

Statutory Audit Market Study  
Competition and Markets Authority  
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DATE: 30 October 2018

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Dear Sir/Madam

### **Invitation to comment: Statutory audit market**

EY welcomes the opportunity to respond to the CMA's Invitation to Comment on the Statutory Audit Market (the "Invitation to Comment").

The role of auditors is to enhance trust and confidence in financial markets. However, recent events, such as the collapse of BHS and Carillion, have weakened public trust in corporate information and capital markets. In order to ensure capital markets are trusted and what companies report to the public is trusted, the audit function needs to change to improve audit quality and the audit itself needs to be modernised to meet public expectations. It is vital that this should be accompanied by further reforms to ensure healthy regulation fostering greater accountability of auditors and management, new corporate reporting rules, an enhanced audit product, stronger regulation and reinforced public interest. Reforms to audit alone will not restore public trust, sustained confidence or prevent corporate failures.

Reform should be wide ranging and anchored around the following five key changes, on which we provide greater detail further below:

- All audit firms need to focus on better quality audits and be answerable for failure, including higher fines and sanctions where audits fail. There should be accountability at senior levels where audit quality systematically falls short.
- Management and directors (including audit committees) are primarily responsible for the accuracy of corporate information, upon which shareholders and stakeholders rely. They must play a greater role in that regard and should be held accountable through a framework of enhanced regulatory oversight. The Sarbanes-Oxley reforms in the US, where the management of a public company is required to certify the material accuracy of financial statements, could be adapted to the UK market ("UK-SOX").
- Corporate reporting needs to evolve to meet society's needs, particularly regarding the going concern and viability of companies and the measurement of the long term value creation for stakeholders and other risks.
- Audit itself must be brought into the 21<sup>st</sup> century, by taking advantage of technology to enhance reliability and focus assurance on the financial statements and other key indicators. Indeed, all reforms will need to take account of the changing demands of society in addition to being more forward-looking. The audit firms must also have a revitalised purpose focusing on public interest.
- Finally, we need investment in and expansion of our overall regulation, to ensure we have appropriate scrutiny of companies, directors and auditors.

In addition, changes to encourage greater choice in the UK market for audit services should be introduced in parallel with these key reforms. However, all solutions must be viewed against the overriding principle of audit quality and, ultimately, the market must be made attractive to encourage new entrants to join.

Significant and comprehensive reform can support a strong future for UK companies and a healthy capital market, as well as encouraging responsible capitalism. However, it will take a concrete series of changes across several areas, underpinned by regulation, to oversee and deliver them. This is why we welcome the recent and ongoing reviews: the Joint Select Committee Report on Carillion, the Kingman Review of the FRC, the additional request of Sir John Kingman from the Secretary of State, Rt. Hon Greg Clark, the FRC's review of ethical guidance and corporate reporting, the CMA's own Market Study and the proposed independent review of audit ("Project Flora").

It is also important that UK reform takes account of the global nature of corporate reporting and audit, so that it can be effectively implemented. Otherwise, there is a real danger of isolating the UK and damaging the vibrancy of our capital market.

We provide our responses to the specific questions set out in the Invitation to Comment in Appendix 2.

## Market Investigation

The CMA has also issued a Market Study Notice and requested views on whether it should conduct a Market Investigation. We would welcome a Market Investigation that focuses on choice and the need for a resilient audit market. Much has changed since the last review of the FTSE350 market by the Competition Commission and the proposed Market Investigation could have a considerably wider scope: large companies, both listed and private, and public interest entities ("PIE"). We acknowledge that whilst the changes introduced following the last Market Investigation and the EU audit reforms that were introduced shortly thereafter resulted in increased tender activity between the Big Four audit firms, they did not reduce concentration in the FTSE350 audit market. Although we believe reform of corporate reporting and audit should be undertaken in a holistic manner, there are a number of fundamental issues, particularly around choice of auditor that require proper market analysis in order to properly assess their potential effectiveness. Should an investigation proceed we would suggest that it takes account of the effect of the reforms suggested herein.

## Greater accountability of auditors and management of audit firms for audit quality

1. **Global networks.** Multinational companies require audit firms with global reach in order to ensure consistently high quality audits. In addition, greater access to non-audit specialists across the network strengthens the quality of audit in a way that is not possible within a UK-only firm. In EY's case, greater levels of integration have enabled us to provide the scale of investment necessary to improve audit quality along with a consistent global application of audit tools and methodology. To help achieve something similar and with a view to meeting public expectations on audit quality, each licensed firm in the UK could report to the regulator<sup>1</sup> on its own investment plans over the succeeding three year period. Whilst we acknowledge that investment in audit on the requisite scale may be challenging for some (and possibly raise barriers to entry), we have proposed some ways in which these challenges could be addressed.

<sup>1</sup> Please note that as the future of regulation is under review by Sir John Kingman, we refer throughout to the "regulator" rather than the Financial Reporting Council. This is not a reflection on what the outcome might be from the Kingman review.

2. **“Red flag” obligations.** To further demonstrate and enhance accountability, audit firm professionals and other professional service providers could have legally mandated and protected “red flag” obligations to report any matters that they suspect might compromise the continuing operation of their client’s business. The obligations could include raising concerns with management, then progressively to the board, the non-executive directors and ultimately to regulators for possible investigation. In order for such a regime to be effective, legislation would be required to implement this proposal.
3. **Non-audit services.** To address concerns in relation to conflicts of interest between a firm’s audit role and the provision of non-audit services of large private companies, the application of the strict EU PIE rules could be broadened to cover these entities in line with the expanded reporting requirements contained in the Companies (Miscellaneous Reporting) Regulations 2018 and using the same criteria as contained under paragraph 23 of the Regulations. The regulator could also re-examine those areas where an auditor is not permitted to provide services to its audit clients (the so called “black list”) to ensure it remains up to date and appropriate.
4. **Senior leadership responsibility.** To increase the accountability of audit firms for audit quality, the audit firm’s Chairman and Head of Audit could be accountable for audit quality through an annual certification that the firm has made the necessary investment in audit and audit quality. Such a requirement would also have the benefit of enhancing confidence in the quality of challenger firms and, accordingly, choice.
5. **Conflicts Committee.** We recommend that firms conducting PIE audits should be required to establish a conflicts committee, or a similar body, although we note that some firms, including EY, already have these in place. The conflicts committee would meet regularly and report annually to the regulator on its remit and how it has managed conflicts. The regulator would then be in a position to understand how conflicts are managed and provide further guidance on conflicts’ management. This enables the regulator to provide a view on whether firms are handling conflicts appropriately and act when they are not.
6. **Expanded audit firm reporting.** To build further confidence that audit firms are accountable for quality, there should be expanded annual reporting by audit firms to the public. Currently, there is a requirement to produce a Transparency Report under the EU Audit Directive, but this is not as extensive as it could be. New and additional areas of reporting by the firms on how they are delivering value to their stakeholders could include greater information on internal and external inspection results, trends on independence and conduct violations, extended information on audit and non-audit services provided, including talent attraction and retention data, diversity and gender gap data, new business opportunities not accepted, output from culture assessments and information on environmental sustainability practices.

