

Statutory audit markets study
Competition and Markets Authority
7th Floor
Victoria House
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London WC1B 4AD

6 November 2018

[Submitted via email to: statutoryauditmarket@cma.gov.uk]

Dear sir or madam

Consultation: Statutory audit market

Chartered Accountants Ireland (the Institute) welcomes the opportunity to respond to this important consultation by the Competition and Markets Authority (CMA).

The Institute has 27,000 members worldwide, almost 6,000 of which are in the UK, and is a Recognised Supervisory Body (RSB) under Schedule 10 of the Companies Act 2006. As such, our membership includes statutory auditors registered in the United Kingdom and Ireland.

There are currently nine PIE audit firms operating in Ireland, all Institute member firms. To develop this consultation response we formed a working group of representatives of the majority of those firms. Whilst views amongst the firms on certain of the specifics of the proposed measures may vary, in the time permitted we undertook to provide perspectives and not to seek a consensus view if there are points on which there is substantive disagreement.

Introductory comments

The Institute fully supports a continuing regulatory and legislative focus on, and measures that will enhance, audit quality. We also recognise the importance of public confidence in the statutory audit function, and therefore public perception in terms of auditor independence and objectivity is also important.

We have, however, very serious concerns about the length of time allocated to the CMA consultation. There is sufficient evidence available to support the view that the capital markets value the contribution of independent statutory audit to the functioning of the system. Given this importance, we consider that a consultation period of approximately three weeks on such a wide range of issues/measures is wholly inadequate. We would therefore urge the CMA to reconsider its approach to its consultation on the statutory audit market. We consider that a much more in-depth consultation is required, with a greater level of detail/evidence provided to stakeholders, on a smaller number measures considered to have the

most potential to have a significant impact on audit quality, to allow for all stakeholders to provide more considered responses.

We would also argue that the CMA consultation is not operating in isolation. The consultation paper mentions the Kingman review of the Financial Reporting Council (FRC). The Monitoring Group consultation on the international auditing standard setting processes is on-going and a white paper is expected at the end of this year or early in 2019. Significant EU measures on regulating the audit market are still relatively new and are bedding in. There have also been developments in UK corporate reporting requirements, such as the viability statements, which perhaps have not yet achieved the enhancements in reporting targeted. Coordinated changes to the corporate reporting regime may be needed to address societal needs identified rather than looking at statutory audit in isolation.

There are a wide range of potential measures addressed in the consultation paper, many of which are untested. For others, such as joint audit, or more stringent mandatory audit firm rotation requirements, there may be evidence of the effectiveness of the measures in other jurisdictions which could prove very useful to stakeholders in coming to considered positions on the measures. For example Ireland has implemented a strict ten year mandatory audit rotation period. Other EU jurisdictions have operated mandatory rotation rules for a number of years before the recent EU wide rules took effect. It could only be helpful and informative to the CMA, and to other key stakeholders in the UK process, to receive balanced and evidence-based views/perspectives from firms and companies involved in rotation not just in the UK, but in Ireland and other EU jurisdiction as to their experiences with mandatory rotation. We note that Irish firms and their clients have engaged in a significant number of tendering processes and rotations in the past couple of years since the coming into force of the EU Audit Regulation and Directive in June 2016.

Further, the consultation paper recognises that the themes of ‘incentives’, ‘choice and switching’ and ‘resilience’ are “inextricably linked” and notes that combinations of the three groups of measures could be implemented together. Given the range of potential measures addressed, there could quite conceivably be conflicting outcomes between them in terms of the themes and/or unintended consequences arising from a combination of measures. We consider that there is a need for rigorous impact assessment and cost/benefit analyses in advance of any decisions to implement any measure or group of measures arising from the CMA consultation.

