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Hermes Investment Management and Hermes EOS response to the BEIS initial consultation on recommendations by the Competition and Markets Authority's Market Study on Statutory Audit Services

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About Hermes Investment Management and Hermes EOS

Hermes Investment Management is an asset manager with a difference. Our purpose is helping beneficiaries retire better by providing world class active investment management and stewardship services. With £36 billion[1] in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial – and consider the impact our decisions have on society, the environment and the wider world. Our stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £501 billion[2] on behalf of over 40 international institutional investors. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

Our response

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?

Yes, we do agree that the new regulator should be given broad powers. The regulator should have the power and be required to mandate minimum standards for both the appointment and the oversight of auditors, and to monitor compliance with these standards. As suggested, there should be some flexibility and minimisation of undue bureaucracy where possible.

[1] Source: Hermes as at 30th June 2019
[2] Source: Hermes as at 30th June 2019

It is important the role and expected efficiency of Audit Committees are clear. The CMA provided some appropriate suggestions in its market study update paper[3] and final report[4] as to the areas in which standards should be set and how Audit Committees should report. The Investment Association's (IA's) Guidelines on Audit Tenders, which lay out how the IA's members consider that a company's shareholders should have the opportunity to engage on the appointment process if they wish, may also be a useful resource. Quality of audit should be the key priority in the appointment and oversight of auditors, and this should be reflected in the standards created. Accountability and competition should increase as a result, as well as audit quality. As identified in the CMA's Market Study Update,[5] factors such as 'cultural fit' are currently often prioritised over exercising scepticism and challenging management in the criteria for FTSE 350 auditor selection.

The regulator should be able to require information from Audit Committees in order to monitor compliance with these standards and, if necessary and proportionate, should place an observer on the Audit Committee as the CMA suggests. Due to the significant resourcing requirement of the latter, we recommend that it is trialled initially on a selective basis to see if it impacts positively on audit quality. As suggested by the CMA, it could then be introduced first to the FTSE 350 before being expanded to a broader selection of Public Interest Entities (PIEs) and large privately-owned companies. Regulatory scrutiny could also be achieved through mandatory reporting directly to the regulator before, during and after a tender process, as well as a subsequent annual report on the monitoring of audit quality.

Remedial action should be available to the regulator, including publishing its findings on poor- and high-performing Audit Committees, writing to Audit Committees to highlight deficiencies and in particular writing to shareholders to give them the information needed to challenge Audit Committees and auditors. We agree that suggesting a change in Audit Committee Chairs or ordering re-tendering should only be used as a measure in serious cases, although it is a useful final resort to hold Audit Committees to account.

It is important that the Audit Committee and board remain accountable for auditor selection and monitoring, in order to fulfil their duties to shareholders and their fiduciaries. It is their role as insiders accountable to investors to be more knowledgeable about the business than an external body and they can therefore more accurately assess the skills required in an auditor. We would advise against taking the decision out of the board's hands as Sir Kingman suggests in his letter to the Secretary of State for BEIS[6] and as is maintained as an option for consideration in the long term by the CMA. We believe it is important to increase board accountability rather than remove it. Taking away responsibility for selecting the auditor would make them less accountable for the quality of the audit, which it is their role to enforce. However, we support the view that it would be beneficial to have regulatory oversight of the appointment decision, and for the rationale behind the decision to be reported to investors.

This measure should be supported by enhanced engagement between Audit Committees and shareholders, for example through a requirement for the auditor to present at the

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[3] 4.16 a) and b)
[4] 5.18-20
[5] 3.22-28
[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/765547/auditor-appointment-letter-to-greg-clark-december-2018.pdf

audited company's AGM. Most investor stewardship activity is currently focused on board composition, executive remuneration and most recently climate change; there is relatively little on audit matters. A minority of investors engage more widely and comprehensively on a range of different issues including audit, but there is a lot more than can be done as an industry. We would suggest more systematic engagement with Audit Committee Chairs by shareholders, and trialling ad-hoc meetings between the Audit Committee Chair, shareholders and auditors of a company before an audit to discuss underlying assumptions used in accounts in relation to financially material factors. For this to work effectively, shareholders will need to take accounting skills and experience to engagement meetings with the company. This is something the industry can action without a change in legislation.

