

Response to the initial consultation on recommendations by the Competition and Markets Authority

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ACCA supports its 219,000 members and 527,000 students (including affiliates) in 179 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of 110 offices and centres and 7,571 Approved Employers world-wide and 328 approved learning providers who provide high standards of learning and development.

Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA is a Recognised Supervisory Body (RSB) for audit under Schedule 10 of the Companies Act 2006. The FRC, as the audit competent authority, delegates certain audit regulatory tasks to ACCA as an RSB under a Delegation Agreement. This places an obligation on ACCA as an RSB to fund the FRC's performance of any tasks that have not been delegated where these relate to the regulation of auditors registered with ACCA. This funding covers the costs of the FRC's audit review activities, audit enforcement activities and standard-setting procedures.

We welcome this initial consultation considering the recommendations from the Competition and Markets Authority. We agree with the consultation document that there are no "easy solutions" and that the proposals are "wide-ranging and ambitious".

In our response to the CMA's December 2018 update paper, ACCA highlighted the risks to audit quality of the CMA's proposed remedies to increase choice in the audit market. We are therefore disappointed that many of these remedies have been carried forward unchanged in the CMA's final report.

ACCA has responded on the Kingman review, the Competition and Markets Authority study and the Brydon Review and provided evidence to the BEIS Select Committee. Details of these responses (and underlying research which has informed are responses) are enclosed at Appendix 1.

Our previous responses highlighted the need for more evidence to support the suggested changes, both in terms of evidence that they would improve audit quality, and visibility of potential costs and risks to be managed. These concerns have not been addressed adequately, leaving a residual risk of radical change being implemented in the absence of evidence over impact, consequences and cost.

As outlined in our response, we consider that other measures, such as a cooling-off period after rotating off the audit (as reflected on page 203 of the CMA final Report) and a prohibition on management dismissing an audit firm, would be more effective in increasing audit quality in the short term. These measures would also allow the Government more time to understand the impacts of its remedies by introducing them on a small-scale trial basis.

The CMA argues that is the collective implementation of the proposals that will achieve their desired outcome. However, by introducing such wide-ranging proposals simultaneously, we may fail to identify the policies that increase audit quality by comparison to those that harm it. Instead, ACCA recommends using the proposal for a five-year review of progress to trial, rather than mandate, recommendations in order to give an informed and balanced understanding of their viability.

It is important that action is taken - there is an urgent need for audit to evolve –and all participants in the corporate governance arena need to address how the scope and purpose of audit can change to meet these expectations. It is vital that the UK economy has efficient and effective capital markets and that there is confidence in the corporate framework with greater transparency of the health of a company through effective forms of audit and wider assurance. We are therefore pleased to note that the Government is proposing a coordinated response that incorporates the outputs of the final CMA study, Kingman review and BEIS inquiry rather than acting on these individually.

Our response comprises a number of key points which we consider to be fundamental to this initial consultation. We also include responses to the individual questions posed in the consultation document.

We welcome the opportunity to be involved as the consultation process progresses to support the development of an audit system that is proportionate, effective and credible and which operates to uphold the public interest.

Further information about ACCA's comments on the matters discussed here can be requested from Maggie McGhee (maggie.mcghee@accaglobal.com).

Key points

- In assessing the remedies proposed by the Competition and Markets Authority (CMA), ACCA reiterates our long-held belief that any proposals must focus primarily on increasing audit quality. This is fundamental to investor and public confidence and the longevity of reform. It is also important to guard against unintended consequences. Adverse changes have the potential to impact on the attractiveness of the UK for business.
- The successful reform of audit (and change is needed) is dependent on the implementation of reforms across the wider reporting and governance ecosystem. Audit can ultimately only meet the needs of the user if reporting requirements also evolve to meet their needs. The evolution of reporting (and subsequently) auditing (or assurance) requirements may be undermined by reforms.
- It is important that, in assessing all proposed changes, an impact assessment is undertaken to assess the cumulative, additional costs of all of the various Government initiatives relating to audit. By introducing such wide-ranging proposals simultaneously, we may fail to identify the policies that increase audit quality by comparison to that harm it. Instead, ACCA recommends using the proposal for a five-year review of progress to trial, rather than mandate, recommendations in order to give an informed and balanced understanding of their viability.
- In evaluating responses to this consultation and deciding upon a proposed way forward, Ministers should consider carefully the evidence base available in support of each suggestion, the related cost/benefit analysis, and the practicalities of implementation.
- ACCA proposed alternative interventions in our initial response to the CMA. We continue to believe these represent robust and more targeted interventions. These include a “cooling-off” period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity (as reflected on page 203 of the final CMA report) and considering a prohibition on management from firing their auditors during their terms of service.
- Our responses to the individual questions posed in the consultation paper are outlined in the following pages.

