



March 18, 2013

Inquiry Manager  
Statutory Audit Investigation  
Competition Commission  
Victoria House  
Southampton Row  
London, WC1B 4AD  
United Kingdom

By email: [auditors@cc.gsi.gov.uk](mailto:auditors@cc.gsi.gov.uk)

**STATUTORY AUDIT SERVICES MARKET INVESTIGATION NOTICE OF POSSIBLE REMEDIES  
UNDER RULE 11 OF THE COMPETITION COMMISSION RULES OF PROCEDURES**

Dear Sir/Madam:

The International Federation of Accountants (IFAC) thanks the UK Competition Commission (the “Commission”) for its thorough independent review and welcomes the opportunity to comment on the Statutory Audit Services Market Investigation *Notice of Possible Remedies*. Through its membership, currently 173 professional accountancy bodies in 129 countries and jurisdictions, IFAC represents approximately 2.5 million accountants in public practice, industry and commerce, government, and education.

We note the Commission’s observation that it applied its own judgment in reaching provisional findings, because “to a greater extent than in many market investigations, the nature of the evidence base we faced meant that clear-cut distinctions between competing explanations for a number of issues were hard to determine.” This observation highlights the need for extreme care to be taken in implementing remedies and regulatory reforms, as they may have unintended consequences.

**General Comments**

IFAC recognizes the importance of high-quality auditing and acts to promote and enhance audit quality around the globe. This includes supporting the development, adoption, and implementation of high-quality, internationally accepted auditing and quality control standards, promoting the need for global regulatory convergence, and supporting the development of strong professional accountancy organizations and accountancy firms. Recently, the International Auditing and Assurance Standards Board (IAASB) issued a consultation paper titled [A Framework for Audit Quality](#), which describes the input and output factors that contribute to audit quality at the engagement, audit firm, and national levels, and demonstrates the importance of appropriate interactions among stakeholders and the importance of



various contextual factors, such as the applicable financial reporting framework, corporate governance arrangements, and broader cultural factors within the jurisdiction.

IFAC supports measures that aim to enhance competition in the audit market. It recognizes that the Commission has been mandated with the task of considering market and competition matters in this inquiry. However, IFAC notes that the Commission is required to consider the effect of proposed remedial actions on relevant customer benefits, which are defined broadly in terms of price, quality, and choice and innovation.

Given the critical role that auditing plays in the economy—in terms of being a mandated service that aims to enhance the credibility of financial reporting and which provides benefits to the broader public well beyond those who are directly involved in the process—IFAC believes that the primary focus of reforms to auditing should be to enhance quality. It believes that a fundamental basis for introducing reform measures should be sound evidence, including analysis of relevant costs and benefits, that their implementation will indeed lead to improved audit quality. Governments and regulators should give careful consideration to proposed reforms that are primarily directed towards other aims, to ensure that they do not adversely impact audit quality as a whole.

Consequently, the comments included in this letter are primarily directed towards matters pertaining to audit quality.

In recent years, the auditing profession has been subject to continuous scrutiny, and high levels of regulatory oversight, inspection, and debate. Arguably, there has been unparalleled focus placed upon the role of the external auditor in the financial reporting supply chain. The performance of the external audit has received relatively greater examination than other aspects of financial reporting, including the preparation of financial statements, oversight of such preparation, and the internal control, risk management, and governance arrangements of organizations (including the roles of directors, audit committees, executive management, and internal audit). External audit is a critical component of high-quality financial reporting. However, external audit cannot be expected to be the only measure that ensures the quality of financial reporting.

A number of major changes to independence requirements, such as mandated audit partner rotation requirements and prohibitions on the provision of certain non-audit services, were introduced in many countries, including the UK, over the past decade. These changes are still relatively new, and have not been in place sufficiently long enough to adequately assess their impact. To propose and implement further changes at this time makes it virtually impossible to determine with any certainty the effectiveness of past, as well as future, regulatory reforms in the audit profession.

