CMA joins call to split audit and consultancy

The UK Competition & Markets Authority (CMA) says legislation is now needed to address both the lack of choice and competition in the audit market. There is also genuine concern about the vulnerability of the industry to the loss of one of the Big 4.

The CMA is recommending the separation of audit from consulting services, mandatory 'joint audit' to enable firms outside the Big 4 to develop the capacity needed to review the UK's biggest companies, and the introduction of statutory regulatory powers to increase accountability of company audit committees.

CMA chairman Andrew Tyrie said too many audits fall short, with more than a quarter of big company audits considered sub-standard by the regulator. "This cannot be allowed to continue," he stressed.

He went on: "The government now has three reports to hand. In large part, they come to similar conclusions. Conflicts of interest cannot be allowed to persist; nor can the UK afford to rely on only four firms to audit Britain's biggest companies any longer. Early action will require legislation – hence the CMA's proposals."

The CMA recommendations are:

- **Operational split:** Auditors should focus exclusively on producing the most challenging and objective audits, rather than being influenced by their much larger consultancy businesses. Given the difficulties with an immediate global structural split, at this stage the CMA is only recommending an operational split of the Big 4's UK audit work. This will require separate management, accounts and remuneration, a separate CEO and board for the audit arm, separate financial statements for the audit practice, an end to profit-sharing between audit and consultancy, and promotions and bonuses based on the quality of the audits.
- **Mandatory joint audits:** More choice and competition for audits of big businesses can and should drive up their quality, but the barriers to entry for 'challenger' audit firms are currently large. The CMA is recommending mandatory joint audits to help increase capacity at the challenger firms, choice in the market and thereby drive up audit quality. It believes challenger firms should work alongside the Big 4 in these joint audits and jointly be liable for the results! There may be initial limited exceptions to the requirement, based on criteria set by the regulator, focused on the largest and most complex companies. However, any company choosing a sole 'challenger' auditor should be exempt, says the CMA. It is envisaged that the joint audit requirement should remain in place until the regulator deems that choice and competition have improved enough to address the vulnerability of the market to the loss of one of the Big 4.

The Competition and Markets Authority has released its proposals to ensure audit competition. It's now over to the government to implement the changes

- **Audit committees:** The CMA says it is essential that audit committees choose auditors by seeking those likely to provide the most robust and constructive challenge to the accountancy practices of their companies. That means the regulator should hold audit committees more vigorously to account. This may include ensuring that committees report their decisions as they hire and supervise auditors, and that the regulator issues public reprimands to companies whose committees fall short of adequate scrutiny of their auditors.
- **Five-year review:** The regulator should review the effects of these changes periodically, in the first instance in five years from the full implementation date. It is then that they should look to see whether to go beyond the operational split already proposed, and how to fine-tune the joint audit remedy to adapt to market developments.

However, there is one professional body that is not happy with the CMA's recommendations and is prepared to say so – the CBI. The UK's premier business organisation says some of the CMA's audit recommendations risk damaging UK plc's world leader reputation.

It said that improving the quality of audit to enhance public trust and investor confidence is paramount. But CBI President John Allan said: "The guiding star for any reforms must be a focus on what works." He felt that mandating joint audits will add cost and complexity for business, with no guarantee of better outcomes. Operational splits could also restrict access to the skills required to carry out complex audits.

Allan suggested that other ideas, such as greater scrutiny of audit committees by the regulator have merit and could safeguard against high-profile corporate failures, which have rightly prompted searching questions.

He explained that with the Byron review yet to report a false move now could create yet more uncertainty and undermine confidence in corporate Britain.

It is also being reported that several of the Big 4 are now considering the options of a judicial review of the recommendations. They seem to be particularly worried about the introduction of mandatory joint audits.

This proposal 'surprised' many, given the level of opposition from companies in their submissions to the study, and the lack of evidence that such a move improves audit quality. PQ