Response to questions

Q1: 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?

The audit committee is an important part of effective corporate oversight and audit committees play a vital role in capital markets' investor protection. We believe that the audit committee's role and the accountability mechanisms supporting the effective operation of their functions should be reassessed. This should go beyond the provision of guidance and support a constructive engagement and enhanced accountability.

We therefore support the development of standards that would encourage audit committees to prioritise independence and sceptical challenge and the effective oversight of auditors.

The EU Audit Regulation and Directive, which gave audit committees of Public Interest Entities (PIEs) a pivotal role in monitoring the quality and independence of the external auditor, are still embedding and best practice is still emerging. The CMA analysis of the role of audit committees does not fully consider how changes to the role of audit committees introduced by the European Audit Regulation and Directive have impacted behaviour. A fundamental question – which the CMA's analysis does not identify – is whether the existing regulatory and policy framework incentivises audit committees to select from a narrow group of large firms. And, if so, what can be done to respond if this is felt to be risky from the perspective of market resilience or to be undesirable from a public policy point of view

It is important that emerging best practice is identified and used to support the development of standards. It should also draw on existing guidance. For example, the recent publication by IOSCO of its 'Report on Good Practices for Audit Committees in Supporting Audit Quality'¹. This document provides good practices that audit committees may consider when recommending the appointment of an auditor, assessing potential and continuing auditors, setting audit fees, facilitating the audit process, assessing auditor independence, communicating with the auditor and assessing audit quality.

There remains a risk that the proposed remedy, which proposes close regulation of audit committees, could undermine audit committees' accountability and reduce transparency in decision making. There is a risk that the proposed regulatory intervention (by confusing accountability) could ultimately limit innovation and encourage audit committees to default to a

¹ <http://www.iosco.org/news/pdf/IOSCONEWS518.pdf>

'tick-box' approach. Audit committees are accountable to investors. We therefore would instead support greater transparency in the reporting of audit committees to investors in all areas of their work (including the appointment of auditors) and the adoption of non-regulatory mechanisms to further encourage the adoption of best practice by audit committees.

We recognise however that additional powers/duties to the regulator would fit with the Kingman vision of a stronger and more powerful regulator. The consultation paper notes the need for proportionality and we must guard against undue bureaucracy. The value of an audit committee cannot be ascertained through a report or through observation during part of the process and whilst we welcome the proportionate approach adopted by the CMA in its final report we do not believe that this would provide the evidence basis required to support the objective and could lead to an expectation gap by wider stakeholders.

We would endorse the complementary proposals suggested by the CMA which seek to enhance engagement between audit committees and shareholders, for example by implementing recommendations from the BEIS Select Committee on transparency of fees and a requirement on the auditor to present at the audited company's AGM. We would encourage the new regulator to consider what additional disclosure should be made during the audit process – for example publication of the significant risks identified by the auditor at the planning stage. This recommendation reflects the findings of our global research into the impact of including key audit matters in audit reports². This research identified that, by providing a focus for discussions between the audit committee and the external auditor, key audit matters enhanced the quality of these discussions. Similar benefits could be achieved by increasing the transparency of audit at the planning stage and whilst under active audit.

Finally, we do not agree that the CMA's alternative proposal for the selection of auditors to be moved to an independent body should be considered. This proposal would be a very wide-ranging change to corporate governance and would have significant, very possibly detrimental, impacts. In particular, we are concerned that this measure would undermine the central role of the audit committee in managing the relationship with the external auditor, managing the audit tendering process and reviewing the external auditor's independence. Ultimately, such a proposal could reduce choice, as it could mean there are fewer incentives for the audit committee to manage the independence of firms that may be the company's auditor in future.

From a practical perspective, such an independent body would need to have the capacity and capability to match the audit needs of a Public Interest Entity with the audit skills of a firm every time an audit is put out to tender. In addition, it would need to have the capacity to 'monitor the performance' of the auditor on every one of these engagements.

² <https://www.accaglobal.com/gb/en/professional-insights/global-profession/key-audit-matters.html>

Q2. What comments do you have on the ways the regulator should exercise these new powers?

- For instance, do you have any comments on the conditions that should be met for the regulator to exercise its powers to take remedial action?
- Are there particular events (such as a poor audit quality review, early departure of an auditor or a significant restatement of the company's accounts) which should trigger the regulator's involvement?

