

Press release: CMA proposes reforms to improve competition in audit sector

The Competition and Markets Authority (CMA) has published an update paper outlining serious competition concerns and proposing changes to legislation to improve the audit sector for the benefit of savers and investors alike. It is now putting these proposals out for public consultation.

Following the launch of its [market study](#) in October, the CMA has identified a number of reasons why it believes audit quality is falling short:

- companies choose their own auditors, and as a result we have seen too much evidence of them picking those with whom they have the best 'cultural fit' or 'chemistry' rather than those who offer the toughest scrutiny
- choice is too limited, with the Big Four audit firms conducting 97% of the audits of the biggest companies
- auditors' focus on quality appears diluted by the fact that at least 75% of the revenue of the Big Four comes from other services like consulting

In order to address these concerns, the CMA is proposing legislation to: separate audit from consulting services; introduce measures to substantially increase the accountability of those chairing audit committees in firms, and impose a 'joint audit' regime giving firms outside the Big Four a role in auditing the UK's biggest companies.

CMA Chairman Andrew Tyrie said:

Addressing the deep-seated problems in the audit market is now long overdue. Most people will never read an auditor's opinion on a company's accounts. But tens of millions of people depend on robust and high-quality audits. If a company's books aren't properly examined, people's jobs, pensions or savings can be at risk.

The CMA will now consult on a number of proposals for robust reform. These intractable problems may take some years to sort out. If it turns out that the proposals are not far-reaching enough, the CMA will persist until the problems are addressed.

CMA Chief Executive Andrea Coscelli also commented:

We have moved fast to come up with a comprehensive package of proposals for legislation, which we will now consult on. Successful reform of the audit market will require legislation, in combination with planned improvements to regulation as recommended by Sir John Kingman.

The reforms proposed by the CMA are:

A split between audit and advisory businesses

To get higher quality, auditors should focus exclusively on audit – not on also selling consulting services. One way of achieving this could be a structural break-up. But the international networks these firms belong to and the extent to which audit firms draw on expertise of those advising businesses would make this protracted and complex. A more immediate solution would be for audit and non-audit businesses to be split into separate operating entities. To be effective this will also require separate management, accounts and remuneration. That way auditors will only be rewarded for scrutinising an organisation's accounts but will still be able to draw on expertise from other parts of the firm.

Regulatory scrutiny of auditor appointment and management

Audits are a legal requirement, to ensure that companies act in the interests of their owners rather than their managers. Given the relative lack of engagement by investors and owners of some of Britain's largest companies, these companies should not be left to appoint their own auditors alone. The CMA proposes close scrutiny of audit appointment and management to make sure those appointing auditors are held to account and independent enough to choose the most challenging audit firm, rather than – for example – the cheapest.

Encouraging more choice

At present, many of the UK's largest companies have little choice, given that one or more of the Big Four may be conflicted. Competition is weak. The CMA proposes that audits of the UK's biggest companies (FTSE 350) should be carried out by at least 2 firms, at least one of which would be from outside the Big Four. This will give mid-tier firms access to the largest clients, allowing them to develop their experience and credibility, while also ensuring a cross-check on quality. A possible alternative is a market share cap – ensuring that some major audit contracts are only available to non-Big Four firms.

The CMA's proposals only address some of the concerns in this sector. Sir John Kingman's independent review addresses another: issues with current regulation. Today the government has announced a review of the purpose and scope of the audit more widely. It is already clear from the CMA's work that a robust approach will likely be required here too.

The CMA now welcomes comments on its update paper by 21 January 2019.

Notes to editors

1. Market studies are carried out using powers under section 5 of the Enterprise Act 2002 (EA02) which allows the CMA to obtain information and conduct research. They allow a wide consideration of issues affecting the market. They can include a range of outcomes including

recommendations to government, enforcement action and referral for market investigation.

2. The CMA welcomes views on its update paper by 21 January and hopes to conclude its work as soon as possible in 2019.
3. The Big Four audit firms in the UK are Ernst & Young (EY), Deloitte, KPMG and PricewaterhouseCoopers (PwC).
4. The CMA is the UK's primary competition and consumer authority. It is an independent non-ministerial government department with responsibility for carrying out investigations into mergers, markets and the regulated industries and enforcing competition and consumer law. For CMA updates, follow us on [Twitter](#), [LinkedIn](#) and [Facebook](#).
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