Statutory Audit Market Study
Competition and Markets Authority
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30 October 2018

Dear Project Team

Statutory audit market- Invitation to comment

1 Introduction
Mazars, the international, integrated and independent organisation, specialising in audit, accountancy and advisory services welcomes the opportunity to comment on 'Statutory audit market: Invitation to comment' of 9 October 2018. As of 1st January 2018, Mazars operated as a truly internationally integrated partnership in 86 countries with an operating capacity via professional teams in an additional 35 countries. Mazars draws upon the expertise of 20,000 women and men led by 980 partners working from 300 offices worldwide. In the UK, Mazars currently has around 130 partners and over 1800 employees, and is ranked one of the top 10 firms nationally.

2 Substantial reform of statutory audit market urgently needed
We welcome your pressing ahead with your market study as a matter of priority. Substantial reform of the UK audit market is urgently needed. In our opinion, its current composition with excessive levels of concentration, which have persisted for decades, poses a direct threat to audit quality. The challenges of maintaining an orderly market while protecting against conflicts of interest, ensuring the market remains innovative in the context of changing stakeholder expectations, and mitigating against the risk of one of the four largest firms leaving the audit market, for whatever reason, are substantial and have to be faced and addressed.

3 Principles to guide choosing the optimum way forward
There is widespread agreement that previous attempts to address competition and concentration in the statutory audit market, and especially that for listed companies, have not been successful. To move forward in the optimum way this time, we propose a number of principles should be applied:

- the changes introduced should have a very high probability of success. This requires practical initiatives whose implementation has been thought through and have ideally been tried and tested as opposed to being theoretical in nature;
- change should be introduced as soon as possible in order not to lose momentum;
- the aim should be for a temporary intervention leading to the creation of a genuinely competitive market with capable newcomers as this is what will stir innovation; and
- the overriding aim should be to enhance audit quality and ensure auditing adapts to the major interlinked changes occurring in business, technology and societal expectations. This is essential in order serve the public interest and, in so doing, to remain attractive as a career option to the most talented young accountants of this and future generations.

4 Independent review needed on the future of reporting and auditing
We support a major independent review being undertaken of the current and future needs of investors and other stakeholders with regards to audited information in corporate reports and how the information should be presented to maximise accessibility and improve understanding. The world of business has changed considerably in recent years and it is not clear that reporting and auditing have kept up with developments in the wider marketplace especially when it comes to information in the annual report beyond the financial statements. We welcome the FRC's just announced project on The Future of Corporate Reporting but it is essential that the future of reporting and auditing be considered together. The implications of Brexit on reporting and auditing are among the issues that will need to be addressed.

5 Market share caps with joint and sole audit appointments to be at centre of reform package
A market caps based approach with joint audits at the upper end of the FTSE350 should be at the centre of a statutory audit market reform package: there is a very substantial concentration of audit fees in this part of the market and it is where the systemic risk is greatest. Joint audit will also allow the reform to be achieved with fewer audit switches than would otherwise be needed as challenger firms will be able to steadily build up their share of large audits in the early years of the reform being implemented with a linkage to improvement in audit quality overall. Sole audits could remain for the rest of the listed market and for other PIEs although it could be argued that joint audit could equally facilitate access to the wider PIE market for firms that are currently not minded to operate in it.

6 The Big 4 PIE market share should be reduced to no more than 80% of audit fees within 5 years
The aim should be to reduce the combined market share of the Big 4 to 80% of audit fees on a steady basis over 5 years in each of the FTSE350 market, that for other listed companies and that for unlisted Public Interest Entities in financial services. At that stage consideration should be given to tightening the cap to a 70% market share for the Big 4 over the following two to three years. Such caps will give the main challenger firms, including Mazars, sufficient time to expand as needed. Caps would remain in place until the CMA determined a sustainable and resilient competitive audit market had emerged.

7 Full and balanced review of joint audit's potential in creating a vibrant audit market overdue
A full and balanced review of the potential for joint audit to strengthen competition and audit quality is needed. France, the one major market in which joint audit is present for listed companies, is also the one where concentration is materially lower and the pool of audit firms operating in it significantly broader than in other jurisdictions. Beyond addressing the current market structure inadequacies, a strong case can also be made for joint audit on grounds of quality. Leading businesses have become larger and more complex due to globalisation and financial reporting has become

inherently more subjective as the use of fair value has, for example, increased. In this modern business environment there is significant merit in two firms designing and undertaking the audit of our largest listed companies, reviewing each other's work and agreeing their view on the key issues arising on the audit before giving their overall opinion on the whole financial statements for which each joint auditor is then jointly and severally liable. Where joint audit appointments are made on a staggered basis, this makes the transition when auditors change smoother with the balance being struck between the deep knowledge of the ongoing auditor and the fresh pair of eyes brought by the newly appointed one.