Additionally, the objectives of certain proposed regulatory reforms, including the remedies proposed by the Commission, are not always clear. At times, there seems to be some confusion between measures that aim to address audit market and competition issues, and those which aim to address audit quality and independence issues. While IFAC appreciates that the Commission has endeavored to draw a link between these issues, it is not clear whether some of the proposed remedies will, by directly attempting to address an independence concern, address the audit market and competition issue.



IFAC notes that there have been several examples in other jurisdictions of recent reforms that have been proposed as a means by which to address market and competition issues or perceived audit quality issues. However, there has been little or no evidence to show that the proposed reforms would have the desired effect. For example, mandatory audit firm rotation has been raised by some regulators as a means for enhancing audit quality, although the evidence in this area is, at best, mixed. From a market perspective, it is conceivable that mandatory audit firm rotation and mandatory tendering may result in organizations moving their audit service requirements between Big 4 firms and, thus, will have no impact on the barriers to entry that are perceived to exist between the Big 4 firms and other firms. In such a scenario, a further outcome may be increased costs and increased prices, with no guarantee of enhanced audit quality.

Finally, increasingly, the array of measures being proposed by different jurisdictions, appear to have some level of extra-territorial impact; especially as they relate to multi-national organizations operating across borders. At a time when financial and economic uncertainties demand coordinated global solutions, it is unfortunate that nationalistic and fragmented responses to the problems confronting the global economy are becoming more common. IFAC encourages governments and regulators—especially those that are part of the G-20—to endeavor to work in a more coordinated manner in developing and implementing key regulatory reforms.

In the following sections, IFAC includes a general discussion of its views on each of the remedies, without responding to each of the questions individually.

### **Remedy 1: Mandatory tendering**

**Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:**

- (a) **What an appropriate time frame for requiring mandatory tendering might be, given the bounds suggested above?**
- (b) **Whether and for what reason the measure may be subject to ‘comply or explain’ implementation?**
- (c) **How a valid ‘tender’ and its constituents should be defined, including whether and how best to provide access to relevant information on an ‘open book’ basis?**
- (d) **What costs and benefits would arise as a result of this remedy?**
- (e) **What should be the requirements for phasing in this remedy? For example, those companies with the longest period since last tender may be required to tender first within a specified period.**
- (f) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

IFAC is of the view that careful consideration and a thorough analysis of the costs and benefits of mandatory tendering need to be undertaken before implementing such a reform. As the Commission notes, there are potentially very high costs—monetary, human, and time—involved in a tendering



process, from both the organization's and audit firm's perspectives. Furthermore, if the aim of the Commission is achieved, and a larger number of firms are submitting tender bids, the entire cost structure for auditing will rise across the board, with no guarantee that it will enhance audit quality.

The Commission's assertion that "under a more frequent system of tendering, resources expended by firms in mounting bids and companies in assessing bids would be reduced in view of the greater frequency of tendering" does not seem to consider:

- The potentially larger number of audit firms submitting bids;
- The potentially larger number of bids that organizations will need to assess;
- Changes in staff in the organizations undertaking the assessments;
- The potentially larger number of bids that each audit firm may decide to make; and
- Changes in audit firm staff over time.

Furthermore, regular tendering can serve to potentially divert the attention of the audit committee, management, and the auditors from their ongoing responsibilities for financial reporting and auditing.

One aspect of the proposed remedy to which IFAC is strongly opposed is the suggestion that all tendering firms would have access to the files of the incumbent auditor. Such an arrangement would present enormous difficulties for auditors, who are bound to ethical codes that are founded on the notion of confidentiality as a basic principle. Furthermore, it fails to consider the importance of "trust" in the auditor-organization relationship, as well as potentially increasing the auditor's liability exposure.

### **Remedy 2: Mandatory rotation of audit firm**

**Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:**

- (a) What an appropriate time frame for requiring mandatory rotation might be, given the bounds suggested above and how this might relate to mandatory tendering periods if this were also to be pursued?**
- (b) Should any such measure be subject to a waiver from the regulator (FRC) if a company's choice of auditor was substantially constrained and how would such a waiver operate?**
- (c) How a valid 'tender' and its constituents should be defined as a prelude to rotation, including whether and how best to provide access to relevant information on an 'open book' basis?**
- (d) What costs and benefits would arise as a result of this remedy?**
- (e) What should be the requirements for phasing in this remedy? For example; those companies with the longest period since last rotation may be required to rotate first within a specified period.**
- (f) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**



While audit firm rotation may be seen to be responding to the adverse effects on competition noted, it is possible that mandatory audit firm rotation may result in organizations moving their audit service requirements between Big 4 firms and thus will have no impact on the barriers to entry that are perceived to exist between the Big 4 firms and other firms.