2. 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?

The use of all new regulatory powers should be targeted to avoid adding significant burden or unnecessary bureaucracy.

The key condition to spark regulatory involvement with an Audit Committee would be a failure to meet the new standards set by the regulator, for example evidence of the Audit Committee prioritising cultural fit over independence and sceptical challenge in selecting an auditor, the influence of management on the Audit Committee's recommendation of auditor, or the unjustifiable exclusion of non-Big Four firms. The auditor departing early or the significant restatement of a company's account, particularly when this occurs repeatedly within a few years, should also warrant investigation by the regulator to determine the cause.

In terms of conditions relating to audit firms themselves, the regulator should be able to intervene as outlined in paragraph 4 of our response to Question 1 if there is a poor audit quality review, including a lack of evidence sought or general lack of challenge of management, or any other indication that the standards set are not being met. We support the Kingman recommendation to broaden the scope of the Audit Quality Review (AQR) and Corporate Reporting Review (CRR) to allow rapid reviews of accounts and audits with a focus on challenges to audit quality and high-level assessment of whether the accounts are true and fair.[7]

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

We were involved in the development of the Investment Association's (IA's) Guidelines on Audit Tenders, which lay out how the IA's members consider that a company's shareholders

[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

should have the opportunity to engage on the appointment process if they wish. The regulator could use these guidelines developed by shareholders to inform their standards.

A report by auditors and the Audit Committee Chair at a company's AGM would provide an opportunity for shareholders to monitor compliance. The regulator could make this mandatory in order to engage shareholders. The efficiency of such an engagement would be improved if the regulator were to inform shareholders when an issue was identified with the auditors or the audit itself, and provide them with information to challenge the company and its auditors. This could be done by publishing notices on the regulator's website. The Audit Committee reports should also disclose the rationale for judgements made, and not simply rely on the external auditor's report.

There are also approaches shareholders can take without regulatory action, as described above, including more systematic engagement with Audit Committee Chairs and auditors.

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

We do not have evidence on the costs of specific options, but would suggest trialling approaches with the FTSE 350 to assess cost-efficiency and initially targeting the companies with the highest risk or poorest performance history. We would encourage a review of best practice in other jurisdictions.

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

We would like to see six to eight well-resourced, material audit firms to emerge from any remedy within the next ten years. Whilst not without its disadvantages and disliked by the Big Four representatives to whom we have spoken, the CMA makes a good case for joint audits, relative to other proposals aimed at delivering less concentration in the UK audit market. If implemented effectively joint audits should improve choice for large company audits and address audit market resilience concerns, by addressing some of the 'supply- and demand-side' barriers identified by the CMA and helping challenger firms to build expertise alongside the Big Four.

The CMA's report suggests that some of the concerns expressed in relation to audit quality in a joint audit (such as a potential reduction in audit quality and the risk of issues falling through the gaps between the two audit firms) have not manifested themselves in the French market where similar measures are in place. When consulted by the CMA, the majority of French Audit Committee Chairs and the French public audit oversight body did not agree with the argument that joint audits are lower quality, risk things falling through the gaps or are a significantly higher cost. We understand that most of the evidence at worst suggests that joint audit does not lead to an improvement in audit quality. There could even be an increase in audit quality, through the cross review of the relevant parts of the audit carried out by the alternate firm and the fresh perspective available more frequently from newly appointed auditors if companies choose to tender each part of the joint audit separately.

Evidence from the French market does suggest increased choice, with Mazars significantly increasing its market share since imposition of a balanced joint audit in 2011 even without the requirement to select one challenger firm. The continued dominance of the Big Four in

the French market has been used as evidence that joint audit does not increase competition, but this fails to account for the mandatory inclusion of a challenger firm in any UK joint audit pairing. It will be important that the share of the fee, and therefore the share of the audit work, allocated to challenger firms increases over time. If joint audit is implemented, the CMA's proposed design of the remedy seems sensible, and the evidence presented suggests that it is unlikely to negatively impact audit quality but should improve competition and market resilience. Once challenger firms become more well-established and are on a more even footing with the current Big Four, the requirement to have a joint audit, or at least the requirement for one of the joint auditors to be a challenger firm, should be reviewed by the regulator. If joint audit has had a positive impact on audit quality, it may be advisable to maintain a joint audit requirement, perhaps with fewer restrictions on the composition of the auditors involved.