As outlined in our response to question 1, we support the development of standards that would encourage audit committees to prioritise independence, sceptical challenge and effective oversight and the adoption of non-regulatory mechanisms to further encourage the adoption of best practice by audit committees but agree that providing additional powers/duties to the regulator would fit with the Kingman vision of a stronger and more powerful regulator.

In deciding on an appropriate way forward, BEIS should model the likely cost of these proposals, in terms of both direct cost of the regulator and cost to business. The consultation is currently seeking ideas and estimates to develop a picture of methodology and cost rather than consulting on a clearer and costed proposal. This increases the risk of unintended consequences.

Q3. How should the regulator engage shareholders in monitoring compliance and taking remedial action?

See response to question 1.

Q4. What would be the most cost-effective option for enabling greater regulatory oversight of audit committees? Please provide evidence where possible.

See response to question 2

Q5. Do you agree with the CMA's joint audit proposal as developed since its interim study in December?

We were not supportive of the joint audit proposal in the interim study and our position remains unchanged. The final proposal which requires FTSE 350 companies (with limited exceptions) to be jointly audited by at least two audit firms, with at least one being a non-Big Four firm, does not address the concerns that we raised in our initial response.

Our position reflects the fact that there is an insufficient evidence base to demonstrate that the proposal will not be detrimental to audit quality - the evidence from academic research is mixed at best³. Moreover, as we previously noted in our response to the CMA, mandatory joint audit could

³ Francis, J. R., Richard, C., & Vanstraelen, A. (2009) finds a positive link between audit quality and joint audit. However, Ratzinger-Sakel, N. V., Audoussert-Coulier, S., Kettunen, J., & Lesage, C. (2013) find 'limited empirical support to suggest that joint audits lead to increased audit quality, but some empirical support to suggest that joint audits lead to additional costs'. Deng, M., Lu, T., Simunic, D. A., & Ye, M. (2014) indicate that 'joint audits by one big firm and one small firm may impair audit quality'.

introduce a veneer of competition which may instead further crystallise the distinction between Big Four and challenger firms and codify Big Four involvement in all FTSE 350 audits.

Requiring one of the joint auditors to be a challenger firm creates new market distortions and will impinge on the accountability of the audit committee in its selection of the most appropriate auditor.

Given the lack of available evidence as to its positive contribution to quality, we remain of the opinion that it would not be responsible to require joint audit across the FTSE 350 at this stage. However, in order to develop an evidence base, the new regulator should seek to convince investors and audit committees of the merits of joint audit in order to encourage some companies to adopt joint audit voluntarily. This will allow a much better comparison of the benefits and disadvantages of joint audit and should help investors assess the impact of joint audits on audit quality.

This approach would also allow for solutions to be considered to the practical barriers in mandating joint audit which would have unintended consequences. These include proprietary issues in respect of methodology, the increased challenge of effective communication and appropriate oversight across the audit team and the increase in the number of tenders in which firms must participate, further increasing the burdens of audit tendering on challenger firms.

Q6. 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?

As outlined in our previous responses to the CMA, we do not consider that joint audit will enhance audit quality (and may be detrimental) and therefore we are not supportive of this proposal (noting that the CMA state that the remedy is designed to address resilience and competition as opposed to quality). However, if such a proposal is implemented then the exemptions proposed by the CMA are sensible. In order to maintain the accountability of the audit committee, it should also be permitted for the audit committee to "comply or explain" why a joint audit is not appropriate in its circumstances to shareholders. This will serve to protect that principle of audit committees and shareholders being able to freely select their auditor.

Whilst we acknowledge that less complex audits would not be appropriate for joint audit it is important to collate a robust evidence base as any reforms are implemented to understand why audit committees are not appointing challenger firms in audits where the complexity and size is not a significant barrier.

Q7. 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?

The proposal recommends a minimum of a 30% share being allocated in a joint audit to a second firm. This proposal (with the limited exemptions) would create capacity challenges and be unachievable without a staged approach. We have concerns on the capacity and capability of

challenger firms in the short and, indeed, medium term, to carry out these roles across FTSE 350 audits. Capacity growth is a longer term challenge and will require full commitment from these firms. The Government should seek evidence to assess the commitments and plans in place to address these challenges in order to inform its final decision on the proposal.

It should also be noted that any staged approach would adversely impact on the choice of auditor available to an audit committee and again undermine accountability and the free selection of auditor. Therefore, if this proposal is enacted we support the CMA's proposal that any change should be at the point of re-tender (or earlier if the audit committee is seeking to appoint a new auditor).

Q8. 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?

