

## Competition & Markets Authority (CMA): Statutory audit market – Update paper

Dated 18 December 2018

### Response from Santander UK plc

#### Overview

1. Having previously submitted a response to the Invitation to Comment issued on 9 October 2018, Santander UK plc (Santander) welcomes the publication of the CMA Update Paper dated 18 December 2018 (the Update Paper) and the opportunity to comment on the remedies that are being proposed by the CMA in that paper.
2. Santander is a wholly owned UK subsidiary of Banco Santander and is a public interest entity (PIE) as defined by EU law. It is required under the Companies Act to have its annual accounts subjected to an external audit. As a result, Santander would consider itself an interested party with regard to certain of the remedies proposed by the CMA in the Update Paper.

#### Response to Proposed Remedies

3. In the following paragraphs, Santander has commented on Remedy 1 (Regulatory scrutiny of Audit Committees), Remedies 2 and 2A (Mandatory joint audit and Market share cap), Remedy 5 (Full structural or operational split between audit and non-audit services) and Remedy 6 (Peer review). We have not commented on Remedy 3 (Additional measures to support challenger firms) or Remedy 4 (Market resilience) but would concur with the desire for increased competition within the market, rather than contraction and the need for market resilience.

##### **Remedy 1: Regulatory scrutiny of Audit Committees**

*Paragraph 4.16 of the Update Paper*

*(a) A requirement that Audit Committees report directly to the regulator before, during and after a tender selection process*

4. Santander would agree that the auditor appointment process should focus on quality, independence and challenge and is therefore supportive of any enhancements to process in this regard. It is however important that a company retains the ability to appoint an auditor with the right skills for their business. It is also important that the introduction of any regulatory requirements do not add unnecessary time delay to the auditor appointment process and that there is a clear balance between any new requirements bringing rigour to the process whilst ensuring that shareholder and board accountability is maintained. The level of, and approach to, any regulatory touch points/interventions during the tender process itself

is not further outlined within the Update Paper. As noted in our response to the Invitation to Comment, having comparatively recently been through a tender process, the existing commitment for both the entity undertaking the tendering and the audit firm cannot be underestimated and any additional reporting requirements would clearly add to this. Whilst broadly supportive of this proposal, Santander would therefore request that the above points are taken into consideration when developing the framework for the reporting to Regulators.

*(b) A requirement that Audit Committees report directly to the regulator throughout the audit engagement*

5. The Santander Audit Committee continually assesses external audit quality, providing regular feedback to the external auditor lead partner, with a formal documented assessment being completed on an annual basis. Similarly, through regular separate meetings with management and PwC, the Audit Committee addresses any material disagreements between the auditor and management. Santander is therefore of the view that it would be wholly feasible for meaningful interventions to be demonstrated through either independent observations of Audit Committee meetings or inspection. Whilst broadly supportive of this proposal, Santander considers that it would however be important that any requirements didn't introduce an additional, unnecessary burden which could detract from the comprehensive work already being undertaken by the Audit Committee.

*(c) The ability for the regulator to issue public reprimands, or direct statements to shareholders*

6. The Update Paper provides no specific detail as to how any such reprimands or direct statements would work in practice. Whilst broadly supportive of this proposal, Santander considers that it would be important for any such remedies to operate in an effective and fair manner and clear criteria would need to be established, agreed and applied in a consistent manner to prevent inappropriate or unwarranted "naming and shaming".

*Paragraph 4.17 of the Update Paper*

7. Santander is broadly supportive of the proposal to make public, as far as possible, the results of quality assessments, such as AQRs. The Santander Audit Committee currently makes full use of the publically available data in this regard and already questions its external auditors on the results of any internal or external quality inspections on the Bank's audit work to support its consideration and assessment of audit quality. Additional data would only enhance this process.

*Paragraph 4.18 of the Update Paper*

8. Santander notes that the proposal is that the enhanced regime would apply, at least initially, to FTSE 350 Audit Committees. The Update Paper does however indicate that the requirements may be extended to all PIEs. Santander would note in this regard that PIEs, such as ourselves, who are non UK parented already have some additional oversight of audit quality

driven at a group level. If however the final decision is that the plans for the regime are to be extended, it is important that this is communicated as soon as possible so that all impacted UK organisations are fully aware of the application of the remedy. If there are plans for the regime to be extended over a period of time this should also be communicated, together with likely timescales.

## **Remedy 2: Mandatory joint audit**

*Paragraphs 4.31 and 4.32 of the Update Paper*

9. Santander notes the proposals regarding the establishment of a mandatory joint audit plan and joint audit opinion. As detailed in our response to the Invitation to Comment, we are not supportive of this due to concerns regarding the additional cost, potential duplication of work and the impact on short reporting cycles. Most importantly, Santander considers that joint audits are more likely to impair rather than enhance audit quality. These concerns remain.

*Paragraph 4.33 of the Update Paper*

10. With regard to the proposal to apply regulatory oversight to this remedy from the outset of the process (i.e. from the point of selection of each of the joint auditors), Santander would make similar comments to those detailed in paragraph 4 above, such that it is important that a company retains the ability to appoint an auditor with the right skills for their business and that the introduction of additional regulatory oversight in this regard does not add unnecessary time delay to the auditor appointment process. Furthermore, Santander consider that any oversight requirements ultimately implemented in relation to a joint audit process should be defined as part of the regulatory scrutiny of audit requirements detailed in paragraphs 4.16(a) and (b) of the Update Paper so as to ensure there isn't unnecessary duplication of review/scrutiny.

