At this stage I send this response anonymously and in a personal capacity.

I am employed in financial services industry and from time to time assist external auditors in the external audit of aspects of the firm for which I work. There seems to be variable quality and experience of the staff of external auditors. In addition, there seems to be a great deal of duplication: auditing work that has already been audited by other audit firms and productivity is clearly an issue.

In order to overcome some of inefficiencies, conflicts and quality of the current audit approach of financial firms I suggest a national entity is created that audits financial firms **-** Financial Audit Company (FAC).

This is similar to the NAO style auditor detailed on page 32 of the study. I believe that the issues identified in the study can be overcome:

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a) whilst not subject to competition it might still have the ability to innovate and improve. The issues that the CMA is currently investigating suggest that the current approach is not necessarily functioning well. There are many innovative public sector bodies that provide services commensurate with private sector equivalents (e.g. the Pension Protection Fund).
b) this does not follow. There are many national bodies that provide oversight and have experience: the PRA and the FCA for example. And of course the National Audit Office.
c) staff could be recruited from the Big Four or from other firms. The FAC would compete with other firms for staff for that technical experience as well as building that in-house. There should be no assumption that a public sector body should pay staff less than in the private sector. The FAC would be a non-profit firm as distinct to a public sector body. Plenty of staff work for bodies such as the Bank of England, the FCA, PPF, Nest, NAO and do so with some success as they offer attractive career paths. The FAC could also do the same and there should be no reason why a career in the audit function at one of the Big Four could be deemed to be more attractive than the proposed FAC. Staff might move from the FAC to the PRA, the FRC or the FCA or NAO from time to time.
d) It would not need to sub contract to other firms. Any entity regulated by the PRA would have those regulated entities audited by the FAC irrespective of the domicile of those PRA regulated entity. That may mean that individuals at the FAC did indeed have to develop some international knowledge; but that knowledge would be applied as to how that international audit requirement integrates into the regulated PRA entity. Indeed it might ensure that non-UK aspects of an entity regulated by the PRA had the same audit quality as those audited in the UK. If other countries were to establish a similar national audit body the FAC could ascribe reciprocity and recognise that any product or service audited by that national body had equivalence of an FAC audit and would not require additional FAC auditing.

Remit: To audit all firms that are regulated by the Prudential Regulation Authority (PRA). I have suggested limiting the FAC to only financial firms at this stage as I perceive a high level of integration amongst financial firms and a high level of overlap of external audit. As financial firms pose structural risk to the economy it may warrant a different audit body in the same way that financial firms are regulated differently to non-financial firms.

Further as detailed below an audit certificate provided by the FAC would be used in the external audit of non-financial firms so there would be some benefit to the non-financial sector (indeed it might mean that as the non financial sector could rely on an audit certificate from the FAC for some of its external audit it would have less audit work and expense).

This would:

- enable other audit firms to provide audits of only non-financial firms increasing their corporate capacity
- ensure that there are fewer conflicts of interest in audit appointments which often limits the choice of external audit firms that a financial firm can realistically choose

Under the proposed approach any financial firm regulated by the PRA would have to appoint the FAC for its external audit function.

That would enable:

- external auditors to provide consultancy services to financial firms without the current audit conflict of interest dilemma (as they would no longer be permitted to conduct audits of financial firms)
- ensure consistency of approach across the audit industry for financial firms
- ensure staff have detailed knowledge and experience of financial audit issues
- identify best in class procedures and audit outputs from one firm and share with another on an anonymised basis
- the PRA could identify specific issues it would like the FAC to focus on drawing on the output of the Financial Policy Committee at the Bank of England

Conduct of an Audit by the FAC

Any firm that has an input into its business that is audited by the FAC would not need to be audited for the output of that audited entity. For example, if the FAC audited an insurance company (Financial Firm A - FFA) any product (Product A FFA/A) that was held by another firm (either financial or non-financial) would not need to be audited again for that product. This reduces duplication and increases productivity; an audit by the FAC would be assumed to run through legal entities and certificate the audit of that product or service:

Example 1:
Financial Firm A (FFA) is regulated by the PRA and produces Product A (FFA / A). FAC audits firm FFA and product FFA / A
Financial Firm B (FFB) is regulated by the PRA and produces Product B (FFA / B). FAC audits firm FFB and product FFA / B

Financial Firm C has only two assets on its balance sheet FFA / A and FFA / B. The FAC audits FFC but in doing so assumes that the valuation, policies and procedures of the assets on FFC's balance sheet are correct (i.e. FFA/A and FFA / B have been audit certificated).

As the products FFA/A and FFA/B have been audit certificated they will be audit certificated for all holders of those products further reducing duplication. The output of FFA and FFB will not be required to be audited at FFC. The audit requirement will be the input into FFC has been correctly applied.
This enables the staff of the FAC to focus on original source audit as well as how products, services and transactions are integrated and managed.

A non-financial firm that holds FFA/A or FFA/B would not require its external auditor to independently value or examine these products as they are deemed to be audit certificated.

Example 2:
A financial firm D provides bank payment services to a range of financial and non-financial customers. The FAC audits FFD and audit certificates its payment services. Firm FFE (financial or non-financial) that uses the payment services of FFD does not need these services to be further audited on the output of those services. All that is required is that the input of the services into FFE is audited; as the process of that service has already been audit certificated the audit requirement is that it is integrated into FFE correctly.

Organisation: A non-profit entity that provides the external audit obligation of all firms regulated by the PRA.

Staff: An employed staff that would audit financial firms. These individuals would be able to audit firms across the financial industry enabling:

- The FAC staff to share the best ideas found at a financial firm and suggest improvements in the post external audit submission at another financial firm
- Staff members to be experts in financial firms, products and services
- Staff members to be able to conduct audits at different times throughout the year so as to plan the FAC's workload and avoid peak to trough workflow
- Additional staff to be appointed for a secondment period from other audit firms (which are restricted to audit non-financial firms) so that there is cross industry collaboration and avoidance of too narrow an industry approach
- The FAC not to rely on secondments or contractors to fulfil its staffing requirements. The staff need to be fully employed by the FAC to reduce agency costs and promote knowledge of the financial audit requirement
- Improvement in productivity of both the external audit staff and the financial audit industry

Financing of the FAC:
Any firm regulated by the PRA would have to be audited by the FAC. A levy based on the gross balance sheet and revenue of any financial firm would be applied:
Using gross balance sheet rather than net assets encourage financial firms to net (compress) transactions
A revenue measure would ensure that service only firms also contribute to the levy
The levy applied would be a function of the budget set by the FAC's Board. As a non-profit entity its cost and revenue should broadly match.
Smaller firms might benefit for this approach. There is a minimum cost in providing an audit function and small firm must incur a larger cost as a proportion of their revenue or balance

sheet. This might promote competition in the financial industry by larger firms implicitly subsidising small firms' external audit fees.

Governance of the FAC:
The Board would include a member from the PRA, the Financial Conduct Authority, the Financial Reporting Council, a representative from a large financial firm, a representative from a small financial firm, a representative from a non-financial firm, a representative from an audit firm (which by definition only provides services to non-financial firms)
Individuals on the board would stand in a personal capacity so neither the PRA or the FCA would be responsible for the FAC and the FAC would not report to either body.