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?

If the joint audit proposal is implemented, we agree with the proposed exemptions, including with the suggestion that those complex entities should be entirely exempt from joint audits rather than be required to appoint two Big Four auditors, due to the reduction in choice of auditor upon rotation. Over time, however, we would expect the number of companies suitable for exemption based on the complex nature of their accounts to shrink as challenger firms' experience and capacity increases and along with it the range of firms which they are equipped to audit. The regulator must ensure that all exemptions are genuine. Otherwise, challenger firms will never be able to audit the most complex firms as they will never have the opportunity to build their experience. Measures will also need to be in place for situations in which no challenger firm bids for an audit. As above, if joint audit is effective in improving both choice and audit quality, we would suggest removing the requirement of appointing a challenger firm or reclassifying those challenger firms which have successfully grown to take on more complex FTSE 350 audits, but maintaining the requirement for joint audit.

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?

We do not have evidence on the capacity of challenger firms, however given the support amongst most challenger firms for joint audits we understand that they see themselves as having the capacity to begin providing joint audit services to the FTSE 350, with the exception of the most complex FTSE 100 companies. The CMA expects the remedy to be fully implemented within ten years. This should be sufficient time for challenger firms to increase their capacity, as the CMA's modelling suggests. We would advise ongoing monitoring by the regulator to ensure challenger firms are scaling up at the required pace.

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?

Some UK auditors already carry out joint audits under the current liability regime. According to the CMA some of the arguments put forward against carrying out joint audit under the

current liability regime are not accurate and it could continue to work if both auditors sign the accounts and cross-review the other's work. There is still the possibility under the current liability regime for any damages to be apportioned according to fault, and auditors can agree a liability limitation agreement in a contract with a company. The French joint audit practice operates under a similar regime and has been able to function effectively. However, the Brydon review's consideration of proportionate liability in a joint audit regime should inform further consultation on this topic, and it may be necessary to subsequently conduct a more thorough legal review.

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

As the CMA proposal recommends, joint audit will need to be implemented carefully and at a pace that allows challenger firms to scale up their capacity and skillset as required. Requiring a transition to joint audit no later than when a company's next tender arises should be sufficient. Changes to the remedy can be made by the regulator based on feedback from initial implementation.

It will be important to clearly define the roles and responsibilities of each auditor at the start of the process, and we are supportive of the requirements that each audit firm should carry out substantial proportions of the work, as close to 50% each as is possible, and receive at least 30% of the audit fee, to ensure that one firm is not more dominant than the other. It will be of key importance to take lessons on effective implementation from the French market.

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?

We do not have anything to add on this question.

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

Shared audit would be less effective in increasing audit market choice than joint audit, as the smaller firm would remain secondary to the larger. A number of objections from respondents to the market study to joint audit seem in fact to refer to shared audit and the potential risks it would bring to audit quality. For example, respondents have pointed out examples where audits carried out by more than one auditor failed to pick up fraud, but these were in fact shared audits not joint audits. We are in agreement with the CMA that joint audit would be preferable to shared audit.

An imposed market cap could lead to reduction of competition and potentially audit quality due to cherry-picking of clients by auditors and greater restriction of a company's choice of auditor, which restricts the ability of Audit Committees and shareholders to freely select their auditor. There would also be a risk to audit quality in an immediate scaling up of challenger firms' coverage of larger and more complex firms. Some of those opposed to joint audits argue that the market share cap would be effective more swiftly than a joint audit, but also that the efficiency of joint audits would be restricted by the delay in challenger firms achieving the necessary growth. We agree with the CMA that this is a contradiction. We have not seen any evidence that market caps would enable the necessary increase in skill and capacity to happen any quicker than a joint audit, but in fact due to the challenger firms acting as sole auditor there is at least as great a risk to audit quality in the interim

under a market cap until they have fully scaled up. The CMA sets out a convincing case that the market share cap would not be a preferable option, but we agree with their recommendation that it should be maintained as a future option depending on the success of other measures.