Under a joint audit, both auditors are jointly responsible for – and therefore jointly liable for – the financial statement audit. We therefore welcome the CMA's clarification that the 'minimum share' of audit work being 'set by a regulator' at 30 % would be transitional. This has issues (as outlined in our response to question 7) regarding capacity and capability but does present a more accurate representation of joint audit than that included in the initial CMA consultation.

We consider it as unlikely that firms would voluntarily submit to joint audit under the existing liability framework during a transition period. As such, a new liability framework that recognises more equitably the relative contribution of each joint auditor seems an inevitable consequence of the CMA's proposals for joint audit.

Q9. Do you have any suggestions for how a joint audit could be carried out most efficiently?

If this proposal is implemented, the focus should be initially on maintaining the effectiveness of the audit rather on efficiency, and there should be recognition that audits will (at least in the short to medium term) be less efficient. It is important that the collective impact of cost to business is considered when implementing any proposals.

Primarily, an efficient (and quality) audit will be dependent upon strong and effective communication between audit firms to coordinate and review their work.

Q10. 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?

Yes. The empirical evidence considering joint audits is limited however it is clear that joint audits will increase audit costs and therefore we consider the estimated range to be a fair reflection of the additional costs.

We do not view cost considerations as a key factor in assessing whether a proposal should be adopted - the suitability of any proposal should primarily consider audit quality. Proposals that enhance audit may well justify increased costs.

Q11. Do you agree with the CMA's assessment of the alternatives to joint audit, including shared audit?

No. The key reason why CMA state that they are not recommending shared audit is because they do not believe it would be as effective as joint audit in reducing barriers for challenger firms. We remain of the opinion that this alternative proposal would introduce a challenger firm in a more controlled way which could help to address institutional bias. This use of shared audits could be expanded over time as the implications for audit quality are assessed. We do not consider that the evidence base supports the mandating of joint audits.

Q12. 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?

As stated above, the proposal by the CMA in its final report may well be counter-productive and introduce a veneer of competition which may instead further crystallise the distinction between Big Four and challenger firms and codify Big Four involvement in all FTSE 350 audits. It would also not reduce barriers to entry related to the scale and geographical reach required of an audit firm because both audit firms would take responsibility for the audit as a whole.

Q13. Do you agree with the CMA's proposals for peer review? How should the regulator select which companies to review?

The CMA states that the proposal for a peer review for a sample of audits which not subject to a joint audit (prior to the signature of the audit report) is designed to improve audit quality by introducing an additional, independent quality check. The peer review is proposed to be conducted by a challenger firm and CMA suggests that this will further assist in reducing barriers to entry.

We did not support this proposal in our previous response and the rationale for peer review in the final report does not address these concerns. Fundamentally, we do not agree that the proposal will support an increase in audit quality.

In order to support effective oversight of audit, it is imperative that there are clear accountability lines. The engagement partner is fully responsible for the audit opinion provided on the accounts.

As outlined in our previous response, the asymmetry of information between the engagement team and an independent firm would severely limit effectiveness. The ability to undertake the full range of work previously proposed (review of the audit file, process and conduct financial analytical reviews, re-perform audit tests on material and risky audit areas, identify any weaknesses that exist in the audit and report to the audit committee and the sector regulator) in advance of the accounts being signed off would require significant time and resources and therefore would delay results to the market. Equally, a reduction in this scope would not allow the suggested outcome to be achieved. The proposal duplicates many of the functions of an engagement quality reviewer, but in much greater depth, undermines the accountability of the signing auditor and will increase future conflicts of interest.

The cost versus benefit of a peer review is not articulated and whilst it is highlighted that the peer reviewer would not be liable for the accuracy of the accounts, they would incur significant reputational risk. Once again the incremental costs on business of the cumulative additional costs should be considered to ensure that the benefit to the investor and the wider stakeholders are considered.

Finally, the mandating of a challenger firm would subsequently have negative impacts on choice were the audit to subsequently be considered suitable for a joint audit. The peer review would therefore impinge on auditor independence and rotation. It is important, in implementing any proposal, that potential unintended consequences and implications for the future audit market are fully considered.

Q14. Are any further measures needed to ensure that the statutory audit market remains open to wider competition in the long term?

ACCA proposed alternative interventions in our initial response to the CMA. We continue to believe these represent robust and more targeted interventions. In summary, these were:

- A “cooling-off” period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity (as reflected on page 203 of the final CMA report).
- Considering a prohibition on management from firing their auditors during their terms of service.
- Whether there are non-regulatory ways of encouraging best practice among audit committees in ensuring auditor independence and audit quality.

