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Dear Project Team

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

### **1 Introduction**

Mazars, the international, integrated and independent organisation, specialising in audit, accountancy and advisory services welcomes the opportunity to comment on 'Statutory audit market: Invitation to comment' of 9 October 2018. As of 1st January 2018, Mazars operated as a truly internationally integrated partnership in 86 countries with an operating capacity via professional teams in an additional 35 countries. Mazars draws upon the expertise of 20,000 women and men led by 980 partners working from 300 offices worldwide. In the UK, Mazars currently has around 130 partners and over 1800 employees, and is ranked one of the top 10 firms nationally.

### **2 Substantial reform of statutory audit market urgently needed**

We welcome your pressing ahead with your market study as a matter of priority. Substantial reform of the UK audit market is urgently needed. In our opinion, its current composition with excessive levels of concentration, which have persisted for decades, poses a direct threat to audit quality. The challenges of maintaining an orderly market while protecting against conflicts of interest, ensuring the market remains innovative in the context of changing stakeholder expectations, and mitigating against the risk of one of the four largest firms leaving the audit market, for whatever reason, are substantial and have to be faced and addressed.

### **3 Principles to guide choosing the optimum way forward**

There is widespread agreement that previous attempts to address competition and concentration in the statutory audit market, and especially that for listed companies, have not been successful. To move forward in the optimum way this time, we propose a number of principles should be applied:

- the changes introduced should have a very high probability of success. This requires practical initiatives whose implementation has been thought through and have ideally been tried and tested as opposed to being theoretical in nature;
- change should be introduced as soon as possible in order not to lose momentum;
- the aim should be for a temporary intervention leading to the creation of a genuinely competitive market with capable newcomers as this is what will stir innovation; and
- the overriding aim should be to enhance audit quality and ensure auditing adapts to the major interlinked changes occurring in business, technology and societal expectations. This is essential in order to serve the public interest and, in so doing, to remain attractive as a career option to the most talented young accountants of this and future generations.

#### **4 Independent review needed on the future of reporting and auditing**

We support a major independent review being undertaken of the current and future needs of investors and other stakeholders with regards to audited information in corporate reports and how the information should be presented to maximise accessibility and improve understanding. The world of business has changed considerably in recent years and it is not clear that reporting and auditing have kept up with developments in the wider marketplace especially when it comes to information in the annual report beyond the financial statements. We welcome the FRC's just announced project on The Future of Corporate Reporting but it is essential that the future of reporting and auditing be considered together. The implications of Brexit on reporting and auditing are among the issues that will need to be addressed.

#### **5 Market share caps with joint and sole audit appointments to be at centre of reform package**

A market caps based approach with joint audits at the upper end of the FTSE350 should be at the centre of a statutory audit market reform package: there is a very substantial concentration of audit fees in this part of the market and it is where the systemic risk is greatest. Joint audit will also allow the reform to be achieved with fewer audit switches than would otherwise be needed as challenger firms will be able to steadily build up their share of large audits in the early years of the reform being implemented with a linkage to improvement in audit quality overall. Sole audits could remain for the rest of the listed market and for other PIEs although it could be argued that joint audit could equally facilitate access to the wider PIE market for firms that are currently not minded to operate in it.

#### **6 The Big 4 PIE market share should be reduced to no more than 80% of audit fees within 5 years**

The aim should be to reduce the combined market share of the Big 4 to 80% of audit fees on a steady basis over 5 years in each of the FTSE350 market, that for other listed companies and that for unlisted Public Interest Entities in financial services. At that stage consideration should be given to tightening the cap to a 70% market share for the Big 4 over the following two to three years. Such caps will give the main challenger firms, including Mazars, sufficient time to expand as needed. Caps would remain in place until the CMA determined a sustainable and resilient competitive audit market had emerged.