8 More open audit tendering and better information for shareholders
There should be a more open process for audit tendering with a regulatory or investor-led body operating a website that contains details of all listed and other PIE tenders and which enables any eligible firm which wishes to apply to undertake a particular audit to be able to do so. This is often not happening currently despite our understanding that this is expected by the legislation. In addition, shareholders should be provided with information by their audit committees on the names of the two potential auditors put forward to the board, which firms responded to the tender, which were shortlisted and the selection criteria used in arriving at their preferred choice. Moreover, investors should be encouraged to take a more active interest in the appointment of the auditor than has generally been the case until now.

9 Stronger limits on the non-audit services PIE auditors can provide to their audit clients
To avoid actual and perceived conflicts of interest, PIE auditors in future should only be able to provide a much more limited range of non-audit services to their audit clients from an agreed list made up of audit-related services and a modest list of others which would raise no conflicts of interest. Auditors should also set out in their audit reports actual and perceived conflicts of interest and how they have been managed or mitigated.

10 Barriers to Big 4 partners moving to challenger firms should be removed
If the necessary audit reforms are to succeed**,** it is very likely that a number of partners will need to move from Big 4 to challenger firms. At present this can be very difficult as they can have notice periods of up to 2 years and when they announce they are leaving the partnership their variable remuneration, a substantial part of the total, is often removed making recruiting partners from Big 4 firms very difficult. This barrier to fair movement needs to be removed.

11 Support for relevant expertise in larger firms to be made available to smaller firms
Where larger firms have special expertise, e.g. with regards to audit software or experts with particular skills that would assist smaller firms to undertake PIE audits, we support it being made available to them and would be happy to discuss contributing ours to such a scheme.

12 Independent investor-led Commission for a Fair Audit Market to oversee reforms
An independent investor-led Commission for a Fair Audit Market (CoFAM) should be established to monitor and oversee the implementation of agreed market reforms and to ensure commitments are being met. It would also liaise with audit committees, investors and other stakeholders to facilitate the necessary changes in approach by them too but shareholders in companies should remain responsible for individual auditor appointments as this is an essential element of the system of corporate governance and company law. We do not believe it would be practical or desirable for an

independent regulatory body to be directly responsible for the appointment of the auditors to individual companies.

13 Need for proportionate regulation and liability and regulatory focus on competition issues
If challenger firms are to enter the market for listed and other Public Interest Entities, including at the upper end, they will need assurance that the regulatory system will be proportionate and based on a model which involves firms and regulators working together to promote a learning environment and a culture of continual improvement. In addition, the regulator should have an objective in their articles to have due regard to competition issues in their work as recommended by CMA in their last review but never adopted. A number of other proposed changes in regulation have been recommended by us in our response to the consultation of the Kingman Review. There would also be merit in investors agreeing to proportionate liability for auditors on listed and other PIE clients.

14 Robust reform needed and better if by consensus
Robust reform of the statutory audit market for listed companies and other Public Interest Entities, of the type set out in this letter, is essential if the statutory audit market is to meets the needs of investors, other stakeholders and wider society. This will require significant changes by Big 4 and challenger firms, investors, audit committees, regulators and professional bodies. We believe the best way forward is for all the above participants in the statutory audit market to agree the way forward and then move forward wholeheartedly on its implementation. Mazars is committed to playing our full part to make change happen.

15 Responses to questions in consultation paper and further discussion
Our detailed responses to the questions in the consultation paper are set out in an appendix to this letter.

We would be very pleased to meet you if you would find it helpful to discuss further any of the points in this letter.

Yours sincerely

Mazars LLP

Competition and Markets Authority
Statutory Audit Market: Invitation to comment

Appendix-Responses to consultation questions

1. **How well is the audit sector as a whole serving its stakeholders?**

   We believe there are significant opportunities for the market as a whole to fulfil the needs of its stakeholders' more fully.

   We support a major independent review of how the audit sector is serving its stakeholders and how it can best meet their needs in the decades ahead. There is an inherent risk for a service protected by statute, especially where there have been no new players entering the upper end of the market in a significant way for decades, that it becomes ossified. This poses significant dangers to society as the need for high quality and highly trusted assurance on the performance, position and prospects of leading businesses is at least as great as it has been in the past if there is to be confidence in capital markets and, more broadly, in corporate information used in economies around the world.

   It is not possible to look effectively at the future of auditing without at the same time considering the future of reporting as the two are inextricably linked with assurance only being of value if it is provided on information that is helpful to users in their assessing, and making decisions on, the business to which it relates.

   It is far from clear that reporting and auditing have kept pace with the enormous interlinked changes in business and technology in recent decades and the developing societal expectations of business and auditing. It is now of course feasible to provide 'formal' corporate information at different times, in segmented ways and in different formats. Whilst there may be benefits in providing some audited information more frequently than yearly there remains benefit in having an annual audited review though we believe such a review needs to go beyond that contained in the current financial statements and more fully embrace the increasingly intangible nature of businesses linked to their purpose, people, culture and, where applicable, their brands. For many leading businesses their main assets are overwhelmingly intangible in nature and they are generally very inadequately represented on their balance sheets and not fully discussed elsewhere in the annual report.

   Among issues that the review should consider are the information stakeholders require and the nature of assurance they need on it; how to stimulate innovation to meet stakeholders' needs; the extent to which standards in reporting and auditing are helping or holding back the fulfilment of stakeholders' needs; other factors hindering innovation such as liability issues; and the respective roles of management, the board, auditors, investors, regulators and professional bodies in developing an effective system of reporting and auditing.

