

Our ref PRM/AFE/00100000

21 January 2019

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

Dear Sirs

### **Statutory audit services market study**

Kreston Reeves LLP appreciates the opportunity to respond to the Update paper issued on 18 December 2018 as part of your study of the statutory audit market.

Kreston Reeves LLP is a firm of Chartered Accountants that is amongst the top 25 largest firms in the United Kingdom. Based in London and the South East, we predominantly operate in the SME market providing audit and other accountancy services. Our client portfolio does though extend to include AIM-listed companies. We are a member firm of Kreston International, a global network of independent accounting firms. We are also a member of the Association of Practising Accountants and the Forum of Firms.

By virtue of our size and client base, as a firm we do not have experience of all the matters being considered by the update paper. We consider it vital however that the study takes into account the views of mid-tier firms such as ourselves, thus we have provided responses to those questions in the update paper where we feel that our opinion has sufficient merit to be considered as part of the study. These detailed responses to the questions raised in the invitation to comment are contained in Appendix 1.

### **Key points**

*As with our response to your initial consultation, our primary concern is that care should be taken not to overburden the bulk of the audit profession and the SMEs that they serve as a consequence of issues that relate solely to the top tier of the audit profession and public interest entities.*

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If you have any questions on the contents of this letter then please contact Peter Manser at the address shown.

Yours faithfully

*Krista Leever LLP*

## **Appendix 1**

### **Statutory audit market Invitation to comment**

#### **Responses to specific questions**

##### **Question 1**

Do you agree with our analysis in section 2 of the concerns about audit quality?

*We acknowledge the significant concerns that currently exist regarding audit quality, and agree with your detailed analysis set out in section 2, only insofar as it relates to the audit of public interest entities.*

*We are of the opinion though that the situation for the provision of audit services in the SME market is somewhat different, where there is considerable competition between providers and no evidence that suggests poor audit quality is an issue.*

*Our paramount concern is therefore that any measures introduced to address issues of audit quality do not have any adverse impact on the SME market.*

##### **Question 2**

Do you agree with our analysis of the issues that are driving quality concerns, as set out in section 3? In particular:

- a. Issues relating to the role of Audit Committees and investors in the process of appointing and monitoring auditors;
- b. Limitations on choice leading to weaker competition;
- c. Barriers to challenger forms for FTS<sup>350</sup> audits;
- d. Resilience concerns; and
- e. Wider incentive issues raised by the multi-disciplinary nature of the large audit forms.

*We agree with your detailed analysis of the issues driving quality concerns in the market for the audit of public interest entities.*

##### **Question 3**

For all remedies, what should the scope of each remedy be?

*We are of the opinion that it would be sensible that common criteria should be applied to all remedies in order to avoid confusion and promote ease of application. In deed, we would welcome a common definition of what constitutes a public interest audit that can be applied across the entire regulatory framework for the same reasons, including in respect of the application of reporting, auditing and ethical standards.*

*The criteria to be used should take account of the needs of the wider body of stakeholders that place reliance upon financial reporting. We would not use membership of the FTSE350 though as the sole criteria for setting the scope, given the volatile nature of its membership being reconsidered quarterly.*

#### **Question 4**

How could the regulatory scrutiny remedy be best designed to ensure that the requirements placed on Audit Committees by a regulator are concrete, measurable and able to hold Audit Committees to account?

*We believe that the composition of Audit Committees should reflect the various stakeholder interests in a company. This includes the interests of the Regulator, whether it be the Financial Reporting Council or a potential successor. Some form of public reporting by Audit Committees to the Regulator on key decisions such as auditor appointment we do consider would be of benefit. It would be part of the Regulator's role to ensure that quality is the principal factor used when selecting auditors and when reviewing the audit engagement.*

#### **Questions 5 – 9: Mandatory joint audit**

*As a mid-tier firm we have a particular interest in the development of ways by which we will be able to gain greater access to the market for providing audit services to public interest entities. We are of the opinion that greater adoption of shared audit would be the best means of doing so, providing us with an opportunity to gain valuable market experience. We are thus disappointed to see that it is joint audit that is the preferred remedy. We would not consider ourselves at present to be a challenger firm, lacking the resources or experience at this time to be considered such, and consequently feel unable to put ourselves forward as a potential joint auditor under the proposals you are suggesting.*

