



MARKET STUDY ON STATUTORY AUDIT SERVICES – INITIAL CONSULTATION ON RECOMMENDATIONS BY THE COMPETITION AND MARKETS AUTHORITY

Issued 13 September 2019

ICAEW welcomes the opportunity to contribute to the initial consultation by the Department for Business, Energy and Industrial Strategy (BEIS) on the recommendations made by the Competition and Markets Authority (CMA) following its Market Study on Statutory Audit Services, published on 18 July 2019, a copy of which is available from this [link](#). This follows our previous submissions to the CMA, in October 2018 (available from this [link](#)) in response to its invitation to comment, and in January 2019 (available from this [link](#)) in response to its update paper.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 153,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and to apply the highest professional, technical and ethical standards.

Audit is undergoing an unprecedented level of scrutiny. We commend the action taken by Government over the last eighteen months to tackle underlying issues of regulation, quality and concentration in the market, with three major reviews now entering their final stages. We look forward to seeing these brought together as soon as possible to produce a comprehensive and coherent programme of reform.

We have welcomed the vision of Sir John Kingman's independent review of the Financial Reporting Council (FRC) for a strong and credible new regulator - the Audit, Reporting and Governance Authority (ARGA) – with enhanced powers to intervene in the large corporate market. While accepting the recent analysis of the Business, Energy and Industrial Strategy Parliamentary Select Committee that the audit sector is showing signs not just of an 'expectation gap' but a 'delivery gap' as well, we have argued that a necessary foundation for change should be a fundamental examination of the role of audit itself. The demands of investors and others – such as employees, customers, suppliers and pension-holders – have rightly increased in recent years, and the purpose, scope and practice of audit need to keep pace. Sir Donald Brydon's independent review of the quality and effectiveness of audit, now well under way, is therefore timely and has our full support.

We have always believed that the work of the CMA should be considered alongside that of the other two reviews. While we note that one of the aims which the CMA set for its Market Study was to promote the long-term resilience of the sector (in the sense that a greater number of viable competitors in the market would protect customer choice in the event of withdrawal by a major firm) we would argue strongly that this cannot be seen as an end in itself, detached from the paramount priority of ensuring that audit improves and continues to give audit customers and other stakeholders what they need. Despite several high-profile corporate collapses and audit failures in

recent years, we are sceptical that the number of competitors – as such – available in the market for large corporate and Public Interest Entity (PIE) audits has a direct causal link to auditor performance.

However, ICAEW is confident that a consensus now exists across the audit sector that increased choice in this market is both necessary and desirable. This will require a basket of measures which address three interconnected aspects of the current situation: changing how the Big Four firms operate, reducing the obstacles which currently deter their potential challengers from entering that market and, finally, supporting audit customers to exercise their extended freedom of choice.

ICAEW feels that urgent action to address public concerns regarding audit – alongside wider issues of corporate governance and management accountability – is vital to maintaining confidence in business. While it makes sense for Government to get the process of reform under way, and to achieve as much as possible even in advance of any new legislation, we remain convinced that much greater priority should be given to establishing ARGA. The existence of a vigorous regulator, equipped with the necessary authority and resources, is a prerequisite for the success of any interventions aimed at improving market resilience. For our part, chartered accountants are ready to be willing partners in change. We look forward to working with all parties to produce effective measures which will improve quality and increase choice in the market, while ensuring that audit meets the future requirements of the UK economy and wider society.

MAJOR POINTS

Background

1. Without detracting from the importance and impact of a series of high-profile corporate failures in recent years, ICAEW considers that as a whole the audit sector in the UK is working well and its customers are satisfied. It operates to rigorous professional and technical standards and is recognised internationally as high calibre. Outside the FTSE 350, medium-sized companies and small businesses across the UK economy are served by thousands of audit-registered firms: competition is strong and quality is high. However, for large corporate entities and PIEs choice is much more restricted, because relatively few firms other than the Big Four are currently perceived to possess the scale and capacity to conduct audits at this level. Even this choice is – quite rightly – further limited by independence considerations.
2. ICAEW notes that the audit sector plays a key role in creating and sustaining domestic and international investor confidence in the UK business sector and wider economy. Possible measures to increase competition and choice in the market for large corporate and PIE audits must be seen in the context of the need for the UK, after its exit from the European Union to be perceived positively as a global trading partner and as a place where the business and investment environment is both attractive and well-regulated.
3. ICAEW believes that the paramount issue is audit quality, and ensuring that it continues to improve and continues to meet the existing and evolving expectations of audit customers and other stakeholders. The actual number of competitors operating at any time is an important but secondary aspect, and not necessarily directly connected to audit quality. It would not be a positive outcome if regulatory or legislative interventions brought more firms into the market for large corporate and PIE audits, but seriously jeopardised quality and significantly increased costs for audit customers.
4. We note the relatively recent work conducted by the CMA's antecedent organisations, the Office of Fair Trading and the Competition Commission. This culminated in a thorough investigation of the market for statutory audit for large companies, conducted between October 2011 and October 2013. In the short time since the Order implementing the package of remedies to emerge from that investigation came into effect in January 2015 (followed by the EU Audit Directive and Regulation in June 2016) there has been, as the CMA observes, 'some positive change' in the operation of the audit market. It is still too early to assess the longer-term impact of these measures, but one consequence has been a more even spread of clients in the FTSE 100 among the largest audit firms, as mandatory rotation causes companies to change auditors more often. This suggests that competition is working, at least within and between the Big Four firms, and audit customers can and do exercise choice.

Proposed remedies

5. Nevertheless, ICAEW agrees that improving the resilience of the market is now both necessary and desirable, and that the measure of this should be the extent to which firms from the next tier and beyond are successful in winning, conducting and retaining audit work in the FTSE 350. Given the current stark difference in capacity and scale between the Big Four firms and even the largest of their potential challengers, this will not be achieved if the latter are expected to compete for unitary audits on a like-for-like basis – unless there is a radical re-ordering of the sector through an intervention such as a segmented market share cap. We therefore see the benefit of proposals which aim to bring about a partnering approach, mandating or facilitating for each large corporate audit a level of formal collaboration between one of the Big Four firms and a firm from the next tier or elsewhere.