   To create sustainable value, auditing needs to be of relevant information, it needs to enhance its reliability and for this to happen there needs to be a high degree of trust in the auditors as substantial judgement will inherently need to be exercised in determining whether a true and fair view can be expressed on the audited information.

The necessary innovation is most likely to come and be successfully sustained in a truly competitive market where:

- there are additional **audit firms** actively involved at the upper end of the market and where all firms seek to manage their audit practices in a responsible fashion, to be responsive to changing stakeholder needs and to be conscious of market perceptions of conflicts of interest, e.g. through avoiding the provision of significant consulting services to audit clients;
- **audit committees** ensure auditing takes place within a framework of good governance, with an ethical and transparent culture, and liaise effectively with both the auditors and shareholders on key auditing issues;
- **shareholders** take an active interest in the appointment of auditors and in their reports; and
- the **regulator** seeks to promote a culture of improvement and high quality audit with fair and proportionate regulation that attracts the leading talent of successive generations to recognise the societally important role auditors play and to be attracted to it.

All of the key players have much to do to achieve the objectives outlined above.

Theme 1: The audit framework

2. How well does the audit framework support the interests of both direct shareholders and also wider stakeholders in the economy?

As mentioned above, auditing forms an integral part of the broader framework of corporate governance and company law governing companies and needs to be consistent with it.

The responsibilities of directors in most circumstances are set out in s172(1) of the Companies Act 2006.

> ‘(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to—
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.’

In line with the above approach as regards the purpose of a company, directors and auditors are appointed by the shareholders. We believe that under present company law this should continue to be the case with them having due regard to the needs of other stakeholders. Of course, if company law were to change in this area it would be important to review the role of audit.

Furthermore, in high level terms, the range of issues of interest to all stakeholders would include whether annual appointment remains relevant or whether auditor independence would be strengthened by appointment for a number of years and whether the auditor should just be responsible for expressing an opinion on the financial statements or should have a broader role as ongoing 'guardian' of the well-being of the business.

Theme 2: Incentives and governance

3. To what extent do the decisions made by audit committees support high-quality audits, whether through competition for audit engagements or otherwise?

Audit Committees have a critical role in promoting effective governance and, in particular, in helping ensure there is an ethical and transparent culture in the business with strong levels of challenge and support in the boardroom and the audit committee. These are vital in enabling effective audits to be undertaken, both internal and external. It may therefore be worth considering whether, when reviewing the quality of an audit for a major listed company, the regulator should look at the role of the audit committee in helping support it as well as how the audit committee fulfils its responsibilities when audit tenders are being undertaken.

Whilst the situation will naturally vary between companies, in general audit committees of leading listed companies are not currently having the full positive effect they could have on the quality of audits especially as regards the appointment of auditors.

The current market has for decades shown an excessive degree of concentration and this poses threats to audit quality through the creation of the situation where the four largest firms are 'too big to fail'. Audit Committees at the upper end of the listed market are not only not appointing firms outside the Big 4, they are often not even inviting other firms to tender and sometimes as few as two firms are involved in tender exercise which limits the ability to make a properly informed choice between alternative offerings.

As a number of other industries, including airlines, telecoms, pharmaceuticals and food retailing, have demonstrated, it is often the new players that challenge the existing order and bring innovation that addresses emerging market needs.

More effective liaison by audit committees with their investors on auditing matters, including better setting out how they have chosen their preferred audit firm to recommend to shareholders for appointment, would also help investors play a more active role in audit appointments than at present.

4. How has this changed following the Competition Commission's intervention?

The specific interventions of the Competition Commission, as set out in the current Invitation to comment, have not of themselves had any noticeable effect on the statutory audit market.

As a result of the introduction of the European audit reform, which happened at broadly the same time as the Competition Commission's interventions, and led in the UK to the introduction of mandatory rotation of auditors after a maximum of 20 years and compulsory tendering, there has been an inevitable increase in companies changing audit firms but this has only involved switching between one Big 4 firm and another and indeed, as pointed out in the Invitation to comment, the very small share of FTSE350 audits held by non-Big 4 firms has been further reduced. The impact of the reforms has also been reduced by a long transition period for making the necessary changes which extends out to 2023. Moreover, in many instances, despite the relevant Regulation making clear that audit firms outside the Big 4 that are eligible for appointment should not be excluded from the tendering process, many challenger firms have not even been invited to submit a tender proposal.

The European audit reform also brought in new limits on the amount and nature of non-auditing services that can be provided by auditors to their audit clients with the maximum level of non-audit fees being set at an average of 70% of the audit fee over the past three years. Whilst generally the amount of non-audit work undertaken by auditors of PIEs seems to be falling, there is a fairly widespread feeling that the current maximum should be further reduced to a significant extent.

Theme 3: Choice and switching

5. Is competition in the audit market working well? If not, what are the key aspects hindering it?

No, competition in the audit market is not working well and is not operating in a way that satisfies the public interest for the reasons outlined above.