We consider the implications of the on-going negotiations for the UK exit from the European Union are very relevant to the consultation. Statutory audit is currently defined in, and subject to, the requirements of EU legislation. The likely outcomes of the exit negotiations remain unclear at this point. We refer you to the recent joint statement by this Institute, ICAEW, ICAS and ACCA following the publication of the UK Government’s technical notice on company law: <https://www.icaew.com/-/media/corporate/files/about-icaew/policy/joint-statement-on-accountancy-and-brex-it-final-121018.ashx>. It addresses matters such as common audit regulation and ownership structures. Issues such as ‘equivalence’ between the EU and the UK for the purposes of statutory audit and regulation, post exit, could be impacted by measures implemented unilaterally in the UK. Many PIE groups operate on a pan-European and global basis and their auditors by necessity also. Our member firms are reporting significant practical difficulties and constraints being

experienced by international groups already in dealing with differing regulations globally on issues such as mandatory firm rotation. Given the significance of the UK market in global economic terms, UK-only measures to address audit quality have the potential to exacerbate such difficulties for international groups and to counteract the CMA theme, for example, of increasing choice in the audit market. We consider that significant engagement with the CMA's counterparts and audit and financial reporting regulators in other major international markets would be essential to arrive at coordinated solutions enhancing corporate reporting and statutory audit globally.

Our comments in the attached appendix are organised on the basis of the proposed measures as presented in the consultation document. Please contact me if you would like to discuss any of the points that we raise in more detail. We look forward to further engaging with the CMA on this very important consultation.

Yours respectfully

Mark Kenny

Director, Representation and Technical Policy

Chartered Accountants Ireland

Appendix – Comments on individual measures proposed in the consultation

1. *Greater partial or complete restriction on audit firms providing non-audit services (NAS) to their audit clients*

- 1.1. We do not consider the provision of NAS to PIE audit clients to be a significant threat to independence in this jurisdiction. A review of the disclosures in the annual reports of Ireland's largest listed entities would suggest that the level of NAS fees from audit clients as a percentage of overall fee income is quite low in absolute terms and by reference to the 70% cap. Having said that, and in recognition of the importance of public perception as regards the independence of the statutory auditor, we consider that this measure is one worthy of more detailed consideration. Referring back to our introductory comments, such a measure would be consistent with EU legislation, which allows Member States to implement more stringent prohibitions and should not therefore, adversely affect arrangements put in place post exit by the UK and the EU to allow for the effective functioning of the audit market across Europe.
- 1.2. In further considering this measure, it would be critically important that a clear distinction is drawn between audit-related services, services which practically or by virtue of legislation or regulation, have to be undertaken by the incumbent statutory auditor, and NAS which may be provided by any professional accounting firm.

2. *Prohibit audit firms from providing non-audit services not only to their audit clients, but also any other large company or PIE*

- 2.1. Whilst we consider that it would be appropriate to explore enhanced restrictions on providing NAS to audit clients, as discussed above, we do not agree with prohibiting or restricting NAS to non-audit clients. It is quite a similar proposal to splitting accounting firms into audit-only and NAS firms, and would have the same detrimental effects on audit quality, in our view, as discussed in point 3 below.

3. *Split the UK arms of major accounting firms into audit-only and non-audit services practices*

- 3.1. We do not support the introduction of requirements for audit-only firms. We note the arguments included in the consultation paper at paragraph 4.10 against the implementation of such a measure and agree with them. We would emphasise the potentially counterproductive/negative implications of the measure on overall audit quality.
- 3.2. It is imperative to the conduct of high quality audits that the firms have access to the input of experts in non-audit specialisms such as valuations expertise, pensions, specialist financial instruments, tax, IT and actuarial services etc. Individuals of such knowledge and expertise are much less likely to join, or

be retained by, an accounting firm which only conducts audit engagements. These individuals maintain their high professional standards through their involvement in a wide range of non-audit engagements specific to their sector expertise. If, as we expect, firms are unable to retain these experts within audit-only firms to the extent and quality necessary, the need for the expert input into a quality audit remains and the knowledge and expertise would have to be procured externally from third party providers, which would raise many of the same issues considered in respect of audit firms as to independence, conflicts of interest and choice in respect of experts. International auditing standards contain specific requirements pertaining to the use of third party experts in the conduct of an audit, recognising the increased complexity and risk to audit quality of such arrangements, where the expertise is not held in-house. In addition, it would also have significant cost implications.

In this context it is important to understand the reasons why the European Commission rejected audit only firms in its consideration of potential reforms to the PIE audit market.