The CMA final report (paragraph 6.91) has identified some further potential measures at reducing the barriers to challenger firms. These included reducing the notice period for Big 4 senior staff and partners; sharing of audit technology with challenger firms; a tendering fund to meet the tender costs incurred by Challenger firms; a clear framework for the handover of data from the incumbent audit firm to the new auditor; and the restrictions on ownership of firms removed. The suitability of these proposals is considered in subsequent questions.

Q15. What factors do you think the regulator should take into account when considering action in the case of a distressed statutory audit practice?

We are supportive of the proposal for the regulator to play a stronger role in monitoring the financial resilience of the firms and overseeing strong, credible contingency and turnaround plans.

To support this, the regulator should work with firms to prepare for different potential scenarios. Government (BEIS) should be engaged in this and assess whether there is a need for additional

powers to be made available to the regulator in the case of an emergency in order that they can step in and support the UK audit market.

However, the international context of audit must also be considered and we are pleased to note that this is reflected in the final CMA report. Firm failure, if it happens, is as (if not more) likely to originate outside the UK and it will be difficult for the UK regulator or special administrator to do anything to prevent it. Once concerns about the quality of a firm's audits snowball, it may be impossible to prevent a succession of companies removing the firm as auditor.

Q16. What powers of intervention do you think the regulator should have in those circumstances, and what should be their duties in exercising them?

As outlined in our response to question 15, we are supportive of the proposal for the regulator to play a stronger role in monitoring the financial resilience of the firms and note that the proposal is also consistent with the recommendations of Sir John Kingman. In order to be effective, an assessment of any additional powers should be only made following consideration of a detailed analysis of scenarios.

The analysis undertaken would need to distinguish between the gradual declines cited by the CMA versus the risk of sudden collapse of a firm. It is important for audit quality that market forces operate effectively and whilst it would be critically appropriate for the regulator to take decisive action to address audit quality, it would not be appropriate for actions to be taken to promote market resilience at the cost of the public interest.

We are pleased that the final proposal as reflected in the report refers to the regulator having "the necessary powers" as opposed to the original suggestion that the regulator should have the ability to allocate audits in such circumstances to specific firms. The unintended consequences of such a proposal would have been significant.

Q17. 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?

In our earlier submission to the CMA (and in our evidence to the BEIS Select Committee) we did not support an operational split between audit and non-audit services. We were concerned that the evidence on which it was based did not adequately demonstrate that separation would enhance audit quality and therefore confidence. In particular, we highlighted the potential impact upon audit quality through making it more difficult for audit firms to access specialist skills. The final CMA report acknowledges these concerns but does not adequately address them.

The analysis presented continues to overemphasise the importance of non-audit profits to the professional judgements of audit partners and underemphasises the importance of audit profits to the professional behaviour of non-audit partners and staff. It also fails to distinguish between non-audit assurance services and non-audit consulting services. Audit engagement partners need to use experts to support their audit judgements. Where these non-audit experts are sharing in audit profits, as they do currently, they have a financial and cultural incentive to work together to deliver audit quality.

Subsequent to our earlier submissions to the CMA we have undertaken further research to consider the impact of a multi-disciplinary firm on audit quality and to further understand the public perception regarding the perceived conflict of interest that arises.

Our work on public perceptions on audit was a global research initiative entitled '*Closing the expectation gap in audit*'⁴ which was published on 9 May 2019. We conducted this research believing it to be in the public interest for an open dialogue involving auditors, company management directors, the broader accountancy profession, stakeholders and the public to explore what kind of audit future the public expects. All play a role. Our findings demonstrate that, importantly, the public sees audit as part (but not all) of the solution to unacceptable corporate behaviour, making sure financial statements give a holistic 'true and fair view', and ensuring fraud is addressed and appropriate levels of professional scepticism are applied.

This research was based on a survey of 11,000 people across 11 countries (including 1,000 in the UK), weighted evenly by sample size, gender and spread across age, education level and household income. The Countries included in the initiative are; Greece, Czech Republic, New Zealand, South Africa, Australia, Netherlands, Singapore, Canada, UAE, Malaysia and the UK.

In respect of non-audit services, the findings of the survey (conducted with Chartered Accountants Australia and New Zealand (CA ANZ))⁵ suggest that the current rules around non-audit services actually go beyond what the public expect. The results also indicate there is limited support for audit-only firms, or for capping of non-audit services provided to non-audit clients.