The key aspects, which are interlinked, hindering competition are/have been:

- the **failure of FRC to embrace competition in its objectives,** as proposed by the CMA, and, for example, not encouraging more open tendering processes through its guidance as well as a general lack of oversight of the implementation of the European audit reforms;
- the **brands of the Big 4 being better known** as a result of the substantial size of their consultancy practices with them working/having worked with most listed companies
- the **alumni effect** favouring the Big 4 with many former partners chairing audit; committees of large listed companies and alumni also often being the CFO/FD as well as fund managers and others being more familiar with the Big 4;
- **audit committees not getting to know non-Big 4 firms** and to understand their strengths and capabilities and, in particular, underestimating their international capabilities;
- the 'chicken and egg' challenge with **audit committees of major listed companies being unwilling to appoint an auditor who has not previously audited a similar company** even though they may have all the necessary knowledge and skills; and
- a **misperception that firms need turnover approaching that of the Big 4** in order to be effective auditors of most listed companies which ignores the fact that most of their turnover is linked to consulting rather than auditing and even for auditing does not have to be of equivalent size for the vast majority of listed audits.

6. In particular, how effective is competition between the Big Four and between other firms and the Big Four?

While it would generally appear that there is active competition between the Big 4 firms when they compete through tenders for appointments, there is the significant issue in a number of instances involving listed companies where it would appear that fewer than four firms, and sometimes only two, are eligible for or willing to submit audit tenders with the others being conflicted by virtue of their consultancy work for the company or as a result of work performed for a direct competitor.

In one or two sectors, including banking, where in the past not all of the Big 4 had major listed clients, this situation has now been addressed.

There remains a substantial problem in that the Big 4 and non-Big 4 are not competing on a level playing-field with regards to audit appointments in the listed audit market. There are a number of reasons for this and these are discussed in our response to Question 5 above.

7. How has this changed following the Competition Commission's intervention?

The direct Competition Commission intervention was, as mentioned, very limited in nature. It requires audit tenders every 10 years for FTSE350 companies, for example, but these are expected anyway under the UK Corporate Governance Code, though in setting out their requirement the Competition Commission, as was, recognised that other changes were being introduced as a result of the European audit reform which it was thought would also assist in the creation of a more competitive large listed audit market.

The European audit reform with mandatory rotation has led to more switching of auditors but to the extent the switching was mandatory this has not been the result of a change in buyer behaviour and the switching, as discussed, has only been from one Big 4 firm to another, with inherent challenges in assessing audit quality when the number of firms involved in a tender process is limited.

8. What is the role for competition in the provision of audit services in delivering better outcomes (i.e. consistently higher quality audits)?

Competition has a direct influence on delivering better outcomes, i.e. consistently higher quality audits, in two key respects:

- fair and healthy **competition is needed to remove the risks of 'regulatory capture'** associated with there, in effect, being only four players in the FTSE350 market: if one left, for whatever reason, and especially if it were one of the larger players, it would be very difficult to ensure an orderly and stable market with just three players thereby limiting the courses of action open, in practice, to the regulator and thus their ability to drive improvements in audit quality. Conversely regulatory action may lead one or more of the Big 4 firms to conclude the audit market is more risky and less profitable than the consultancy market leading to them focusing just on that market instead; and

- in markets where the same few large players have been dominant for decades they will generally **not have been under pressure to innovate** and so the market is likely to have become fairly ossified. In these circumstances, new entrants will help to bring innovations that will enhance audit quality. Fresh pairs of eyes are always helpful in looking at markets afresh and identifying stakeholders' key unmet needs.

9. In practice, how much choice do large companies and public interest entities have in the appointment of an external auditor?

As discussed above, some large listed companies currently consider they have very little choice as to their auditor given a number of Big 4 firms may have conflicts of interest and due to the possibly unconscious bias against the challenger firms and a lack of understanding of their geographical spread and sector expertise. To the extent that audit committees of listed and other PIE entities perceive, rightly or wrongly, that investors and others, including regulators in the financial services sector, favour the Big 4, this will also serve to constrain their choice of auditor.

10. What are the key factors limiting choice between auditors?

The need for the auditors to have the necessary scale to undertake the audit and the necessary expertise both in relation to auditing public interest entities and the sectors covered by the businesses concerned.

11. What are the main barriers to entry and expansion for non-Big Four audit firms?

The barriers to entry linked to brand, buyer behaviour and the alumni effect have been set out above.

In addition, it is unduly hard for challenger firms to recruit audit partners from Big 4 firms as most of their remuneration is often discretionary in nature and ceases as soon as they give notice to leave the partnership which may be of two years' duration making the cost of their switching to a challenger firm prohibitively high.

Theme 4: Resilience

12. Is there a significant risk that the audit market is not resilient? If so, why?

There is a very significant risk that the market is not resilient for the reasons set out above.

Were one of the Big 4 firms to leave the market for whatever reason, whether of their own decision or otherwise, and neither circumstance can be ruled out, it would be very challenging to maintain a strong and stable market given the current degree of concentration.