6. In that context, we believe that joint or shared audits would certainly help challenger firms acquire relevant experience, specifically in the eyes of potential audit customers in the FTSE 350. With sufficient time, effort and goodwill, either could be made to work, although both face significant practical obstacles. For example, the willingness of audit customers to accept external constraints on their freedom of choice (and the likely increased financial and management costs) is largely untested, and we sense that the readiness of some challengers to move into this market is highly contingent on favourable and potentially asymmetric changes in the liability regime and regulatory intensity.
7. Specifically, if Government decides to proceed with mandatory joint audit as envisaged by the CMA it must be on the basis that it is confident that the ultimate prize (which is principally the undoubted benefit of having a greater number of competitors in the market for FTSE 350 audits) justifies both the investment of political and regulatory effort and the impact on audit customers in the near term. It will require significant commitment over an extended period of time, including strong and enduring Ministerial sponsorship, to address businesses' likely concerns on cost, complexity and capability, and to deliver a set of systemic interventions around liability and regulation. Also, this will take place against a public backdrop of issues thrown up by the transition, quite possibly including 'teething problems' on audit quality.
8. ICAEW does not dispute that all this may be possible, but we would be concerned that, within the overall reform package which must integrate the outcomes of the work of Kingman, Brydon and the CMA, implementing joint audit could consume disproportionate time and resources. Similar considerations would apply to shared audit, but, arguably, to a lesser extent.
9. ICAEW believes that the use of peer review, as also proposed by the CMA, raises some very significant practical issues. We can see a potentially valuable role for an independent review panel, probably appointed by the regulator, although this will do more to improve audit quality than address issues of market resilience.
10. While ICAEW is broadly supportive of the CMA's proposal to increase regulatory oversight of audit committees, we caution that this would be a complicated and sensitive undertaking. We agree it may have some place in situations where there are specific concerns about the competitiveness of an audit tender, or quality of audit work. We question however whether a regime of detailed and regular reporting by all audit committees to the regulator would be a proportionate remedy.
11. We remain sceptical that increased regulatory oversight of audit committees will have a major impact on market resilience but see it as part of a wider drive to improve accountability and visibility to investors and other stakeholders. Nevertheless, given the likely investment of time and resources it will require, set against the potential benefit, we believe that implementation of this power should not be in the top tier of priorities, although provision for it should certainly be included in any new primary legislation.
12. As we have said in our submission to the consultation on the recommendations of the Kingman Review, the importance of not over-burdening ARGA cannot, in our view, be overstated. The new regulator must take robust and potentially difficult decisions on its early goals and how it can most effectively achieve them. It will take time to acquire the resourcing and capabilities needed to undertake all of its proposed objectives, duties and functions: the current issues affecting UK corporate governance and audit cannot wait for that. Rather than attempting to do everything at once, we recommend that ARGA concentrate from the start on improving audit quality, governance and reporting, leaving some complex technical matters emerging from both from the Kingman Review and the CMA Market Study, which are important but less urgent, to be worked through in due course.

13. While ICAEW welcomes the CMA's conclusion not to seek the break-up of the Big Four firms, we have concerns about its recommendation that these firms put in place a strategic and operational split between their audit and non-audit services. We believe that although it would be difficult to justify not extending this principle to challenger firms outside the Big Four, doing so is likely to handicap significantly their ability to compete in the market for FTSE 350 audits.
14. Alongside that, ICAEW recommends that time should be allowed for the effect of changes already made voluntarily by the Big Four firms to be assessed, and consideration given to whether any necessary further effect could be achieved by strengthening the application of existing safeguards. Each of the large integrated multi-disciplinary firms operates to a single standard of professionalism and ethics: this underpins a consistent and coherent culture which is shared across a firm's operations. The work these firms do – and the values they follow in doing it – reaches into a wide range of capital markets and business settings where transparency and reliability are important: these are much broader than audit alone. Consequently, we believe that much greater focus should be given to strengthening and sustaining this positive culture in firms, which will help ensure the confidence of capital market participants in contexts beyond their use of audited financial statements.
15. ICAEW believes that the CMA's proposals with regard to mitigating the potential consequences of one of the Big Four firms failing or withdrawing from the audit market would require the development and implementation of an extensive, and probably highly intrusive, suite of legal and regulatory interventions. We consider the investment of time and effort that would be needed to deliver this to be disproportionate to the risk.

Better Regulation and proportionate approach

16. While ICAEW believes strongly that the momentum of reform must be maintained, given the radical – indeed, the untried – nature of some of the proposals set out by the CMA and their potential consequences, not just for the audit sector but for business in Britain generally, we recommend that sufficient time is allowed for further consultation, debate and development, and we stress the importance of applying Better Regulation principles. Alongside the outcomes of the Kingman and the Brydon Reviews, the overall cost of the audit reform programme to business is likely to be very significant and it is essential that the expected benefits that justify this are carefully identified. To ensure that the final package is effective and delivers what is expected of it, it is essential that there is a comprehensive consultation with stakeholders once the detail of the measures and the results of impact assessments have been established.
17. Although they would be difficult and time-consuming to arrange, we think it would be prudent to conduct pilots or trials of both joint and shared audits (and possibly other proposed measures) before proceeding to full implementation. We also believe that the interventions which finally emerge from the Market Study process should be periodically reviewed (probably by ARGAs) to assess whether the desired effect has been achieved, and whether their continued operation is necessary and beneficial.
18. We emphasise the need to future-proof these proposals particularly in the light of the Brydon Review. In ICAEW's response to the Call for Views by the Brydon Review (ICAEW representation 64/19), we recommended consideration of a *'new three pillar model of User-Driven Assurance, one directed by the needs of the primary user - the shareholders. This would comprise a range of assurance outputs, demanded and delivered as and when appropriate, and could involve multiple providers'*. We stated that such an approach *'could be an effective way of meeting the needs of all users – and finally and fully closing the expectation gap'*. However, we also consider that such an approach could play an important

role in increasing competition and choice in the audit market, as it would encourage the development of *‘niche providers with particular assurance specialisms’*. We have stated that we are ready to work with the Brydon Review to develop further the concept of User-Driven Assurance.

Global leadership

19. Finally, ICAEW believes that a significant national economic opportunity will emerge from the current fundamental challenges facing audit in the UK, and the systemic reform which must follow. The outcomes of the Kingman Review of regulation and the Brydon Review of the quality and effectiveness of audit may well combine to produce a programme which becomes an international exemplar and allows Britain to show global leadership in developing solutions to issues affecting many other major jurisdictions. That said, the work of the CMA on longer-term market resilience may be seen as addressing conditions specific to the UK and might be less applicable elsewhere.
20. Particularly in the context of the exit of the UK from the EU, we also highlight the importance of this country maintaining a fair, open, welcoming economy for inward investment: robust audit and corporate reporting are a key part of this, but it must not be at disproportionate cost. We should be careful to ensure that the package of measures supports and strengthens the audit sector in the UK and does not impede its international competitiveness as a key export.

ANSWERS TO SPECIFIC QUESTIONS

CHAPTER 1: AUDIT COMMITTEE SCRUTINY

Question 1: Do you agree that the new regulator should be given broad powers to mandate standards for the appointment and oversight of auditors, to monitor compliance and take remedial action? What should those powers look like and how do you think those powers would sit with the proposals in Sir John Kingman’s review of the Financial Reporting Council?

21. Insufficient evidence has been made available to justify broad powers. However, if the regulator is empowered in these areas then we have some comments and concerns.

