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Dear Andrew,

Market Study on Statutory Audit Services – Initial consultation on recommendations by the Competition and Markets Authority

I am writing on behalf of KPMG LLP (KPMG), the UK member firm of the KPMG International network, in response to the Department for Business, Energy and Industrial Strategy's (BEIS) initial consultation (BEIS Consultation) on the recommendations made by the Competition and Markets Authority (CMA) following its Market Study on Statutory Audit Services (Market Study).

Audit is a critical enabler for the UK economy. The trust it provides is essential for the effectiveness of our capital markets. It is paramount that we have a competitive and resilient audit market which has the confidence of shareholders and other stakeholders.

We believe that the current scrutiny of audit and corporate regulation, of which the CMA's work is a part, represents a valuable opportunity to re-affirm the purpose and scope of audit. It also provides an opportunity to re-balance accountabilities for corporate governance and reporting and to address concerns around audit quality and perceived conflicts in audit - thereby enhancing the world-leading position of the UK in the sector.

We recognise the need for change which sees more firms auditing the largest companies and inspires greater confidence that audits are of consistently high quality and delivered objectively.

KPMG has already taken action to restore trust in our profession. We were the first firm to commit to discontinuing the provision of non-audit services to the FTSE 350 companies we audit and the first to offer enhanced audit opinions with 'graduated findings'. We have made significant investments in audit quality and have improved, and provided greater transparency around, the governance and performance management of our audit business.

We believe the impact of these changes has been to strengthen audit quality and are pleased to see that this is beginning to be reflected in the results of our recent Audit Quality Review inspection by the Financial Reporting Council (FRC).

Whilst we are supportive of the thrust of the CMA's stated aims, we do however have concerns over a number of its proposed measures (or their implementation), which we do not believe will achieve these aims and in some cases could damage audit quality.

Key considerations

In our earlier (11 June 2019) response to BEIS' consultation (BEIS FRC Review Consultation) on Sir John Kingman's Independent Review of the FRC (FRC Review), we set out some principles which we considered important for BEIS in its implementation of the recommendations. Whilst we have not repeated these principles in our response, we believe that a number of them are equally relevant to BEIS' consideration of the CMA's recommendations and summarise below their particular relevance in this context:

- *Balancing effective regulation and stimulating growth and investment* - The UK regulatory regime needs to be seen as one which ensures confidence in the governance of and reporting by companies, but does not result in unnecessary expense or burden which puts the UK out of line with other comparable jurisdictions. Elements of the CMA's recommendations (such as Joint Audits and enhanced Audit Committee (AC) scrutiny) will result in increased costs and regulatory burden for companies. Any benefits need to be balanced against the risk of stifling innovation, growth or the attractiveness of the UK for inward investment and as a destination for companies seeking to access the international capital markets.
- *Accountability for the success of corporate Britain* - Many parties have important roles to play in the success of corporate Britain and the quality of corporate reporting - in particular the management and boards of companies, investors, auditors and regulators - and there needs to be a fair division of responsibility and legal accountability between them. In the current framework there is an asymmetry in the respective responsibilities between these parties with the role and authority of the auditor often overstated, while the roles of the executive management and board are widely understated. Addressing concerns with audit alone will not restore confidence in corporate governance and reporting.
- *Proportionality is critical* - The oversight and enforcement regime needs to be proportionate, focussing on protecting those who rely on company performance and reporting and seeking continuous improvement, rather than having an undue focus on punishment. We are advocates for the Audit, Reporting and Governance Authority (ARGA), the new body the FRC Review recommends, acting as an improvement regulator which we do not consider means that the regulator needs to be, nor should be seen to be, "soft". This proportionality is critical not just to ensure the appropriate balance between effective regulation and the continued attractiveness of the UK as referred to above, but also to ensure that individuals of a high calibre are encouraged to take on senior management, director or audit roles, rather than be deterred by consequences that are perceived to be disproportionate or unfair.
- *The CMA's recommendations are only part of the picture* - Alongside the CMA's Market Study are a number of other important initiatives - notably the FRC Review and Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit (Brydon Review). The CMA's recommendations cannot be considered in isolation. Initiatives arising from each of these reviews should be examined together to ensure that they are implemented in a consistent and complementary fashion.