In its [press release](#) commenting on European Commission proposed legislation, IFAC noted that it does not support the proposal for mandatory audit firm rotation “because there is not sufficient evidence that (it) will have a positive impact on auditor independence and audit quality, and that the benefits will outweigh the risks and costs.”

Additionally, as noted previously, IFAC does not believe that the impacts on audit quality of the audit engagement partner rotation requirement, introduced no more than a decade ago, have yet to be properly assessed.

### **Remedy 3: Expanded remit and/or frequency of Audit Quality Review team (AQRT) reporting**

**Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:**

- (a) How the AQRT’s remit should be designed in terms of enhanced scope and frequency. For example;**
  - (i) How frequently should FTSE 350 company audits be reviewed (and whether this should differ between FTSE 100 and FTSE 250 companies)?**
  - (ii) Should the AQRT be required to published (sic) FTSE 350 results separately from other Public Interest Entity results?**
  - (iii) Should the AQRT be required to change the scope of its review and if so, how? For example; should the AQRT be required to revisit key audit judgements based on the information then available?**
  - (iv) How could AQRT reporting be expanded to allow better comparison of Big 4 and non-Big-4 firms?**
- (b) How should any expanded remit of the AQRT be funded?**
- (c) What costs and benefits would arise as a result of this remedy?**
- (d) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

IFAC believes that audit firm inspections and reviews of firms performing audits of public interest entities (PIEs), by independent audit regulators such as the AQRT, should be performed utilizing an appropriate risk-based approach. While IFAC recognizes that a minimum period between reviews should be established, it considers that a risk-based approach should take into account a range of indicators; including the size of the audit firm, issues arising from previous reviews, the organizations that the audit firm audits, the market capitalization of and industries within which those organizations operate, and other information that may have come to the attention of the regulator (e.g., complaints).



Consistent with its view that promoting and enhancing audit quality should be the primary focus, IFAC considers it appropriate to take a holistic approach to audit quality and consider the role that independent audit regulators may play, as well as the audit firms and markets that should be subject to review. With this in mind, it can be argued that measures aimed at enhancing audit quality should not be restricted to a narrow range of organizations subject to audit. Therefore, rather than differentiating between FTSE 100 companies, FTSE 200 companies, FTSE 350 companies, and PIEs, focus should be placed on PIEs as a whole, with an appropriate inspection and review regime defined according to a risk-based approach. It is not clear that the AQRT needs to change the scope of its reviews, as it should be suitably flexible to appropriately adapt to the audit firm, organizations, and issues that arise.

Additionally, IFAC recognizes that careful consideration would need to be given if the AQRT was to attempt to make a direct comparison between Big 4 and non-Big 4 audit firms. The mere fact that the AQRT is differentiating the two potentially signals to the market that, indeed, a difference exists in the audit quality between them. The AQRT would need to provide readers of any such reporting with sufficient information to ensure that they are well acquainted with the details of the objectives and processes of the reviews, as well as definitions and descriptions of key terms and interpretations, in order to minimize any potential market confusion.

IFAC does not believe there is necessarily the need to expand the remit of the AQRT. However, if such a decision is made, as the changes are being made essentially for the benefit of shareholders it seems reasonable to assume that funding for any changes would be derived from shareholders.

The government would need to consider means by which shareholders might be levied, either in relation to the shares they hold, the dividends they receive, or within the organization prior to the distribution of dividends.