Standards

22. The regulator should begin with a review of existing standards. It is imperative that both the regulator and audit committees are clear about what is required. For example, standards should be clear about the respective roles and responsibilities of boards, audit committee chairs, other audit committee members, auditors and shareholders. If Kingman’s recommendation to develop an enforcement regime specifically for audit committee chairs is implemented, it must be cross-referenced in the standards for audit committees.
23. The regulator should develop best practice as well as minimum standards in order to encourage high-performing audit committees to continue to work to a high standard. However, best practice must be clearly differentiated from required standards. The ambiguity that has existed around the status of FRC guidance must be avoided.

Monitoring

Observations

24. Observations pose various risks and there may be unforeseen consequences. The CMA refers to observations of audit committee meetings and observations of ‘*other parts of the audit process.*’ No further detail is provided, but what is in scope may affect the risks and consequences.
25. Although the regulator’s powers are focussed on audit committees’ appointment and oversight of auditors, the agendas for audit committees are far more varied, for example risk management and internal controls – including anti-fraud, bribery and whistleblowing policies, and crisis management and business continuity. If regulatory attention or returns are limited to tendering and oversight, there is a risk that audit committees will start to regard other areas as less important.
26. In addition, if the regulator observes a decision being reached, and with the benefit of hindsight that decision is questioned by the regulator themselves or by a third party, then the regulator may find themselves being blamed for not stepping in sooner (please refer to our answer to Question 2 regarding litigation). Any argument which attempts to differentiate observation from participation is unlikely to be sustainable.
27. We suggest that the regulator accepts requests for observations. Requests may arise from concerns, a wish to improve, or because there is confidence that the regulator will observe best practice which others can learn from, ie, the regulator will ‘name and fame’. Audit committees, shareholders, trade unions, employees and workers should be allowed to request regulatory observations of audit committees.
28. The resources and costs involved in holding exit interviews of audit committee members may be justifiable. The regulator is most likely to benefit from exit interviews with audit committee

members (including chairs) who are departing prematurely, but random selection of departing committee members for interview may also be useful.

Appointments

29. The CMA's estimate of an average of 35 tenders per annum for the FTSE 350 may be inaccurate as tenders may not be evenly spaced. A survey of expiry dates for auditors' appointments would establish if there is clustering. If there is a particularly busy period for appointments then the regulator is likely to need significant resources over this period, perhaps on a temporary basis. A survey should also ask questions about auditors' tenures, as unusually long tenures may warrant regulatory attention.

Information

30. Kingman has warned of the futility of boilerplate. We share this concern, but at the same time we recognise that returns are widely used by regulators which need some baseline information. There is also general value in regulators initiating regular contact. We remain of the view that targeted reporting at key stages of the tendering process will be the most valuable approach. Reports submitted after audits have been completed could also be valuable to the regulator, auditors, audit committees, shareholders and others if these reports detail what has gone well and what needs improvement.

Grading

31. Routine gradings of all audit committees will be costly and incongruous with the risk-based approach. If gradings are based solely on information provided by audit committees or companies, experts will quickly establish what to say to maximise the chances of a good grading. The system could quickly fall into disrepute. The focus should be on improving Audit Quality Review (AQR) reports, including the gradings included in these reports. The CMA has not provided any information which justifies its confidence that grading audit committees would be more straightforward than the AQR process.

Remedial action

32. We agree with all of the proposals regarding remedial action in appropriate cases – public reprimands, publication of findings (or summaries), and writing to audit committees to highlight deficiencies.
33. We deal with information for shareholders in our response to Question 27.
34. Kingman has singled out audit committee chairs for possible removal, so there must be a reconciliation between the collective responsibility of all audit committee members and the special individual responsibility of chairs. There must not be any impression that the responsibilities of ordinary audit committee members has been diminished.
35. Kingman has proposed that the regulator be able to require removal or retendering of auditors. He has also suggested that the regulator is given the right (but not duty) to appoint auditors for PIE audits if there are quality issues, if there is an early departure of the auditor, or in the event of a meaningful shareholder vote against the proposed auditor appointment.
36. Although the suggestion of regulator-appointed auditors seems radical, the concept of state appointment of auditors is not new. The Secretary of State can already appoint an auditor if the company fails to do so.
37. Clarification is needed about the following challenges arising from the regulator's appointment of auditors: whether shareholders would still vote on the audit fee as well as on the regulator's selection; whether the audit committee would still be responsible for oversight of auditors who have been chosen for them; and whether an auditor chosen by the regulator contracts with the company or with the regulator.

Question 2: What comments do you have on the ways the regulator should exercise these new powers?

38. The Hampton Principles for Better Regulation are an essential condition. Close adherence to these principles will put the regulator on a solid footing, but the regulator must be prepared and resourced to deal with complaints and litigation where they arise.
39. Remedial action must be preceded by a robust investigatory process. In appropriate cases the regulator should allow a time-limited opportunity for improvement before it considers remedial action.
40. Poor audit quality reviews and restatement of accounts must trigger the regulator's involvement. Whistleblowing and early departures of board members (including audit committee members) should also trigger involvement. ICAEW receives cessation statements when an auditor makes an early departure.

Question 3: How should the regulator engage shareholders in monitoring compliance and taking remedial action?

41. Shareholders should be able to alert the regulator.
42. Kingman has recommended that the regulator should be able to recommend to shareholders that the audit committee chair should be changed, and this is engagement in respect of remedial action.
43. However, in general the regulator must operate independently. Although shareholders should be informed about monitoring and remedial action, they should not be actively engaged in these activities. There must be no perception that shareholders can force the regulator to act.

Question 4: What would be the most cost-effective option for enabling greater regulatory oversight of audit committees? Please provide evidence where possible.

44. The cost of regulatory oversight of audit committees may outweigh the benefits. If regulatory returns are imposed, they will generate a quantity of information which can only be sensibly managed through electronic submission and exception reporting, followed by sampling. ICAEW and the FRC use sampling, and risk factors taken into consideration include first year audit, profit warnings and change of auditor. Wherever possible, sampling by ARGAs should make use of audit committees' existing record-keeping, such as minutes of meetings. This will avoid duplication and will therefore be cost-effective for companies.

CHAPTER 2: MANDATORY JOINT AUDIT AND PEER REVIEW

Question 5: Do you agree with the CMA's joint audit proposal as developed since its interim study in December?

45. As context for this chapter on mandatory joint audit and peer review, and given the reference to shared audit, we would like to flag our latest thinking on these issues. Our thinking has been evolving following extensive consultation and stakeholder engagement and we have developed a *Future of Audit* thought leadership essay¹, *Shared and joint audits: are two auditors better than one?* which has been published today. In this essay we state in summary:

¹ Our *Future of Audit* thought leadership essays are available from this link: <https://www.icaew.com/technical/thought-leadership/audit-and-assurance-thought-leadership/the-future-of-audit>.

The audit market for larger listed companies in many jurisdictions, including the UK, is now dominated by four audit firms and their international affiliates. These firms are significantly larger than ‘challenger’ firms. Governments and regulators in a number of jurisdictions are considering whether to intervene in this market in an attempt to increase audit quality, competition and choice. Mandating shared or joint audits might be one way of achieving this.