- *International considerations* - Consideration needs to be given as to the extent to which of the CMA's recommendations (for example, joint audit) should apply to audits of UK Public Interest Entities (PIEs) which are not UK companies. If reforms are needed to enhance confidence in audit, then there is no logical reason for differentiating the requirements based on a company's domicile.

The CMA's recommendations

We have set out in the Appendix our responses to the detailed questions included in the BEIS Consultation and summarise our comments on three of the CMA's principal recommendations in the following paragraphs.

Audit Committee Scrutiny

We consider that most ACs of FTSE 350 companies do a good job. They make informed and independent decisions, steered overwhelmingly by the need for a high-quality audit. In our experience, sceptical challenge is a priority over cultural fit. But it is right that all participants in the corporate reporting ecosystem should be properly accountable.

We are supportive of a regulatory framework defining appropriate standards for ACs (including the appointment and oversight of auditors) and of the ARGA having the powers to hold ACs to account where they have clearly failed to discharge their responsibilities. However, we consider that such powers should be in the context of a more general ability to hold ACs (and directors more widely) to account rather than the narrower form recommended.

We agree that further transparency on the work of ACs would be beneficial and would provide shareholders with better information in order to engage with ACs more effectively and challenge as necessary. We are in favour of an enhanced level of engagement and dialogue between auditor, AC and shareholders.

Mandatory joint audits

We believe that the UK needs more firms capable of auditing our largest companies and support initiatives to make the market more accessible to players capable of delivering high-quality audits. The form and implementation of any measures need to support the overarching objective of enhancing (or at least not being detrimental to) audit quality.

In our engagement with the CMA we acknowledged that joint audits, shared audits and/or market share caps could have a role to play in this regard, though we expressed a preference for market share caps. Although not the option recommended by the CMA, we continue to believe that market share caps, whilst raising their own implementation challenges, could avoid some of the potential issues associated with joint (or shared) audits. We also believe that shared audits may be a preferable alternative to joint audits, as the associated challenges to audit quality, audit costs, and auditor incentives may be more manageable.

We are not in favour of the CMA's recommendation and in particular the rapid and widespread implementation of joint audits that that recommendation would involve.

We believe that joint audits may present significant risks to audit quality, and will lead to practical challenges as well as additional costs to audited entities. In particular we consider it unlikely that the regime proposed by the CMA could be implemented in the timescales it envisages because the appetite, capability and capacity of smaller audit firms to take on the audits of larger companies in large numbers and on an equal footing (the latter of which we believe to be essential) is unconfirmed.

We also note that joint audits are not generally favoured by Audit Committee Chairs (ACCs), and that they have only mixed support from customers for the audit, namely investors. Furthermore, there is little evidence of joint audit regimes in comparable jurisdictions increasing choice significantly. For example in France, which is regarded as the market where joint audits are most established, only Mazars outside the Big Four has any significant scale amongst the largest French companies. Moreover, joint audits are more burdensome and costly for companies than single firm audits. In this regard we note the example of the regime formerly in place in Denmark, where joint audits were abandoned on the basis that their unnecessary high costs were not compensated for by tangible benefits.

Despite these concerns, if joint audits are to be pursued, we will respond positively and do everything we can to make them work effectively. We believe that in light of the associated challenges and risks, a thoughtfully designed pilot programme – in which we would willingly take part (alongside other willing and credible participants) – would provide the opportunity to assess the challenges of wide-spread implementation of joint audits and whether these might be resolved, and potentially address the associated concerns of other stakeholders. Such a pilot programme might be accompanied by a similar scheme for shared audit as a potential alternative option. Furthermore we believe that regulatory guidance on the application of current auditing standards to the context of joint audits would be beneficial.

Operational separation

We have for some time believed that enhanced governance and performance management of audit businesses (and transparency thereof) for firms auditing PIEs is essential. For this reason we agree with the CMA's recommendations in this regard but such enhancements should not be limited to the Big Four.

This belief has led us to make the significant changes to our firm that we have implemented over the last 18 months. We have created a separate governance structure for our audit business, with its own Chair, its own oversight committee, its own executive committee and its own performance management. We have made quality the primary determinant of our audit partners' discretionary remuneration, and of career progression in our audit business. We have also increased transparency around the financial performance of our audit business. We believe that these measures, together with further measures planned, fulfil the CMA's ambition to both demonstrate our focus on quality and provide greater transparency of how our audit business operates.

