditor remuneration.

4.41(c) – transferring the powers to appoint audit firms and manage their performance to other independent institutions or bodies such as a sector regulator or stock exchange

This measure proposes taking powers away from individual audit committees and giving those powers to a new organisation. That new 'independent institution or body such as a sector regulator or stock exchange' would need to have the capacity and capability to match the audit needs of a Public Interest Entity with the audit skills of a firm every time an audit is put out to tender. In addition, it would need to have the capacity to 'monitor the performance' of the auditor on every one of these engagements.

Where this approach has been applied in the public sector, through PSAA, this has not widened choice in the audit market. The PSAA requires a 'proven track record' in undertaking public audit work. If this criterion were to be replicated in the new organisation for appointing Public Interest Entity auditors, it would similarly be expected to lead to a reduction in choice. On the other hand, if the new body were to prioritise widening choice in the market, it could lead to a reduction in audit quality. Additionally, if the new body were to be responsible for managing the performance of audit firms, this could create challenging conflicts of interest between its appointment and oversight roles.

This measure would also undermine the central role of the audit committee in ensuring auditor independence and audit quality. And it could reduce choice, as it could mean there are fewer incentives for the audit committee to manage the independence of firms that may be the company's auditor in future.

4.46(a) – the creation of an insurance-based system for audit

Audit is assurance, not insurance. It does not – and cannot – inoculate against loss from 'any diminution in value of shareholders' invested capital'. Risk-free investment would pay a risk-free return, not an investment return. While it is feasible to buy insurance against more limited types of loss, it tends to be prohibitively expensive.

4.46(b) – an 'NAO style' national auditor

We don’t consider the proposal to replace all audits with an NAO-style national auditor to be credible. The NAO (or another new body) could never have the capacity to undertake all Public Interest Entity audits, particularly when considering those entities’ global businesses.

For a few Public Interest Entities or large unlisted companies with more limited geographical reach, it is perhaps feasible that a national auditor could undertake those audits. The CMA may wish to consider whether there is value in seeing what it would take for this to be implemented.

If an NAO-style national auditor were to be considered, the CMA should consider whether it should be subject to the rules on mandatory retendering and mandatory rotation and, if not, what additional safeguards might be necessary to underpin auditor independence and audit quality.

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.

Above, we have highlighted as measures the CMA should consider as part of its review:

- Whether there should be a “cooling-off” period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity. This may help to allay public concerns that the auditor’s judgement in the final year of the audit relationship could be affected by the firm’s desire to sell consulting services to that entity in the following year. A cooling-off period of two years might be an appropriate balance between protection of independence and choice of service provider [Ref: CMA paragraphs 4.8(a) and 4.8(b)].
- Considering a prohibition on management from firing their auditors during their terms of service [Ref: CMA paragraph 4.31(b)].
- Whether there are non-regulatory ways of encouraging best practice among audit committees in ensuring auditor independence and audit quality [Ref: CMA paragraphs 4.31(a) and 4.31(c)].
- Whether an NAO-style national auditor could serve as auditor for certain Public Interest Entities or large unlisted companies and what it would take or this to be implemented [Ref: CMA paragraph 4.46(b)].

For these measures, alongside the measures already being considered by the CMA, we encourage the CMA to collect sufficient data and evidence to form a view of their market impact, cost and efficiency.

Restrictions on audit firms providing non-audit services

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?

We have no figures for the relative scale of benefits and costs.

As highlighted above, separating audit and non-audit services practices would be very problematic for Public Interest Entities as it would mean they could not use their auditor to provide audit-like non-audit services such as half yearly reviews or regulatory assurance reports. It would also undermine audit quality by creating barriers to audit firms from accessing expert input on key areas of the audit.

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?

We do not see that the international affiliations of member firms would constrain the creation of audit only firms. However, we do not see the creation of audit only firms as desirable, as noted above.

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

As highlighted above, separating audit and non-audit services practices would be very problematic for Public Interest Entities as it would mean they could not use their auditor to provide audit-like non-audit services such as half yearly reviews or regulatory assurance reports. It would also undermine audit quality by creating barriers to audit firms from accessing expert input on key areas of the audit.

The EU Audit Regulation and Directive introduced very significant restrictions on auditors providing non-audit services to European Public Interest Entities, including a fees cap. The impact of these restrictions is still being determined.

Market share cap

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

We believe proposals for a market share cap to be misguided and problematic, as noted above.

To the extent that there is to be a market share cap, a numbers-based cap is less problematic to administrate than a fees-based cap.

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

No.

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?

We believe the costs of a market share cap outweigh any potential benefits.

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

We do not support a market share cap.

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

Conceptually, joint audit would seem to make it more likely that a company would have a Big Four firm auditor, not less. In this case, this could fuel the perception that the market is concentrated in favour of the Big Four.

Incentives and governance

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?

In practice, audit committees are transparent to these groups. Audit committees are accountable to investors. Given the potential for severe unintended consequences, we do not believe this should change.

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?

No. This proposal would be a very wide-ranging change to corporate governance and would have significant, very possibly detrimental, impacts. In particular, we are concerned that this measure would undermine the central role of the audit committee in managing the relationship with the external auditor, managing the audit tendering process and reviewing the external auditor's independence.

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

We do not support this proposal. We can see only risks and costs.

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?

No. More frequent retendering and more frequent rotation would increase the costs of audit. Evidence from non-Big Four firms is that they already find the costs of tendering for audits to be prohibitive.

Internationally, we observe that the trend is to introduce mandatory retendering and mandatory rotation. However, the trend is also to lengthen the period of mandatory retendering period where this is short compared to the global norm of ten years.

Other comments

While the issues of the audit market and wider financial reporting processes are of significant public concern right now, and it's right that the CMA should address these issues with urgency, the timetable for this review is extremely short.

Three weeks provides little time for respondents to be able to address these issues appropriately. It also makes it difficult for respondents to provide robust evidence in support of their positions. The CMA needs to ensure that it has robust evidence before making wide-sweeping changes to audit and corporate governance that may be damaging to UK investments.

The CMA's report, in focusing on perceptions of market failure, seems to have overlooked the context of these cases: most audits do deliver what they promise and most audits do have appropriate audit quality. We are concerned that the CMA, in wishing to be seen to be responding to public concern may lose sight of the benefits of the existing audit market and will introduce measures that impose costs that far exceed their benefits. The lack of time for appropriate, effective consultation makes this risk more likely.

We are disappointed by the lack of an obvious linkage to the significant body of research that informed the previous report by the CMA's successor body, the Competition Commission.

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[i] Francis, J. R., Richard, C., & Vanstraelen, A. (2009) finds a positive link between audit quality and joint audit. However, Ratzinger-Sakel, N. V., Audousset-Coulier, S., Kettunen, J., & Lesage, C. (2013) find 'limited empirical support to suggest that joint audits lead to increased audit quality, but some empirical support to suggest that joint audits lead to additional costs'. Deng, M., Lu, T., Simunic, D. A., & Ye, M. (2014) indicate that 'joint audits by one big firm and one small firm may impair audit quality'.

[ii] https://www.accaglobal.com/gb/en/professional-insights/global-profession/Tenets-of-quality-audit.html