

Competition and Markets Authority

Via Email: statutoryauditmarket@cma.gov.uk

Management and Investment Resources

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Response to Consultation on the Updated Paper on Statutory Audit Services Market Study

I am responding to this consultation as someone who is an active investor in the shares of listed companies. My answers to the detailed questions are given below in red, but let me say that on the whole I support the recommendations in the report. As you indicate therein, there have been too many failures of audits and improving the quality of audits is exceedingly important to investors who rely on the information published by companies.

I have only responded to those questions which are of wider interest to investors in companies.

Consultation questions

1) Issues

- a. Do you agree with our analysis in section two of the concerns about audit quality? **Yes**
- b. Do you agree with our analysis of the issues that are driving quality concerns, as set out in section three? **Yes**

2) Remedies

For all remedies:

3. What should the scope of each remedy be? Please explain your reasoning. For example, should each remedy apply to all FTSE 350 companies, or be expanded to include PIEs or large privately-owned companies that could be

deemed to be in the public interest? I would support the proposed remedies being applied to all FTSE-350 companies and to large privately-owned companies. However I would like smaller fully listed and AIM companies to be covered by some of the remedies as the same audit problems appear in such companies and many AIM companies are now quite large. It might create a perverse incentive for listed companies to move down to AIM if they could reduce audit costs by doing so. But I accept that it would be too costly to include the smallest companies in the remedies.

Remedy 1: Regulatory scrutiny of Audit Committees

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? Please respond in relation to requirements both during the tender selection process and during the audit engagement. This is a difficult question to answer without a clearer definition of what it is hoped to achieve. In general a “principle” based approach rather than a “rule” based approach seems wise if excessive complexity and cost is to be avoided.

Remedy 2: Mandatory joint audit

5. What should the scope of this remedy be? Please explain your reasoning. Should the requirement to have a joint audit apply to all FTSE 350 companies or potentially go wider by including large private companies? I suggest that this remedy be only applicable to FTSE 350 companies and larger AIM companies. What types of companies (if any) should be excluded from a requirement for joint audit? None that I can think of.
6. Should one of the joint auditors be required to be a challenger firm? Yes. If so, should this be required for all companies subject to joint audit? Yes. Are there any categories of companies to which this requirement should not apply? Please explain your reasoning for each of the answers.
7. Should a minimum amount of work (and fee) allocated to each joint auditor be set by a regulator? Yes. If so, should the same splits apply across the FTSE 350? Yes (please comment on the illustrative examples in section four). Please explain your reasoning.
8. Our provisional view is that there would be merit in the joint auditors being appointed at different times. Should this be mandated, or left to the choice of individual companies? I see no reason to mandate this. How should companies manage (or be mandated to manage) the transition from a single auditor to joint auditors?

9. Should a joint liability framework be introduced to encourage active participation in the market by the Big Four and challenger firms? Please explain your reasoning. In the context of joint audits, what are the advantages or disadvantages of auditor liability being proportionate to the audit fee of the joint auditors, compared to the auditors being jointly and severally liable? **So far as investors are concerned, joint and several liability would be a positive advantage to ensure audit quality in theory. But in practice as auditors avoid liability for most failings, it might not matter a great deal.**

Remedy 2A: Market share cap

10. How could the risks associated with a market share cap, such as cherry-picking, be addressed? **In general I am not supportive of a market share cap remedy. It might distort competition rather than improve it.**
11. Would it need to apply only to FTSE 350 companies, or also to other large companies, and if so, which?

Remedy 3: Additional measures to reduce barriers for challenger firms

12. We welcome evidence from stakeholders on the existence of barriers to senior staff (including partners) switching quickly and smoothly between firms. We also welcome views on how justified such barriers are, bearing in mind commercial considerations that audit firms have.
13. We welcome estimates on the costs of setting up and running a tendering fund or equivalent subsidy scheme, and views as to how this should be designed.
14. We welcome comments as to whether the Big Four should be compelled to license their technology platforms at a reasonable cost to the challenger firms, and/or contribute resources (financial, technical, algorithms and data to enable machine learning) towards developing an open-source platform. In the first scenario, we also welcome comments on how such a 'reasonable cost' might be determined in such a way that it is affordable for challenger firms but does not disincentivise Big Four firms from innovating and developing new platforms. **I doubt the practicality of compelling licensing of technology platforms and it might discourage innovation. Encouragement of independent third-party solutions is what is required which will only be viable if the audit market is made more open and less dominated by a few audit firms.**

Remedy 4: Market resilience

15. How could a resilience system be designed to prevent the Big Four becoming the Big Three, not just in the case of a sudden event, but also in the case of a gradual decline? Please also comment on our initial views to disincentivise and/or prohibit the movement of audit clients (and staff) to another Big Four firm.
16. How could such a system prevent moral hazard? Please comment on our initial view.
17. What powers would a regulator and a special administrator require, and how would their roles be divided? At what point should a regulator or a special administrator be able to exercise executive control over a distressed firm? Please comment on our initial view.
18. What could be done regarding the challenges relating to the fact that an audit firm's value lies in its people and clients – which would be complicated to restrict? Please comment on our initial view.

Remedy 5: Full structural or operational split

19. Do you agree with the view that the challenges to implement a full structural split are surmountable (especially relating to the international networks)? **A full structural split would certainly be preferable But I find it difficult to comment on the practicality of doing so.** If not, please explain why it would be unachievable, i.e. that the barriers to implement this remedy could never be overcome, including through a legislative process.
20. How could an operational split be designed so that it would be as effective as the full structural split in achieving its aims, without imposing the costs of a full structural split? In your responses, please also compare and contrast the full structural split to the operational split.
21. With regards to the operational split, please provide comments on:
 - implementation risks and whether they are surmountable: e.g. how any defined benefit pension schemes could be separated between audit and non-audit services;
 - risks of circumvention and how they could be addressed e.g. how audit firms could circumvent the remedy through non-arm's-length transfer pricing and cost allocations;

- implementation timescales to separate the audit firms and how soon the remedy could be brought into effect;
 - ongoing monitoring costs for the audit firms and a regulator;
 - role and competencies of a regulator in overseeing ongoing adherence to the operational split.
22. Under an operational split, how far, if at all, should it be possible to relax the current restrictions on non-audit services to audit clients? For example through changes to the blacklist or to the current 70% limit.
23. Should challenger firms be included within the scope of the structural and operational split remedies? **I can see no reason to exclude them. To do so would create competitive anomalies.**
24. Which non-audit services (services other than statutory audits) should the audit practices be permitted to provide under a full structural split and operational split? **I can see no reasons for exceptions.** Please explain your reasoning.

Remedy 6: Peer review

25. What should be the scope (ie which companies) and frequency of peer reviews, if used as a regulatory tool? **I would suggest all fully listed and AIM companies be covered and that such reviews be undertaken on all such companies at least every three years with some companies that are likely to be more at risk of audit failings having random more frequent reviews. Additional reviews might also be prompted by expressed shareholder or other stakeholder concerns.**
26. How could peer reviews be designed to best incentivise auditors to retain a high level of scepticism, and thus improve audit quality? **It's surely simply a question of making sure the peer reviews were of adequate quality and not biased by knowledge of the audit firm in question or past practices.**

C) Next steps

27. What are your views, if any, on our proposal not to make a market investigation reference?

Yours sincerely

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Managing Director