4. *Market share cap*

4.1. We note the concerns raised in paragraphs 4.14 to 4.17 of the consultation paper. While there are differing views as to the likely benefits of adopting a market share cap approach, there is general agreement, however, that there are some very significant practical challenges which would be associated with this measure, including potentially further restricting choice for a cohort of PIEs. Some of the most significant concerns/challenges from our perspective include:

- Who makes decisions about audit firms relinquishing specific audit engagements and how such decisions are arrived at? Are the entities themselves involved in these decisions and how is their own choice affected by such decisions?
- What metrics would be employed in measuring market share – which markets? Number of entities? Market capitalisation? Level of profits?
- Would sector concentration and expertise issues impact on choice even with the application of a market share cap?
- The international impact of such a measure would again be relevant – how would it impact entities headquartered in another jurisdiction but with a dual listing on the FTSE?
- The status of the market cap for PIE firms at a particular point in time could restrict a PIE's choice of potential audit simply due to a matter of timing.

The methodology of applying a cap would necessitate very careful consideration and consultation.

5. *Joint audits, shared audits and peer review*

- 5.1. We consider joint audits to be an area which would merit further detailed consultation and consideration. As noted in our introductory comments, and indeed in the consultation paper, this is a measure which has been implemented in other jurisdictions such as France, which would allow for an evidence-based assessment.
- 5.2. We also consider there to be merit in considering proposals for shared audit in more detail. In an Irish context, we have noted some movement/opening up of the audit market in relation to the audit of the Irish PIE subsidiaries (e.g. insurance and banking entities) of international groups because of the introduction of mandatory rotation. This has involved some larger non-Big 4 PIE audit firms being appointed to significant PIE audit engagements and in that context developing an approach to working with other PIE-audit firms through being the auditor of components of the group – akin to a shared audit approach. Reports published by the Irish Auditing and Accounting Supervisory Authority (IAASA) indicate that between 2014 and 2017 the number of audit firms with ten or more PIE audits has increased from four firms to seven firms. Our PIE audit firms have indicated that they already have some experience in practice in cooperating with other firms in this context both positive and negative.

We consider that the CMA consultation process would benefit from direct engagement with the firms and entities in question on the impact of this development on audit quality.

- 5.3. Joint audits and shared audits will increase the costs of statutory audit. Critical challenges would include liability sharing and the willingness in that context to cede control of significant aspects of the audit. Other valid questions may include how such measures would impact on the independence of firms jointly auditing, or conducting a shared audit of, a PIE in terms of future rotation and choice. And critically, in our view, the CMA needs to establish that the implementation of such measures will have a material impact on audit quality, an objective supported by all stakeholders.
- 5.4. As regards peer review, whilst there may be potential benefits of such an approach, we foresee very considerable, if not insurmountable, practical challenges associated, particularly within current reporting schedules and deadlines. Current experience of both internal and external quality review processes indicate the time and level of detail necessary for such reviews. These challenges include:
- Significant cost increases;
 - How to establish the sharing of responsibility and liability between primary auditor and reviewer;

- Arrangements for dealing with material disagreements between the primary auditor and the reviewer, and the reporting thereof;
- Independence issues in the future for the reviewing firm and the impact on choice for the entity concerned;
- Challenges with regard to the interaction with the regulatory regime and the quality assurance process.

It is possible that a better alternative to peer review might arise in the context of the approach taken to monitoring by the regulator.

6. *Direct support to the mid-tiers by the Big Four and professional bodies*

- 6.1. The question of willingness to share technical know-how with other firms is a matter for the firms themselves to comment on. In that context, we would note the significant levels of investment made by the firms concerned in proprietary technical knowledge and processes, both by Big 4 and mid-tier firms. Further detailed evidence on the mid-tier's need for such knowledge sharing should be sought before any decision is made to pursue this potential measure.
- 6.2. The Institute's governing charter recognises our public interest mandate, which obviously includes supporting the goal of high quality statutory audit. The Institute aims at all times to support its members and member firms in this regard. The concepts of 'public interest' and 'member support' are at the forefront of all our activities. Over many years we have, for instance, supported the FRC in the development of practice notes, bulletins and other information documents aimed at supporting audit quality in Ireland and continue these efforts now with IAASA as Irish auditing standard setter. We would be happy to explore how we as an Institute could contribute in an appropriate and feasible manner to direct support of mid-tier firms, should a decision be made that this proposal is worthy of more detailed consideration. However, we currently find it very difficult to envisage the involvement of the professional accountancy bodies in the process. As you are aware, there are currently four Recognised Supervisory Bodies (RSBs) in the UK – our Institute, ICAEW, ICAS and ACCA. Is it envisaged that each RSB would be involved in the provision of this support, or that a single RSB would provide access to interested audit firms, regardless of their RSB affiliation? Agreeing to be involved in such a process would represent a major policy decision by an RSB, and not one to be taken lightly. Significant investment in IT and people is likely to be required to allow the relevant accountancy body or bodies to support this process – how would this be funded? There would also be very significant legal and liability issues/hurdles to be dealt with. RSBs are themselves regulated, and the regulatory implications of RSB involvement would need careful consideration.