#### **Remedy 4: Prohibition of contractual clauses in template documents limiting choice to the Big 4 firms**

**Views are invited on the specification, effectiveness, and proportionality of this remedy and, in particular, on the following:**

- (a) The range of documents to which this prohibition should be imposed and how the prohibition could be best implemented. For example: are there documents in addition to Loan Management Association lending agreements that this prohibition should cover?**
- (b) What costs and benefits would arise as a result of this remedy?**
- (c) Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

IFAC supports the removal of the prohibition of contractual clauses in template documents limiting choice to the Big 4 firms; and supports measures that are directly targeted toward enhancing competition in the audit market.



### **Remedy 5: Strengthen accountability of the External Auditor to the Audit Committee (AC)**

Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

- (a) **How this remedy could be practically specified and implemented? For example, what change to Audit Committee Chair (ACC) availability and remuneration would be necessary for ACCs to take on an enhanced role effectively? How should this measure be specified to avoid circumvention?**
- (b) **Whether this remedy could be implemented as an extension to the current guidance on the role of the AC? How this could be implemented without affecting the current collective legal obligations of the directors of a company?**
- (c) **What costs and benefits would arise as a result of this remedy?**
- (d) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

IFAC recognizes the important role that appropriately resourced, well-functioning audit committees play in promoting and enhancing audit quality, and encourages initiatives aimed at strengthening this role. With respect to their relationships with external auditors, IFAC supports measures that aim to strengthen the direct reporting requirements of the external auditor to the audit committee, and the audit committee chair, on matters pertaining to audit fees, the provision of non-audit services, and relevant matters pertaining to the appointment of the auditor.

### **Remedy 6: Enhanced shareholder-auditor engagement**

Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:

- (a) **What are considered to be the most effective means of enhancing shareholder engagement on audit and financial reporting issues?**
- (b) **Suggestions as to how such means could be achieved.**
- (c) **What costs and benefits would arise as a result of this remedy?**
- (d) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

As noted previously, IFAC recognizes the important role that audit committees play in promoting and enhancing audit quality, and encourages initiatives aimed at strengthening this role. As the audit committee is a committee of the Board of Directors, which is elected to represent shareholders, the interests of shareholders are most efficiently protected and represented through its operation when it is well-resourced and well-functioning. While organizations may wish to change their constitutions to require shareholders to be involved in determining the need for tenders for external audits or the reappointment of an audit firm, such a requirement should not be imposed upon them.



However, IFAC acknowledges that there is merit in considering measures that require an audit engagement partner—responsible for the external audit of the organization—to attend, and to present to, the annual general meeting of the organization. This includes a dedicated “question-and-answer” agenda item.

**Remedy 7: Extended reporting requirements—in either the AC’s of auditor’s report**

**Views are invited on the specification, effectiveness and proportionality of this remedy and, in particular, on the following:**

- (a) **How the CC may best support the FRC in establishing enhanced reporting and whether there are other avenues, including direct measures by the CC, that should also be pursued?**
- (b) **What should be the scope and form of enhanced reporting proposals? For example:**
  - (i) **whether further disclosure should be made via the AC’s report or the auditor’s report;**
  - (ii) **what the content of the additional disclosure should be. For example, should this be some form of commentary as to how the company’s interpretation of the accounting standards compares with the norm; or commentary on the main topics of debate between auditor and management; or something else; and**
  - (iii) **what guidance as to the form of the disclosure should be required?**
- (c) **What costs and benefits would arise as a result of this remedy?**
- (d) **Whether there are any other relevant considerations to be taken into account in evaluating and implementing this remedy?**

IFAC welcomes appropriate comprehensive reporting by Audit Committees with respect to the discharge of their responsibilities; and considers that reporting by the Audit Committee and the auditor should be complementary. IFAC recognizes the need for enhanced auditor reporting, and supports the work being undertaken by the IAASB in this area, in its current [auditor reporting project](#). Given the importance of global regulatory convergence and the fact that UK auditing standards are based on international standards (i.e., International Standards on Auditing (ISAs)) issued by the IAASB, IFAC encourages the Commission to determine ways in which it can support the work of the IAASB, as well as the UK FRC.

A remedy that focuses on extended auditor reporting complements remedies that aim to encourage greater shareholder-auditor engagement, including proposals for the auditor to attend, and to present at, annual general meetings.