The evidence that exists is far from compelling in terms of the impact of a second audit firm on audit quality or cost. There is also, inevitably, uncertainty about how successful any reforms might be in increasing competition and choice. But as a general principle, two professional opinions are often considered better than one and seeking a second opinion is seen as a good thing. This is at the heart of the joint audit debate for some, to whom it seems obvious that two audit firms issuing a joint audit opinion must be better than one. For others, joint or shared audits are simply one way of increasing competition and choice in the audit market which, of itself, should improve audit quality.

However, some audit firms and investors remain unconvinced that the risks and long-term costs associated with joint audits in particular can be justified. They argue that while shared and joint audits are often referred to as if they were simple alternatives to each other, operationally they are very different, and they have different profiles in terms of risks and rewards for companies, audit firms and investors.

Both shared or joint audits would take time to implement. They would need to be phased in as existing audits come up for tender, allowing challenger firms time to recruit new staff, adapt their audit processes, develop and implement training programs and to enhance their quality control and risk management systems. Audit fees may well be higher, particularly for joint audits. Regulators would need to monitor progress to ensure that challenger firms were progressing as expected.

Shared or joint audits are not a quick fix and would require sustained investment of regulatory time and effort over a number of years, and substantial investment on the part of challenger firms. Investors and audit committees would need to adapt to different ways of working with auditors and audit firms will not make the necessary investment if they believe that there is any real risk that the reforms will be reversed, as has happened in a number of jurisdictions. It may take at least 10 years to see full benefits from the reforms and if that proves too long, other alternatives need to be considered.

46. As we noted in our response in October 2018 to the CMA’s Market Study, while joint audit could enhance challenger firms’ market share, experience and expertise, it has proved unpopular in the UK market historically.
47. The CMA’s proposal to introduce mandatory joint audit for most FTSE 350 companies has been met with concern in some quarters, by the companies that would be subject to joint audit, and the investors who would ultimately bear the costs of paying for two firms to undertake the audit work. Companies are not keen on the additional management time involved, and the disruption that will inevitably result from having to tender for and subsequently appoint a second audit firm. Until such time that evidence shows that joint audit increases audit quality, shareholders may not welcome the higher costs that joint audit will likely impose on the audited entities.
48. It may be helpful for BEIS to refer to academic evidence on the subject of joint audit. For example, a review of joint audit by Dr Siddiqui of Manchester University, published in January 2019, comments that recent evidence suggests that joint audit would have no impact on audit quality. The report also highlights the ‘free-rider’ problem of joint audit, and the significant effect that co-ordination costs have on the overall cost of joint audit. There is of course other academic evidence available with differing findings.

49. Mandating joint audit would be a very significant measure and could complicate matters significantly for audit committees. The additional consultation steps are likely to strain reporting deadlines and may require them to be re-assessed. Also, it cannot be assumed that many firms outside the Big Four will be able to take on all of the commercial and regulatory responsibilities of such audits quickly, including obtaining insurance cover for the joint liability attached to the audit of FTSE 350 companies. Challenger firms may need to consider self-insurance in a similar manner to larger firms, as set out in our answer to Question 8. Taking on these responsibilities may prove difficult and necessitate a significant increase in audit fees.
50. In summary, the mandatory appointment of a non-Big Four joint auditor to most FTSE 350 companies is a radical proposal that would involve significant disruption and cost, and suggests that alternative remedies should be considered, such as shared audit. This is explored further in our answer to Question 11. Restructuring the market to introduce greater competition and choice will take time and significant resources to achieve and it is crucial that resources are targeted on the measures that can most effectively deliver that objective.

Question 6: Do you agree with the CMA's proposed exemptions to the joint audit proposals? How should the regulator decide whether a company should qualify for the proposed exemption for complex companies?

51. Were joint audit to be applied to the FTSE 350, we agree that there should, in the first instance, be an exemption for the largest and most complex entities where there may not be immediate capacity in challenger firms to participate. We also agree that there should be an exemption for audits of investment companies, and those that do not prepare consolidated accounts. However, if the rationale of joint audit is to increase audit quality and prevent future audit failures, then logically all other FTSE 350 companies should eventually require a joint audit regardless of whether they have appointed a challenger firm or not. To suggest that an increase in audit quality is only needed on those audits where the incumbent is a Big Four firm is not borne out by evidence from FRC audit quality reviews, or recent audit failures.
52. That joint audit requires such a complex system of exemptions to function evidences some of the practical challenges of such change, and again suggests that alternative remedies should be considered, such as shared audit. This is explored further in our answer to Question 11. Shared audit may provide some of the benefits of joint audit, including allowing challenger firms to develop experience and expertise in the FTSE 350 market, without some of the liability challenges or logistical complexities of joint audit. The components of the audit that are allocated to a challenger firm under a shared audit could be determined on a company by company basis, so may still be appropriate for some of the entities which would be exempt from the joint audit requirements.

Question 7: Do you agree that challenger firms currently have capacity to provide joint audit services to the FTSE350? If a staged approach were needed, how should the regulator make it work most effectively? If not immediately, how quickly could challenger firms build sufficient capacity for joint audit to be practised across the whole of the FTSE350?

53. We understand that challenger firms currently have capacity to provide joint audit services for some FTSE 350 companies. However, our assessment is that the provision of joint audit services to all FTSE 350 companies, notwithstanding the exemptions above, would take significant time to implement fully. It would require substantial investment by challenger firms and the sustained commitment of time and effort over a number of years by ARGAs.
54. We suggest that joint audits should be phased in as existing audits come up for tender and, assuming that tenders are evenly distributed, that accordingly around ten years would be

needed to provide joint audit services to all or most of the FTSE 350 market. This would allow challenger firms time to recruit new staff, adapt their audit processes, develop and implement training programmes and enhance their quality control and risk management systems. Using the tendering process as the primary mechanism for change would provide the market with transparent information and help to minimise disruption and the cost of transition. Such a gradual approach may also help avoid unintended consequences. A company could of course choose to appoint a challenger firm earlier than required, depending in part on the readiness of the challenger firm to accept the engagement.

55. However, we understand that tenders may be grouped together due to the introduction of the mandatory audit rotation rules. We therefore suggest a useful exercise would be to analyse the timing of the tenders and hence the likely pace of change. It may be, for example, that only around five years would be needed to provide joint audit services to most of the FTSE 350 market albeit it at the risk of increased disruption and cost of transition.
56. Making transition work effectively would need to be a priority for ARGAs. We suggest that the new regulator monitors progress towards the achievement of the stated goals, including the development of greater capacity among challenger firms, and should be ready to intervene as necessary.

Question 8: Do you agree with the CMA's recommendation that the liability regime would not need to be amended if the joint audit proposal were implemented?