### **Stronger, independent and well-funded regulation**

7. **Independent licensing regime.** We propose that firms auditing PIE and large private companies be licensed by an entirely independent regulator and no longer by any of the Recognised Supervisory Bodies. It is important to have an independent regulator to ensure public trust in the regulation of corporate reporting and of those that audit such information. Regulation of audit and audit firms should also be properly funded to be effective and to avoid both real and perceived conflicts of interest

8. **Regulatory intervention.** To ensure audit firms are meeting their obligations, independent oversight could be expanded to include greater powers of intervention when an auditor is repeatedly failing, including holding both individual auditors and senior managers of firms to account. In this respect, the regulator should conduct an expanded independent oversight role over PIE and large private company audits that:
- Focuses on both firm-wide controls (including culture) and material issues on specific engagements;
  - Holds auditors accountable if they fail to meet their responsibilities, including a procedure for recommending audit committees change auditors following demonstrable repeated instances of failures of professional judgment or scepticism in the audit of the company; and
  - Use the new, more stringent, regime of fines and other sanctions that penalise audit firms that do wrong materially and intentionally or fail to remediate issues over time. This should be kept under review to examine the effectiveness of the new sanctions regime, particularly where persistent problems are identified. However, increased financial sanctions could also be a barrier to entry and therefore negatively impact competition. We suggest that the interplay between fines and competition be fully explored as part of a Market Investigation.

We note that the Financial Reporting Council has this year introduced a revised Audit Firm Monitoring Approach with new requirements regarding appointments to audit firm leadership and monitoring firms across five pillars: leadership and governance; values and behaviours; business models and financial soundness; risk management and control; and evidence on audit quality. Although it has not yet completed its first review, this new regime should provide stronger oversight of audit firms. While we support further regulatory intervention, this needs to be balanced with the need to maintain an attractive audit practice which is able to attract and retain talent.

9. **Oversight of systemically sensitive companies.** The regulator should be provided with enhanced authority, adequate resources and a specific remit to monitor the accounts of systemically sensitive companies (e.g. companies supplying key public sector services such as infrastructure, schools, hospitals, technology, etc). This could include oversight along the lines of prudential oversight or closer monitoring.
10. **International alignment.** In order to strengthen the overall quality of audit and to promote greater consistency and audit quality across borders, the regulator should be provided with a strong mandate to seek global alignment and oversight, including with respect to inspection regimes.
11. **Audit innovation.** The regulator's remit should include the encouragement of competition and innovation in audit. It should also perform regular reviews of the scope of audit to ensure it continues to be fit for purpose, as innovation expands the range of corporate information available and societal expectations as to what should fall within the scope of audit grows. The regulator should have the resources, skills and technology to support an evolving audit market.
12. **Health of market.** Similar to the financial services regulator, the regulator's remit should include a requirement to ensure the market remains healthy overall.

## Stricter governance over corporate information

13. **A new certification by management on the material accuracy of the financial statements and effectiveness of internal controls over financial reporting (UK-SOX).** In order to improve reliability of corporate reporting, we propose a regime that also heightens the accountability of management of listed and large private businesses by drawing on reforms made in the United States under the Sarbanes-Oxley Act. CEOs and CFOs should be responsible for certifying the material accuracy of financial statements and the effectiveness of internal control over financial reporting. This would cause them to put in place the necessary systems and infrastructure to enable them to make these certifications, including establishing and maintaining internal controls over financial reporting. To be consistent with the UK Corporate Governance Code and underlying guidance, the obligations on management in relation to the establishment of internal controls could focus not only on internal controls over financial reporting, but also on internal controls over, for example, the principal risks of the business and the company's viability. By taking this approach, such a regime would get to the heart of weaknesses that have been identified in recent controversies, such as Carillion and BHS. The regulator would require enhanced powers to oversee and enforce this regime.
14. **Auditor attestation.** In addition to the obligations on management outlined above, the auditor would be required to attest to the effectiveness of the controls management are required to establish and maintain. This would allow more robust challenge to companies being audited and result in enhanced assurance to shareholders and other stakeholders.

## Stronger governance oversight by audit committees

15. **Tender reporting.** In order to improve trust in the audit appointment and oversight process, the primary role of the audit committee must be strengthened. Under the current regime, the audit committee makes recommendations to the board and ultimately to shareholders. At the same time, the audit committee plays a crucial role between management and the auditor in pursuit of high quality reporting and audit. This role needs to be reinforced with enhanced transparency on audit committee activity. Audit committees should remain directly responsible and accountable for the appointment, compensation and oversight of the external auditor, with stronger regulatory oversight. In addition, audit committees should be encouraged to provide more information to investors on its tender processes when making a recommendation to appoint or reappoint an auditor.
16. **Transparent tender regime.** In order to support accountability of the audit committee for this role, a "transparent tender" regime could be created. The "transparent tender" process would involve the audit committee which, at the end of the tender process and following a recommendation to appoint or reappoint an auditor, reports on the process and outcome to the regulator. The audit committee chair could also be required to meet with the regulator to provide further information on the process undertaken. This would allow the regulator to have more visibility of competition, choice, fees, innovation and quality assessment. Annually, the regulator would also be required to issue a public report to the Secretary of State stating its views on the audit market (including choice and competition), auditor procurement, and audit committee effectiveness. In particular, the regulator should satisfy itself that audit quality is a higher priority than price, that bids have been properly and fairly assessed and that challenger firms (if bidding) have been treated appropriately with a view to improving choice and ensuring audit quality. The proposed items to be included in reporting to the regulator are set out in Appendix 1A to this letter.

17. **Price v. quality.** In addition to the transparent tendering regime, audit committees could be required to adopt a blind tender process whereby a bidder provides its tender without the price until after a decision has been made as to the preferred bidder. This would encourage proper emphasis on audit quality and innovation rather than price.
18. **Other assurance.** Audit committees have to date shown a reluctance to seek assurance beyond the limits of the current scope of audit. Whilst we discuss reform to corporate reporting below, audit committees can already seek greater assurance and should consider whether this is needed. In many cases, other assurance would not necessarily need to be done by the auditor and, therefore, could be an additional way to expand choice in the market.
19. **Audit committee reporting.** In addition, audit committee reporting and disclosure could be expanded. We have set out in Appendix 1B our proposed additional reporting requirements. Of particular note is the need to enhance reporting to shareholders around agreed scope and resources. This disclosure would provide information upon which investors would be expected to engage with audit committees, particularly if they have concerns about the actions the audit committee has taken. Given that the regulator has important responsibilities in holding audit committees to account for carrying out their responsibilities, the regulator would also be expected to periodically review at least a sample of these reports to assess the effectiveness of audit committees in managing their responsibilities.