**Remedies that we are not currently minded to consider further**

**The CC invites views on all these possible remedies which we are not minded to consider further and on any other possible remedies that we have not included in this Notice which interested respondents consider may be effective in addressing the adverse effect on competition (AEC) we have provisionally found. Where respondents are of the view that these remedies could be effective, they are asked to submit evidence to support their views and in particular provide views of the costs and benefits of the measures and any other relevant factors that they consider**





**significant to the evaluation of the measures in addressing the AEC we have provisionally identified.**

IFAC is not familiar with evidence that audit quality will be enhanced through the potential remedies the Commission is “not currently minded to consider further”. Therefore, unless such evidence becomes available, IFAC does not believe these potential remedies should be seen as being potentially effective in addressing the adverse effect on competition described by the Commission.

IFAC’s positions with respect to the provision of non-audit services by audit firms, joint audits, and the appointment of the auditor are outlined in its response to the [European Commission Green Paper on Audit Policy: Lessons from the Crisis](#), issued in December 2010,

#### **Packages of remedies**

**Views are invited as to whether any particular combinations of remedy options would be likely to be effective in addressing the AEC we have provisionally found. Views are also sought as to whether there are any particular combinations of remedies which are likely to interact adversely in reducing effectiveness or otherwise lead to undesirable outcomes.**

Subject to the comments made in preceding sections, IFAC believes that the remedies number 4. through 7. (inclusive) could be considered as a package of remedies.

As noted previously, IFAC cannot support the proposed remedies 1. through 3. (inclusive), as it does not believe that there is sufficient evidence to demonstrate that such remedies will have a positive impact on audit quality. Moreover, it is as yet unclear of the impacts on audit quality of the raft of changes made to the auditing profession and auditing market over the past decade. To make further major changes at this time will lead to greater confusion about the impact and efficacy of past and future reforms.

#### **Relevant customer benefits**

**Views are invited on the nature, scale and likelihood of any relevant customer benefits within the meaning of the Act and on the impact of any possible remedies on any such benefits.**

IFAC understands the importance of ensuring that appropriate costs and benefits are assessed in determining whether to implement regulatory reforms. While it considers that enhancing audit quality should be the primary focus of regulatory reforms relating to auditing, IFAC recognizes that there comes a point when the costs of developing and implementing measures will exceed the benefits of striving for audit quality improvement. However, it is not clear that there is sufficient evidence to support the notion that measures aimed at lowering prices or providing greater choice will lead to enhanced audit quality.

With respect to the issue of innovation, IFAC notes that innovation is not always easily achieved in a heavily regulated environment, where the delivery of a service is mandated. IFAC notes that the Commission suggests, as an example of innovation, the possibility on multiple assurance products providing different levels of assurance. Such a proposal, if adopted, would potentially create great confusion in the market, make comparisons between organizations more difficult, and make determining audit quality much more difficult to achieve.



Notwithstanding the difficulty of innovating in such an environment, IFAC draws the Commission's attention to the vast range of fundamental innovative changes that have occurred in the auditing profession in the last decade. These include:

- The development of high-quality, clarified ISAs that require a risk-based approach to auditing. ISAs have been adopted and implemented in approximately 80 countries around the globe, including the UK, and are the basis of policies and methodologies, to the extent practicable, used for the conduct of transnational audits by 23 international networks of accounting firms represented in the Forum of Firms;
- The ongoing development of high-quality auditing and assurance standards by the IAASB, in areas of emerging need, such as auditor reporting and auditing disclosures in a financial statement audit;
- The establishment of oversight and inspection arrangements in many countries around the globe, including the UK, for the oversight and inspection of audit firms performing audits of PIEs;
- Stronger independence and quality control requirements for audit firms; and
- More efficient and consistent audit practices by audit firms and global audit networks through the use of technology and innovative work programs.

Please do not hesitate to contact us should you wish to discuss any of the matters raised in this letter, or require any further information.

Sincerely,

A handwritten signature in black ink, appearing to read 'Fayezul Choudhury', with a stylized, flowing script.

Fayezul Choudhury  
Chief Executive Officer