57. We think it is premature to conclude that the liability regime would not need to be amended. The prospect of joint and several liability is likely to be unattractive to both audit firms in a joint audit situation. Under the current regime, firms are not just held accountable for their own actions, but also, potentially, for the actions of those in the company and the other audit firm. Each joint audit firm would become liable for the work of employees of another audit firm, over whom they have no control or supervision, and little means of managing their risk exposure. Challenger firms would become liable for the actions of the Big Four firm, on very large and complex audited entities, where existing professional indemnity insurance cover may be insufficient. Challenger firms may need to consider self-insurance in a similar manner to larger firms, to cover the higher level of risk associated with the audit of considerably larger and more complex businesses, as well as the increased risk associated with joint and several liability. The liability regime is likely to prove a barrier in many situations without some reform.
58. We believe that alternatives should be considered, for example making liability proportionate to responsibility for losses arising, and considering reform of the current liability limitation agreement regime.

Question 9: Do you have any suggestions for how a joint audit could be carried out most efficiently?

59. We have a number of suggestions for how a joint audit could be carried out efficiently, set out below.

Developing new standards and guidance

60. Joint audits are effectively excluded from the scope of International Standard on Auditing (ISA) 600 on group audits. At the time of writing, the IAASB was updating and revising ISA 600 and there were no plans to cover joint audits. There is therefore no international equivalent of the French auditing standard on joint audits, NEP-100².

² Norme d'exercice professionnelle (NEP-100) 'Audit des comptes réalisés par plusieurs commissaires aux comptes'.

61. NEP-100 sets out high-level requirements for balance in the allocation of work, for the assessment by both audit firms of audit risks and the control environment, and for the performance of critical reviews of the work performed by the other firm. It also sets out a joint approach to communication with the audited entity.
62. ARGA should therefore develop a standard and additional guidance for auditors. Any such guidance could go further than NEP-100 in providing more specific criteria on how to determine the allocation of component audits and business cycles between the two firms, and communication with audit committees. It could also provide guidance on when the challenger firm should take a more active role in coming to a joint position on a particular accounting treatment, or in testing critical business cycles (rather than simply reviewing the work of the other auditor), and on the need for supplementary testing for larger components.
63. The development of a new standard would need to be a priority for ARGAs and would be essential for monitoring audit quality.
64. Domination by one audit firm within a joint audit arrangement would limit the effectiveness of any reform, and legislation, regulation or guidance would need to cover the percentage of the audit to be performed by the challenger firm, as proposed by the CMA.

Preparing for change

65. Audit committees would need to prepare for the transition to joint audit well in advance of the next audit tender. They would need to identify able and willing challenger firms, and address any conflicts arising from the provision of non-audit services. Appointment of the two audit firms at different times might help with the carrying forward of knowledge, avoiding the replacement of both firms simultaneously. Circumstances are probably too variable for this to be mandated but we would certainly encourage it.
66. Audit firms too would need to prepare. Joint audit would require additional planning and entail additional risk for Big Four firms as well as challenger firms, and would likely result in higher fees. The existing business and pricing models used by audit firms might need reconsideration. Challenger firms would need to consider to what extent they are willing to invest in tendering and preparing for new audits.
67. ARGAs would need to prepare for the risk that in some cases, companies would be unable to appoint a challenger firm with the skills or scale necessary to serve as joint auditor, or with the risk appetite in respect of some companies. While ARGAs might be keen to encourage as many joint auditor appointments as possible, and would seek to limit the number of companies exempted, it would need to develop an alternative arrangement, as proposed by the CMA.
68. An EU concession exists that allows joint audit appointments to extend to 24 years, rather than 20 years for a single appointment. This was not enacted in the UK due to the limited use of joint audits, but we would encourage Government and ARGAs to revisit this.

Question 10: The academic literature cited in the CMA's report suggests the joint audit proposal would lead to an increased cost of 25-50%. Do you agree with this estimate?

69. Many larger firms believe that the additional costs associated with joint audits are likely to be significant for the entities audited and for audit firms because of the duplication of work involved. Both firms need to reach their own conclusion on the group audit, and each must perform a certain amount of testing in the areas the other firm has audited. Each firm's work on component audits and group-wide business cycles will need to be reviewed twice, once by each firm.

70. Conclusions drawn from academic and other analyses on the effect of joint audits on audit fees have been mixed, ranging from no significant differences to increases in excess of 25%. It is important to remember that audit fees are not the only cost to be considered, because more management time and resources are needed to support the audit process if two firms are involved.
71. We believe it will be almost impossible to calculate the cost on implementation, due to the number of other relevant changes to governance and regulation being made concurrently, which may well have just as significant an impact on audit costs as joint audits.

Question 11: Do you agree with the CMA's assessment of the alternatives to joint audit, including shared audit?

72. We remain more sceptical than the CMA on the merits of joint audit compared to other potential remedies and suggest that shared audit is considered as a possible alternative to joint audit. There are many important similarities and differences between shared and joint audit, as well as questions about whether they are better than single audits. This is explored in our *Future of Audit* thought leadership essay, *Shared and joint audits: are two auditors better than one?*.
73. Some audit firms and investors remain unconvinced that the risks and long-term costs associated with joint audits in particular can be justified. They argue that while shared and joint audits are often referred to as if they were simple alternatives to each other, operationally they are very different, and they have different profiles in terms of risks and rewards for companies, audit firms and investors. Audit fees may well be higher for joint rather than shared audits, and audit firm exposure is greater for joint rather than shared audits.
74. Shared rather than joint audits are perhaps one way of overcoming 'Catch-22' situations in which challenger firms are unable to demonstrate that they have the experience to bid for larger engagements without first having gained that experience. This may be particularly the case for the very largest listed companies with complex operations requiring specialist skills and a global reach that challenger firms do not have.

Question 12: How strongly will the CMA's proposals improve competition in the wider audit market, and are there any additional measures needed to ensure that those impacts are maximised?

FTSE 350 audit market

75. It could be argued that there is already competition, but not enough choice, in the FTSE 350 audit market. We believe anyway that the CMA's proposals would increase the number of participants in the FTSE 350 audit market.
76. Mazars, the largest challenger firm in France, argues that the joint audit requirements there have helped to ensure greater representation of challenger firms in the audits of the largest companies. Thirteen non-Big Four firms are involved in the audit of the top 100 French listed companies, compared with only one involved in the FTSE 100 in the UK. However, France only mandates joint audits, it does not mandate the involvement of a challenger firm. As a result, a significant proportion of the joint audits of the largest listed companies in France involve either two Big Four firms or one Big Four firm and Mazars - arguably a 'Big Five' regime. The CMA's proposals seek to address this possibility by prohibiting two Big Four firms being appointed as joint auditors together.

Other public-interest entity audit markets

77. The CMA's proposals may help challenger firms win work in other PIE audit markets (such as the AIM quoted and smaller listed audit markets) by helping such firms to gain credentials in the FTSE 350 audit market. We do not recommend mandating similar measures for other markets at this stage, but suggest ARGA monitors these markets to understand the impact of these reforms and assess whether further reforms are necessary.
78. Several audit firms have told us that the PIE audit market is unattractive due to features of the current regulatory regime. This is something ARGA may wish to assess to encourage more firms to enter the market.