### **Corporate reporting needs to change to meet future needs**

20. **Broader reporting.** It is clear that public expectations regarding corporate reporting are evolving rapidly. Therefore, companies should be required to report on a broader range of corporate information, such as the long term value they are creating for investors and their stakeholders. Corporate reporting needs to be updated to meet future needs and provide information that helps investors to make better investment decisions and engage on long term risks. Ongoing development of corporate reporting must continue to take technological advancements into account and also move towards greater assurance over key risks, such as going concern and viability, cyber risk controls, culture, corporate governance and sustainability. As corporate reporting requirements evolve and new approaches develop in areas such as communicating long term value, assurance should keep pace with those changes to provide shareholders and stakeholders with corporate information that meets their needs and, ultimately, assurance about what they are told by companies. Reporting on a variety of risks and value issues should be developed over time to enhance reliability of reporting and cover a range of issues beyond traditional financial statements.
21. **Expanded assurance.** Broader reporting introduces the opportunity for enhanced and expanded assurance. This could be developed to enable greater choice and the participation of different businesses in assuring corporate reporting, starting with these new areas of mandated assurance being opened up to firms other than the external auditor, where appropriate. In order to ensure the needs of investors and other stakeholders are taken into account, they should be deeply engaged with the development of enhanced corporate reporting. To address concerns on corporate viability, an immediate change could involve expanding mandated assurance over company viability.
22. **Technology.** With the development of technology, the nature of audit will change and the audit market itself is changing. These changes open up opportunities for disruptive alternatives to the current incumbent firms, as well as for having multiple firms involved in audits of various aspects

of corporate reporting. Auditing standards need to keep pace with rapid technological developments. This will ensure that the investment by global firms in innovation can be fully utilized in our audit system and encourage audit committees to include technological capabilities in their tender criteria. This will also encourage ongoing investment by firms utilising the multiple skills and investment capacity of multi-disciplinary practices.

23. **New entrants.** The adoption of technology may facilitate new entrants into the UK audit market.

### Supporting a sustainable choice of strong providers

24. **Competition.** As well as the reforms suggested above, there is a need to encourage a sustainable choice of strong providers to compete with the Big Four firms. In addition to the creation of a “transparent tender” regime (as described above) other measures could be considered to support greater choice and enhance the availability of more providers. In particular, we recommend:

- Providing the regulator with the power to recommend to an audit committee that the company’s auditor be changed where it can be demonstrated through the inspection and enforcement process that there have been repeated instances of failures of professional judgment or scepticism in the auditor’s audit of the company.
- Waiving or modifying the cooling-in period for non-audit services, where the regulator believes this is warranted to enhance choice of auditors and support greater audit quality, and provided that it is satisfied that the risks regarding conflicts and independence can be appropriately mitigated. This could be achieved by a “no action” letter regime to provide comfort to audit committees when they may otherwise breach the requirements.
- Providing the regulator with power to waive or extend the mandatory firm rotation period, where this will enhance choice and support greater audit quality, provided that it is satisfied that the risks can be appropriately mitigated. A “no action” regime could apply here as well. This would allow an audit committee to work with potential new providers and, thereby, put those providers in a position to tender for the audit at a later date.
- Providing for mandatory assurance of company viability.
- Examining open source technology arrangements to assist firms in enhancing their technological capabilities. Other potential pathways may involve a disruptor bringing technology solutions to the open market that can be accessed regardless of the size of a firm.

### Engaging investors for more accountability

25. **Investor engagement.** Investors have the ultimate decision-making power regarding the appointment of auditors. However, the level of engagement by investors has been relatively low on audit and assurance compared to areas such as executive remuneration. By way of illustration, our analysis shows that the proportion of FTSE 350 companies with a vote over 98% in favour of appointing/reappointing the auditor was 78.9% in the 2013-14 AGM season and 76.9% in the 2016-17 AGM season, indicating very little change. The proportion of votes above 20% against appointment or reappointment rose from 0 to 0.6% over the same period, but this remains a very small proportion. Investors need to become more involved in considering all of the company’s principal risks (including viability) through regular engagement with audit committees. With the measures we propose regarding greater public reporting by the audit committee of the tender process and periodic reports on audit quality, shareholders will have more information upon which to base their vote. Moreover, the additional measures regarding accountability of management, audit committees and audit firms will enhance investor confidence in financial reporting. The



Stewardship Code should include stronger reference to engagement on corporate information, audit, auditors and management of risk to ensure more attention is given to this aspect of the stewardship role.

### **Address issues regarding payment of dividends and pension liabilities**

26. **Pension safeguards.** We proposed above that audit committees should report on the company's dividend policy, including how the board has taken into account pension funding requirements, continued access to finance, gearing risks and timeliness of payments to suppliers. Given the particular problems that have arisen in relation to the adequacy of pension funding, we support additional powers being given to The Pensions Regulator to conduct its oversight of the adequacy of pension liability provision and capacity to require faster pay down of such liabilities. In addition, the CEO and CFO could be legally required to certify the funding of pension liabilities on an annual basis.

### **Better measures to address failing companies**

27. **Pre-insolvency regime.** Alongside the measures we propose in relation to systemically sensitive companies, it is also important to ensure that our regulatory regime provides better tools for addressing failing companies. This is needed in order to provide the opportunity to revive companies in distress rather lead straight to insolvency, which tends to be the outcome under the current limited regime. In our submission to the BEIS Consultation on Insolvency and Corporate Governance, we suggested that a new pre-insolvency regime (similar in nature to Chapter 11 in the United States) should be introduced to allow companies to receive protection through a moratorium and obtain debt finance. This would strike a balance between being rehabilitative and punitive, and address the current position in the UK's regime that a company can only file for protection when it runs out of funds. This type of measure would increase the likelihood of companies surviving and thereby reduce disruption to workers, suppliers and other stakeholders that flow from insolvencies.

### **Conclusion**

In conclusion, we are in favour of change that will improve the quality of corporate information and accountability of all parties in their respective roles. This change must result in an audit regime that works in the public interest, is accountable and remains sustainable over time. However, it is also important to make the right changes in order to address the issues that companies, investors, regulators and the public are concerned about: public accountability, quality of corporate information and audit, assurance over information of particular concern to shareholders and stakeholders and improved choice in the audit market. It is also crucial that any changes implemented support the UK's global position and do not isolate the UK capital markets. We believe the above measures will make a real change in the market and help to address these issues. However, whilst they cannot guarantee that companies will not fail in the future, they will strengthen the reliability of corporate information.

As this letter makes clear, and as the CMA itself has acknowledged, the issues are complex. Tackling any one single issue, or targeting reform in only one direction, will not achieve a lasting improvement. A careful and considered approach is required, from all sides, to ensure comprehensive and effective reform. We would therefore welcome a Market Investigation and further opportunities to engage with the CMA on these issues.



I would be very pleased to engage with you further on this important consultation. Please feel free to contact me if you have any questions on the points raised in this letter or you would like to discuss other matters related to the Invitation to Comment.