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?

Any proposals implemented should be frequently reviewed to ensure they are having the intended effects.

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

We are highly supportive of an additional review process before the signing off on accounts, which could be very effective in ensuring audit quality. For those companies exempt from joint audit, peer review would provide a useful means of doing so. It is important to scope out peer reviews such that they are most effective and not excessively costly. There is potentially a significant cost and resourcing impact, so we are supportive of the focus on those companies who are exempt from joint audits.

Given the potential incentives to find issues with even high-quality audits by competitors, we had initially advised that the review is instead carried out by an arm of the regulator, perhaps with experienced auditor secondees (in a similar method to that used by the Takeover Panel), to ensure full independence. While the scope of peer review has now been limited to those not subject to joint audit, we would still suggest consideration of such an approach for those firms which will be subject to a peer review. Such a review would have the same role, focus and funding as is suggested by the CMA for a peer review to avoid duplication of the AQR's work. This would avoid potential reduction of choice or independence issues in future tender processes.

If peer reviews are carried out by an audit firm as proposed, we agree that using challenger firms would be a way of increasing capability and thereby improving competition, and that peer reviewers should not sign the audit opinion or be liable for accuracy of the accounts. The regulator should select and pay peer reviewers to avoid any potential conflict of interest, possibly funded through a levy on audit firms of PIEs.

We would suggest a focus on companies with high risk plus additional random allocation, similar to the method used to select audits for review by the FRC AQR. Reports should be submitted to the Audit Committees of the companies reviewed, the regulator and shareholders, and ideally made public.

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

Any proposals implemented should be frequently reviewed to ensure they are having the intended effects. Proposals implemented as a result of other consultations related to the audit market, including the FRC's post implementation review of the 2016 Auditing and Ethical Standards and the independent 'Brydon' review, should also support increased competition in the audit market through a greater focus on audit quality and independence in the selection and monitoring of auditors.

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

The best strategy to strengthen market resilience would be to increase the number of audit firms carrying out the largest audits, by measures outlined elsewhere, and we would caution against overcomplicated approaches to market resilience. In the meantime, in the case of a distressed statutory audit practice preserving the audit quality for that firm's clients should be a key priority. Movement of audit clients and staff to another Big Four firm should not be restricted, assuming that firm has the capacity to take them on.

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

We support the proposed new regulatory powers of regulator to monitor the health of audit firms. However, we do not believe that movement of audit clients and staff to another Big Four firm should be restricted in the case of a distressed statutory audit practice. The regulator may be unable to ensure that audit quality would be maintained at a Big Four firm in distress, particularly if audit staff began to leave the firm. It is important to avoid the 'too big to fail' mentality amongst the Big Four.

We do agree that the CMA should be able to require the audit practice to identify the source of the problem and modify their contingency plans. We would be cautious about the level of intervention available to the regulator, in order to avoid moral hazard - audit partners taking too much risk in expectation of a bail-out. The regulator should have a monitoring function, but should encourage audit firms to manage their own risks effectively. However, if the regulator does have the power to take over a firm in distress, learnings should be drawn from other industries in which bespoke insolvency regimes already exists. For example, Ofgem has in place arrangements for monitoring the financial health and ring-fencing of protected energy companies and the ability to apply to the Court to place a protected energy company into special administration.[8] We would advise this approach, with an appointed independent turnaround specialist taking a role on the executive board or taking executive control over the company completely, rather than the regulator itself taking over the company. As proposed, a ring-fenced amount of equity should be maintained by each audit firm to fund such a process in the case of financial distress to minimise moral hazard.

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?

We do agree with the CMA's view that there is an 'underlying tension created by the different objectives of audit and non-audit work'[9], with impacts on firm culture and potentially the willingness of auditors to challenge clients due to the greater revenue and profits brought in by the non-audit work of the firm.

[8] https://www.ofgem.gov.uk/ofgem-publications/50678/arrangements-responding-financial-distress-guidance-doc-final-pdf
[9] 3.189

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?