Other audit markets

79. We note that thousands of audit firms participate in the non-PIE audit market, auditing tens of thousands of these other entities. We do not consider competition and choice to be a concern in these markets.

Non-audit services market

80. Big Four and challenger firms all provide accounting, tax, legal and consultancy services that prevent them from simultaneously acting as auditor. Joint audits would reduce choice in the market for both audit and non-audit services, with two firms prevented from tendering rather than one. It therefore seems possible that temporary regulatory waivers might be needed in the event of audit firm mergers or acquisitions

Question 13: Do you agree with the CMA's proposals for peer review? How should the regulator select which companies to review?

81. Where there are specific concerns about the quality of a particular engagement, we support in principle the appointment of a peer reviewer. However, the purpose of such a review must be clear. If the subject of the review is audit quality (which it should be), then whoever performs the review should possess greater skill, knowledge, and experience than the engagement team whose work is subject to review. If the objective is increasing competition and choice, then this proposal may help enable challenger firms to expand their capabilities.
82. The consultation notes that the peer review exercise may provide additional experience to the challenger firms. However, this results in a 'chicken and egg' scenario; for a peer review in the first place, the reviewer is required to be sufficiently competent to perform the assignment, or they would be in breach of their professional ethical responsibilities. If the reviewer does not have such competence, the review can contribute nothing to audit quality. If the reviewer has acquired such competence, then on competition grounds, the peer review is unnecessary.
83. It should also be noted that the peer review firm would likely become subject to the same independence restrictions as the statutory auditor, and would thus be restricted from providing some non-audit services to the audited entity. This may result in reduced choice in the market for those other services.
84. The concept of an independent peer review to improve audit quality should be considered, but must be implemented in an appropriate manner to achieve the intended result of improved audit quality. A complete review of files would be very expensive and add to sign-off time. A review restricted to a discussion on the key issues could be useful in the event of uncertainty by auditors.
85. Such uncertainty could be resolved with fewer practical downsides by enabling the auditor to gain a second opinion from a regulator-appointed panel, rather than mandating a peer review

of certain FTSE 350 audits. Should a regulator-appointed panel be created, it should be accessible to any auditor undertaking a review of a FTSE 350 company.

86. If a regulator-appointed panel is created, we believe that scepticism among auditors could be strengthened by ensuring there is no regulatory penalty or intervention arising from engagement with it. This would give auditors the confidence to approach the panel for a second opinion rather than keeping the discussions ‘in house’. Scepticism on the part of the panel would also be maintained by ensuring that the representatives on the panel that auditors engage with are from separate firms.

Question 14: Are any further measures needed to ensure that the statutory audit market remains open to wider competition in the long term?

87. Mandating joint audits would be such a significant change that we would be cautious about introducing further significant changes in the first instance. We would recommend instead that ARGA reviews progress in five years, as recommended by the CMA, and considers ‘how to fine-tune the joint audit remedy to adapt to market developments’.
88. Government and ARGA would need to establish a process for monitoring joint audits to determine whether competition and choice does in fact increase over time, and whether there is a positive effect on audit quality.

CHAPTER 3: MEASURES TO MITIGATE THE EFFECTS OF THE DISTRESS OR FAILURE OF A BIG 4 FIRM

Question 15: What factors do you think the regulator should take into account when considering action in the case of a distressed statutory audit practice?

89. Overall, we believe the CMA’s concerns about resilience are the least likely to merit significant action. In seeking to enhance governance and audit quality, BEIS could more cost-effectively focus elsewhere. Any actions that are taken should be proportionate to the likely risk to the public of a major firm failure. Beyond the costs of transition and potentially redoing audit work, the main effect on investors in public companies of an auditor’s failure would be on confidence in its financial statements. Such an effect could conceivably affect value in the short term, but with no change to fundamentals would be expected to be temporary.
90. Therefore, while it makes sense for the regulator to be well-prepared for firm failure, and appropriately equipped to deal with it, these powers need careful calibration to ensure they are proportionate to the risks. We explore in our answer to Question 16, the powers we believe to be appropriate.
91. In particular, we believe that either preventing staff and/or audited entities moving to another audit firm, or mandating their transfer, cuts significantly across core rights and market operations. We do not believe the risk to the public of auditor failure justifies such powers. Instead, any resilience system should focus on incentivising and supporting challenger firms to take on additional audits in the event of a decline or sudden event, rather than mandating or controlling which audit firm companies should move between.

Question 16: What powers of intervention do you think the regulator should have in those circumstances, and what should be their duties in exercising them?

92. The regulator should be adequately equipped to deal in an orderly fashion with the consequences of the failure of a major audit firm. A key part of this is robust planning for the response should such a situation arise.

93. Audit firms could be required to produce ‘living wills’. In our submission to the CMA, we suggested that these would be continuity plans, similar to those in the banking sector, setting out how service would be maintained if an audit firm collapsed. The regulator could be given the power to monitor these plans to ensure they are adequate.
94. We would expect the regulator to undertake regular simulations of such scenarios, and to propose realistic and achievable resolutions. In these ways, the likelihood of an audit firm failing due to lack of planning could be significantly reduced. Nevertheless, designing the resilience system in too much detail risks it being inappropriate for the specific circumstances of any particular scenario, and so the focus should be on principles rather than proscription.
95. Any resilience system should not attempt to restrict the movement of an individual audit firm’s staff or clients. An effective competition regime that ensures there are strong challengers in the audit market could have the same effect without the problems inherent in any attempt by the regulator to direct transfers. An effective market for alternative auditors would provide natural incentives and an effective mechanism for staff and clients from a failing firm to transfer.
96. If additional measures are deemed necessary, to be held in reserve for emergency use, it would be better to enable the regulator to intervene and appoint an administrator to take executive powers when it identifies the need to do so. Such powers would include the right to address quality control and partner remuneration, but not to block movement of staff and audited entities.
97. Moral hazard could be avoided by building the resilience system around the expectation that any costs arising from a sudden event or decline are kept within the sector. This could be characterised both by ensuring that firms are liable for fees associated with the activity of a special administrator when intervention is required, and by strengthening challenger firms’ ability to take on additional staff and audits to reduce market dependency on individual firms.

CHAPTER 4: OPERATIONAL SPLIT BETWEEN AUDIT AND NON-AUDIT PRACTICES

Question 17: Do you agree with the CMA’s analysis of the impacts on audit quality that arise from the tensions it identifies between audit and non-audit services?