7. *Reducing the barriers for senior staff to switch between audit firms*

- 7.1. As regards senior audit staff, we do not consider there to be significant barriers to switching firms in the Irish market and are not aware of contractual notice periods here in excess of three months. We note that movement of senior staff between Irish firms is not uncommon. At partner level, there may in addition be non-compete clauses in place and the potential impact of such clauses as barriers to entry would merit some further consideration.
- 7.2. The consultation paper discusses barriers to switching in the context of mid-tier firms being able to build capacity, and therefore increasing choice in the audit market. However, in our view, a detailed consideration of the impact of contractual notice periods for staff, and non-compete clauses at partner level, as potential barriers to switching needs to be balanced to take into account the potential negative impact of any changes in terms of audit quality. The loss of audit partners or senior audit staff members before an audit is completed would be very disruptive and be a significant risk to maintaining a high quality audit. This issue is particularly relevant during audit 'busy season'. We consider that this would be a key regulatory consideration also in terms of assessing risk.
- 7.3. It should also be noted that there are long cycles involved in planning and executing audit tender processes, which themselves take place well in advance of the conduct of an audit, such that individual notice periods and partner non-compete clauses should not, in our view, represent significant barriers to attracting the necessary people.

8. *Changes to restrictions on ownership of audit firms*

- 8.1. We would agree with the comments in the consultation document (paragraph 4.26) about the risk to independence and objectivity arising from commercial pressures. We would also note, in the context of the above discussion on the implications of UK/EU exit negotiations, that audit firm ownership is an area specifically regulated by EU legislation.
- 8.2. We would also note that such firms would still be subject to the same regulatory environment as existing firms.

9. *Break-up of the Big Four into smaller audit firms*

- 9.1. We do not support the 'break-up' measure proposed. We agree with the challenges noted in paragraph 4.28. In particular we refer back to our introductory comments about the European and international ramifications of a UK-only measure such as the break-up of firms. To ensure audit quality, the audit of a large global company needs to be conducted by a large global audit network, with the scale to invest in the specialisms and IT required for such engagements. As such, the same major concerns as regards audit quality, scalability and access to expertise arise with this proposal as for certain of the other measures in the consultation discussed earlier in this submission.
- 9.2. Other challenges include the fact that there are a number of firms which operate on an all-island basis in Ireland, i.e. both in Ireland and the UK. How would a break-up operate in such circumstances?

10. *Improving the transparency around the tendering process*

- 10.1. We see merit in the proposal that the regulator would provide some information about tendering processes to enhance transparency, specifically paragraph 4.32 points (a) and (b).
- 10.2. We do not, however, agree with the suggestion in paragraph 4.32(c) that 'blind tenders' be implemented. We cannot see how this would function in practice. Would it, for example, be a process decided purely on documentation, with no meetings between audit and client representatives? Is there not thereby a significant risk that price will become over-emphasised as a deciding factor in appointment? We are aware, however, of tendering processes having taken place whereby the price information was not provided until an advanced stage in the decision-making process. This development appears to us to be positive, with a greater emphasis being placed on quality.
- 10.3. We also do not think the publication of firm intellectual property in the form of tender documents is an appropriate measure (paragraph 4.32(d)). An audit tender is multi-faceted and the tender document is only one element of the tender process.
- 10.4. We consider that PIEs could be encouraged to provide more transparent reporting with regard to their own tendering processes and the governance of those processes. We would welcome support, guidelines and education for companies, developing best practice to ensure that high quality tender processes are undertaken.

11. *Measures to reform mandatory tendering and auditor rotation*

11.1. As mentioned earlier in this response, Ireland has implemented the mandatory rotation requirements of the EU Audit Regulation and Directive differently to the UK. Irish PIEs must rotate their auditors after a ten year tenure. As a result, there have been quite a few rotations since the legislation was implemented in June 2016. As also noted above, firms have reported to us that:

- There have been significant difficulties experienced by international groups with Irish PIEs as a result of the rotation rules differing from other jurisdictions, particular in the context of US multinationals;
- Due to the rotation requirements, there has been a movement amongst some PIE subsidiaries in Ireland towards appointing non-Big 4 auditors.

