

Competition & Markets Authority (CMA): Statutory audit market – Invitation to comment**Dated 9 October 2018****Response from Santander UK plc****Overview**

1. Santander UK plc (Santander) welcomes the opportunity to input into the CMA Statutory Audit Market Study Invitation to Comment dated 9 October 2018 (the Market Study).
2. Santander is a wholly owned UK subsidiary of Banco Santander and is a public interest entity (PIE) as defined by EU law. It is required under the Companies Act to have its annual accounts subjected to an external audit. As a result, Santander would consider itself an interested party with regard to the Market Study.
3. []

Response to items raised in the Market Study

4. Santander notes that the Market Study does not cover Themes 1 (The scope and purpose of the audit) and 5 (Regulation of audit in the UK). Santander proposes making certain observations relating to Themes 2 (Incentives) and 3 (Choice and switching) as we have relevant experience in relation to the effectiveness of the existing process in these areas. We do not propose to comment on Theme 4 (The resilience of the audit market), other than noting that we would be concerned if any of the Big 4 exited the audit market. In addition, comments have been provided in relation to some of the potential solutions which have been proposed in the Market Study. Where appropriate our comments have been linked to the relevant paragraph within the Market Study.

Incentives*Paragraph 3.18 of the Market Study*

5. Santander recognises that a statutory audit, as currently contracted, is primarily a service for our shareholder. We have robust processes in place to ensure that auditor selection and annual oversight of the audit planning and execution are completed in a transparent and well communicated manner with full challenge from the audit committee, which is comprised solely of non-executive directors.
6. We would also note that our regulators are another key stakeholder and the effectiveness of our external audit process is communicated, challenged and discussed both in bi and tri lateral meetings.

Paragraph 3.19 of the Market Study

7. Following the implementation of legislative changes as a result of work undertaken by both the Competition Commission and the European Commission to address concerns relating to the statutory audit market, and specifically the enhancements to the accountability of auditors to audit committees and extended audit committee reporting, Santander is of the view that a number of the concerns raised in the Market Study have already been mitigated to a large extent, particularly with regard to incentivisation. Santander does, however, fully recognise the importance of addressing the issues of public perception in the context of recent high profile company failures and considers that reviewing the purpose and scope of the audit is core to this, as is a continued focus on audit quality. We do not consider that a high quality audit diverges from our shareholders interest.

Paragraph 3.21 of the Market Study

8. The Santander audit committee considers the data collected by the Financial Reporting Council's (FRC) Audit Quality Report (AQR) and challenges our external auditors as appropriate. Santander's external auditors are also required to communicate the relevant results of their own internal quality processes.

Choice and Switching

9. Santander recognises that the above mentioned legislative changes do not appear to have improved the position of mid-tier auditors and their access to larger audits. This is particularly the case in highly specialised industry sectors or for companies with a large global footprint.

Paragraph 3.25 of the Market Study

10. Santander recognises that the provision by an external auditor of non audit services could create an actual or perceived conflict of interest and therefore welcomes the additional rigour provided by the FRC's Ethical Standard in this regard. Santander operates a robust process, which is further reviewed at a Banco Santander group level, to ensure independence and objectivity in relation to the engagement of our statutory auditor to provide any non audit related services. This includes approval by the audit committee of each engagement, in advance of it commencing, with a full assessment of risks and safeguards as per the Ethical Standard being undertaken. If the statutory auditor is proposed for any non audit work, Santander management have to clear an additional hurdle as to why the statutory auditor is best suited for the role; in this regard, familiarity with the organisation as a result of their role as statutory auditor is not considered suitable justification and there has to be clear, demonstrable business rationale. The audit committee has also adopted, on a voluntary basis, the future EU fee cap of 70% and this is tracked and monitored at each audit committee meeting. Santander has seen no evidence that any non audit related engagements have influenced the outcome of our external audits in any way, nor would we expect them to given the nature of this work and the audit committee's oversight of its allocation.

11. The Banco Santander group has a global presence in a number of jurisdictions including Spain, Portugal, Germany, Poland, US, Brazil, Mexico, Chile and Argentina which requires our external auditors to have global financial services capability. Santander consider that this can only currently be provided by the Big 4 and that this is unlikely to change in the short to medium term.

Paragraph 3.26 of the Market Study

12. The Banco Santander group underwent an audit tender process in 2016, including Santander. Given the specialist industry knowledge required and the global nature of our business, it was considered appropriate at a Banco Santander group level to only request the remaining Big 4 members to tender to replace the incumbent Big 4 audit firm. As noted in paragraph 11, Santander, in a UK context, does not believe that any of the firms outside of the Big 4 currently have a sufficient critical mass in financial services to audit a complex organisation of our scale. However, we consider that a choice of three firms represents sufficient supplier choice and, in addition, each of the firms tendered what Santander considered was a competitive fee.
13. Santander does not consider that a firm auditing one of our competitors represents a reduction in choice as “Chinese Walls” between the audits are capable of being designed and maintained effectively by the audit firms. Indeed, it is necessary for our external auditors to have extensive industry experience and this is most likely to be obtained through other financial services audits.
14. Santander would note that the majority of its audit committee members are not alumni of the Big 4 and at the time of the recent tender, the audit committee chair was also not an alumna of a Big 4 firm. Our audit tender process was designed to avoid bias.
15. Santander does not consider that, with a proactive audit committee acting on its behalf, there are significant limits on shareholder capacity to appraise the external auditor’s performance. However we do agree, based upon our relatively recent tender experience, that there are considerable costs to the business of switching auditor.