*Paragraph 4.36 of the Update Paper*

11. Santander would concur with the proposal that certain types of companies, such as banks, should be exempted from being required to appoint a non-Big 4 audit firm as one of the two joint auditors. As detailed in our response to the Invitation to Comment, we do not believe that currently any of the firms outside of the Big 4 have sufficient critical mass in financial services to audit, even in the capacity of a joint auditor, a complex and global organisation of our scale.

## **Remedy 2A: Market share cap**

*Paragraphs 4.64 to 4.75 of the Update Paper*

12. Although an area primarily for detailed consideration by the audit firms themselves, Santander considers that there is an indirect risk, depending upon the design of any market cap, that there could be a reduction in the capacity of those audit firms who are able to audit complex companies in certain industry sectors which in turn could adversely impact audit quality. There would potentially be an increased risk of this under option two, as detailed in paragraphs 4.72 to 4.75 of the Update Paper.
13. If market share caps were to be ultimately introduced, Santander is of the view that there would need to be a clear, and relatively long, timeline for transition – established in consultation with industry and regulators – to avoid adversely impacting audit quality. We also consider wholly owned subsidiaries which are PIEs should not be subject to caps so as to maintain common auditors throughout the wider group.

## **Remedy 5 – Full structural or operational split between audited and non-audited services**

*Paragraph 4.117 of the Update Paper*

14. We note the proposals in 4.117. We would however reiterate the point made in our response to the Invitation to Comment in terms of the robust application of process and governance by the Santander Audit Committee to ensure independence and objectivity in relation to the engagement of our statutory auditor to provide any non-audit related services and its voluntary adoption of the future EU fee cap of 70% which is tracked and monitored at each Audit Committee meeting. As previously noted, Santander has seen no evidence that any non-audit related engagements have influenced the outcome or quality of our external audits in any way, nor would we expect them to given the nature of this work and the Audit Committee's oversight of its allocation. Santander would therefore suggest that a more rigorous application of these principles across all large UK organisations may be an acceptable alternative to the proposals within Remedy 5, if only as an intermediate measure. In addition consideration could be given to the introduction of some form of annual certification requirements for senior audit staff, including partners, under which they are required to take greater accountability for ensuring and driving audit quality, including in relation to non-audit service conflicts.

*Paragraph 4.118 of the Update Paper*

15. Santander would note that from a corporate's perspective it would be important to ensure that, regardless of the remedy ultimately implemented, there remains easy access to subject matter specialists, some of who may of necessity sit in the non-audit business, to support the audit of some of the more complex areas of business.

## **Remedy 6: Peer review**

### *Paragraph 4.141 of the Update Paper*

16. Santander would observe that, unlike the proposal made in the Invitation to Comment for a peer review as an alternative to a joint audit, and which Santander was generally supportive of, the current proposal is for a peer review in addition to a joint audit. As noted in paragraph 9 above, Santander is not supportive of the proposed mandatory introduction of joint audits.
17. Whilst Santander is broadly supportive of the peer review proposal, as it recognises that the additional scrutiny of the auditor's work as a result of a peer review may deliver value for an audit committee in support of its review and sign off of the accounts, careful consideration would be needed in terms of the extent of work to be undertaken by the peer auditor in conjunction with the company itself so to avoid undue time delay and provision of duplicative information. Furthermore, it would be important that the reviewing firm is able to complete a review of sufficient quality and in accordance with the objectives as set out in paragraph 4.144 of the Update Paper in support of often very tight financial reporting deadlines. For example, to perform a meaningful peer review of one of the highest risk area for a bank, being the expected loss provision under IFRS 9, would be of necessity very onerous.

### *Paragraphs 4.142 and 4.143 of the Update Paper*

18. Santander notes that the proposal is for the peer reviewer to be appointed by the regulator and would be broadly supportive of this as long as the peer reviewer has adequate industry and sector knowledge to deliver a fully informed and relevant review. The independence requirements of such a peer reviewer will, however need to be carefully considered as, as detailed in our response to the Invitation to Comment, Santander currently uses, amongst others, all three members of the Big 4 who are not our external auditors for non-audit related projects and we would not wish this market to be contracted.
19. Santander further notes that the proposal is that the cost would be borne by a levy on all FTSE 350 and large companies but that the regulator would in turn determine which companies would be subject to review. Santander supports the concept that the initial focus should be on those companies who are considered higher risk or requiring scrutiny. However to deliver an appropriate level of assurance across all companies, albeit over a longer period of time, Santander would suggest that there is a rolling cycle over which all FTSE 350 and large companies would be subject to a peer review.
20. Santander is wholly supportive of the drive to deliver better audit quality and the introduction of remedies to incentivise this. These should however be implemented in a clear and controlled way, recognising the costs and constraints and with an organisation retaining responsibility to choose and engage an appropriate statutory audit firm, with the right calibre of technical skill and competence to deliver an audit that satisfies the needs of shareholders on a timely basis and without additional or unnecessary burden.