We will be publishing a report entitled 'Audit quality in a multidisciplinary firm' later in September. This research was undertaken with CA ANZ and the International Federation of Accountants (IFAC) and it considered what the evidence says about the multi-disciplinary model and its relationship with audit quality. Most existing peer reviewed research⁶ points towards an increase in audit quality in cases where a firm offers both audit and non-audit services because it allows for the sharing of expertise and systems. Researchers attribute this advantage to a range of factors including knowledge transfer, where auditors benefit from the knowledge of their multi-disciplinary colleagues and vice versa. The literature review, which covers the past few decades of research, suggests that the separation of audit and non-audit services creates a barrier for such positive spill-over effects to occur. A limited number of papers indicate that, beyond a certain point, financial dependence may pose a threat to independence. However, there are rules in place to address such risks.

The underlying data and statistics for these research reports are available to BEIS.

⁴ https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf

⁵ [What the public wants from audit](#)

⁶ [What is the relationship between audit quality and non-audit services? An overview of the existing literature, Jan Bouwens \(June 2018\)](#)

Q18. 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?

We do not consider that an operational split will enhance audit quality and we do not consider that the evidence presented demonstrates that it will have the desired outcome. Since the publication of the CMA's earlier report, some audit firms have themselves outlined proposals to introduce new governance arrangements sitting over their audit practices – reflecting in part the direction of the CMA's proposals. Current voluntary approaches stop short of the key elements of operational separation such as non-profit share between the audit and non-audit parts of the firm but demonstrate that the operational split can be implemented.

Q19. Are there alternative or additional measures which would meet these concerns more effectively or produce a better market outcome?

In ACCA's earlier response to the Competition and Markets Authority call for evidence we recommended that, to further demonstrate auditor independence and not jeopardise audit quality and innovation, there be a "cooling-off" period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity (see page 203 of the final CMA report). This may help to allay public concerns that the auditor's judgement in the final years of the audit relationship could be affected by the firm's desire to sell consulting services to that entity in the following year. This proposal was also included in the BEIS Select Committee report on the Future of Audit.

We consider that this proposal has real merit in addressing concerns over auditor independence, and so warrants further consideration alongside the CMA's proposals.

Q20. Do you agree with the CMA's proposal to keep a full structural separation in reserve as a future measure?

No. We do not agree that a full structural split would enhance audit quality for the reasons articulated in our response to question 17. The CMA final report does not provide additional evidence in support of this proposal.

Moreover, a full structural split could lead to cases of artificial compliance, where firms have separate ownership but continue to work closely together due to historical ties. The CMA considers that the risk of a firm exiting the audit market if faced with a requirement to split and the proposed severe penalties for non-compliance to be low. In practice, we believe it is at least likely that some firms will do so. Self-evidently, this would not support choice in the audit market.

Q21. What implementation considerations should Government take into account when considering the operational split recommendations? Please provide reasoning and evidence where possible.

In addition to the points we have raised in our responses above, it is important that the potential impact of this proposal is considered in the context of the outcomes of the other reviews and in particular any proposed expansion to the scope of audit. Changes in the scope of audit may further necessitate the need for a broader range of expertise within an audit team.

Q22. 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?

Each of the other possible measure requires careful analysis in terms of advantages, disadvantages, potential costs and implementation challenges. The CMA argues that is the collective implementation of the proposals that will achieve their desired outcome. However, by introducing such wide-ranging proposals simultaneously, we may fail to identify the policies that increase audit quality due to those that harm it. Instead, ACCA recommends using the proposal for a five-year review of progress to trial, rather than mandate, recommendations in order to give an informed and balanced understanding of their viability.

It is imperative that in evaluating responses to this consultation and deciding upon a proposed way forward, Ministers should consider carefully the evidence base available in support of each proposal, the related cost/benefit analysis, and the practicalities of implementation.

Q23. Do you agree with the CMA's suggestions regarding remuneration deferral and claw back?

The CMA final report suggests that "any profit share and unit awards for partners could be deferred for a period from the year of the award, with a portion of the award vesting in each subsequent year. The retained amounts could be subject to a claw-back provision, whereby the audit board would have the option to reduce the payment to individuals".

We were unclear what behaviours this proposal is seeking to address and whether this proposal envisages that remuneration would be dependent upon future years' audit quality results of the individual or if it would be assessed at a firm wide level. In our experience, most if not all audit firms already reflect audit quality in partner remuneration arrangements, and also penalise partners for poor audit quality inspection outcomes. It is therefore not clear what this proposal would add.

This approach is regulation at a micro level. The enforcement of micro-regulatory proposals is time-consuming, deflects from key activities and lacks proportionality.

Q24. How would a deferral and clawback mechanism work under a Limited Liability Partnership structure?

See response to question 23.