We do not agree with the element of the CMA's recommendation to require separate profit pools for audit partners and non-audit partners. In our view this carries a significant risk of unintended consequences. It would reduce our capacity to invest in technology and innovation, raise the cost of audit, make audit firms more vulnerable and risk adversely impacting audit quality. The audit market would be less resilient as a result.

* * *

Please do not hesitate to contact me should you have any questions in relation to our response.

Yours sincerely,

Bill Michael
UK Chair and Senior Partner

Appendix – Detailed Responses

Throughout this response we refer to the existing FRC, the FRC in transition and the Audit, Reporting and Governance Authority as "the ARGA" (notwithstanding our comments on the naming of the new regulator in our response to the BEIS FRC Review Consultation). References to the "FRC" are to the historic activities of the FRC.

CHAPTER 1 - AUDIT COMMITTEE SCRUTINY

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?

The ARGA should have broad powers to hold directors to account

1.1 We agree with the CMA that "*Audit Committees have a vital role in selecting and managing the performance of auditors to ensure that auditors maintain professional scepticism, challenge management, and thus deliver high quality audits*"[1]. However, AC oversight of the auditor and the audit process is but one aspect of the role of AC members and to single out this particular responsibility without regard to others is to place undue emphasis on it to the potential detriment of other important areas. It is important, therefore, that BEIS' proposals are formed in the holistic context of the ARGA's oversight of companies and directors more generally.

Transparency and shareholder engagement can be improved

1.2 We comment on the specifics of the CMA's proposed remedies below, but at the outset would also note the CMA's proposed remedies are focussed more on AC oversight than transparency and shareholder engagement, notwithstanding that the CMA's analysis would appear to support greater emphasis on the latter. The CMA's "additional suggestions" focus on enhancing engagement between ACs and shareholders, and we comment on this in paragraphs 1.11 – 1.14 below.

1.3 We consider that there is scope for enhanced transparency, in particular in relation to an AC's role in the appointment of auditors. In our response to Sir John Kingman we suggested enhanced disclosure, including a requirement for the Board to publish, as part of its recommendation to shareholders, more extensive details as to the execution of a tender, and the rationale behind its decision to propose the appointment of a specific firm and its remuneration[2]. A similar case might be made for greater disclosure of how ACs have considered audit quality

[1] CMA Statutory audit services market study Final Report, 18 April 2019 (CMA Final Report), paragraph 5.1.
[2] KPMG letter to Sir John Kingman 9 November 2018.

on an annual basis, but it is likely that such disclosure may quickly become routine without any great value.

1.4 We also consider that increased AC / shareholder engagement may increase the confidence of shareholders that ACs are discharging their audit oversight responsibilities effectively. The disclosures referred to in the previous paragraph would provide an obvious mechanism for shareholders to ask questions on the tender and appointment process, but we also consider that there could be greater dialogue between ACs and institutional shareholders around the process of auditor selection, both in advance and during the process. For example, larger companies might be encouraged or required to seek the views of the largest shareholders, and this process might form part of the enhanced disclosure referred to above.

The CMA's recommendations

1.5 Turning to the specific CMA recommendations, these are that[3]:

- *"The regulator should have the power and a requirement to mandate minimum standards for both the appointment and oversight of auditors."*
- *"The regulator should have the powers and a requirement to monitor compliance with these standards, including the ability to require information and / or reports from Audit Committees, as well as placing an observer on a Committee if necessary."*
- *"The regulator should take remedial action where necessary, by for example issuing public reprimands, or making direct statements to shareholders in circumstances where it is unsatisfied with Audit Committees. The more severe measures proposed by Sir John Kingman might complement our remedy 'in the most serious cases'."*

We comment on each of these in the following paragraphs.