Ideally, we would prefer audit and advisory services to be completely split, as this is cleaner and would resolve some of the conflicts. We do however have some concerns about the disruption that such a split would bring to the current audit delivery model, the quality it could provide and the resource implications. We therefore previously expressed reluctance to see a break-up of audit versus advisory activities as an immediate step. If such a split is enacted, the design of the remedy will be key to ensure minimisation of risk to audit quality. If the firms are, as is suggested, able to maintain the ability for audits to draw on non-audit expertise, albeit with transparent transfer pricing, this should reduce the impact on audit quality, and audit staff should be incentivised to focus on increasing audit quality and bidding for audit tenders, without the distraction of non-audit work and the conflict of interest/safety-net of non-audit revenue.

In the case of an operational split we strongly support the governance recommendations for audit firms made by the CMA and set out in 4.5 a) to h) of the BEIS consultation paper, including a separate CEO And Chair for the audit practice with a majority of independent non-executives, separate financial statements for the audit practice and transparent transfer pricing. We believe the implementation of such recommendations would go a long way towards ensuring a positive impact on audit quality. The key with any split will be the ring fencing of profit pools and partners to avoid conflicting incentives, and corresponding transparent public financial reporting. If for any reason there is not an operational split between audit and non-audit services, we would advise that such governance recommendations should still be applied to multidisciplinary firms. Where they don't exist already, we would like to see internal audit quality teams to check the work of audit engagement teams at the firm, a practice which we understand is already becoming more common.

If such a split were enacted, we believe it should eventually be applied to all firms. Much like the Big Four, the majority of income for challenger combined audit and non-audit firms comes from non-audit services. As these firms grow in size and gain increased market share, we believe there should be equally stringent measures to ensure there is no tension between audit and non-audit services.

Given the international nature of the large multidisciplinary firms and the resulting difficulty of a full structural split, we understand the reasoning behind the CMA's recommendation of an operational split as it would tackle the diminished focus on audit quality that may be caused by a multi-disciplinary firm culture. However, conflict of interest regulations would still apply in the case of an operational split, meaning that the UK audit branch of a multidisciplinary firm could not audit the work, such as tax advice, of any other part of the same international company. The split would therefore not increase choice, although we believe it would increase audit quality. The FRC are also currently consulting on a restriction of the advisory services permitted for audit clients, and will need to take into account the impact of an operational split. Were such a list to be introduced, this could limit the choice of auditors even further, depending on how it works alongside an operational split. Therefore other measures to increase the choice of auditors available to a company will be very important.

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

We see the limitation or total prohibition of the provision of non-audit services to audit clients as a key measure. As mentioned in our answer to Q18, the FRC is currently consulting on a proposal to introduce a list of permitted services that auditors of Public Interest Entities can provide to audit clients, limited to those which are closely related to audit and/or required by law and regulation. This would replace the current list of prohibited services.

Whilst a structural split would to a large extent negate the need for such legislation as the audit and advisory services would belong to separate firms, the limited list of permitted services would not achieve the desired impacts of an operational split, for the reasons set out in the BEIS consultation paper[10] – even with restriction of permitted services, audit partners would still share in the profits of non-audit services; audit staff could still be used in non-audit services and vice versa; there would still be a shared culture with audit and non-audit arms of a multidisciplinary firm; and firms would still factor in the loss of non-audit work when deciding whether or not to bid for an audit, which reduces choice of auditor for companies. Carrying out one of these two measures therefore does not negate the need for the other.

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

Yes. This should be reviewed in 3-5 years' time after the impact of the initial proposals can be assessed. As the CMA acknowledge, this would need to be carried out at an international level in order to be effective. There would be significant costs and risks associated with such a split, and it would need to be carefully implemented in order to ensure the quality of audit was not affected.

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

We do not have anything to add on this 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?

We agree that there should be a five year review of any remedies implemented and any that have been maintained as an option in future. This should include looking at the behaviour of Audit Committees and the criteria they are using to select auditors. We do not support moving to the independent appointment of auditors. It is important that the Audit Committee and board remain accountable for auditor selection and monitoring, in order to fulfil their duties to shareholders and their fiduciaries. It is their role as insiders accountable to investors to be more knowledgeable about the business than an external body and they can therefore more accurately assess the skills required in an auditor.