Yours sincerely

Hywel Ball  
UK Head of Audit

## **Appendix 1**

### **A. Transparent tendering - reporting requirements**

As discussed in the letter, we propose a regime of transparent tendering with reporting on the process and decision to appoint or reappoint an auditor. The reporting requirements would include:

- Which firms were asked to tender and why they were chosen to tender? If only Big Four firms were invited to tender, explain why others were not invited.
- What criteria were used to make a determination of the preferred auditor?
- How did the audit committee weigh up audit quality, innovation and fees?
- What process was undertaken to make a determination of which firm to recommend to shareholders?
- Who was involved in the decision-making process?
- What connections each of those involved in the decision-making process has or has had with the tendering firms.
- How has the audit committee managed any conflicts of interest of any decision-maker involved in the tender process?
- If the current auditor is to be reappointed, what audit quality assessments have been examined by the audit committee in coming to its decision and how does it view the quality of the current auditor and what are the reasons for its view?
- How has the audit committee taken account of technology and innovation in reaching its recommendation?
- Where a new auditor is proposed, what plans are in place for transitioning to the new auditor?
- What consideration was given to the wider assurance needs of the company and which services have been sought and which have not (including reasons for not taking up assurance options)?

### **B. Additional reporting by the audit committee**

As mentioned in our letter, we propose broadening reporting by audit committees to enhance transparency. In particular, reporting and disclosure should be expanded to include:

- Details around the agreed scope of audit and resources required;
- The full range of audit and non-audit services that a company purchases from its auditor and the major audit firms in reasonable detail, including an explanation of why it has purchased any non-audit services from its auditor;
- Which information has been audited and to what level, which information has been the subject of third party assessment or assurance and which information has not been assessed by any third party (auditor or not);
- Its approach on each of the following: financial statements, viability, going concern, cyber security risk, culture, etc;
- The company's dividend policy, including how the board has taken into account pension funding requirements, continued access to finance, gearing risks and timeliness of payments to suppliers; and
- A more extensive periodic assessment (at least every five years) of the auditor's quality and independence should be undertaken and publicly disclosed.

## Appendix 2

### Responses to Questions Raised in the Consultation

No	Question	Response
<b>(A) Issues</b>		
<b>Overall</b>		
1	How well is the audit sector as a whole serving its stakeholders?	<ul style="list-style-type: none"> <li>Research globally shows consistently that investors value the audit in its current form. However, it is clear that this is not enough and that they and other stakeholders expect more from corporate reporting and audit than is currently being delivered. We are committed to meeting this challenge and in that regard we refer to our covering letter for a detailed examination of how the sector and the audit product itself (among other proposals) can better serve stakeholders. We believe the Joint Select Committee Report on Carillion, the Kingman Review of the FRC, the additional request of Sir John Kingman from the Secretary of State, Rt. Hon Greg Clark, the FRC's review of corporate reporting, the CMA's own Market Study and the planned independent review of audit have an important role in establishing how the value derived from audit for stakeholders can be enhanced.</li> </ul>
<b>Theme 1: The audit framework</b>		
2	How well does the audit framework support the interests of both direct shareholders and also wider stakeholders in the economy?	<ul style="list-style-type: none"> <li>The provision of corporate information to shareholders and stakeholders is in need of reform. The needs of society are changing and a broader group of stakeholders is now seeking assurance over more than just the financial statements.</li> <li>As corporate reporting is evolving, shareholders expect to see more information around some of these issues, such as: <ul style="list-style-type: none"> <li>Long term value creation</li> <li>Viability statement and working capital reviews</li> <li>Corporate governance</li> <li>Culture</li> </ul> </li> <li>With the demand for increased information in those areas, there is also the need for enhanced assurance. This will only be possible under an updated framework, with clarity over the responsibilities of the auditors and</li> </ul>

		<p>the preparers of this information. We have detailed in our letter our views on how such accountability could operate, including our UK-SOX proposal.</p> <ul style="list-style-type: none"> <li>• In respect of the evolution of corporate reporting, by way of example, EY has already been looking at reporting on long term value creation through the <a href="#">Embankment Project for Inclusive Capitalism</a> (the “Embankment Project”) which is focused on finding a measureable, comparable and meaningful way for companies to better articulate how value is created for material stakeholders such as employees, society, business and investors. It is this type of disclosure which represents an important part of the future of corporate reporting, and which management control and audit frameworks should accommodate.</li> <li>• We support the need to ensure the relevance of corporate reporting and the extent of assurance and audit that needs to be conducted in relation to these disclosures.</li> <li>• Care needs to be taken to understand to whom such assurance is being given and the extent of liability, if any, that might attach to obligations, recognising that some providers may not be prepared to accept such liability. Therefore, if the remit of the audit is extended, liability reform may also be required.</li> <li>• In order to do this effectively, there is also a need to update auditing standards, including modernising these to take account of the new capabilities within firms, particularly in relation to technology.</li> <li>• Accounting standards now require significant judgments to be made in almost all areas of the financial statements. This results in financial statements which are complex and difficult for many people to understand, which runs the risk of further accentuating the audit “expectation gap”.</li> </ul>
<b>Theme 2: Incentives and governance</b>		
3	To what extent do the decisions made by audit committees support high-quality audits, whether through competition for audit engagements or otherwise?	<ul style="list-style-type: none"> <li>• Audit committees vary in both their remit and quality. The audit committee’s remit must be strengthened so it is suitably responsible and accountable for, and transparent about, the decisions it makes. In our experience, audit committees genuinely want the best quality audit, especially for large complex companies. However, other parts of companies may consider other</li> </ul>

		<p>work undertaken by firms to be more valuable to the organisation.</p> <ul style="list-style-type: none"> <li>• Audit committees have to date shown reluctance to seek assurance beyond the limits of the current scope of audit (e.g. forensic assessments or viability reviews) as they have a relatively limited remit. This is why we propose in our letter to move beyond the current scope of auditing the financial statements to consider requiring other forms of assurance with clear transparency about the services the audit committee has sought and those it has expressly decided not to pursue.</li> <li>• As set out in our letter, the increased accountability of preparers, boards and audit committees and strengthening the hand of auditors (including with the board and audit committee) will enhance the quality of financial information provided to shareholders (and other stakeholders) and support higher quality audits.</li> <li>• For all significant tenders, whether successful or not, we perform a post-tender review, and those that we have undertaken over the last few years have shown that quality is a more important driver of the result than price. However, there could be greater focus given to the benefits of technology and innovation. Ongoing monitoring of audit quality by the audit committee could be strengthened, and investors and stakeholders would benefit from greater transparency regarding the tender process and audit quality.</li> </ul>
4	<p>How has this changed following the Competition Commission's intervention?</p>	<ul style="list-style-type: none"> <li>• Neither the Competition Commission reforms nor the EU audit reforms implemented shortly thereafter have led to reduction in concentration. In fact, there has been a slight increase in concentration amongst the Big Four firms.</li> <li>• There has been a substantial increase in rivalry amongst the Big Four firms, as well as an increase in innovation that has provided real benefits to companies. Whilst historically audit committee chairs have fed back that there is little to differentiate between Big Four firms, this view has lessened as a result of some of these benefits. This increase in rivalry between the Big Four firms has been a beneficial outcome from the Competition Commission's intervention, but it has not reduced market concentration.</li> <li>• However, the increased cost of tendering (and its uncertain outcome), and the cost of transitioning to a</li> </ul>