1.6 While the CMA acknowledges that there are various standards already in place, it states that these are "insufficient" but is not specific as to why, merely observing that they either lack statutory force or "*have not had sufficient effects to alleviate our concerns*"[4]. We would question whether the issue is really with the standards themselves or rather with other aspects - such as practical application of the standards by ACs, transparency (as discussed above), the current level of monitoring undertaken by the regulator or the lack of powers to enforce (addressed by the third of the CMA's recommendations above). In particular we would note that there is no present barrier to the regulator improving standards and / or guidance if necessary or desirable and we are supportive of the adequacy of these being subject to regular review. We are also supportive of statutory

[3] CMA Final Report, Section 5, Summary.
[4] CMA Final Report paragraph 5.3.

backing for the ARGA and the standards it sets, not only as it relates to standards relating to ACs (and their oversight of the audit process and the auditor) but more generally (see paragraph 1.9 below).

1.7 We agree that the ARGA should have the powers and a requirement to monitor compliance with these standards, including the ability to require information and / or reports from ACs. In terms of monitoring, this might be segregated between "routine" and in response to particular concerns - with the latter covered by the recommendations made following the FRC Review (see response to Q2 below) or where investors (see response to Q3 below) or others have raised concerns. For more routine monitoring, the obvious source would be the AC's report (in the Annual Report) of how it has discharged its responsibilities. The FRC Review recommends that the ARGA's Corporate Reporting Review role should extend to other elements of the Annual Report, which would therefore include the AC's report. We agree with this recommendation. This review process would allow the ARGA to raise questions on the content of the report where it considered that effective discharge of the AC's responsibilities was not described which in turn would help identification of whether this was a deficiency of reporting or underlying processes: the former would be more easily remedied, whereas the latter might require further intervention.

1.8 In relation to placing an observer on ACs, we consider that this could have merit - not as a blanket requirement for all companies but in specific circumstances where the ARGA had concerns about the extent to which / how the AC was discharging its responsibilities in relation to audit / auditor oversight. There might also be a justification for having an observer specifically in relation to the audit tender process, if the enhanced transparency and shareholder dialogues outlined above do not address shareholder concerns about the auditor appointment process. In this regard, our suggestion to Sir John Kingman[5] was that:

- A panel of "independent experts" would be established, for example by a nominating committee comprising investors or the regulator.
- Panel members would need to be experienced professionals, most likely currently serving as non-executives (or recently retired from such roles) or recently retired senior auditors.
- The "independent expert" would supplement the company's internal committee overseeing the tender process.
- The Board of a company would continue to make a recommendation to shareholders, but the "independent expert" would report to the shareholders who would then be better placed to decide whether to endorse the Board's recommendation or adopt a different approach.

[5] KPMG letter to Sir John Kingman 9 November 2018.

1.9 As we have stated in responses to other consultations, in particular in our response to the CMA's Market Study Update Paper (CMA Update Paper), we agree that the ARGA should have the powers to hold ACs to account where they have clearly failed to discharge their responsibilities, but that such powers should be in the context of a more general ability to hold ACs (and directors more widely) to account. Whilst this power could include public reprimands, or making direct statements to shareholders in circumstances where it is unsatisfied with ACs, we believe that the nature of the powers should be defined in relation to the broader discharge of duties of non-executive directors.

1.10 We comment on the measures proposed in the FRC Review in response to Q2 below.

Additional suggestions

1.11 The CMA makes an additional suggestion to complement its recommendations of enhancing engagement between ACs and shareholders, "….*for example by implementing recommendations from the BEIS Select Committee on transparency of fees and a requirement on the auditor to present at the audited company's AGM*"[6].

1.12 In terms of greater engagement between ACs and shareholders, we are supportive of this (see our response to Q3 below).

1.13 Whilst not opposed to greater transparency of audit fees, hours spent and rates, we are not convinced that there is any great benefit to this but conversely see potential for such data simply to give rise to numerous questions regarding differences between individual companies. We comment further on this in our response to Q27 below.

1.14 In relation to the auditor presenting at the AGM, it is somewhat unclear as to why the CMA links this to the oversight of ACs. The question of the auditor presenting at AGMs is a matter which Sir Donald Brydon has consulted on in his *Call for Views* and we do not comment further on this here. If, however, the CMA's intent was to suggest that ACs (rather than the auditor) should be available to answer questions (including in relation to their oversight of the audit) at the AGM, then we would agree, but note that there is nothing which currently precludes shareholders asking questions of AC members (who will normally be present at the AGM) should they wish to do so.