98. We are concerned that the CMA’s analysis fails to differentiate sufficiently between non-audit services (‘NAS’) provided to audited entities, and NAS provided to clients where there is no audit relationship. As the CMA notes, several of the Big Four firms have announced that they will no longer provide non-essential NAS to FTSE 350 entities that they audit, regardless of any changes proposed by the CMA.
99. We have not seen any evidence that the participation by audit partners in the overall profits of the Big Four firms affects the quality of the judgements they make on their audit engagements. The chance of this being a factor in their work is rendered even more remote by the cessation of the provision of NAS by the Big Four firms to large audit clients. The ability for audit partners and other audit team members to be financially rewarded for cross-selling NAS to the entities they audit has been prohibited by FRC regulation for some years now.
100. Similarly, the ‘One Firm’ culture should have no bearing on the quality of audit work performed by the audit practice. The integrated multi-disciplinary firms operate to a single standard of professionalism and ethics. This work reaches into a wide variety of capital market contexts where transparency and reliability are vital. The CMA identifies the need for audit to have a distinct set of values centred on objectivity and challenge. While we agree that there is a distinction required in culture to some extent, the fundamental ethical principle

of objectivity applies to all chartered accountants in all of their professional and business activities, as does the requirement to apply professional scepticism and judgement.

101. We note the CMA's reference to conflict rules exacerbating tensions between audit and non-audit work. The existing auditor independence requirements, included primarily in the FRC Ethical Standard, have regard to the independence requirements in the EU Audit Directive and Regulation, and the Code of Ethics of the International Ethics Standards Board for Accountants. ICAEW's own Code is based on the latter. Changes in audit firm structure would have no impact on whether different parts of the firm were considered part of the audit firm network for independence purposes, and we do not see that these proposals should require or permit a change to the independence requirements. This means that the proposed operational split will not address the conflict position, as the independence rules will still apply to both parts of the operationally split firm as if they were operating as one. An operational split will therefore not increase choice in the market.

Question 18: What are your views on the manner and design of the operational split recommended by the CMA? What are your views on the overall market impact of such measures?

102. Given the action already being taken by the firms in this area, we urge Government to not mandate further splits until a compelling evidence base has been established that justifies such action. Proceeding with operational separation as currently committed will still raise practical difficulties that merit further work.
103. On the basis that joint audit, or an alternative measure to improve audit quality and choice in the market, is implemented, the benefits of incremental measures such as operational split would certainly be reduced. In particular, it would become difficult to justify allocating the significant time and resources that would be necessary to separate the audit and non-audit elements of a firm.
104. It is also important to consider the Brydon Review of the role and future of audit. That Review is considering what society wants from audit and what auditors may be capable of delivering in the future. Any changes implemented now must not constrain or stifle further development.

Question 19: Are there alternative or additional measures which would meet these concerns more effectively or produce a better market outcome?

105. Rather than segregation, we believe the focus should be on strengthening and reinforcing the overall culture within each firm, which would produce a positive impact across all activities. As we outline above, we do not believe that a structural or operational split is justified by independence concerns, as these are robustly dealt with by restrictions on the provision of non-audit services to audited entities. The crucial factor is the maintenance of an objective mindset when conducting audits.
106. It might be possible to address external perceptions by enhancing the transparency report. We suggest that Government explores this option.

Question 20: Do you agree with the CMA's proposal to keep a full structural separation in reserve as a future measure?

107. We do not agree that full structural separation should be kept in reserve as a future measure. As the CMA acknowledges, there would be significant costs and potentially adverse consequences. In particular, we believe that the complexities of contracting independent expertise, often during a condensed 'busy season', and the potential reaction of the

international networks of the affected firms, should not be underestimated. We do not see any net benefit to the UK market for large company audits from a full structural separation.

Question 21: What implementation considerations should Government take into account when considering the operational split recommendations? Please provide reasoning and evidence where possible.

108. The firms affected are best placed to assess the detailed changes that would be necessary and the potential costs that would be incurred. ARGAs will also need to be closely involved.
109. An operational split would cause significant disruption and cost. Scoping that included any audit firm that, for example, audits a FTSE 350 company, could act as a significant disincentive to auditors looking to move into that market on a small scale. Were operational separation applied, it would be better to restrict the scope in the first instance and reassess the costs and impact after a specified period of time, before extending the requirement.
110. The FRC Ethical Standard, in discussing the boundaries between audit and non-audit work, notes that there are a number of ‘audit related services’ which are typically carried out by the audit engagement team and which are related to the work performed in completing an audit. Such services include regulatory and other reports, and extended audit work on financial information and controls in certain circumstances.
111. The FRC Ethical Standard further notes other ‘additional services’, for which it is generally accepted that the auditor of the entity is an appropriate provider. Examples cited include; ‘audit and other services relating to public reporting as *reporting accountant* on financial or other information of the *audited entity* in a prospectus or circular (including reports that may be required by the Prospectus Rules, the Listing Rules and the Take Over Code)’; and, ‘reports, that are not ‘audit related services’, required by the competent authorities / regulators supervising the audited entity, where the authority / regulator has either specified the auditor to provide the service or identified to the entity that the auditor would be an appropriate choice for service provider’.
112. It would be appropriate and logical for the audit element of the practice to be able to carry out such work, and it would likely involve significant disruption were such services required to be offered by a non-audit element of the practice, as a result of an operational split.

CHAPTER 5: OTHER POSSIBLE MEASURES

Question 22: Do you agree with the CMA’s other possible measures? How would these suggestions interact with the main recommendations? How would these additional proposals impact on the market?

113. Please see our answers to the questions below.

Question 23: Do you agree with the CMA’s suggestions regarding remuneration deferral and clawback?

114. The basis on which audit firms award remuneration to their audit partners is complex and dependant on a series of factors, which arguably already includes an element of risk that the CMA is seeking to apply under these proposals.
115. However, ring-fencing certain amounts and placing them on hold would pose a series of risks for the individual, the firm and for certain outside agencies. Taxation and pension rights may be affected, as well as the basis upon which the profit before apportionment to individual partners is determined. There are further challenges in the treatment of an exercised clawback in the funds of the firm and the limited liability partnership (LLP). Indirect

consequences may include compromise of the audit ownership tests and the independence of the principals involved.

116. The intent of the Companies Act is that the firm takes responsibility for the quality of the audit opinion, including adequate supervision of its principals that sign audits on its behalf. That they individually should be accountable is true, but the framework requires that the duty is as much to the firm, which is the immediate policeman, as to the wider public and regulators. Interfering with remuneration would be a dilution of the firm's responsibility which we do not think an appropriate tool to enforce centrally, though one perhaps individual firms might consider as part of their own procedures.

Question 24: How would a deferral and clawback mechanism work under a Limited Liability Partnership structure?

117. As noted above, we have several concerns around the application of such a mechanism, and do not consider it prudent to comment on how it might work under an LLP structure.

Question 25: Do you agree that liberalising the ownership rules for audit firms would reduce barriers for challengers and entrants to the market?