		<p>new client is high and affects profitability of audit firms for up to five years, considerably tightening margins and making the audit market less attractive for challenger firms and new players. In addition, as a result of these factors, firms have to consider the returns closely for each tender they undertake.</p> <ul style="list-style-type: none"> <li>• The EU audit reforms have affected this even more substantially due to mandatory rotation, which has increased the number of competitive tenders and reduced choice.</li> <li>• In many, but not all, instances we have seen audit committees taking ownership of the process and seeing themselves as accountable for auditor selection, and in more limited instances, fee considerations. However, more emphasis on the value of innovation, ongoing monitoring of audit quality and greater transparency around tenders would enhance their role.</li> <li>• The investors' role in monitoring audit quality is practically limited to appointing the audit committee to ensure that their interests are considered appropriately, in a transparent and prescriptive manner. Therefore there needs to be an ongoing focus on ensuring that audit committees are encouraged to be as independent as possible from management and undertaking their role appropriately. Given the mechanisms in place, investors seldom vote against a proposed auditor except in rare circumstances (usually in response to an already known controversy).</li> <li>• By way of illustration, our analysis shows that the proportion of FTSE 350 companies with a vote over 98% in favour of appointing/reappointing the auditor was 78.9% in the 2013-14 AGM season and 76.9% in the 2016-17 AGM season - very little change. The proportion of votes above 20% against appointment/reappointment rose from 0% to 0.6% over the same period, but this remains a very small proportion.</li> <li>• We believe the reform suggestions we have made in this response will lead to better results, particularly for competition and choice.</li> </ul>
<b>Theme 3: Choice and switching</b>		
5	Is competition in the audit market working	<ul style="list-style-type: none"> <li>• We have seen increased rivalry between the Big Four audit firms in recent years since EU legislation and</li> </ul>

	<p>well? If not, what are the key aspects hindering it?</p>	<p>Competition Commission remedies were introduced. Nonetheless, the following would improve the level of competition:</p> <ul style="list-style-type: none"> <li>○ Improved management of conflicts by audit committees and potential bidders, so that more firms are clean to tender;</li> <li>○ The need for broader expertise in certain sectors to ensure that more firms can be considered to tender for audits requiring sector specialism.</li> </ul> <ul style="list-style-type: none"> <li>• The cost of audit tendering is significant and a barrier to entry for challenger firms. If companies tendering their audit paid for these costs, this would negate this barrier and could lead to enhanced competition. In addition, transition costs should be paid for and disclosed separately.</li> <li>• Suggestions included in Question 6 around potentially providing relief from independence rules in exceptional circumstances, would address some of these issues and further enhance competition and choice.</li> </ul>
<p>6</p>	<p>In particular, how effective is competition between the Big Four and between other firms and the Big Four?</p>	<ul style="list-style-type: none"> <li>• As mentioned in our response to Question 4, since the Competition Commission’s intervention, rivalry between the Big Four audit firms has strengthened considerably, with increased tendering activity across the market, often when it is not mandated. Nonetheless, there has been a slight increase in concentration of the market share held by Big Four firms with challenger firms not breaking through. It should be noted that we have only had a short period of time since the intervention to judge the long term effect of the changes. Indeed, not all companies in the FTSE350 have tendered their audit since this intervention and even amongst those that have, many have not yet had their first full audit cycle, so the full extent of the outcome of these reforms is not clear.</li> <li>• One of the unintended consequences of the reform is that choice has declined (due to a combination of removing the incumbent from tendering and independence rules requiring “clean” bidders, without any provision for relief from these strict rules). The requirement for mandatory rotation means a market of four players is effectively reduced to three for audit bidding and sometimes even fewer given independence rules, reducing choice considerably.</li> <li>• Due to the greater frequency and rivalry of tendering, the overall cost of tendering has increased, meaning that audit firms are being more selective about which</li> </ul>



		<p>audits they will tender for based on the returns they will get from the investment required to tender.</p> <ul style="list-style-type: none"> <li>• In addition, the cost of transitioning to a new client is high and affects profitability for up to five years.</li> <li>• Although there is increased scope for challenger firms to tender, particularly in the FTSE250 market, these increased costs, along with the risks associated with audit, have reduced the attractiveness of the FTSE350 market for challenger firms. This is illustrated by the decision of Grant Thornton, the fifth biggest firm in the UK, to withdraw from the FTSE350 tender market altogether.</li> <li>• There is some scope for improving choice, and potentially competition, by providing relief from independence rules in exceptional circumstances and where appropriate waiving the “clean” period. At present, there are examples of audit committees and companies having not planned a tender sufficiently in advance and therefore these current rules, strictly applied, prove restrictive.</li> <li>• The audit committee should continue to take responsibility for appointing auditors. However, much greater transparency about the tender process and decision making should ensure shareholders have more information to make decisions regarding approving proposed appointments (see our letter for more details).</li> <li>• In looking at choice and competition, it is also vital to look forward as the audit market is changing quite rapidly. In particular, considerable investment is going into technology that will change the nature of audit work, giving enhanced assurance due to a greater coverage of the data subject to audit. However, this also opens up the possibility of new players entering the audit market from non-traditional sources, such as from a technology/AI perspective. Regulators could look into how new players could participate in the market.</li> <li>• In addition, any proposals to improve choice and competition must take account of the global nature of organisations and the need for audit firms to have access to global networks in conducting an audit of most FTSE350 companies. The largest, most complex organisations continue to need to have access to the largest, most globally integrated audit firms. This includes the extensive technology infrastructure such</li> </ul>
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		<p>firms support which gives improved assurance and insights.</p> <ul style="list-style-type: none"> <li>• There is also a need for substantial numbers of non-audit staff to support audits. A lack of access to depth of expertise and personnel for audit also makes it difficult for challenger firms to demonstrate that they have the capabilities required to compete for the audit as a whole.</li> </ul>
7	How has this changed following the Competition Commission's intervention?	<ul style="list-style-type: none"> <li>• Please refer to our answer to Question 6.</li> </ul>
8	What is the role for competition in the provision of audit services in delivering better outcomes (i.e. consistently higher quality audits)?	<ul style="list-style-type: none"> <li>• There has been a strong link between investment, particularly in audit technology, and the increased level of strong and healthy competition in the audit market. In our view, this is one of the most positive consequences of the move to mandatory tendering and rotation, and it is hoped that the environment of ongoing mandated tendering will continue to see this level of investment.</li> <li>• Again mentioned in our letter is the lack of correlation between audit quality scores and shareholder approval of firms, something that we may have expected to have changed over time, particularly when there have been rotations.</li> <li>• Therefore, competition can have a positive effect on audit quality. However, there is a fine balance between increased competition and the time spent on tendering and addressing competitive pressures and supporting audit quality, which should be taken into account. In addition, whilst competition has brought quality up the audit committee's agenda, effective regulation is just as important to sustainable audit quality and the right balance must be struck between these two objectives. Our UK-SOX proposal would provide a more robust regulatory regime and accountability to enhance the quality and reliability of corporate information.</li> </ul>
9	In practice, how much choice do large companies and public interest entities have in the appointment of an external auditor?	<ul style="list-style-type: none"> <li>• The audit committee has the opportunity to manage choice through how they make arrangements regarding non-audit services as they prepare for a planned audit tender. This has not been as well utilised as it could have been during the first few years following the Competition Commission order and the EU audit legislation, but audit committees should be encouraged to look at ways to ensure they have competitive choices for their tenders.</li> </ul>