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

[6] CMA Final Report page 132.

quality review, early departure of an auditor or a significant restatement of the company's accounts) which should trigger the regulator's involvement?

2.1 The FRC Review made a number of recommendations in relation to cases of serious concern as to potential corporate failure, namely that the ARGA should have powers to require explanations from a company (Recommendation 46); where appropriate, to undertake a skilled persons' review (Recommendation 47) and to publicise the results when in the public interest to do so (Recommendation 48); and to follow up as a result of an inspection (Recommendation 49). As we indicated in our response to the BEIS FRC Review Consultation, we are generally supportive of these Recommendations, subject to a number of comments which (where relevant) we summarise below.

2.2 In relation to "triggers" for the exercise of these powers, we consider that the circumstances suggested as justifying a review envisaged in Recommendation 47 are sufficiently broad without the need of having to specify particular triggers related solely to AC performance. These circumstances included where there (a) are serious grounds to believe that important aspects of corporate governance are seriously deficient and (b) where there is sufficient intelligence that an AC is not doing its job effectively or is being unduly influenced by executive directors[7]. Whilst we consider that these criteria would already provide the appropriate mechanism for regulatory intervention envisaged by the CMA, in our response to the BEIS FRC Review Consultation, we expressed the view that ultimately the ARGA should have power to commission such a review in any circumstance where it considers appropriate in the context of its strategic objective[8].

2.3 In relation to follow-up powers, whilst we agreed in our response to the BEIS FRC Review Consultation that these were necessary, we suggested that further consideration was necessary as to the nature of those powers following on from a fuller consideration of which aspects of company law and regulation the ARGA is charged with enforcing[9].

2.4 The FRC Review made one further recommendation in this area, namely that the ARGA should have the power to order the removal of the auditor (Recommendation 49) which we highlighted (in our response to the BEIS FRC Review Consultation) was inconsistent the FRC Review's own conclusion on directors' removal (in Recommendation 50) that "*Decision making should rest, as now, with Boards and shareholders*"[10]. We consider that, to be consistent, if ARGA was of the view that the auditor should be replaced or the audit re-tendered, that this view should be communicated to shareholders for a decision where the board of the relevant company had not already taken steps to effect

[7] FRC Review, paragraph 3.16.
[8] KPMG response to BEIS FRC Review Consultation, paragraph 8.8 of Appendix.
[9] KPMG response to BEIS FRC Review Consultation, paragraph 8.10 of Appendix.
[10] FRC Review, paragraph 3.17, Recommendation 50. KPMG response to BEIS FRC Review Consultation, paragraph 8.11 of Appendix.

such a change. A similar analysis would apply to other matters which are the prerogative of shareholders (such as the appointment of directors, etc).

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

3.1 As explained in response to Q2 above, we consider that monitoring compliance and remedial action should primarily be a matter between the ARGA and the relevant company and only escalated to include shareholders in more serious instances.

3.2 However, investors should be encouraged or even required to raise concerns in relation to a company where the company is unwilling to engage or respond appropriately to valid concerns an investor has raised, recognising that the extent of ARGA's interest and intervention may be different when similar concerns are raised by multiple investors as opposed to when concerns are held by a single investor.

3.3 We note the recommendations firstly of the FRC Review that the nature of ARGA's interaction with investors should extend beyond Environmental, Social and Governance (ESG) specialists at more senior levels in wider and deeper dialogue with UK investors (Recommendation 43) and secondly the FRC's own current proposals in relation to revising the Stewardship Code. We are supportive of both initiatives and have suggested to the FRC that the latter might be enhanced by investor reporting of how they engaged with the ARGA which might include the extent to which concerns were being shared with the ARGA[11].

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

4.1 In our view the cost, and therefore cost-effectiveness, of regulatory oversight of ACs cannot be divorced from the broader oversight of companies and their Boards envisaged by the wider range of responsibilities and powers recommended for the ARGA by the FRC Review. We are therefore not in a position to comment on cost-effectiveness.

[11] KPMG response to the FRC's consultation on its proposed revisions to the UK Stewardship Code 29 March 2019.

