Will – As promised, please find my view of the audit market.

I have not been able to get any feedback as to whether this response represents TPR's official position, so please in treat the following as my personal views and those of some colleagues I work with.

As discussed when we spoke, TPR uses publicly available information to assess the strength of employer covenant and how this compares to the funding position of the defined benefit pension scheme (s) the employer supports. Therefore, one of our primary sources of information we rely upon to make this covenant assessment are audited statutory financial statements. Please note that we do not normally consider statutory pension disclosures as part of our covenant assessment.

In terms of the structure of this response, I have followed the consultation questions as set out in section 6 of the CMA's Statutory Audit Market paper.

A. Issues

1. From our perspective, the key issue here is how well auditors understand the businesses they are auditing. Internal profit and cost pressures together with operating changes have led to the larger firms adopting a partially outsourced model where audit field work is performed remotely and the concern is that this reduces business understanding and therefore ability to effectively challenge management assumptions, especially in complex contractual environments,[ ]. Additionally, corporate culture is not audited and where risk taking is encouraged excessively this may lead to inappropriate revenue recognition for example.
2. The audit framework generally supports the needs of stakeholders well in terms that it does provide a measure of assurance to those stakeholders as to the veracity of statutory accounts. That said, the relationship between shareholders and auditors is a remote one as auditors are appointed by and paid by company management. Outside of confirming the auditors at a AGM, shareholders have no oversight of auditors as they conduct their duties.
3. Consider shareholder representation and participation Audit committees?
4. For larger corporate audits, the introduction of mandatory rotation appears to have led to significant switching of auditors amongst the Big 4 rather than across the audit sector as was originally hoped. This is closely linked to brand which is discussed in 5 below.
5. Perception of brand may be a key hinderance to improving competition. Big 4 auditors market themselves on the quality of the people they recruit, the training provided and the other expertise (such as industry) they can provide. High profits are seen as vital in attracting the best quality partners, but this may have drifted away from core technical expertise to the ability to win work. Also, all Big 4 suppliers have global reach which smaller competitors may not be able to match. Therefore, large companies , often their lenders and other stakeholders perceive the brand offered by Big 4 audit supplier to provide more assurance.
6. See 5 above.
7. See 4 above.
8. Competition is required to manage conflicts of interest and to ensure that auditor independence is not compromised. Audit is a commodity and whilst it is important to focus on consistently higher quality audits, it would also be helpful to concentrate on improving business understanding and limiting surprises to the bare minimum. Professional bodies may have a role to play in more rigorously ensuring that relevant professional experience and training is in itself properly deployed and of sufficient quality.

9. Please see 5 above.
10. Perception as discussed in 5 above and the capability and reach of smaller competitors.
11. Whilst many firms employ audit technology platforms (some of which are global) audit essentially remains a commodity, differentiated by the quality of the people who deliver it, the brand of the audit firm and buyers' (and that of their stakeholders) perceptions. What has not taken place yet is the technological disruption that will lead to a radical shift in the sector economics.
12. No comment.
13. No real comment here apart from (as outsiders to the processes) FRC investigations appear to take a very long time. Whilst it is important to investigate thoroughly, this has to be balanced with timely enforcement.

B. Potential Measures

14. No comment
15. Minimum pricing may be considered to ensure that larger audit firms do not use their resources to price out competitors. This would increase the cost burden on audited companies, but would help focus more on the quality of the audit provision. Furthermore, restrictions on higher margin "special work" (ie additional work the auditors perform on behalf of clients, not directly relevant to the audit) performed by audit teams. The mechanism of how a minimum price would be achieved could prove overly complicated however. Other potential measures are:

- Restrictions on non-audit services provided to audit clients. Rather than a blanket ban, possibly a % of audit fee as a cap?
- Tighter/ more stringent auditing standards (note o/s scope of CMA review but given that changes in accounting standards have increased subjectivity in the numbers then maybe it is time to recognise the need for a more detailed audit review)
- Bigger role for FRC, more investigations, higher fines, prohibiting audit partners
- Controls on who is on audit committees and reporting requirements

16. See 15 above.
17. No comment.
18. No comment, but please see 15 above.
19. An aggregate of audit and non audit fees originating from the audit base of each firm to measure the true economic value of audit clients to an audit provider and what imbalance in the relationship exists.
20. No comment
21. No comment
22. No comment
23. Possibly. Seems to work well in France and effectively ensures that audit work is reviewed as it is performed which will enhance quality. However, presumably geographical reach is limited to UK based audits only.
24. No comment
25. No comment
26. No comment
27. No comment.