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Statutory audit market study
Competition and Markets Authority
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Victoria House
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21 January 2019

Dear Sir

Statutory audit market – invitation to comment

I write on behalf of Nationwide Building Society's Audit Committee to comment on your Statutory audit services market study Update paper dated 18 December 2018.

I have not repeated here the comments made in our earlier response to the CMA's invitation to comment on the proposed study, but note that the report has not changed our previous comments. This letter focuses on the proposed remedies set out in your Update paper. In overall terms we would emphasise strongly:

- the importance of maintaining focus on audit quality;
- assessing any remedies on their contribution to improving quality;

- we are concerned that a number of the remedies focus on increasing participation in the audit market but not on benefits to customers (being the audit committee on behalf of members/shareholders) and specifically quality.

We believe that a number of the proposed remedies might have the inadvertent impact of damaging audit quality to the detriment of stakeholders.

We wholly or partly support a number of the proposed remedies.

Regulatory scrutiny of how audit committees carry out their duties in respect of auditor appointment and monitoring, without diluting the responsibility of the Audit Committee (Remedy 1), is a reasonable measure. In most cases this should be a retrospective review by the Audit, Reporting and Governance Authority (ARGA), but in high risk situations could entail continuous monitoring of the appointment process by ARGA. We would anticipate ARGA developing a risk adjusted approach to oversight.

We are also supportive in general of measures which will help challenger firms to develop their experience and expertise to enable them in due course to take on larger and more complex audits (Remedy 3) although, as recognised in the Update paper, these need to be explored further. We are supportive of reducing the barriers to senior staff moving provided they are proportionate particularly from a client perspective eg it is important to take into account the impact on an existing audit. We are open minded on the sharing of technology provided implementation, training, maintenance and charging are robust. It will be necessary to determine who owns the technology (it may not be the UK member firms of the Big 4) and to ensure that the pricing is sufficient to ensure ongoing investment.

We support exploring protecting the resilience of the Big 4 (Remedy 4). The adequacy of capital and insurance play a major part in this together with corporate veils between member firms. Detailed work needs to be undertaken to seek to ensure that insolvency law does not detract from the wider public interest. Ring fencing of audit firms could restrict availability of capital. We consider there is a greater chance of audit failure (rather than other services) affecting the resilience of Big 4 firms and so there is a resilience benefit in ensuring all services are provided through one limited liability partnership.

We believe there is some merit in operational independence of Big 4 firms' audit practices from their consulting services, although any remedy must ensure that auditors continue to have access to specialists who play a critical role in audit of technically complex and specialist subjects. It will be important to balance the costs of operational independence against the benefits. We do not support or believe it is necessary to have greater prohibitions on non-audit services and reiterate our belief that conflicts of interest can be overcome by the introduction of shared audits and an onus on audit committees to ensure that they do not engage big 4 firms for services that would stop a firm tendering for an audit. However, we do not support changed legal structures for firms and believe they would primarily be for perception benefits rather than tangible benefits. We are concerned that any legal separation of audit practices from the remainder of the firms by, for example, ring fencing would reduce resilience due to reduced access to capital. We consider it probable that the ARGA will be able reduce the chances of a catastrophic auditing failure in this country and so consider that resilience and related matters should be part of ARGA's terms of reference.

We do however have strong objections to some of the proposed remedies.

We do not believe that mandatory joint audit (Remedy 2) would contribute to improving audit quality, and it would increase significantly the cost and inefficiency of the audit process. Mandating that a challenger firm undertakes a significant part of a large audit exposes that firm to challenges arising from a lack of experience and expertise needed to carry out the work, and does not give the firm an opportunity to develop that experience before becoming responsible for the audit. We believe strongly that developing expertise over time is essential to enable challenger firms to succeed, and will be critical to ensuring that audit quality is maintained and indeed improved. A rushed change could well be detrimental to audit quality and undermine the remedy. The suggestion that for a specialist company, two Big Four firms might act as joint auditors illustrates this problem; the need to implement joint audits in this way would also clearly further restrict choice of audit firm for complex businesses who would only have a choice of two firms when one of the incumbents is due for rotation. This will be particularly relevant in complex financial services companies that comprise a major part of the UK economy. Further, on the realistic assumption that all firms' partners and staff are fully engaged currently, the report fails to address the need for a very significant number of new auditors that would need to be recruited and trained (a process that takes c. 12 years to reach partner level) as a result of the duplication of work required in joint audits. It also fails to address the cost and appetite of insurers for the substantially increased risk in all firms, but particularly the challenger firms, arising from joint and several liability.

We are strongly of the view that a shared audit would be a preferable approach, particularly as it allows a challenger firm to develop experience and would serve to overcome restrictions on audit tendering arising from narrowly defined and relatively trivial independence issues; the secondary firm would undertake work where the independence of the statutory auditor is impaired, reporting both to the company and to the appointed statutory auditor. This would increase competition. We also oppose a market share cap (Remedy 2A), as explained in our earlier response. We believe that this undermines the accountability and control of the audit committee, and that there is a risk that certain companies find that the choice of firms available to act as auditor is limited unacceptably, potentially to firms who lack relevant expertise. This damages audit quality, choice and competition. Consequently, we do not support this remedy for the FTSE350 or any other entities.

We are not supportive of a tendering fund (Remedy 3). It is unclear who would pay for the tendering fund. Whether it is corporates directly or the Big 4 and hence the corporates indirectly, this would interfere with the market place and increase overhead costs. We are supportive of tendering costs being commensurate with work to be realistically undertaken which would be the case with shared audits.

We do not support general peer reviews. All big 4 audits are reviewed by independent partners prior to the issue of audit opinions. The introduction of a third party, particularly with the scope of duties set out in the report would add substantial cost and time to the completion of audit reports which would in turn interfere with the effective operations of capital markets that require the timely provision of information. We believe quality should be judged by ARGA that could in exceptional circumstances impose reviews in high risk situations or where there is prima facie indication of deficient governance or audit quality.

Yours faithfully

KAH Parry OBE MA FCA

Audit Committee Chairman, Nationwide Building Society