

October 30, 2018

Statutory audit market study
Competition and Markets Authority
7th floor
Victoria House
37 Southampton Row
London WC1B 4AD

Via email: statutoryauditmarket@cma.gov.uk

**Statutory audit market
Invitation to comment**

Dear Sir/Madam,

The International Federation of Accountants (IFAC) values the opportunity to comment on the Competition and Markets Authority's (CMA) *Statutory audit market Invitation to comment* (the ITC). IFAC is well suited to provide an international perspective, including contextual observations regarding audit quality and initial views on some of the remedies under consideration.

IFAC strongly concurs with the CMA that regulation and competition should work hand in hand to deliver audit quality that serves shareholders and investors and trustworthy financial information that provides the confidence necessary for the proper functioning of the market economy. With these objectives in mind, it is preferable to seek steps that focus on making the audit market and its sub-segments more attractive to a broader set of firms, and supporting those firms, rather than to take steps that handicap or penalize firms already serving particular segments of the market, thereby jeopardizing quality and potentially risking those firms withdrawing from the market. This may include for instance measures impacting on the capacity of firms to recruit high quality professionals and multidisciplinary teams at the scale needed to serve the large end of the audit market (please refer also 'Remedies we believe are likely to cause adverse outcomes' below).

In that context, IFAC recognizes the critical importance of the behavior of the firms, in particular with respect to audit independence. This includes setting the right tone at the top and reward systems to promote a culture of integrity throughout the firms' activities. It is incumbent on the firms to consider and implement the mechanisms needed to fulfil this requirement.

We agree with the value of a holistic review, as noted in the ITC, into the future of audit and its role, and the audit framework. Internationally, this is a topic of significant focus with substantial investment and resources currently dedicated to facilitating dialogue and innovating solutions to underpin the future of audit and how it serves shareholders, investors and the wider economy into the future. For example, we note extensive work by and dialogue among the international network firms which comprise the [Forum of Firms](#), the International Auditing and Assurance Standards Board's Audit Quality Framework (outlined below), and significant work by professional accountancy organizations globally, much of which is curated on the [IFAC Global Knowledge Gateway](#).



The interconnectedness of today's globalized businesses, economies and markets has been a central and pervasive factor in how audit firms and the audit market have evolved to serve the financial information needs of investors and other stakeholders. We were encouraged by recognition in the ITC of several international considerations, and in tackling the issues raised we urge the CMA to prioritize the international ramifications of United Kingdom-based solutions overlaid on this global setting.

Audit Quality and Audit Committees

IFAC recommends using the International Auditing and Assurance Standards Board's [Framework for Audit Quality](#) (the Framework) as a comprehensive approach to defining audit quality. A clear definition is important to holistically consider the three sets of issues outlined in the ITC and the potential value and impacts of remedies under consideration. The Framework presents an approach to defining audit quality, distinguishing critical inputs, processes, outputs, interactions within the financial reporting supply chain and factors that create an environment which maximizes the likelihood that quality audits are performed on a consistent basis.

Importantly, the Framework contextualizes the roles, relationships and interactions of auditors, management, those charged with governance (including audit committees), regulators, and users of financial statements. To deliver quality information, the financial reporting ecosystem requires all components to be fully engaged and effective, including the role of management in establishing effective financial reporting controls and processes.

Crucial to the financial reporting supply chain is the clarity and effectiveness of how audit committees and those charged with governance exercise oversight of the statutory audit, and financial reporting processes led by management. IFAC strongly supports efforts to strengthen and clarify this role, including its link with shareholders and investors (see also below, 'Remedies we believe particularly warrant further consideration').

Remedies we believe warrant further consideration

Strengthening audit committees and their links to shareholders - The narrative on incentives outlined in the ITC points to numerous issues surrounding shareholders' links and enfranchisement with audit committees, and the independence from management of those charged with governance -- perhaps more so than it indicates issues concerning oversight of the statutory audit specifically (section 3.8). We strongly believe that those charged with governance are best placed to oversee the audit on behalf of shareholders and it is therefore critical to strengthen and support this role and to address perceptions that audit committees are not sufficiently independent of management, or that the link to shareholders is not sufficient.

Measures to improve the transparency around the tendering process - We believe the measures outlined in the ITC could with further consideration and refinement add to the effectiveness of the tendering process which is a primary juncture for competition in the audit market.



Remedies we believe are likely to cause adverse outcomes

Split the UK arms of major accounting firms into audit-only and non-audit practices - We agree with the concerns around splitting major accounting firms into audit-only and non-audit practices outlined in the ITC (section 4.10). In particular, we agree that there is significant potential for adverse impacts on audit quality due to lack of in-house multidisciplinary expertise increasingly required on large, complex audits, and hampering the ability of firms to attract qualified staff. Current trends toward broader, multi-capital reporting, the increasing complexity of businesses, and demands of financial reporting underscore the need for multidisciplinary firms.

Break-up of the Big Four into smaller audit firms - We agree with the concerns about breaking up the big four firms into smaller firms outlined in the ITC (section 4.28), in particular we concur that there will likely be adverse impacts on the ability of smaller firms to deliver quality audits of the scale required.

Break the link between company management and auditors - We question validity of equating of “management” with “audit committee”, and believe strengthening the audit committee role and its link with shareholders (as above) will be more effective than moving this role to a new, alternate body.

An insurance-based system for audit - This model appears to assume the role of auditors is to prevent diminution of value in shareholder’s invested capital - something out of an auditors control and which is at odds with the concept of a market based economy. The proposal could also have significant ramifications on the incentives involved in the actual role of auditors -- assuring the availability of quality financial information. The consultation summary commences with “...tens of millions of ordinary people depend in some way on independent audits to help ensure that companies report truthfully on their performance.” This suggests that the current definition of an audit is consistent with the need to confirm performance, and is consistent with a functioning market. It does not mean that an audit provides protection from corporate failures.

A ‘National Audit Office-style’ national auditor - We agree with the concerns outlined in the ITC (section 4.51), in particular the likelihood that this would create an alternative set of issues in regard to incentives and would likely have an adverse impact on audit quality and confidence in financial information.



In closing, IFAC commends the CMA on its practical and balanced approach to setting out the issues in the ITC. We support a consideration of factors that led to concerns over audits. We also appreciate inclusion of evidence of improvements in audit quality stemming from recent efforts by the profession and auditing firms. Those improvements are also reflected internationally, with the largest six firms globally now half way through an initiative agreed with IFIAR to reduce the percentage of inspected audits of listed public interest entities with at least 1 finding, and within 1 percentage point of the agreed target.

Should you have any queries please don't hesitate to contact Russell Guthrie or myself.

Regards,

Kevin Dancey
Incoming Chief Executive Officer