The extent to which reporting and audit does not seem to be keeping pace, or has not kept pace, with overlapping changes in technology, the globalisation of business and societal attitudes to business also challenges the resilience of the market.

In addition, the current regulatory system could pose significant challenges to market resilience It may lead a major firm to question whether it wishes to remain in the audit market for PIEs or may cause some challenger firms to question whether they should enter the large listed market especially if they are concerned that the principle of proportionality will not be fairly applied in the case of challenger firms. Whilst supporting robust sanctions where there have been deliberate misdemeanours or wilfully reckless behaviour, a distinction needs to be drawn between such circumstances and other mistakes. If a Big 4 firm were to leave the large listed audit market or a number of challenger firms were to decide not to enter it because they considered the risk/reward ratio to be not fairly balanced, this would significantly affect market resilience in an adverse manner.

Furthermore, if the regulatory system acts as a deterrent to the auditing profession recruiting some of the best talent of its generation on the grounds that they can earn higher rewards, with less risk of reputation damage for mistakes, the long-term strength of the profession will suffer substantially again leading to a threat to the audit market's resilience.

Theme 5: Regulation

13. What is the appropriate balance between regulation and competition in this market?

Given that we consider, as discussed, that a truly competitive audit market would promote audit quality through reducing the risk of regulatory capture and introducing innovation that meets stakeholder needs, we believe it is very important that regulation does not act to artificially limit competition by, for example, not being proportionate in nature or by acts of omission such as failing to promote a fully open tendering system.

Theme 6: Potential measures

14. Please comment on the costs and benefits of each of the measures in Section 4 and how each measure could be implemented.

Restrictions on non-audit firms providing non-audit services
These are discussed in our response to Question 16 below

Measures to reduce the barriers for non-Big 4 firms to build their capacity
We have discussed our response to 4.13(a) market share cap on the Big 4 and 4.13(b) variations on joint and shared audits in our responses to Questions 19-23 below.

Of the other ideas raised:

- **4.13(c) direct support to the mid-tiers by the Big 4 and professional bodies**
  We understand some challenger firms may find it helpful to have technology or technical support directly from the Big 4 or channelled through the professional bodies. We would be in favour of such support and would be willing to discuss making available our own experts in areas such as financial services and also our audit software to other firms.

- **4.13(d) reducing the barriers for senior staff to switch between audit firms**
  This is a very important area to address as a significant number of moves of experienced partners between the Big 4 and challenger firms is likely to be needed if challenger firms are to increase their capacity to undertake more PIE audits. At present, in some Big 4 firms when partners announce they are leaving the partnership the very substantial discretionary element of their remuneration is removed for the period of their notice, which can be of 2 years duration, reducing the ability to attract such partners to challenger firms.
- **4.13(e) changes to the restrictions on the ownership of audit firms**
  We do not see this as an important issue and, indeed, there would be risks to audit quality in reducing the current requirements requiring most voting rights to be held by qualified auditors. We believe it will be feasible to obtain the necessary financing for growth of the audit practice through use of our existing sources of finance.
- **Break-up of the Big 4 into smaller audit firms**
  Whilst this option has attracted a fair amount of press coverage, we believe the emphasis should be on the other practical reforms discussed in the Invitation to comment, in particular the market caps with joint audit approach. We agree with the analysis set out in paragraph 4.28 that breaking up the Big 4 firms would 'pose significant and potentially insurmountable challenges'. A more practical way forward may be for Big 4 firms to package certain audit portfolios and transfer them to challenger firms together with relevant partners and staff under TUPE.
- **Improving transparency around the tendering process**
  We strongly support measures that will improve the tendering process and increase the transparency surrounding it. We believe there would be merit in a central online register of tenders with it being clear that all firms which are interested in applying for a particular tender may do so and with the results of the tenders and the reasons for decisions made during the appointments process being published. Other countries, such as Germany, have in place a far more open audit tender system than we observe in the UK.
- **Measures to reform mandatory tendering and auditor rotation**
  These are discussed in our response to Question 27 below.
- **Measures to further strengthen audit committees and/or their link to shareholders**
  There would be merit in strengthening the link between audit committees and shareholders through audit committees providing more information to shareholders on the auditor appointments process. Audit committees of PIEs are required to provide the names of two potential auditors to their boards including their preferred choice of auditor and it would be helpful if in addition to providing both names to shareholders they also indicated their criteria for selection as well as the names of firms which submitted a proposal and of those that were shortlisted.
- **Break the link between company management and auditors**
  As discussed in our response to Questions 25 and 26 below, we are not persuaded of the merits of an independent body appointing the auditors. In terms of shareholders appointing directly, this would presumably require them firstly to nominate an appointments panel of shareholders, in place of the audit committee, and then to propose a firm to all the shareholders given the nominations group would generally represent only a relatively small proportion of total shareholdings in the company.

We are not convinced shareholders would be willing to commit their time to such an exercise and, in addition, audit committees are meant to be made up of wholly independent directors and they should be representing the interests of all shareholders not just the relatively small proportion of the total by voting rights that would be represented on a shareholder nominations committee.