		<ul style="list-style-type: none"> <li>• Whilst we note some of the benefits of mandatory tendering (e.g. technological innovation and fresh challenge) there are few firms with the capability to demonstrate that they can audit complex global entities, and this is accentuated when the incumbent is precluded from tendering. Some of the suggestions we make in our letter regarding improving the market conditions for all firms would serve to improve capabilities. In certain sectors, which have a small number of major players requiring specialist skills (for example resources and banking), this can make competition a challenge.</li> <li>• As independence restrictions have tightened in certain areas, such as tax, under EU reform, this has again meant that companies are having to make commercial decisions as part of any audit tender process. It depends on the audit committee's policy, and the audit committee must play its role in ensuring that there is sufficient competition amongst credible firms. We have seen varying practice on this. For example, some audit committees demand that all audit firms who can credibly compete for the audit tender are "clean" in advance of any tender, or holding a tender so early that firms will not be caught by "cooling-in" rules.</li> <li>• In light of the above, we do not believe that the audit market is significantly different from many others in this regard. The key to ensuring that there is an appropriate level of choice that will also drive audit quality is for companies, audit committees and audit firms to apply the existing rules appropriately. However, if there is potential to apply flexibility to the rules (e.g. limiting cooling-in periods and extending minimum periods for mandatory rotations in exceptional circumstances if the regulator is satisfied that the risks can be appropriately mitigated) to enhance competition without harming quality then this would be encouraged.</li> </ul>
10	What are the key factors limiting choice between auditors?	<ul style="list-style-type: none"> <li>• All audit tenders are different in scale and complexity, and the demands of each company vary in each tender. There is no single factor that consistently limits choice.</li> <li>• Nonetheless, a number of themes have always been prevalent when considering the potential limitations on auditor choice, some of which have been accentuated in light of greater rivalry in the UK market recently. These include:</li> </ul>

		<ul style="list-style-type: none"> <li>○ The international capabilities of audit firms to deliver a globally consistent high quality audit, particularly where companies rely on less well-integrated firms or associates.</li> <li>○ The need for specialist sector capabilities that may mean a quality audit cannot be delivered. This is most often seen in sectors with large scale businesses with deeply specialist accounting and commercial understanding required, such as the banking and mining sectors.</li> <li>○ Global businesses require a consistent global audit that needs to be supported with a global technology platform.</li> <li>○ Complex businesses require audit partners with experience of auditing large multinational businesses. There is not a large pool of such partners and this makes it more difficult for challenger firms to compete in particular circumstances.</li> <li>○ The cost of tendering and the subsequent transition costs can also be prohibitive, as these are borne by the audit firms competing.</li> <li>● In addition, a desire on the part of audit committees to retain existing advisory relationships may mean a firm is not asked to participate in a tender and the lack of existing relationships may mean firms choose not to compete. This represents a potentially significant reduction in choice in many cases.</li> </ul>
11	<p>What are the main barriers to entry and expansion for non-Big Four audit firms?</p>	<ul style="list-style-type: none"> <li>● In addition to the items listed in our answer to Question 10 (international capabilities, specialist sector skills, cost of tendering and transition costs, all of which in themselves act as barriers to entry), a number of other factors may act as barriers to entry, or expansion, including: <ul style="list-style-type: none"> <li>○ the risk of large fines, such as those seen recently;</li> <li>○ the need to rapidly expand and upskill workforce in order to be in a position to win audits with uncertain demand and in advance of any appointment;</li> <li>○ unlimited liability, which becomes more of a concern as audit scope grows, and when shared by smaller groups of partners;</li> </ul> </li> </ul>

		<ul style="list-style-type: none"> <li>○ a lack of capacity to invest in increasingly sophisticated technology with uncertain returns;</li> <li>○ a need to build brand strength and reputation;</li> <li>○ the investment required to create an infrastructure to ensure compliance with the regulatory regime, including inspections; and</li> <li>○ a lack of credible partners to service large corporate audits.</li> </ul> <ul style="list-style-type: none"> <li>● In addition, any reforms to the audit market need to consider the ongoing attractiveness of the market to ensure that all firms can recruit, train and retain the best available talent to undertake audit in the future. A narrower talent base would become an additional barrier to entry or expansion.</li> <li>● Tendering costs, transition fees, cost of regulatory sanctions and the need to invest in skill and capabilities all require significant financial investment from audit firms. The impact in any one year of these costs on the results of the audit business are likely to be significant and therefore may act as a barrier to competition.</li> </ul>
<b>Theme 4: Resilience</b>		
12	Is there a significant risk that the audit market is not resilient? If so, why?	<ul style="list-style-type: none"> <li>● A resilient market needs a number of competing firms. In order to ensure that the resilience of the audit market is enhanced, we support measures that will lead to an increased number of firms competing in the listed and large private company space.</li> <li>● Given the current focus on the audit profession, a number of measures are being considered to ensure that real change occurs. These measures must also be considered in light of the impact on the attractiveness of the market to new joiners and possible withdrawal of firms and individuals (e.g. personal fines). Indeed, there is already a move away from certain areas of the audit market and incentives are needed such that other firms do not follow Grant Thornton's lead in the UK and leave the audit market in certain areas, reducing choice even further.</li> <li>● Whilst the market is resilient as a whole, there is some risk of contagion amongst large firms due to the potential for a single issue to spread across the firm. This will vary according to firm structure. Contingency planning and regulatory oversight will help manage any exposure in this area.</li> <li>● Notwithstanding all of the above, there are many other markets that operate effectively with four or fewer competitors, so the audit market is not unique in this</li> </ul>