CHAPTER 2 - MANDATORY JOINT AUDITS AND PEER REVIEWS

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

5.1 As we told the CMA[12], we believe that having more firms in the UK capable of auditing FTSE 350 companies and other public interest entities (PIEs) would be desirable for the long term health and stability of our capital markets.

5.2 As regards joint audits as a mechanism to achieve this aim, we believe there is an absence of evidence of the effectiveness of joint audit regimes in comparable jurisdictions, and we note that they have at best mixed support amongst ACCs and investors. Furthermore, we believe that implementing any widespread and comprehensive joint audit regime may potentially lead to significant risks to audit quality, in addition to a range of practical implementation challenges.

5.3 Given such risks and challenges, we are not in favour of the CMA's recommendation and in particular the rapid and widespread implementation of joint audits that that recommendation would involve. We believe that the CMA's proposals would require considerable development in order to reduce risks of adverse impacts on audit quality to an acceptable level.

5.4 Some of the elements of a joint audit regime that the CMA proposes would appear to be sensible if pursuing an objective of more firms participating in audits of large UK companies – including exemptions of large or complex companies, a presumed even split of work between auditors and the ARGA having the power to adapt the regime over time. However, in a number of areas the CMA's proposals are lacking in the requisite detail to engage fully, and in other areas where the CMA does provide more detail (such as exemption criteria and implementation timelines), its proposals appear highly ambitious and likely to result in disproportionately high risks to audit quality.

5.5 We discuss these points further below and, where applicable, provide more detail in our responses to Qs 6-12 below.

Lack of evidence of effectiveness of joint audit regimes in comparable jurisdictions, and lack of support amongst ACCs and investors

5.6 The CMA cites the joint audit regime in France, which is regarded as the market where joint audits are most established having been in place for more than fifty years, as supportive of a conclusion that joint audits would reduce market concentration[13]. However levels of concentration in the market for audits of large French companies remain high, with only Mazars outside the Big Four having any significant scale. For companies in the SBF 120 Index, there are some 232 audit

[12] KPMG Response of 25 January 2019 to CMA Update Paper of 18 December 2018, (KPMG Response to CMA Update Paper) paragraph. 5.1.
[13] CMA Final Report, paragraph 6.48.

mandates, but only 19 of these are held by firms other than the Big Four (170 mandates) and Mazars (43 mandates). All but one of these other firms holds just one or two such mandates.

5.7 The CMA also states that "*[a] number of parties expressed support for joint audit*"[14]. However, based on public responses to the CMA (and the CMA's recognition of these[15]), as well as our own engagement with stakeholders, we note that it appears ACCs are generally opposed to joint audits, and that joint audits have only mixed support from customers for the audit, namely investors. This observation is consistent with the Competition Commission's previous market investigation into statutory audit services, which noted that shareholders were almost universally opposed to joint audits[16]. The apparent shareholder sentiment against joint audit risks further detracting from the attractiveness of the UK as a capital market, were a joint audit regime to be implemented.

Risks to audit quality

5.8 A widespread and rapidly implemented joint audit regime may lead to significant risks to audit quality.

5.9 As we explained to the CMA[17], some of these risks are inherent to joint (or shared) audit, including that, in the case of joint audit, if each joint auditor has only partial oversight there is a risk that certain elements "fall through the gaps", and more generally that there may be communication hurdles and risks of moral hazard. In addition, there is a risk that management may seek to arbitrage between the views of different firms on judgemental areas of accounting and this could lead to lower audit quality.

5.10 Other significant risks relate to the extent to which the smaller audit firms collectively possess the scale, capacity, capability and appetite to take on the audits that the CMA proposes, on the basis of its proposed allocation of work between auditors and the envisaged implementation timescale. As we explain in response to Q7, we believe that the CMA's proposals would appear to be overly ambitious in this regard, even if relevant firms were willing to make the necessary investment.