118. The legislation that governs who can be a registered auditor is derived from EU law and requires firms that conduct audits to be at least half-owned by qualified auditors, and such individuals to be members of Recognised Supervisory Bodies. When firms meet those criteria and are prepared to operate under the audit and ethical standards of those supervisory bodies, they are given recognition. The legislation on who can be an auditor, and the professional standards set by the supervisory bodies, recognises that business are complex, accounting for them is complex, and a high degree of understanding of those accounts is required to be able to audit them.
119. The fundamental principles referred to above are vital to the performance of work to a professional standard. They encompass not just objectivity and the related independence requirement, but integrity, professional competence and due care, confidentiality and professional behaviour.
120. While independence is of great importance when conducting an audit, the ownership requirements for entities providing audit services could become more principles-based. We acknowledge that an audit is only of value if it is undertaken by individuals who are independent of the audited entity. However, as long as it remains possible to maintain the fundamental principles of professional ethical behaviour, both actual and perceived, and governance procedures of any audit provider prevent interference in the audit work, more innovative ownership structures for audit providers could be considered. Any change in this area would require a change in the legislation that governs registered auditor eligibility. It should however be noted that, in this context, independence does not of itself result in professional competence.
121. Were the market to be opened up, there would be a need to address the level of understanding of accounting and auditing standards that are necessary to audit accounts. The suggestions made by other reviews to widen the provision of audit services to consultants and IT firms, greatly underestimates the complexity and nature of large company audits. It is rare for material errors to arise from the processing of transactions. Rather, the principal risk areas are those that involve management judgement, for example valuation of work in progress or revenue recognition. It is difficult to conceive that an alternative provider could form an opinion on financial statements without having the requisite professional expertise.

Question 26: Do you agree with the CMA's suggestions regarding technology licensing?

122. We believe that there is a willingness among Big Four firms to share technology and recommend that this is encouraged and facilitated. However, we are wary of compulsion. Fixing a 'reasonable cost' that would incentivise purchase but not disincentivise innovation would be difficult by law or regulation and would almost inevitably arrive at the wrong answer.
123. We also note that Big Four firms are not the only source of technological innovation in the audit sector. Independent suppliers currently play a significant role and we expect this to increase over time. Such matters should be left to the market, at least in the first instance.

Question 27: Do you agree with the CMA's suggestions to provide additional information for shareholders? Do you have any observations on the impact of the Public Company Accounting Oversight Board's database on the US audit market?

124. We are persuaded by the feedback provided to the CMA which indicates that shareholders have the capacity and willingness to take a deeper interest in audit, although we are sceptical that this will ever match their level of interest in executive remuneration.
125. Although we have no objection to the provision of staff hours and fee breakdowns, this will only add to the retrospective information which is either provided to shareholders already or which is available to them on request.
126. The challenge is what information shareholders can or should be provided in advance of voting on the appointment of auditors and the audit fee. At present, audit tender documents and bid-related material are confidential, although the CMA is best-placed to assess the application of competition law. In any event, these documents and materials are very unlikely to be disclosed voluntarily and on request.
127. We continue to support mandatory auditors' presentations at AGMs. Presentations and Q&A sessions with audit committee chairs may also be of interest to workers and other stakeholders.
128. The organisation of the PCAOB database is unhelpful, and the majority of the information available from the database is already available to audit committees. However, the database does inform investors of the identity of individual auditors. This allows investors to check auditors' disciplinary records as these records are also published by PCAOB, although the database and records are published separately. In the UK, the publication of disciplinary findings in respect of audit is already a statutory requirement. In fact ICAEW publishes all disciplinary findings, and we are developing a searchable database in order to further improve transparency.

Question 28: Do you agree with the CMA's suggestions regarding notice periods and non-compete clauses? Do you agree that the regulator should consider whether Big Four firms should be required to limit notice periods to 6 months?

129. There may be reasons for notice periods being longer than six months for equity partners with an ownership interest, due to issues other than competition. These could include the funding of the firm and the firm's tax arrangements. We are not aware of any significant barriers regarding notice periods and non-compete clauses. However, if ARGAs become aware of significant barriers, it should act quickly to remove these.

Question 29: Do you agree with the CMA's suggestions regarding tendering and rotation periods?

130. Mandatory auditor rotation and tendering has only been in force for a short time. An evidence base should be established before any changes to the model are considered. Any such research could also consider the experiences of other EU member states who have opted for more frequent rotation, for example Poland.
131. Tendering was expected to increase competition, choice and audit quality. There is merit in investigating whether or not this has been the case, after a few years of operation. There may be an enhanced role that audit committees can play in ensuring tender effectiveness.

Question 30: Do you have other proposals for measures to increase competition and choice in the audit market that the CMA has not considered? Please specify whether these would be alternatives or additional to some or all of the CMA's proposals, and whether these could be taken forward prior to primary legislation.

132. In ICAEW's response to the Call for Views by the Brydon Review (ICAEW representation 64/19), we recommended consideration of a *'new three pillar model of User-Driven Assurance, one directed by the needs of the primary user - the shareholders. This would comprise a range of assurance outputs, demanded and delivered as and when appropriate, and could involve multiple providers'*. We stated that such an approach *'could be an effective way of meeting the needs of all users – and finally and fully closing the expectation gap'*. However, we also consider that such an approach could play an important role in increasing competition and choice in the audit market, as it would encourage the development of *'niche providers with particular assurance specialisms'*. We have stated that we are ready to work with the Brydon Review to develop further the concept of User-Driven Assurance.

Question 31: What actions could audit firms take on a voluntary basis to address some or all of the CMA's concerns?

133. In our response to the Call for Views referenced in our answer to Question 30, we recommend retaining but improving the statutory audit, with a renewed focus on avoiding disorderly failure and protecting against fraud to address the audit quality gap. Some of the changes we propose here could be made on a voluntary basis by audit firms.
134. We need an independent multi-stakeholder institution that encourages open and constructive debate to consider this issue. The Audit Quality Forum (AQF), which is hosted by ICAEW and supported by BEIS and the FRC, provides a basis for doing this. The AQF's steering group is proposing repositioning the AQF to help maintain momentum for audit reform and support Government calls for auditors and other stakeholders to identify opportunities to effect voluntary change in advance of legislation. In due course, the AQF can also facilitate discussion and the sharing of experience around the implementation and consequences of audit reforms.

Question 32: Is there anything else the Government should consider in deciding how to take forward the CMA's findings and recommendations?

135. We share the Select Committee's desire for the revised Stewardship Code (the Code) to increase expectations of shareholders to be active about audit. This would improve the checks and balances applied to audit, and therefore help the regulator achieve its desired outcomes. However, even if shareholders and audit are added to the revised Code, this will only have maximum impact if the status of the Code is increased through legislation or stronger regulation.
136. We suggest that passive funds only be allowed to lend to institutions which are signatories to the Code, or that there is stamp duty on transactions which do not involve a Code signatory. The regulator could also encourage companies to take a warmer approach to investors who

are Code signatories, by only agreeing to meet investors on an individualised basis if they are signatories, for example.