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

Via Email: statutoryauditmarket@cma.gov.uk

Statutory Audit Market Study
December 2018 Update

Dear Sir/Madam

IFAC, the International Federation of Accountants, welcomes the opportunity to comment on the Competition & Markets Authority's *Update on the Statutory Audit Market Study* of December 18, 2018 (the Update). IFAC is well-placed to provide an international perspective. Our comments include contextual observations regarding audit quality, urging the need for further analysis of the proposals to avoid unintended consequences, and views on the proposed remedies outlined in the Update including potential international impacts anticipated.

IFAC strongly agrees the Update raises important issues. We share the view that independent high-quality audits provide an essential service to shareholders and the wider public interest. Underpinning that service is audit quality, which must remain the paramount objective. IFAC reconfirms its view (stated in our October 9th 2018 response to the CMA Invitation to Comment) that a clear definition of audit quality is required to properly consider any proposals against this objective[1].

IFAC notes the speed with which the CMA has conducted its Statutory Audit Market Study. While recognizing the desire to reduce uncertainty and disruption, IFAC suggests considerable additional impact and cost benefit analysis to ensure remedies are effectively achieving objectives, and that unintended consequences do not undermine audit quality.

Our comments on certain remedies proposed in the Update are attached to this letter.

Please do not hesitate to contact me should you have any questions.

Yours sincerely

Kevin Dancey

Chief Executive Officer

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[1] We recommend the *Framework for Audit Quality* issued by the International Auditing and Assurance Standards Board to more comprehensively conceptualize audit quality.

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IFAC Comments on Remedies Proposed in the Update

CMA PROPOSAL	INTERNATIONAL IMPACTS	IFAC COMMENTS
Remedy 1: Increased regulatory scrutiny of auditor appointment and management	**Not immediately apparent.**	**Support with caution.** IFAC would support strengthened audit committee accountability and oversight, however we are concerned some proposals in the Update may weaken rather than strengthen their role. IFAC's previous CMA submission recommended strengthening Audit Committees and their accountability to shareholders. We believe audit committees are best placed to know their business and represent shareholders in appointing auditors and overseeing the audit. It is hard to envisage regulators replicating business and shareholder proximity, or the skillset of an effective audit committee. Regulatory oversight should be proportionate, and structured to strengthen the Audit Committees' role rather than possible 'second guessing' of judgement. The right balance must be struck, or a fundamental part of the existing audit framework will be weakened. Highly capable candidates must not be discouraged from seeking audit committee appointment. IFAC believes reporting requirements and increased scrutiny will be more successful if carefully applied on an exception basis to enhance oversight, rather than becoming a compliance exercise. We do not believe regulatory involvement in the auditor appointment process, or participation in audit committee meetings, will strengthen accountability. IFAC notes that in addition to direct regulatory measures, we reiterate our support for enhancements to auditor

		appointment transparency and management as outlined in the CMA's previous Invitation to Comment.
Remedy 2: Mandatory joint audit **Remedy 2A: Market share cap**	**Joint audits potentially significant.** Many FTSE 350 constituents have international operations. The joint audit of an international group is significantly more complex than within a single firm network. **Market share cap moderate.** Extraterritorial impacts may arise in auditor appointments involving international groups either headquartered or listed in the UK.	**IFAC believes there is insufficient evidence that joint audits have a positive impact on audit quality.** IFAC also cautions on the possible negative impacts on audit quality due to confusion over roles and responsibilities and complexity of decision making. Implementing a mandatory joint audit regime could have significant cost and efficiency implications. That doesn't mean the issue shouldn't be further studied. Such a review needs to consider all of the potential implications of the change and the views of all stakeholders, including the views of audit committees (the buyer of audit services). The cost of the change as well as possible negative impacts on audit quality due to confusion over roles and responsibilities and complexity of decision making would also need to be considered. **Support with caution.** IFAC may support a market share cap as less disruptive alternative to joint audits. A market share cap could assist non-Big 4 FTSE 350 capacity building. We have residual implementation concerns. Further information and impact analysis is required.
Remedy 4: Resilience regime	**Potentially significant.** As the Update does not contain proposal design details, there is the potential for significant international impacts if non-UK business and firm clients fall within the regime scope.	**Support with caution.** As recognized by the CMA, a resilience regime can create substantial complexity and unintended consequences risks. IFAC may support the resilience regime principle, which recognizes that audit firms play a major role in the economy. We caution that a detailed scheme design is critical to both its success and avoiding possible unintended consequences, including international impacts.

Remedy 5: Separation of audit and advisory businesses	**Operational separation moderate.** Possible administrative challenges associated with international audit and/or advisory services appointments, although not insurmountable. **Full separation very significant.** IFAC's previous CMA submission advised that full separation would likely significantly impact international auditor appointments and UK firm participation in international networks (notwithstanding, the CMA propose such a measure would still allow UK audit only firms to be part of an international multidisciplinary network).	**Do not support 'operational separation'; do not support 'full separation'.** IFAC restates its view that operational and full separation will negatively impact audit quality, as outlined in our previous submission to the CMA[2] and reiterated in our October 24, 2018 Politico Op-ed. IFAC notes that any measures should not handicap any firms' ability to deliver high quality audits or hamper choice, regardless of size.
Remedy 6: Peer review of audits	**Not immediately apparent.**	**Support with caution.** IFAC supports this measure on the proviso that peer review scope is appropriate; does not disrupt the performance of actual audit engagements; and does not duplicate existing review mechanisms. More information is required to fully assess this proposal.

[2] IFAC's submission on the CMA's previous Invitation to Comment stated "we agree with the concerns around splitting major accounting firms into audit-only and non-audit practices outlined in the ITC. In particular, we agree that there is significant potential for adverse impacts on audit quality due to lack of in-house multidisciplinary expertise increasingly required on large, complex audits, and hampering the ability of firms to attract qualified staff. Current trends toward broader, multi-capital reporting, the increasing complexity of businesses, and demands of financial reporting underscore the need for multidisciplinary firms."

IFAC