- **An insurance-based system for auditors/'NAO style' national auditor**
  We are not persuaded of the merits or practicality of an-insurance based system of the type outlined and it may constrain the relationship between auditors, the board and audit committee which , as discussed, we regard as an extremely important element of corporate governance and company law. For similar reasons, we would not support an 'NAO style' national auditor. The significant differences between the private and public sectors need to be recognised and, as the NAO does not have spare capacity, a vast new organisation would need to be set up or the work subcontracted out to existing firms which would seem to defeat the purpose of the exercise. It would also in effect be replacing an oligopoly with a monopoly.

15. **Are there any other measures that we should consider that address the issues highlighted in section 3? If so, please describe the following: a) aim of the measure, b) how it could be designed and implemented, and c) the costs and benefits of each such measure.**

    Whilst we strongly endorse a market cap supported by a joint audit approach for companies at the top end of the FTSE350 and have suggested how this may be implemented in a voluntary way through a code overseen by an investor-led Commission for a Fair Audit Market (CoFAM), it may be clearer to give such a body, or an existing regulator, the right to require joint audit in all or part of the FTSE350 to achieve the necessary change.

Theme: Restrictions on audit firms providing non-audit services

16. **One way to create audit-only firms would be through separate ownership of the audit and non-audit services practices of the UK audit firms. Could this be effective, and what would be the relative scale of benefits and costs?**

    The merit of requiring separate ownership of the audit and non-audit practices of the UK-audit firms is very unclear, especially if the audit firms were to be able to remain in the international organisations of which they are a part. It would also be likely to lead to significant upheaval and most of the benefits could be far more simply achieved by prohibiting auditors from providing other services to their audit clients or, at least, significantly limiting the nature of permitted services to a relatively short list of allowable services which are audit-related or which would clearly not pose any conflicts of interest to the auditors. We would also suggest asking the auditors to set out any real or perceived conflicts in their audit report and how they have been managed or mitigated. We support the challenges posed to audit only firms set out in paragraph 4.10 (a)-(e).

    There is merit, however, in expecting a clear management structure for the audit practice within the wider firm and for there to be independent non-executives at the larger firms, both of which are expected under the Audit Firm Governance Code. Such an approach would seem to achieve most of the benefits of audit-only firms whilst avoiding the potential upheaval of forcing a formal split between the audit and non-audit parts of firms. If the audit firm was forced to have separate ownership, this would not of itself stop it for hiring specialist staff from the non-audit part of the network to provide their expertise on particular audits much as happens at present and thus not leading to real change.

17. **How do the international affiliations of member firms affect the creation of audit only firms? What is the extent of common ownership of audit firms at the international level?**

As discussed above, the international affiliation of firms highlights the impracticality of audit-only firms since if they continued to be part of a wider international organisation they would often be working with member firms in other countries which would very rarely be audit-only firms hence in practice audits would not be carried out by audit-only firms even if that was the requirement for the UK firm.

By way of background, Mazars is an internationally integrated firm owned by its partners around the world with significant global profit-sharing arrangements between partners in different countries. Most of the other firms are networks with firms separately owned at country level and joined together by means of an international network in which member firms participate and which provides services to its national member firms.

18. **What should be the scope of any measures restricting the provision of non-audit services? For example, applying to the Big Four only, the Big Four and the mid-tier audit firms, or any firm that tenders for the audits of large companies and PIEs?**

Whilst it would be in our self-interest to suggest otherwise, we consider any restrictions relating to the provision of non-audit services should logically be related to particular classes of client rather than particular audit firms, i.e. those clients in respect of which it is considered, for protection of the public interest, that the highest standards of independence and perceived independence should apply.

We would suggest that additional restrictions should be introduced for FTSE350 companies and unlisted Public Interest Entities in financial services. We would propose that auditors of these businesses should only be able to offer non-audit services of an audit-related nature or others from an approved list which would not present any conflict of interest to the auditor.

Theme: Market share cap

19. **How should the market shares be measured? - number of companies audited, or audit fees or some other measure?**

We believe market shares should be measured by reference to share of audit fees in the market concerned as this is the best guide to the true share of the market held by a particular firm or grouping of firms.

Given there is a very marked concentration of audit fees at the top end of the FTSE 350 market, measuring by the number of listed companies audited could lead to an artificial understanding of relative market shares as it would be possible to audit a substantial number of listed companies as audit clients whilst having a very small share of the total market as measured by audit fee and no involvement with systemically important businesses. For example, challenger firms could audit 20% of listed companies by number with this accounting for less than 5% of total audit market fees across the listed market if the companies concerned were at the lower end of the market in terms of size of audit fee.

As one of the critical reasons for addressing excessive concentration is the need to ensure the market would be resilient were one of the largest players to leave it, for whatever reason, it is essential that the cap encourages challenger firms to be involved at the upper end of the market as well as the other parts of it. It is therefore important for the purpose of applying the cap that the listed market needs to be appropriately segmented, i.e. into the FTSE350 and other listed companies, and the cap should be based on share of total audit fees rather than number of companies audited in each market.

20. Could the potential benefits (greater choice, and resilience) of a market share cap be realised?

Yes, the potential benefits of a market share cap could definitely be realised.

