



CREATING AN AUDIT PROFESSION
THAT MEETS THE NEEDS OF SOCIETY

The importance of auditing

The UK is living through an unprecedented downturn in economic activity as a result of Covid-19, combined with enormous change and uncertainty and the impact of leaving the European Union. Auditing plays a vital role in establishing trust in the economy and wider society. Its importance is never greater than in times, like the present, when the risk of businesses failing and of fraud are at their highest.

Auditors are responsible for providing reliable and independently verified information on the true state of companies' health. This information serves not only investors, but employees of those companies, pensioners, suppliers, banks, and numerous other groups. A well-functioning and trustworthy audit system underpins confidence in the UK's economy as a whole.

Without high quality auditing, individuals and businesses may suffer at the hands of unrealistically optimistic views of business performance or, worse, instances may occur where fraud is allowed to go unchecked. The likelihood and consequences of such problems are exacerbated during this time of major change and uncertainty in business and society.

Mazars is calling for:



Greater competition, choice and market resilience



The implementation of the CMA's thorough and independent package of recommendations



The establishment of a new, improvement-led regulator as recommended by Sir John Kingman



No further delay to creating a world-class audit sector

The need for effective governance and regulation

Auditing does not exist in a vacuum. It is part of an integrated system of corporate governance that involves directors, auditors and investors all fulfilling their roles effectively in order to ensure companies are well run in a transparent manner which promotes their sustainable success.

Directors have a responsibility to prepare accounts which show a true and fair view and auditors to express their opinion on whether they do so. The regulator needs to take action when failings occur and robust action when appropriate. To be effective over time, however, the regulator must be fair and balanced, proportionate and successful in securing the necessary improvements in the sector it regulates. This requires the promotion of a learning culture amongst all sector stakeholders through keeping up to date with developments and the sharing of best practice and of lessons learned from when problems occur.

The risks of lack of competition, choice or undue market concentration

There must be a reasonable number of auditors participating in the FTSE350 audit market to avoid undue concentration in it. Without sufficient choice between firms to appoint, complacency and a lack of innovation are likely. Undue concentration poses great challenges if one of the dominant firms leaves the market, whether through its own decision, increasingly

possible now that audit accounts for a relatively small share of the dominant firms' turnover, or as a result of its inability to carry on. Companies, including those of systemic importance to the UK economy, may be left without an auditor at a critical time or it may leave too few remaining players controlling the market to an even greater extent than previously leading to almost insuperable problems for the regulator and a serious lack of market resilience.

In a significant minority of cases, leading listed companies are able to choose between only two firms. This is due to the other Big 4 firms mainly not being able, or wishing, to bid as a result of conflicts of interest stemming from other services provided by, for example, their consulting, tax or corporate finance practices.

In the UK the Big 4 firms have 100% of the audit appointments in the FTSE100 and a very high proportion of appointments, and share of fees, across the FTSE350. There are similarly extremely high degrees of concentration in all other leading economies except for France where joint audit has been successfully in place for over half a century.

The current state of the audit market

Three major independent reviews have highlighted the extent of problems in the audit market especially in relation to the audit of FTSE350 companies. In their own words this is how the three reports see the challenges:

CMA	Sir John Kingman	Sir Donald Brydon
<p>“ Cases like Carillion or BHS show the size of the stakes when there is a high-profile failure; the regulator’s quality reviews have revealed that shortcomings are widespread in the UK audit market”.</p>	<p>“ ... having spent most of its institutional life largely in obscurity, the FRC now finds itself subject to tough and persistent criticism.... What this spotlight has revealed is an institution constructed in a different era – a rather ramshackle house, cobbled together with all sorts of extensions over time. The house is – just – serviceable, up to a point, but it leaks and creaks, sometimes badly. The inhabitants of the house have sought to patch and mend. But in the end, the house is built on weak foundations. It is time to build a new house”.</p>	<p>“ Some consider that audit is good enough but the starting place of this Report is that it is not... There needs to be a fundamental shift in definition and approach to ensure that all appropriate opportunities are taken for the auditor to inform as well as to confirm and verify. This will mean sometimes going beyond the information contained in the statements of the directors. With this change in mindset, and appropriate structures and principles, combined with more focused training and better user engagement, I consider that audit can serve a much more useful purpose.”</p>

Creating a world-class audit market

We generally strongly support the recommendations of the three reviews. It is now time for the Government to move towards implementing them without further delay. Not doing so risks further corporate failures and substantial losses to employees, pensioners, the taxpayer, investors and others.