Q25. Do you agree that liberalising the ownership rules for audit firms would reduce barriers for challengers and entrants to the market?

- What positive and negative impacts would this have?
- Do you have any specific proposals for a reformed ownership regime?

The CMA suggestion involves reconsidering the requirement for audit firms to be majority owned by qualified auditors.

As outlined in our response to the original consultation, theoretically, a partnership model, in which the owners of an audit firm are directly involved in its management, ought to be effective in ensuring that every partner bears responsibility for the actions of every other partner. In other words, that every partner ensures audit quality on every audit engagement. So rather than change the restrictions on the ownership of audit firms, which brings a host of unknown problems (as identified by the CMA), a better question is to determine why the partnership model appears ineffective in ensuring consistent audit quality. The Government could determine what existing academic research there is on this issue and what further inquiry might lead to insight.

The original CMA proposal included the suggestion of bringing in external investors. This may have adverse consequences as this may create pressures from those investors to prioritise commercial returns over audit quality. Another key flaw in the original CMA proposal is that a new entrant to the market may struggle to present itself as competitive against the established non-Big Four firms which are already unable to break into the FTSE 350 audit market for the demand-side reasons the CMA has identified.

Q26. Do you agree with the CMA's suggestions regarding technology licensing?

What changes would you like to see made to the current licensing framework?

The final CMA report recommends keeping under review the possibility of cross-industry technology licensing, potentially facilitated by the regulator and / or the professional bodies. The evidence does not identify access to technology as a major barrier. The proposal may also adversely impact competition and innovation in audit as it would reduce diversity in audit methodologies. From a practical perspective, the major audit firms invest in and develop their technology at a global level and it is therefore difficult to envisage how this would work in practice.

Q27. 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?

In principle, we approve of measures which provide additional transparency around the audit process and auditor appointment. We would therefore support better sharing of best practice in audit tendering, with a view to encouraging audit committees to make their tendering processes even better. Current disclosures in annual reports indicate that audit committees do take their responsibilities for managing the tender process and for overseeing auditor independence very seriously. So we do not see that this measure would deliver a step change in competition and choice in the audit market.

As an alternative, this transparency could be underpinned by regulation. For example, a change could be made to either the UK Corporate Governance Code or the Listing Rules to require more extensive disclosures around audit tendering so investors are better informed.

Q28. 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?

In practice, partners and senior employees can and do move between firms. This approach is low level and whilst we have no issue with the underlying suggestion, legislating for notice periods at audit firms is regulation at a micro level.

As noted in our response to question 24, the enforcement of micro-regulatory proposals is time-consuming, deflects from key activities and lacks proportionality. Each proposal, though, should be looked at individually so that the intended benefit is clear and deliverable.

Q29. Do you agree with the CMA's suggestions regarding tendering and rotation periods?

As outlined in our initial response, increasing the frequency of mandatory tendering and mandatory rotation would increase the cost of tendering as a proportion of audit fee income. As such, it would favour larger firms and penalise smaller firms. Given that there is evidence that non-Big Four already find the costs of tendering to be prohibitive, this would be expected to reduce competition and choice in the market by raising barriers to entry.

ACCA's report, *Tenets of a Quality Audit*ⁱⁱ, identifies a tension between auditor independence and the 'closeness' to an entity that the auditor acquires through repeated involvement in the engagement. This builds upon existing academic research which finds that experience of the audit built up over several years can support a more effective risk assessment in accordance with ISA 315 ('Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment').

We have seen that some countries with short mandatory rotation periods, such as Turkey and Singapore (for banks), have now extended them to be more in line with global norm of 10-20 years, due to perceptions that a mandatory rotation period that is too short can harm audit quality.

The 2001 report of the US Public Oversight Board proposed prohibiting public corporations from firing auditors during their terms of service as a corollary to mandatory auditor rotation. We suggest that the CMA consider a prohibition on auditor on dismissal alongside its other measures, as it might provide audit firms with additional capacity to be independent.

We therefore consider that any move to impose forced change of auditor firms every seven years would need very careful consideration. At present, professional standards require change at partner level every five years. Change in either audit partner or audit firm does mitigate the risk of over-familiarity, but it also brings with it cost (in particular the cost for tendering for an audit for both Big Four and challenger firms). We do not believe that there is sufficient evidence available at this stage to support such a proposal. This position reflects our comments in our original submission to the CMA.

Q30. 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.