A properly structured cap, as discussed above, would facilitate the emergence of new players in all parts of the listed and wider PIE markets and facilitate their investing and building up their market shares in a sustainable and planned manner thereby promoting greater choice and resilience across the listed and wider PIE markets.

To ensure the potential benefits are realised, it will be important for the mechanics of how the market share cap would work to be carefully considered and these would include:

- How to allocate the cap between each of the Big 4 firms as they are independent competing entities. We would suggest it should be allocated proportionately according to existing market shares and reset annually so that those increasing their relative market share within the aggregate for the Big 4 are not penalised.
- Whether, in addition, there should be a cap on the maximum market share of any one Big 4 firm. Given that one of the important reasons for the cap is to increase market resilience and, in particular, the ability to withstand any firm leaving the market, we believe there should be such a cap and that it should be set at around 25-28% of market share after five years assuming that the combined Big 4 share has been reduced to 80% by that stage, i.e. an average market share of 20% for each of the Big 4.
- How the cap should be allocated across the listed sector and that for unlisted financial services PIEs. We believe the same arithmetical caps should apply but that the audit markets covering the FTSE350, other listed and unlisted financial services PIEs respectively should be treated as separate segments to ensure the challenger firms are properly represented across the PIE sector.
- For which companies joint audit should be expected/required in order to ensure the caps are achieved. We would suggest that this should be primarily at the top end of the FTSE350.

- How best to facilitate the smooth introduction of any proposed scheme. To achieve this, an investor-led Commission for a Fair Audit Market (CoFAM) should be established. It would issue a code, after full consultation with the Investor Association, National Association of Pension funds and leading international investors on how the proposed scheme would work in terms of expectations as regards audit appointments in different parts of the sector and consult with any audit firms or listed companies seeking variations from the agreed norms.

21. What do you consider to be the relative scale of the costs of a market share cap, such as increased prices and potentially reduced competition, and potential benefits?

There is no reason to suppose a market share cap would increase prices as the creation of a more competitive market in overall terms would generally be expected to reduce prices.

The view that market caps would lead to less competition is also very much open to challenge especially if they were accompanied by the use of joint audit at the upper end of the listed market. Whilst one or more of the Big 4 may have to withdraw from the opportunity to compete on a particular audit when it comes up for tender, the introduction of the market cap would be expected to lead to the addition of at least as many challenger firms as the issue of creating a level playing field between the Big 4 and challenger firms was fairly addressed.

To achieve market share caps that are credible from the perspective of regulators, investors and wider society, the Big 4 would need to convert a number of their audits at the upper end of the listed market into joint audits. In such instances, we would expect that the incumbent Big 4 firm would remain in place and that a tender for an agreed share of the audit would attract a number of challenger firms bidding to join them on the audit assignment concerned and again there is no reason to suppose the total audit fee will increase over time. While there is additional review work as each auditor reviews the other's work as well as their own this, as well as enhancing quality, will be counterbalanced by the positive impact of opening up the market to more competition. It is noted that audit fees in France, where joint audit has led to a more competitive market, are lower in comparable terms than in the UK.

In summary, the benefits of introducing a market cap would be significant in term of the creation of a more competitive market with higher quality audits, more innovation and competitive audit fees.

22. What should be the appropriate level of such a cap, collectively for the Big Four for the measure to achieve its objective? For example, 90%, 80%, 70%?

To be meaningful, one needs to look at the appropriate level of the cap in conjunction the number of years over which it is to be achieved. Moreover, one needs to have regard to both supply and demand considerations: what would lead to a reasonable level of competition which at the same time would be achievable in terms of expansion by challenger firms and/or the emergence of new entrants.

Having regard to the factors identified above, we believe a collective cap for the Big 4 should be set at 80% of market share after five years. We would suggest it should be reviewed at that stage and that consideration then be given then to further tightening the cap to 70% after a further 2 or 3 years as appropriate.

In addition, to setting out the overall market share cap for the Big 4, as discussed above, it would be necessary to decide how to allocate it between them.

The aim should be for the cap to be a temporary measure to drive the creation of a genuinely competitive market that will continue to be so on a sustainable and resilient basis without further intervention and it should be removed once the CMA is satisfied that this stage has been reached.

23. Could a joint audit be an effective means of implementing a market share cap?

The introduction of joint audit for leading listed companies would be an essential and very effective element in the implementation of a market share cap as it would enable challenger firms to participate in audits at the top end of the FTSE350 from early on in the period of reform.

As both joint auditors would be jointly and severally responsible for the opinion, the shareholders would still have the same level of assurance they had from their Big 4 auditor before it became a joint audit coupled with the additional assurance from it also being signed off by the challenger firm. In addition, the shareholders would have the benefit of each firm having reviewed the other's work and both firms having arrived at a common view on key judgements in forming their opinion on the financial statements. The appointment of joint auditors on a staggered basis also enables the audited company to manage auditor transitions more easily with a balance being struck between the deep knowledge of the ongoing firm and the fresh pair of eyes brought by the newly appointed firm.