Paragraph 3.27 of the Market Study

16. As noted above, the Banco Santander audit was recently re-tendered in accordance with the EU legislation.

Paragraph 3.31 of the Market Study

17. []

Paragraph 3.32 of the Market Study

18. Santander has not seen evidence of competitive pricing, subsidised by consultancy revenues, from the Big 4 in a bid to win audit business. As noted in paragraph 10 above, the Ethical Standard now provides a cap on non audit related services such that consultancy revenues would be insufficient to result in a meaningful subsidy. In addition, non audit services unrelated to the audit are competitively tendered.

Observations in relation to certain proposed specific measures*Paragraphs 4.8 to 4.10 of the Market Study*

19. *Prohibit audit firms from providing non audit services to any large company or PIE:* This would severely restrict choice and remove access to suppliers who currently have a breadth of both corporate and sector experience and specialism. Santander currently use all three members of the Big 4 who are not our external auditors for key projects, in addition to other providers outside of the Big 4. Santander considers that it has a sufficient line of sight on the future timing of any tender such that any party to the tender could become fully independent as at the transition date. This was successfully achieved in relation to the recent tender process, although we would note that for financial service organisations where banking services may be provided to audit firms, independence is dependent upon them finding alternative suppliers. In addition, Santander considers that a strong audit committee is in a position to reject a request from an audit firm not to tender for an audit in order to focus on consultancy work.

Paragraphs 4.18 to 4.22 of the Market Study

20. *Introduction of joint or shared audits:* It is noted in the Market Study that this could include a mandatory joint audit requiring two firms to sign off on the accounts of an audit client with each firm sharing responsibility for the audit opinion and audit liability or a shared audit where one firm takes overall control and responsibility and the other provides support on certain aspects of the audit.
21. It is however difficult to see how this could operate in a cost and time effective manner, as it would result in some duplication of work. Careful consideration would also be required in relation to a number of other aspects, including the timely resolution of any material disagreements between the joint auditors and the practicalities of alignment with reporting to non UK parents for organisations such as Santander, where the end result would involve more than one firm providing input/opinion in relation to a material part of the wider group. In addition, and as noted in paragraph 19 above, to achieve independence audit firms may need to find alternative suppliers for banking services upon appointment as auditor for a

financial services organisation. A joint or shared audit could clearly result in these requirements having a wider reaching impact for audit firms.

22. Santander's reporting cycle is short as we provide results to the market the month after quarter close. More than one audit firm being involved in our audit would create additional complexity and potential delay.
23. There are common control systems between a UK based PIE with a non UK parent which, if there were control issues, would become harder to address in an effective manner where audit responsibility is different between the parent and subsidiary.
24. The third option outlined in the paper, of a peer review prior to formal sign off by the statutory auditor, would overcome some of these issues and so could develop greater market access for non-Big 4 firms, albeit the time and incremental cost constraints would still exist.

Paragraphs 4.34 to 4.36 of the Market Study

25. *Increasing the frequency of mandatory tendering and rotation:* Having recently been through this process, the time commitment by both the entity undertaking the tendering cannot be underestimated. As noted in paragraph 19 above, there are issues of independence that need to be addressed pre appointment and there is a clear period of time post appointment in which the new firm undertakes a steep learning curve in terms of understanding systems, processes and personnel, supported by additional commitment of management time. Increasing the frequency of tendering and rotation is likely to be detrimental not only from a time and value perspective but one would also expect audit costs to increase as a result. As noted in para 21 above, for organisations such as Santander there would be the added complexity of having potentially different auditors at a local versus group level.
26. The mandatory requirement in relation to tendering, which Santander fully supports, has only recently been introduced and we consider that its impact on audit quality should be monitored before consideration is given to increasing the frequency of tendering.

Paragraphs 4.40 to 4.45 of the Market Study

27. *Moving the responsibility for appointing auditors away from the audited company through the appointment of an independent body:* If there were a level playing field across all audit firms in terms of specialism, capacity and global reach this proposal could theoretically address any concerns regarding both incentivisation and competition. However, in practice this balance would be extremely difficult to achieve, certainly in the short to medium term. As a regulated entity our Chief Financial Officer and Chair of the audit committee, amongst others, are subject to the Senior Managers & Certification Regime (SMCR) with severe penalties for failure. Removing the responsibility for auditor choice from an organisation, and thereby reducing responsibility for one of our key controls over financial reporting, would not align with the SMCR and other governance and regulatory responsibilities of senior management and board members. An effective audit is regarded as a key component of the comfort the

audit committee obtains in relation to financial reporting. An alternative would be for an independent body to monitor any future audit tenders to ensure they were free of bias.

Paragraphs 4.50 and 4.51 3.26 of the Market Study

28. *NAO style national auditor:* As with the proposal noted in paragraph 20, this would lead to a disconnect with the approach adopted at a group level. We understand that a number of the capabilities and techniques to audit specialist industries, such as financial services, are developed by audit firms on a global basis to which a NAO style auditor would not be party. It is very difficult to see how a national auditor could successfully deliver a process to audit all UK large companies and PIEs, attracting and retaining staff of appropriate technical/sectorial expertise and creating a competitive operating environment.

Conclusion

29. Santander recognises that, whilst there has been improvement, via legislative change and proactive action, to certain aspects of the statutory audit market this has not necessarily resulted in reduced barriers for non-Big 4 firms to build their capacity. In addition there are public perception issues relating to audit quality that need to be addressed.
30. Santander would therefore be supportive of enhancements to the existing measures subject to an organisation retaining responsibility to choose and engage an appropriate statutory audit firm, with the right calibre of technical skill and competence to deliver an audit that satisfies the needs of shareholders on a timely basis and without additional or unnecessary cost.