In our original response to the CMA, we proposed three interventions, which we reiterate below. We continue to believe these represent more targeted interventions which are based on meeting the CMA's objectives and support improvements to audit quality and we urge the Government to consider these:

- Whether there should be a "cooling-off" period following the end of an audit relationship during which the former audit firm is prohibited from selling services to the entity. This may help to allay public concerns that the auditor's judgement in the final year of the audit relationship could be affected by the firm's desire to sell consulting services to that entity in the following year.

This proposal was supported by the BEIS Select Committee Report (The Future of Audit)⁷ which stated:

"We recommend that the CMA seriously considers the benefits of a cooling-off period of three years across which non-audit services could not be offered after an audit engagement had ended. The CMA should see this is a viable option if it does not decide to proceed with a full structural split of audit and non-audit services."

We were pleased that the final CMA report reflected this proposal and suggested that this could be considered by the regulator. This option could be enacted on a voluntary basis by firms (see question 31).

- Considering a prohibition on management from firing their auditors during their terms of service.
- Whether there are non-regulatory ways of encouraging best practice among audit committees in ensuring auditor independence and audit quality (Please see our response to question 1).

Q31. What actions could audit firms take on a voluntary basis to address some or all of the CMA's concerns?

Since the publication of the CMA's earlier report, some audit firms have voluntarily outlined proposals to introduce new governance arrangements sitting over their audit practices. KPMG has announced it would stop providing non-audit services to its FTSE 350 audit clients. Since then it

⁷ <https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf>

has restructured its audit division so that it has a more separate performance management and governance structure. PwC also has plans to split its practice in two – creating a practice with a singular focus on external audit and strengthening its governance with independent non-executives. These represent a step in the direction of the CMA’s proposals, but clearly stop short of the key elements of operational separation such as non-profit share between the audit and non-audit parts of the firm.

Firm governance and culture is central to creating the right incentives for audit quality and is an area where both voluntary and regulatory action could be enhanced. An FRC thematic reviewⁱⁱⁱ⁸ provides a ‘snap shot’ of the actions being taken to establish, promote and embed a culture that is committed to delivering consistently high-quality audits among larger audit firms. There is evidence that firms are investing considerable time and effort on their firm-wide culture, such as accountability frameworks and processes to sanction poor quality work or behaviour. Audit regulation is important in supporting this culture – both negatively, through reporting on areas that need improvement, and also positively by encouraging and supporting proactive measures that improve audit quality.

Q32. Is there anything else the Government should consider in deciding how to take forward the CMA’s findings and recommendations?

The CMA argues that is the collective implementation of the proposals that will achieve their desired outcome. However, by introducing such wide-ranging proposals simultaneously, we may fail to identify the policies that increase audit quality by comparison to those that harm it. Instead, ACCA recommends using the proposal for a five-year review of progress to trial, rather than mandate, recommendations in order to give an informed and balanced understanding of their viability.

Our previous responses highlighted the need for more evidence to support the suggested changes, both in terms of evidence that they would improve audit quality, and visibility of potential costs and risks to be managed. These concerns have not been addressed adequately, leaving a residual risk of radical change being implemented in the absence of evidence over impact, consequences and cost.

Further information

We welcome the opportunity to be involved as the consultation process progresses to support the future development of audit that is proportionate, effective and credible and which operates to uphold the public interest.

Further information about ACCA’s comments on the matters discussed here can be requested from Maggie McGhee (maggie.mcghee@accaglobal.cm).

⁸ [FRC Audit Culture Thematic Review](#)

Appendix 1 – Source research publications

ACCA has responded on the Kingman review, the Competition and Markets Authority study and the Brydon Review and provided evidence to the BEIS Select Committee. The submission to these can be accessed below:

[ACCA Kingman review response](#)

[ACCA CMA study response](#)

[ACCA BEIS Select Committee response](#)

[Brydon call for views](#)

The following ACCA research publications have underpinned our response to this and previous consultations. The underlying statistical data and research are available to the review team:

Closing the expectation gap in audit

https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Expectation-gap/pi-closing-expectation-gap-audit.pdf

The tenets of a quality audit

https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Tenets-of-quality-audit/pi-tenets-quality-audit.pdf

Banishing Bias - Audit, objectivity and the value of professional scepticism

https://www.accaglobal.com/content/dam/ACCA_Global/Technical/audit/pi-banishing-bias-prof-scepticism.pdf

Key Audit Matters - unlocking the secrets of the audit

https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Key-audit-matters/pi-key-audit-matters.pdf

Thinking small first: Towards better auditing standards for the audits of less complex entities

https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Supporting-SME-audit/pi-SME-auditing-standards.pdf

The future of audit

https://www.accaglobal.com/content/dam/ACCA_Global/Technical/audit/ea-future-of-audit.pdf