#### **7 Full and balanced review of joint audit's potential in creating a vibrant audit market overdue**

A full and balanced review of the potential for joint audit to strengthen competition and audit quality is needed. France, the one major market in which joint audit is present for listed companies, is also the one where concentration is materially lower and the pool of audit firms operating in it significantly broader than in other jurisdictions. Beyond addressing the current market structure inadequacies, a strong case can also be made for joint audit on grounds of quality. Leading businesses have become larger and more complex due to globalisation and financial reporting has become

inherently more subjective as the use of fair value has, for example, increased. In this modern business environment there is significant merit in two firms designing and undertaking the audit of our largest listed companies, reviewing each other's work and agreeing their view on the key issues arising on the audit before giving their overall opinion on the whole financial statements for which each joint auditor is then jointly and severally liable. Where joint audit appointments are made on a staggered basis, this makes the transition when auditors change smoother with the balance being struck between the deep knowledge of the ongoing auditor and the fresh pair of eyes brought by the newly appointed one.

#### **8 More open audit tendering and better information for shareholders**

There should be a more open process for audit tendering with a regulatory or investor-led body operating a website that contains details of all listed and other PIE tenders and which enables any eligible firm which wishes to apply to undertake a particular audit to be able to do so. This is often not happening currently despite our understanding that this is expected by the legislation. In addition, shareholders should be provided with information by their audit committees on the names of the two potential auditors put forward to the board, which firms responded to the tender, which were shortlisted and the selection criteria used in arriving at their preferred choice. Moreover, investors should be encouraged to take a more active interest in the appointment of the auditor than has generally been the case until now.

#### **9 Stronger limits on the non-audit services PIE auditors can provide to their audit clients**

To avoid actual and perceived conflicts of interest, PIE auditors in future should only be able to provide a much more limited range of non-audit services to their audit clients from an agreed list made up of audit-related services and a modest list of others which would raise no conflicts of interest. Auditors should also set out in their audit reports actual and perceived conflicts of interest and how they have been managed or mitigated.

#### **10 Barriers to Big 4 partners moving to challenger firms should be removed**

If the necessary audit reforms are to succeed, it is very likely that a number of partners will need to move from Big 4 to challenger firms. At present this can be very difficult as they can have notice periods of up to 2 years and when they announce they are leaving the partnership their variable remuneration, a substantial part of the total, is often removed making recruiting partners from Big 4 firms very difficult. This barrier to fair movement needs to be removed.

#### **11 Support for relevant expertise in larger firms to be made available to smaller firms**

Where larger firms have special expertise, e.g. with regards to audit software or experts with particular skills that would assist smaller firms to undertake PIE audits, we support it being made available to them and would be happy to discuss contributing ours to such a scheme.

#### **12 Independent investor-led Commission for a Fair Audit Market to oversee reforms**

An independent investor-led Commission for a Fair Audit Market (CoFAM) should be established to monitor and oversee the implementation of agreed market reforms and to ensure commitments are being met. It would also liaise with audit committees, investors and other stakeholders to facilitate the necessary changes in approach by them too but shareholders in companies should remain responsible for individual auditor appointments as this is an essential element of the system of corporate governance and company law. We do not believe it would be practical or desirable for an

independent regulatory body to be directly responsible for the appointment of the auditors to individual companies.

**13 Need for proportionate regulation and liability and regulatory focus on competition issues**

If challenger firms are to enter the market for listed and other Public Interest Entities, including at the upper end, they will need assurance that the regulatory system will be proportionate and based on a model which involves firms and regulators working together to promote a learning environment and a culture of continual improvement. In addition, the regulator should have an objective in their articles to have due regard to competition issues in their work as recommended by CMA in their last review but never adopted. A number of other proposed changes in regulation have been recommended by us in our response to the consultation of the Kingman Review. There would also be merit in investors agreeing to proportionate liability for auditors on listed and other PIE clients.

**14 Robust reform needed and better if by consensus**

Robust reform of the statutory audit market for listed companies and other Public Interest Entities, of the type set out in this letter, is essential if the statutory audit market is to meet the needs of investors, other stakeholders and wider society. This will require significant changes by Big 4 and challenger firms, investors, audit committees, regulators and professional bodies. We believe the best way forward is for all the above participants in the statutory audit market to agree the way forward and then move forward wholeheartedly on its implementation. Mazars is committed to playing our full part to make change happen.

**15 Responses to questions in consultation paper and further discussion**

Our detailed responses to the questions in the consultation paper are set out in an appendix to this letter.

We would be very pleased to meet you if you would find it helpful to discuss further any of the points in this letter.

Yours sincerely

Mazars LLP