



Statutory Audit Market Study
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On behalf of Royal Dutch Shell
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By email: statutoryauditmarket@cma.gov.uk

January 23, 2019

RE: Statutory audit market study – Update paper

To the Statutory Audit Market Study Project Team,

Thank you for the opportunity to respond to your statutory audit services market study update paper as issued on December 18, 2018. I am responding as Group Antitrust Counsel of Royal Dutch Shell plc (“Royal Dutch Shell” or “Shell”), and on behalf of Royal Dutch Shell and its subsidiaries.

As an FTSE 100 company, Shell engages a UK-based audit firm to conduct one of the largest audits both within and outside the UK. As such, Shell has a particular interest in a well functioning UK audit market that enables us to engage an auditor that provides a high quality audit in an efficient manner. In some respects, we support your proposals and believe that, when applied proportionally, they could lead to a better functioning audit market with higher quality audits and a greater selection of audit firms from which to choose. This may be evidenced by the approach taken in our latest audit tender that focused on appointment and management of our external auditors based entirely on quality¹. We also established full focus of our auditors on their audit activities by only allowing services that are not related to the audit on an exceptional and immaterial basis². We would like to take this opportunity to comment on three specific elements of the latest proposed remedies.

Mandated joint audits

We have specific and grave concerns on the plan to introduce mandated joint audits. The audit of Shell is one of the particularly complex audits mentioned in your report. This brings significant impracticalities to a joint audit, particularly where it concerns the audit of businesses that operate on a truly global basis.

Shell operates globally with geographically widespread activities and significant controlling, accounting and reporting activities concentrated in Shell Business Operations (SBOs) centres outside the UK. In these SBOs, processes are managed on a global basis and go across segments, countries and legal entities. The country audit partners around the world place reliance on the work performed by centralised audit teams in these SBOs. Sharing responsibility of audit between audit firms will add complexity, inefficiency, and cost. Most importantly is very likely to result in erosion of audit quality.

¹ <https://www.shell.com/investors/environmental-social-and-governance/corporate-governance-library/shell-audit-tender-process-disclosure.html>

² Shell Annual Report and Form 20 F 2017, Note 28 Auditor’s remuneration

Under the CMA's proposed remedy, a challenger audit firm would have to be assigned a "significant proportion of audit work", from 10% initially and gradually increasing to 40-50% as the challenger firms build their capacity. While the challenger firms in the UK may be building their strength and sector knowledge over time following the proposed remedy, there is no mechanism to ensure that their member firms outside the UK will build capability and appropriate sector knowledge to the same extent, given the absence of a similar mandated joint audit requirement outside the UK. This brings a problem of the challenger firm being able to meaningfully address global scope invalidating the CMA objective of assigning a "significant proportion of audit work".

Furthermore, as mentioned in the CMA report, there are very mixed views on whether joint audits improve or decrease the quality of the audit. The main purpose of the mandated joint audit proposal would be to strengthen the challenger firms. We believe that there are better ways to achieve this objective. Foremost, mandated joint audits involving challenger audit firms would need to address the lack of deep sector knowledge and capability. Secondment schemes where audit staff from smaller firms are able to develop capability at larger firms, and in sectors currently not served by these smaller firms, would be a more effective way to broaden the base of audit capability and quality. This would give the challenger firms the ability to strengthen their practice (and ultimately to increase competition in the audit market) without introducing a mandated joint audit requirement.

Regulatory scrutiny of Audit Committees

The report introduces specific regulatory requirements and obligations for audit committees in order to focus competition on quality rather than price. In the CMA report it is noted that "Overall, the evidence from recent tenders suggests that quality is typically viewed as more important than price." The remedy does not appear to address a widespread issue. We are of the opinion that the proposed remedies, in respect of audit committees having to report directly to the regulator and the regulator appointing observers, should only be considered selectively where there are specific concerns. There are a number of companies that demonstrate sound governance and have effective audit processes (as demonstrated by successive good audit quality review outcomes). It would be disproportionate to mandate overly burdensome and impractical requirements for these companies.

We would also note that in relation to our latest audit tender we made disclosures in our 2015 Annual Report about the tender process followed by a paper published describing the tender process and the criteria applied in that process. In our case the information that the CMA would require under the remedy is already publicly available.

Split between audit and non-audit services

Our final observation concerns the proposed forced separation of audit and non-audit services. Many companies, Shell included, apply a policy where the external audit firm is prohibited from providing any services that are not related to the audit, such as advisory services. This is an important policy that is intended to ensure that appropriate auditor independence will be maintained. However, in the execution of the audit it is important that auditors have available appropriate expertise on matters such as taxation, M&A activities, oil and gas reserves etc., to deliver a high-quality audit.

We request that you reconsider the proposed remedy introducing mandatory joint audits because there is no evidence that it would improve audit quality and it raises serious practical challenges regarding implementation.

We take audit quality very seriously and remain open to further consultation and engagement so that remedies to

improve competition and audit quality can be developed that are proportionate, effective and, wherever possible, evidence based. To this end we believe a holistic review of recommendations following the CMA market study, the Kingman Review and the Brydon Review is warranted.

Yours faithfully,

Anne Riley
Group Antitrust Counsel and Associate General Counsel