*This is not to suggest that we do not see joint audit as a viable remedy to help address issues of audit quality. Only that a combination of joint and shared audit should be considered as a potential way forward. By undertaking the audit of subsidiary undertakings in large listed groups, or through performance of part of the audit work of an entity such as assisting with physical stock take attendance, we are of the opinion that shared audit could greatly help to address the audit quality issues that currently exist.*

*With regards specifically to questions raised regarding joint audit, for it to have any significant impact both audit firms will need to be able to demonstrate that they have the appropriate resources, experience and skills necessary for the engagement. Although designed to provide an access route for challenger firms to FTSE350 companies, it does not seem practical at this stage to mandate that one of the audit firms must be a challenger firm, as this criteria may be impossible to meet. For example no challenger firm may at present be able to demonstrate that they have the capability to be involved in a specialist audit such as that of a bank.*

### **Questions 10 – 11: Market share cap**

*It is clearly desirable to avoid over-concentration of audit engagements in a small group of providers. Having reflected further on the merits of implementing a market share cap, we do foresee practical problems that make us question whether it is desirable to introduce such a measure.*

*A market share cap will restrict choice, with companies unable to appoint a provider that already has a full allocation. This appears contrary to the aims of trying to improve competition and audit quality.*

*We are of the opinion that other potential remedies such as joint and shared audit engagements offer a better alternative solution to increasing competition and improving audit quality.*

### **Questions 12 – 14: Additional measures**

*We do not have any experience on the existence of barriers to senior staff switching quickly and smoothly between firms, although there have been issues regarding the time it can take for individuals to obtain the necessary practicing certificate and responsible individual status that enable them to take up the role of an audit partner. We believe that firms such as ours already offer attractive career opportunities for those looking to develop their role in audit, and we hope that the issues now being considered by the CMA will only help to enhance this and make it easier to attract high calibre staff and partners.*

*We are unable to estimate the cost of establishing a tendering fund.*

*We aware that Big Four firms make considerable investment in their audit approach to develop new techniques that will give them a competitive edge over their rivals, and we would welcome access to such technologies where they would help to improve audit quality and efficiency. Compelling the Big Four to make these developments available to challenger firms could though prove to be a disincentive for them, if they are unable to retain the competitive advantages that they bring.*

### **Questions 15 – 18: Market resilience**

*We share the Authority's concerns regarding market resilience, with regards to the provision of audit services to public interest entities. Clearly the regulator, whether the FRC or a successor body, needs to carefully monitor the market and identify any issues that could result in any further weakening to the level of competition that currently exists.*

*We could support the introduction of some form of solvency requirement, similar to that which already exists for financial services providers, as a way of trying to limit audit firms' exposure to potential insolvency. The introduction of controls though to limit the movement of clients and staff appears unworkable to us.*

*Should an audit firm appear to be failing through significant loss of clients, it would probably be due in part to perceived poor audit quality. Restricting the ability of clients to move to another firm appears counter intuitive to a desire to improve standards of quality.*

### **Question 19 – 24: Full structural or operational split**

*We agree that the challenges to implement a full structural split are surmountable with international cooperation, but not that it is desirable. In our opinion an operational split should*

*be the preferred approach, as this should be able to create substantially the same benefits for competition and quality, but at less cost and disruption.*

*Being unlikely to be subject to any structural or operational split we have not considered this issue further.*

#### **Questions 25 – 26: Peer review**

*We share the CMA's view that peer review has the potential to play an important role in driving up audit quality, by identifying issues and addressing them before they can have an adverse effect. In our own experience we appreciate the benefits the internal Engagement Quality Control Review can have on audit quality, and this proposal builds upon this concept.*

*The scope of this remedy needs to take into account the availability of suitable reviewers to undertake the work, and to allow them the time to do so effectively. Measures will need to be introduced to ensure that there are sufficient reviewers beyond the Big Four and have the expertise and resources to undertake this work. Knowing this would help to be able to assess the scope and frequency of peer reviews.*

*It is our opinion that the knowledge that your work is going to be subject to independent review should be enough in itself to ensure a high level of scepticism.*

#### **Question 27**

*We have no views regarding your decision not to make a market investigation reference.*