Joint audit is essential because, with the concentration of fees at the upper end of the market, if the goal of the Big 4 not exceeding 80% of audit fees after 5 years is to be achieved, the minimum for a credible claim that the market is competitive and to reduce the regulatory risk were one of the Big 4 to leave the market, challenger firms will need to have a share of the largest audits which we would not be able to do on our own especially at the start of the period of reform.

The joint audit arrangement would also allow the challenger firm to increase their share of individual audits in the early years of the introduction of the reform which would have the additional merit of providing an in-built mechanism to achieve the annual changes in market cap that would be needed to meet the proposed 80% target for the Big 4 after 5 years.

In assessing the merits of joint audit, it will be important for there to be a fair analysis of the evidence and for undue regard not to be had for decades old anecdotes based on a limited experience of joint audits undertaken in very different circumstances to the present ones. It will be important to challenge myths such as the risk of 'things falling between the cracks' which it can be argued is potentially less likely to happen on a joint than a sole audit given the extra review work undertaken.

Consideration should be given to allowing joint auditors to be in office for the maximum of 24 years before mandatory rotation allowed under the relevant Regulation. It is not clear why when implementing the Regulation this Member State option was not adopted in the UK.

We support joint audit in preference to shared audit on grounds of quality but recognise the latter may have a place in the early years of a dual appointment between a Big 4 and challenger firm as the challenger firm builds up their share of the group audit undertaken to an appropriate level in order for there to be a joint audit which would generally be expected to occur when the firm with the smaller share has around 30% of the group audit.

Theme: Incentives and governance

24. Should the auditors and those that manage them (e.g. audit committees, or an independent body as described in section 4) be accountable to a wider range of stakeholders including shareholders, pension fund trustees, employees, and creditors, rather than the current focus on shareholders?

We believe, as discussed in our response to Question 2, that the auditors responsibilities to shareholders and other stakeholders should be in line with the purpose of the company and consistent with the responsibilities of directors. Under current company law, director should normally lead and direct the company in the interests of the members as a whole whilst having regard to the interests of employees, customers, suppliers and other stakeholders.

25. If yes, should audit committees (in their current form) be replaced by an independent body that would have a 'public interest' duty, including for large privately-owned companies? Should this body be responsible for selecting the audit firm, managing the scope of the audit, setting the audit fees and managing the performance of the audit firms?

No. We do not believe this is a practical idea. We would, however, recommend, as discussed, that whilst the appointment of auditors should continue to be the responsibility of a company's investors, an investor-led Commission for a Fair Audit Market (CoFAM) should oversee the implementation of the arrangements for creating a competitive market through the use of markets caps and joint audit arrangements and should consider issues raised by individual companies or their auditors as to how the proposed system should apply to them.

26. Please describe the benefits, risks and costs of such an independent body replacing audit committees.

The main benefit would seem to be that if an independent body were appointing the auditor there will be at least be a perception that the auditor would feel under less pressure from management to agree to particular judgments or treatments considered favourable to their position. That said, it needs to be recognised that it is the audit committee and the board which have key roles in approving the financial statements and include directors independent of management, wholly in the case of the audit committee and mainly in case of the board, where the UK Corporate Governance Code is being followed. In addition, shareholders are similarly generally independent. of the management of companies listed on the Main Market of the London Stock Exchange in the UK

Crucially, the costs of and complexities of introducing such a system would be substantial and the drawbacks similarly so and so for these reasons we would not support an independent appointing body making audit appointments but, as mentioned, would support the introduction of an investor-led oversight body to oversee the move towards a truly competitive market.

In terms of the drawbacks associated with an independent regulatory body appointing the auditors, these include:

- it interferes in an un-coordinated way in the integrated approach to governance and company law that currently exists which covers the respective and interlocking roles of directors, auditors and investors;
- it fails to take account of the differences between appointing auditors to listed companies and to local authorities respectively, the model on which it appears to be based. Unlike local authorities which are broadly in a single sector, though clearly there are differences between them, and which are local or regional in nature, listed companies and other PIEs conduct business across a wide range of sectors in an enormous number of different countries;
- the PSAA consortium, the local authority arrangement, is a voluntary one which local authorities have decided to join. It is much harder to envisage shareholders voluntary supporting such an arrangement given the dispersed nature of shareholdings; and
- under the PSAA arrangements there are less firms operating in the market than under those previously of the Audit Commission.

The above would suggest appointments would need to be made on an individual basis and given there are over 1,000 listed companies and PIEs this would require significant resource with over 50 appointments to be made each year.

Were issues to arise on the effectiveness of the audit, it would be unclear where responsibility lay: with the independent body that appointed them or with the audit committee for failing to properly oversee their performance.

27. Should companies be required to tender their audits and rotate their auditors with greater frequency than they currently are required to do? What would be the costs and benefits of this?

We have not heard this issue being discussed much in the current debate but it is an important one to consider.

Whilst, a number of countries in the European Union have opted for a rotation period of less than 20 years, if significant change is introduced over the next 5-7 years in the UK market we can on balance see merit in leaving the rotation period at 20 years in order that the reforms in the market place are allowed a period of consolidation. For similar reasons, we would leave the expected or required period before retendering at 10 years.