[10] 4.3

23.Do you agree with the CMA's suggestions regarding remuneration deferral and clawback?

Yes, we are in favour of this measure. It could work in a similar manner to financial services, based on the framework that was introduced by the PRA and FCA[11] and how it has been applied in financial services firms which have a partner model.

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

We do not have anything to add on this question.

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

The CMA notes potential concerns with independence if audit firms were no longer required to be majority owned by qualified auditors. Given recent efforts to improve the independence of audit firms, further research would need to be conducted to determine the likelihood of such a measure negatively impacting auditor independence before it is pursued further.

26. Do you agree with the CMA's suggestions regarding technology licensing? What changes would you like to see made to the current licensing framework?

We have been advised by some in the audit industry that the price of technology needed for more complex audits is decreasing. Enforced technology licencing could also discourage innovation. However, a formal review on the extent to which technology is a barrier to entry and the ability to make a high profit margin at varying levels of audit complexity would help clarify the appropriate action. Whilst price does not seem to be the main driver of auditor selection, significantly higher costs for a smaller firm per audit would be yet another barrier to be overcome. We do have some concerns that pricing for more complex audits may currently rely on accessing expertise or technology from advisory divisions of a multidisciplinary firm at a lower price. Some challenger firms, or firms that solely provide audit services, may need to access external expertise in order to ensure a high quality of audit, and this may result in a significant increase in costs that could form a barrier to entry. In the short term the Big Four and larger challenger firms will likely have a head-start as they already have more advanced technology than smaller challenger or audit-only firms, although if an operational or structural split is enacted this may in time resolve these concerns, depending on how technology is shared between the audit and advisory arms of multidisciplinary firms.

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?

We strongly support the CMA's suggestion to provide additional information for shareholders, in particular: the confidential disclosure of certain aspects of the audit contract to shareholders so that they are aware of the commitments to audit quality made by the auditors and can hold them to account for any underperformance, and the time spent by key members such as the partners of the audit firm. As noted earlier, we believe there

[11] https://www.fca.org.uk/publication/policy/ps15-16.pdf

should be enhanced engagement between the Audit Committee and shareholders, for example through a requirement for the auditor and Audit Committee Chair to present at the audited company's AGM and more systematic engagement with Audit Committee Chairs by shareholders as an industry. Increasing the amount of information available to shareholders would enable more effective engagement.

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

We do not see this as a key barrier for competition and would caution against overly restrictive involvement by the regulator.

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

We agree that the regulator should review the requirements on tendering and rotation. If joint audit is implemented, it should be considered whether there are enough firms to make more frequent rotation feasible without a drop in audit quality, given that a firm would need to have two auditors at any one time. If this is feasible, then we would be more in favour of such a measure in order to reduce the 'familiarity' between auditor and audited company. This will, however, require a sufficient number of audit firms to provide enough of a choice of tenders, accounting for any ruled out by conflicts of interest. If the joint audit proposal is implemented, companies which carry out the tenders at different times will have the fresh perspective of a new auditor more frequently without changing the tender and rotation periods, but given that there is no requirement for them to be tendered at separate times not all companies will benefit from this.

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.

We do not have anything to add on this question.

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

There are a number of measures which audit firms could take on a voluntary basis, in particular those relating to improved governance and transparency which were proposed as part of the operational split (as discussed in section 4.5 of the BEIS consultation paper). This could be matched by increased engagement between shareholders, auditors and Audit Committees. However, even though most of the CMA's proposals are possible to enact within the current regulatory framework, there are a lack of incentives for audit firms to take action and there may be some concerns about damaging competitiveness by being a first mover. Therefore, regulation would be advisable for most measures, particularly for joint audit and operational splits. We would like to see compliance with audit governance requirements reported on a comply or explain basis.

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

Key to the success of any proposals enacted will be to ensure that they are joined up with other reviews relating to the audit industry, including the independent ‘Brydon’ review and the implementation of the independent ‘Kingman’ review.