11.2. In the context of ensuring the highest standards of audit quality, we would also note that the rules with regard to rotation of individual audit partners – a five year period has been implemented in Ireland – are proving challenging in terms of partner succession planning and development.

11.3. We consider that more detailed consultation by the CMA with stakeholders in Ireland, and careful further monitoring of the Irish market in the coming years, could provide the CMA and the UK with some valuable, evidence-based insights into a stricter mandatory rotation regime. As noted earlier in this submission, there are currently nine PIE audit firms in Ireland and statistics are available from IAASA, in its annual 'Profile of the Profession' publication, which indicate an increase between 2014 and 2017 of the number of Irish audit firms with ten or more PIE clients from four to seven firms – for further details, please see: <https://www.iaasa.ie/Publications/Supervision-of-the-Profession>.

12. *Measures to further strengthen audit committees and/or their links to shareholders*

12.1. Whilst we would support any measures that strengthen audit committees' understanding of an engagement with the statutory audit process, it is not clear to us how these measures would enhance audit quality or increase choice in the market.

12.2. Following the transposition of the EU Audit Regulation and Directive in Ireland, increasing the responsibilities on PIE audit committees with regard to the statutory audit and the relationship with the statutory auditor, there is evidence already emerging of greater levels of audit committee engagement with the process. Of course, it will take some time for the full benefits to be realised.

13. *Transfer the power to shareholders, directly or indirectly through shareholder groups, to appoint the auditors*

13.1. We do not believe that the case has been made in the consultation document as to how such a measure will enhance audit quality or increase audit choice. We consider that an audit committee is best placed to make a decision as it has been closely involved in the tender process and has the information required.

14. *Transfer the power to an independent body to appoint the auditors*

14.1. We do not support this proposal. We consider that there would be very significant, if not insurmountable, challenges to the practical implementation of this proposed measure. For instance:

- There could be a large number of tendering processes on-going at the same time so access to resources would be a challenge;
- Also, the regulator would need access to the knowledge and expertise across all relevant sectors to undertake this role on behalf of all UK PIEs in an appropriate manner;
- Implications for the independence of the regulator in carrying out its monitoring functions having appointed the auditor;
- Implications for the reputation of the regulator of a business failure in a PIE to which it had appointed the auditor;
- Potential liability of the regulator to shareholders in such cases of business failure;
- How does the regulator secure against bias, either real or perceived, on its own part in making appointments?
- What happens in the event that the company does not agree with the proposed appointment?
- How does a regulator appointment of auditor work in the context of an international group?

14.2. We could, however, envisage a more involved role for the regulator in terms of the governance and transparency over the process. For instance, in Ireland the Central Bank engages with entities regulated by it on the appointment of auditors. Whilst it remains the responsibility of the entities to appoint the auditor, in an extreme case, the Central Bank has a power of veto. Consideration could be given to a similar approach for the UK audit regulator.

15. *Insurance based system*

15.1. We would just note at this point that this is an untested measure which would require a comprehensive scoping and wide-ranging consultation exercise.

16. *'NAO-style' national auditor*

- 16.1. We do not support this proposal. Such an approach would represent a fundamental change in approach for private sector audit. Some of the key challenges to such an approach are set out in paragraph 4.51 of the consultation document. We refer also to our comments on audit only firms as a NAO style auditor would most likely suffer from the same issues about access to appropriate specialists in order to perform an audit that meets quality standards.
- 16.2. This Institute is also a 'Recognised Qualifying Body' (RQB) in the UK and currently has some 6,000 students at various stages of the training and examination process in Ireland and Northern Ireland. We consider it to be of the utmost importance that the accounting and audit profession continues to be an attractive career choice for high achieving university graduates and school leavers.
- 16.3. It is equally important to note that two thirds of our membership does not engage in audit, but rather works in organisations across all sectors of business, in the charity and not-for-profit sector and in the public sector. Many of these members, and their counterparts from the other UK RSBs and RQBs, are directly responsible for or engaged in financial reporting functions, and the majority of these members obtained their original training via audit practice. Any measures which negatively impact the attractiveness of the accounting and audit profession will almost certainly have a knock-on effect on the quality of financial reporting throughout the economy.