

The reference of the audit market to the CMA came about because of the failure of the auditors of Carillion to predict its failure. It was assumed that higher quality audits would help to prevent the failure of companies, and that a more competitive audit market would improve the quality of audits. The study has not verified these assumptions, and hasn't defined audit quality.

The study has recommended:

1. A split between audit and advisory businesses;
2. Regulatory scrutiny of auditor appointment and management;
3. Encouraging more choice.

There is no evidence that these recommendations, if implemented, would increase the quality of audits or prevent the failure of companies. On the contrary, it is likely that they would increase the complexity of audit, and thereby reduce the quality of audits and increase their cost.

The root cause of insufficient scepticism and independent challenge from auditors is auditors' employment and remuneration by companies. To quote from the *Operation of the audit market: letter from Sir John Kingman to Rt Hon Greg Clark*, "The customers for [auditors'] product are external users of accounts – a company's stakeholders, particularly investors – who clearly do want robust scepticism and challenge. But the customers are not buying the service. If auditors feel obligations to these external stakeholders, they are distant and rather theoretical. With the company, by marked contrast, the auditor has a close and important commercial relationship. And yet the product we are talking about, being purchased on behalf of external stakeholders, is to mark, supposedly objectively and ruthlessly, the company's homework for them."

Auditors are paid by the companies they audit; they would like to continue receiving that payment; therefore they have an incentive to please the companies' leaders by ignoring issues.

Sir John offers this solution: "Instead of an auditor being proposed by the company's board and approved by shareholders, the appointment would be made by an independent body representing the public interest (as, for many years, local authority auditors were, by the Audit Commission). This body would also set the audit fee."

I would go further and recommend that audit should be made a regulatory function governed by the proposed Audit, Reporting and Governance Authority with auditors appointed and remunerated by the Authority from a levy on companies. This change would increase the probability of auditors being appointed purely on the basis of their objectivity and audit ability.