		regard. A continued focus on investment in sustainable audit quality is the most important factor in maintaining a resilient market.
<b>Theme 5: Regulation</b>		
13	What is the appropriate balance between regulation and competition in this market?	<ul style="list-style-type: none"> <li>• In a market where a high quality service is vital for public interest, regulation and oversight will be a high priority and must hold providers accountable for producing that high quality.</li> <li>• However in so doing, regulation needs operate in a way that:             <ul style="list-style-type: none"> <li>○ Positively encourages innovation to take place within existing standards and by existing providers;</li> <li>○ Does not inadvertently exclude new entrants;</li> <li>○ Provides openings for innovation to deliver new entrants; and</li> <li>○ Thinks not only about the attractiveness of the market for new entrants but in terms of attractiveness to capital both financial and human.</li> </ul> </li> <li>• Regulation needs to foster audit quality, and public trust in the profession is fundamental to this. Both the audit firms and the regulator have important roles in the overall ecosystem. Regulation of the audit profession is a key aspect of this, as is ensuring accountability of all players responsible for ensuring high quality financial information is provided to investors.</li> <li>• The balance however lies in ensuring that the accounting profession is held accountable in a positive manner by a regulator which has to establish the principles of governance, transparency and the right incentives, and ultimately has the remit of maintaining a “healthy market” where firms can compete.</li> <li>• The benefits, which it should be held accountable alongside the audit firms to deliver, include the ongoing investment in technology which has proved to be a significant benefit of the current regulatory regime.</li> <li>• As we highlight in our letter, the broader corporate reporting ecosystem also needs to be held accountable in a regulatory environment that is appropriately designed, and continually updated. Regulation that drives competition, choice and quality is therefore important. We welcome the ongoing work of the Kingman review in this area, alongside this review by the CMA, which will ensure that comprehensive measures are delivered across the ecosystem. However, unintended consequences of changes to regulation must also be considered.</li> </ul>

(B) Potential Measures		
General		
14	Please comment on the costs and benefits of each of the measures in Section 4 and how each measure could be implemented.	<ul style="list-style-type: none"> <li>Please see our responses to each of Questions 16 to 27 for our preliminary comments on the measures referred to in Section 4. As our letter makes clear, and as the CMA itself has acknowledged, the issues are complex. Tackling any one single issue, or targeting reform in only one area, will not achieve a lasting improvement. A careful and considered approach is required, from all sides, to ensure comprehensive and effective reform. We support a holistic approach to reform, but there are many suggestions that require careful consideration from a competition perspective and we would welcome a Market Investigation by the CMA to ensure these are properly analysed.</li> </ul>
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.	<ul style="list-style-type: none"> <li>We have set out a number of measures in our letter that would address concerns about the operation of financial reporting and audit.</li> </ul>
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?	<ul style="list-style-type: none"> <li>In undertaking an effective audit, firms need to call on the talents of a range of specialists (e.g. experts in technology, valuations, pensions, derivatives, etc) who are not auditors and would not reside in an audit-only firm. We therefore support the multi-disciplinary model to deliver audits. Non-audit specialists are needed at various times throughout the audit cycle to address technical issues, which is best done with in-house resource.</li> <li>By way of example, even as currently scoped, a modern audit of an international mining group routinely involves more than 10 different areas of specialist expertise in addition to auditors with mining sector expertise. This necessary expertise, and overall capacity to deliver audit</li> </ul>



		<p>quality is improved by professionals gaining experience on companies the firm does not audit.</p> <ul style="list-style-type: none"> <li>• In addition, ring-fencing of the audit business, in and of itself, does not address any of the problems identified</li> <li>• Kevin Dancey, the incoming CEO of the International Federation of Accountants wrote an article in Politico explaining how this might work. A copy of the article can be found at <a href="https://www.politico.eu/pro/opinion-dont-restrict-accounting-firms-to-audits-only/">https://www.politico.eu/pro/opinion-dont-restrict-accounting-firms-to-audits-only/</a></li> <li>• As we set out in our covering letter, we believe that the remit of both corporate reporting and the audit needs to be extended. This would require a greater variety of skills in audit firms, such as expertise in organisational culture.</li> <li>• In addition, providing services to companies the audit firm does not audit provides development opportunities for auditors to broaden their skills, strengthening the audit practice.</li> <li>• Not having these specialists in-house would affect audit quality, increase expense and reduce accountability. Outside specialists would have to be subject to the same standards of quality and ethics, professional values, culture and liability applied to audit firms. Indeed, without in-house specialists, audit firms do not have the ability to make judgments that underpin their audit opinions where expertise is required.</li> <li>• A separate audit firm would also have a reduced capacity to invest in technology on the scale that is possible with a multi-disciplinary firm. At present, there are synergies for this investment across products that firms offer, that would not be realized otherwise.</li> <li>• A firm having offering a wider variety of services is better able to withstand any shocks to the market, enhancing its resilience.</li> <li>• In our letter we have proposed a number of reforms to strengthen corporate reporting, audit and assurance. To some extent this may also require access to broader skill sets, making audit-only firms even less likely to be effective.</li> <li>• Many large audit firms have significant shared service functions in territories outside the UK. These support firms globally and are cross-discipline. An audit-only firm regime would have to address this issue impacting the efficiency and effectiveness of the audit.</li> </ul>
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17	<p>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?</p>	<ul style="list-style-type: none"> <li>• High quality audits benefit from utilising global networks for their delivery and could not be performed on a UK-only basis.</li> <li>• Each global firm is structured differently. In the case of EY, we have one audit methodology and software platform and are organized in such a way as to minimize organisational barriers to deliver quality audits across the globe. We support all firms working towards greater integration across global networks, which we believe leads to increased quality and fosters a consistent global approach to audit work.</li> <li>• Many audits require services to be provided in remote and emerging markets. In order to do so, firms make significant investments via their global networks.</li> <li>• In addition, in the vast majority of audits, audit firms leverage international non-audit expertise on UK audits. Access to a strong network of experts clearly improves the capacity of firms to meet tender requirements and deliver audit quality.</li> </ul>
18	<p>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?</p>	<ul style="list-style-type: none"> <li>• The audit committee is in the best position to determine which non audit services are necessary and they have the right to either approve or prevent the purchase of these services from the auditor. What is most important is that the audit committee is transparent about why it has decided to seek these services from the auditor rather than other firms and it is clear what work is being undertaken by the auditor.</li> <li>• The EU audit legislation currently restricts the level of non-audit services that can be undertaken by an auditor. This is in practice reducing the level of non-audit services. However, there are some services that closely align to the audit and are appropriately undertaken by the auditor. Generally, however, firms are aware that they will lose non-audit work if successful in an audit tender, and this is now broadly accepted across the industry. However, this does mean firms need to consider potential commercial downsides of being appointed as the auditor, and companies need to consider the best service provider for a range of services, and not solely audit.</li> <li>• We support increased disclosure of the details of what is done within the audit and a clear description of any non-audit services provided by the auditor, so investors and other stakeholders can understand and make their own</li> </ul>