In implementing the recommendations in the three reports the focus should be on creating a leading-edge approach to corporate governance, of which audit is an integral part, with an emphasis on the following:



In the final section, we set out how the sector can achieve these goals using the recommendations in the three reviews.

The roadmap to a sector which meets the needs of society

The CMA's recommendations have attracted by far the most intensive lobbying seeking to water them down and, at best, selectively address them. They are critical to real reform taking place and such attempts should be strongly resisted in the public interest. The CMA's proposals for reform of the FTSE350 audit market need to be enacted as a package. They are:

- **Robust regulatory oversight of audit committees** to make them more accountable and ensure that they prioritise quality
- **Mandatory joint audit, including at least one challenger firm**, to increase the capacity of challenger firms and to increase choice in the market and thereby drive up audit quality. There should be initial limited exceptions to the requirement, based on criteria set by the regulator – mainly the largest and most complex companies. Any company choosing a sole challenger auditor should also be exempt from the need to appoint joint auditors
- **An operational split between the Big Four's audit and non-audit businesses**, to ensure maximum focus on audit quality
- **A five-year review** of progress by the regulator.

We also endorse most of the key recommendations of the [Kingman Review](#), in particular that:

- **The FRC should be replaced with a new independent regulator**, fully accountable to Parliament, with clear statutory powers and objectives
- **The new regulator should have an overarching duty to promote the interests of consumers** of financial information, not producers
- **The regulator's corporate reporting work should be extended** from its current limited scope to cover the entire annual report

Finally, we welcome [Sir Donald Brydon's report](#) which, in overall terms, is innovative and radical. Some key recommendations include:

- The creation of a corporate auditing profession governed by principles
- The extension of auditing to areas beyond financial statements
- Mechanisms to encourage greater engagement of shareholders with audit and auditors
- The introduction of a corporate Audit and Assurance Policy, a Resilience Statement and a Public Interest Statement
- The establishment of a 'duty to alert' in certain circumstances
- Suggestions to inform the work of BEIS on internal controls and improve clarity on capital maintenance
- A package of measures around fraud detection and prevention of fraud
- Improved auditor communication and transparency
- Obligations to acknowledge external signals of concern

More competition needed without further delay

To bring about the radical change that is needed in the audit market, we need a strong injection of additional competition and an overriding focus on audit quality. The way to achieve this was set out by the CMA in its thorough independent review.

The BEIS Select Committee's report, 'The Future of Audit', cited previous calls for reform in the 1930s, 1970s, 1980s, and 1990s. The danger of yet again allowing meaningful reform to be derailed is too great to let it to happen this time.

We cannot afford further delay and call for the recommendations of the CMA to be implemented, along with those of Kingman and Brydon in the manner discussed, in order to lay solid foundations for a system of audit fit for the present and the future.



Contact us

Should you require any further information, please do not hesitate to contact:

Bob Neate
Partner

T: +44 (0)7812 167 032
E: bob.neate@mazars.co.uk

David Herbinet
Partner

T: +44 (0)7866 723 987
E: david.herbinet@mazars.co.uk

Anthony Carey
Partner

T: +44 (0)7813 696 787
E: anthony.carey@mazars.co.uk

www.mazars.co.uk

The contents of this document are confidential and not for distribution to anyone other than the recipient. Disclosure to third parties cannot be made without the prior consent of Mazars LLP.

Mazars LLP is the UK firm of Mazars, an international advisory and accountancy organisation, and is a limited liability partnership registered in England with registered number OC308299. A list of partners' names is available for inspection at the firm's registered office, Tower Bridge House, St Katharine's Way, London E1W 1DD.

Registered to carry on audit work in the UK by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at www.auditregister.org.uk under reference number C001139861.

© Mazars 2020-09 38485