**RESPONSE TO CMA AUDIT MARKET & COMPETITION REVIEW**

**From: Professor Atul K. Shah (City University); Professor Richard Murphy (City University); Brian Little; Paul Moore;**

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We welcome this review, and the research, expertise and ideals which have framed the content and recommendations. Overall, we see a greater emphasis on independence and enforcement, and stronger regulatory powers, including personal punishment and accountability, as changes which have been long overdue. If these policy recommendations are accepted and enforced, they could in time transform the quality and independence of audit, and make companies much better governed and accountable than has been the case to date.

In particular, we welcome and endorse the following policy recommendations:

1. Regulatory scrutiny of Audit Committees and independent auditor appointment process;
2. Mandated joint audits;
3. Full structural and operational split between audit and non-audit services;
4. Firm-level accountability for audit quality, with much more robust monitoring and enforcement than has prevailed under the previous FRC regime;
5. Holding individuals and leaders to account.

That said we still think there are desirable changes to make. Our recommendations are as follows:

1. Clearer definition of audit quality and the ethics and principles which lead to better audits is required. Whilst this has been mooted throughout, the definition needs to be clear and enforceable.
2. We welcome the direct reporting and whistleblowing line to the regulator in the case of sensitive areas or concerns discerned by auditors. Often auditors have used the self-fulfilling fear of collapse resulting from an audit qualification to avoid judgement and timely reporting.
3. Given the high systemic risk nature of bank auditing and the complexity of such audits, we would prefer direct independent public auditing of these institutions, with the Big 4 being kept completely out of the picture. Our research on HBOS showed that there are huge additional revenues to be made from a bank audit by the Big 4 which come outside the usual rules e.g. the receipt of loan review fees paid for by borrowers or due diligence work. [ ] This risk has to be eliminated and only audit by a pubic body such as the National Audit Office can negate this risk.
4. We welcome the proposed independent appointment process for auditors and related quality oversight. [ ] However, it is very important the new regulator be completely independent from the Big 4. Presence of public interest academics on such panels could be very helpful in ensuring quality and robustness.
5. Joint audits separate the power of auditors and can bring better quality through competition and different oversight and independence. Although members of both audit firms would

come from the same profession, potentially creating risk of collusion, a joint audit would lead to better audit papers and audit trails about key risk and judgement areas. It is critical that audit files and papers for FTSE 350 entities be easily accessible to public regulators during the conduct of corporate investigations. For too long they have been opaque and covered up, in spite of the fact that the requirement to audit is a state licence earning regular fees for big firms. The normal excuse of client confidentiality should be removed for any state-backed investigations of corporations or auditors. The liability for audit failures in the case of joint audits should be joint for each firm, irrespective of which part was audited by whom. The firms should be required to oversee each others' work. We agree with you that joint audits are better than a market share cap on Big 4 audit firms.

6. Audit partners and senior staff should not be allowed to work for their clients for a minimum period of 5 years after leaving their audit firm. Similarly, former client staff should not be allowed to work on the audits of the client company for a period of five years after recruitment by an audit firm.
7. Market resilience can be solved by strict enforcement of joint audits with medium-sized firms which would eventually reduce the power of the Big 4 and lead to a Big 8 or Big 10 field of large audit firms.
8. We welcome the structural separation of audit from advisory services, although we feel it does not go far enough as Chinese Walls are often paper thin when large fees and revenues are at stake. Ideally, audit firms should be separated from advisory work altogether. This would also solve the resilience problem by breaking up the Big 4. We believe that a pathway to achieve this goal should be established now, with a timescale attached.
9. There should be robust personal monitoring and accountability of senior auditors, and clear reprimands, including fines and imprisonment to act as a deterrent for negligent work.
10. We welcome the suggested remedy of peer review – this will increase audit oversight and monitoring of key risk areas.