		<p>determination of the impact of these services, if any, on independence. We believe this is likely to lead to better decision-making by audit committees about the services they wish to be provided by their auditor. It also addresses an important point around the awareness of what non-audit services are being completed.</p> <ul style="list-style-type: none"> <li>• If further measures were introduced in relation to restrictions on non-audit services, these should apply to all firms conducting audits of PIEs and large companies, not just one set of firms or a specific section of any market. This would be appropriate given the reasons for such restrictions on non-audit services apply to any firm conducting an audit, regardless of size or market share.</li> </ul>
<b>Market Share Cap</b>		
19	<p>How should the market shares be measured? - number of companies audited, or audit fees or some other measure?</p>	<ul style="list-style-type: none"> <li>• Whilst market share caps could open up some of the market, we are not aware that this has been used in a similar market elsewhere in the world. There is a risk of distorting competition and damaging audit quality if capacity is not available to take up available audits.</li> <li>• Some risks associated with market caps are: <ul style="list-style-type: none"> <li>○ As a firm reaches its market cap, there is a risk it could price audits at a premium.</li> <li>○ If firms with specialist partners in a certain sector have reached their cap, this will mean such specialists cannot serve the companies who need them.</li> <li>○ Caps can reduce choice for audit committees and leave them with limited options, particularly if independence rules preclude other firms which have sufficient capabilities - there could be no firm available in some cases.</li> <li>○ Caps could lead to firms “cherry picking” clients and then refusing to compete beyond that, reducing the overall level of competition. “Higher” risk audit clients would become unattractive and are likely to find it more difficult to find an auditor.</li> <li>○ As the membership of the FTSE 100 is fluid, a cap based on that measure would be impractical as a change in the composition of the FTSE 100 (which is completely outside the control of audit firms) could leave firms in breach of the cap.</li> </ul> </li> </ul>

20	Could the potential benefits (greater choice, and resilience) of a market share cap be realised?	<ul style="list-style-type: none"> <li>• Please see our response to Question 19.</li> </ul>
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?	<ul style="list-style-type: none"> <li>• Please see our response to Question 19.</li> </ul>
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%?	<ul style="list-style-type: none"> <li>• Please see our response to Question 19.</li> </ul>
23	Could a joint audit be an effective means of implementing a market share cap?	<ul style="list-style-type: none"> <li>• In our view, the existence of market share caps would not increase the incentives to engage in joint audits.</li> <li>• There is no evidence that joint audits increase quality, independence or choice. They create considerable problems around liability and effective management of an audit, which carries significant additional risk, including to challenger firms. As both auditors must sign off on the same audit, liability for any problems is jointly held and an “innocent party” to a weak audit could be liable for all of the liability incurred. There will also be duplication, leading to higher prices for the same level of assurance.</li> <li>• A joint audit means there are two firms, not one, that are precluded from tendering for an audit when they are subject to mandatory rotation. In France, where joint audits are common, particularly for smaller companies, rotation is only in its infancy. However, it is anticipated that there will be considerable problems in that market due to two firms being precluded from tendering in such cases, especially with more complex clients where experience in France shows that two of the Big Four are likely to be necessary as joint auditors.</li> <li>• However, as discussed in our letter, we believe the areas that audit currently covers need to evolve and a future iteration of the audit could involve different firms conducting an audit over different areas. Whilst it is uncertain whether this would make a substantial</li> </ul>

		<p>difference to market share, particularly as it would depend on how this is defined, it could open up more opportunities for challenger firms in the market.</p>
<b>Incentives and governance</b>		
24	<p>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?</p>	<ul style="list-style-type: none"> <li>• Audit firms, along with other key players in our governance framework, most significantly audit committees, have an important role in supporting responsible capitalism. The work undertaken by auditors and those that engage them needs to engender public trust.</li> <li>• In our letter we have outlined a number of ways in which public trust can be enhanced with increased accountability from a number of parties. These include: <ul style="list-style-type: none"> <li>○ Enhanced reporting which has evolved with society's needs to focus on the viability of companies, long term value creation and other risks;</li> <li>○ Strengthening both the power and accountability of audit committees;</li> <li>○ Examining their remit in other areas, such as the viability of companies, long term value creation and other risks; and</li> <li>○ Giving the regulator wider powers over all parties involved in the corporate reporting ecosystem, i.e. not just the audit firms and qualified accountants.</li> </ul> </li> </ul>
25	<p>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?</p>	<ul style="list-style-type: none"> <li>• It is important that audit committees continue to undertake their key role in overseeing the provision of financial information to shareholders and this includes being responsible for decisions regarding tendering, appointment and reappointment of auditors. We see this as core to the duties of directors and to move appointments to another body would relieve the audit committee of responsibility for any failings in the appointment and if the audit is not of sufficient quality.</li> <li>• Having appointments made by a public body would in our view be unlikely to improve choice, particularly as this is mostly driven by independence requirements and firm capabilities. In addition, appointments may not be suitable for the company in question or meet the needs of the board and the audit committee, which would effectively have no say in the appointment.</li> </ul>

		<ul style="list-style-type: none"> <li>• Furthermore, it is not clear how a public body would set the scope of audit as suggested by the question.</li> <li>• It is also not clear how such a public body could manage the performance of a firm on any audit without a considerable investment in personnel and expertise, which it is not clear is needed to address audit quality issues, and which a well-funded regulator would be better placed to address.</li> <li>• Ultimately, it is important that the audit committee undertakes its role overseeing management in the production and quality of financial information in pursuit of their duties as directors, which includes selecting the most appropriate auditor to audit the information.</li> <li>• As mentioned in our letter, we believe greater transparency around the audit tendering process and decision making, as well as ongoing monitoring of audit quality, will provide investors and stakeholders with the information they need to judge how well their needs are being met.</li> <li>• In addition, audit quality depends on audit committees who are independent of management being open to regular dialogue with auditors about the financial reporting, audit and control environment.</li> <li>• Audit committees also need to more clearly describe to shareholders the services they have sought in relation to audit and other assurance services in key areas of risk and where they have taken a decision not to do so (with reasons for having taken that decision). This will enhance transparency regarding what information provided by the company is being audited and assured.</li> <li>• One way in which the tender process could emphasise the importance of quality over price without the need for an independent body would be to conduct “blind tenders” as described in our letter.</li> </ul>
26	Please describe the benefits, risks and costs of such an independent body replacing audit committees.	<ul style="list-style-type: none"> <li>• Please see our response to Question 25.</li> </ul>
27	Should companies be required to tender their audits and rotate their auditors with greater frequency than they currently are required	<ul style="list-style-type: none"> <li>• Frequent tendering has increased competition, but not necessarily choice. There is a cost associated with tendering that would be heightened with greater frequency, which could dissuade firms from submitting</li> </ul>

	<p>to do? What would be the costs and benefits of this?</p>	<p>tenders. More frequent auditor change would also increase transition costs.</p> <ul style="list-style-type: none"> <li>• The requirement from the EU audit legislation for mandatory rotation has also had a direct bearing on choice. Mandatory firm rotation has also led to increased concentration in the UK audit market, which was foreseen by a number of stakeholders.</li> <li>• In addition, with more frequent tenders and rotation, there is a greater risk of:             <ul style="list-style-type: none"> <li>○ Loss of knowledge, leading to a greater risk in relation to audit quality (although this can be offset by enhanced scepticism).</li> <li>○ Management disruption.</li> <li>○ Increased cost to the company and its shareholders.</li> </ul> </li> </ul>
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