21 January 2019

By email : statutoryauditmarket@cma.gov.uk

Competition and Markets Authority
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Victoria House
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Dear Sir/Madam

Statutory audit services market study update paper

Further to the publication of the CMA's second market study we welcome the opportunity to respond and outline our views on some of the proposed remedies.

Morrisons supports measures that improve audit quality which we recognise is important for all stakeholders, and the comments in this letter reflect this principle. The CMA study, as well as Sir John Kingman's review of the FRC and the proposed Brydon review, are all important steps in making sure that the public concerns over the audit market are addressed. However, any changes need to be proportionate to the risks and concerns the changes are trying to address.

In our opinion, the impact of any proposed remedy on audit quality needs careful consideration to ensure there are no inadvertent outcomes, particularly where multiple options are recommended. One such inadvertent outcome is the potential for decreasing competition arising from a reduction in firms eligible for tendering activity should joint audit and peer review both be introduced. It is noted that the potential for unintended consequences from some of the remedies has already been highlighted by Business, Energy and Industrial Strategy Committee (BEIS). Furthermore, we believe that the cost of any potential remedies should be considered alongside the assumed benefits to make sure that the benefits clearly outweigh the costs to the shareholder.

In response to the proposed remedies we would like to highlight the following:

Remedy 1: Regulatory scrutiny of the Audit Committee
In our experience, the Audit Committee's existing focus, with regard to the statutory audit, is on the quality and challenge provided by the Company's auditor. The areas which have required focus, judgement, and the time of the Committee are reported on in the Annual report and accounts, within the Audit Committee report, to give visibility to stakeholders, in addition to the detail in the

long form auditor report, allowing appropriate scrutiny from shareholders. Shareholders are given the opportunity to ask any questions both in the AGM and in private meetings.

With regards to the appointment of auditors, we believe that we ran a robust process when our audit went out to tender in 2014. Our tender process was conducted over a four month time frame, involved six audit firms and three stages. The Audit Committee led the process and details of the audit tender process were disclosed in the Annual Report and Accounts along with the rationale for the final decision. We believe there could be value in more guidance being provided to Audit Committees regarding the recommended process, selection criteria and disclosure requirements in the Annual Report and Accounts for audit tenders. However, we believe the ultimate decision to recommend auditors for appointment should remain with the independent non-executives and shareholders, as at present.

Having carefully selected the Audit Committee members, following a robust assessment of their skills and experience, it is unclear how involving a regulator in the auditor selection process, who could potentially have no sector experience or detailed knowledge of the business, would improve the decision making process and ultimately improve the process for selecting the auditor. In addition, should the auditor, appointed by a regulator, fail to perform a quality audit, it is not clear where responsibility arising from this would lie? The existence of possible conflicts would also have to be carefully managed, without knowledge of the business this would be difficult for an independent regulator to achieve. Furthermore, the appointment of Independent non-executive directors is subject to approval by shareholders at Annual General Meetings. Will investors be able to hold members of an "Independent Body" to account, and what influence they will have over appointments?

The UK Corporate Governance Code already gives clarity regarding the role and scope of the Audit Committee which includes challenging both management and the auditors in their decision making and execution of their duties. We acknowledge that a well resourced independent body may provide further challenge, but we believe that significant challenge is already provided by our experienced Audit Committee members, and that the revised corporate governance code provides sufficient guidance in this area. The challenge from Audit Committee members is enhanced by the additional knowledge acquired from the other Board meetings that they attend in their roles as non-executive directors of the company. We do not believe there is any additional benefit that would be derived from any ongoing supervision from an independent regulator.

Recent changes to the Code have sought to ensure that the highest standards of corporate governance are maintained. These changes have reinforced the role of the Audit Committee and enhanced the reporting of its activities in the Annual Report. We support such developments as an effective mechanism for providing additional information to investors, and would support further review, if necessary, to ensure that the Audit Committee reporting is addressing the needs of investors.

Board effectiveness, including the Audit Committee, is something that is already subject to external assessment, as required by the Code, and we do not believe that the ability of a regulator to issue public reprimands with regards to Audit Committee procedures would change the approach adopted by the Committee members as they already understand the importance of their role and undertake their duties diligently. However, we believe that guidance on the disclosure of the scope of Audit Committee effectiveness reviews, and any recommendations arising thereof, may provide additional assurance to stakeholders.

Remedy 2: Mandatory joint audit

We are not supportive of the mandatory joint audits remedy as we believe that this could create significant potential audit risk through unclear accountabilities, and higher cost and disruption to UK companies. In the absence of any evidence to show that the quality of challenger firms is better it is unclear how the introduction of joint audits, particularly where it is mandated that one of the firms is a challenger firm, would improve audit quality, even though it may enhance the experience of challenger firms and, over time, improve the overall resilience of the audit sector. In the short term we would have concerns over the impact of mandatory joint audits on quality and efficiency of audit delivery.

We acknowledge that competition in the market is needed, however challenger firms need to be able to demonstrate their ability in terms of resource and capability to undertake each audit that they are appointed to deliver. Mandating a joint audit does not support the overall aim of improving quality, particularly given the risk of gaps in audit coverage, the risk of inconsistency of approach and judgement, and the potential for lack of clarity over accountability for decisions. If, as is suggested, the Big 4 firm initially takes the lead as the challenger firm builds their experiences of a large and/or complex audit, then it would appear to follow that the benefit of having two firms holding each other to account is significantly, if not wholly, reduced. Additionally, a process for resolving any potential difference of opinion between two sets of auditors, for any judgemental matter, would be needed.

We believe that high quality audits are more likely to be delivered where there is a depth of understanding of the industry and business being audited. It is possible that by splitting the allocation of work between different firms the depth of understanding will be adversely impacted unless there is significant duplication of work, which will be costly and have an adverse impact on the amount of time management has to invest in the audit process with no real benefit in relation to quality. It may also slow down the audit process, resulting in audited results being released to the market later than they are currently, adversely impacting shareholders – or to counter this latter point, more results being released unaudited, which again we do not see as a benefit to shareholders.

We see many of these points, with regard to choice and potential conflict, as issues relating to the market cap remedy. We believe that market cap is a better alternative to achieve the aim of increasing audit quality than a joint audit; however, we believe that this could take many years and

that quality would deteriorate in the short term. We also have concerns as to how it would be applied in practice.

Remedy 6: Peer review
It is unclear what additional value this remedy would deliver over and above the measures already in place, such as the internal quality reviews already mandated within the audit firms, as well as the existence of independent quality reviews by the Financial Reporting Council. We do not believe that such a review occurring prior to results being announced would be beneficial for audit quality and could result in a potential delay to the signing of financial statements.

As the peer review would effectively be undertaken by a competitor firm, we believe there is a higher risk of challenge and disagreement in areas of judgement particularly given the suggestion that incentives may be offered to peer reviewers finding weaknesses. As such, a resolution process would be needed which would add a further layer of complexity and delay, potentially resulting in market announcements not being achieved in a timely manner. Additionally, the process of review and the impact of this on independence and competition is unclear; for example, would the reviewing firm be excluded from selection at audit tender and who would bear the cost of the review?

We trust that this response will be of help as part of your considerations.

Yours sincerely

Belinda Richards
Chair of the Audit Committee
for Wm Morrison Supermarkets PLC