5.11 It is therefore critical that if pursued, a joint audit regime is implemented in such a way that allows for smaller audit firms to gain this scale, capacity and capability over a realistic timeframe. Given the proposal for a relatively equal allocation of work between each auditor – with which we strongly agree[18] – at a minimum, both a more realistic set of exemption criteria (as we discuss in response to Q6), and a more realistic implementation timeline (as we discuss in response to Q7) would

[14] CMA Final Report, paragraph 6.11.
[15] See CMA Final Report, paragraph 6.12(g) and CMA Update Paper, paragraph 4.41.
[16] Competition Commission market investigation into statutory audit services, final report, paragraph 17.101.
[17] See KPMG Response to CMA Update Paper, paragraph 5.3.
[18] KPMG Response to CMA Update Paper, paragraph 7.1.

be needed (though these alone would not mitigate all risks associated with joint audit).

Implementation challenges

5.12 A joint audit regime would also be likely to lead to considerable burdens on audited entities, including significant fee increases. We discuss this further in our response to Q10. It should be noted that, in light of the CMA's proposals that the largest companies would be exempted from appointing joint auditors, these burdens are likely to be felt disproportionately by the other companies within the scope of the remedy, which may not currently have the scale of central resource to be best able to cope with managing a joint audit relationship.

5.13 We also note the risk that the interaction between a joint audit regime and other of the recommendations of the CMA that are introduced may lead to adverse unforeseen consequences, including to auditor choice. We discuss this further in our response to Q12.

5.14 In light of the above, we see some merit in a thoughtfully designed pilot programme, which would provide the opportunity to assess and identify possible resolutions to these challenges. We also believe that specific regulatory guidance on the application of current Auditing Standards to joint audits, potentially developed in light of lessons learned from a pilot programme, would be beneficial. We discuss this further in our response to Q9.

Specific elements of the CMA's proposed regime

5.15 Some of the elements of a joint audit proposed by CMA would appear to be sensible if pursuing an objective of more firms participating in audits of large UK companies. Although many of the CMA's recommendations lack the detail required to engage with them fully, in our view such elements would include:

- *Exemptions for larger and/or more complex FTSE 350 companies*. We agree that smaller audit firms currently lack the scale, capacity and capability to take on the audits of such companies on an equal footing with a Big Four auditor. However as we note in response to Q6, we believe that the specific exemption criteria implied by the CMA are unlikely to go far enough;
- *A gradual implementation of the regime*. We agree that implementation should not be immediate, and that the market should be given time to adjust to joint audits. However as we note in response to Q7, we believe that the CMA's proposed implementation timescale is likely to be overly ambitious, creating significant risks to audit quality;
- *Exemptions for companies with sufficiently simple accounts and/or that choose to appoint a smaller audit firm as their sole auditor*. As we explain in response to Q6 we agree that there would be little value in mandating joint audits for these companies;

- *A presumption that the work shares of the two joint auditors are relatively equal*. We strongly agree that this is a necessary element of a joint audit regime, as we explain in paragraph 5.11 above;
- *No joint audits with two Big Four auditors*. Companies mandated to appoint joint auditors should not be permitted to appoint two Big Four firms;
- *ACs being free to decide the respective timings for the appointment of their joint auditors.* We agree that there should be no requirement on ACs to appoint joint auditors at different times, and that ACs should be free to determine when appointments should be made;
- *The ARGA having the power to adapt the recommendation over time*. We agree that the ARGA should have the power to adapt the joint audit regime in response to changes in the market.

Other elements that merit further consideration

5.16 We further believe that any version of the joint audit remedy (if implemented) should contain the following:

- *A 'sunset clause' (or equivalent feature)*. More specifically, if market concentration were to decline significantly following the introduction of the remedy, or the credibility of smaller audit firms were to materially improve, then the measure would be regarded as no longer necessary, and phase-out plans triggered either automatically, or at the request of the ARGA.
- *An appropriate liability regime*. Such a regime should ensure that disincentives to smaller audit firms participating in audits of large companies are minimised, whilst remaining equitable to larger audit firms. In principle, we agree that joint and several liability is the most appropriate framework. However we believe there is merit in considering as an alternative a statutory capping of liability (whether on the current joint and several or proportionate basis between the joint auditors), rather than retaining the current unlimited liability basis. We discuss this further in response to Q8.

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?

6.1 As discussed in our response to Q5, we believe that it is important that any joint audit regime is implemented in such a way that allows for smaller audit firms to gain the scale, capacity and capability required to jointly audit FTSE 350 companies over a realistic timeframe.

6.2 A key question in this regard is whether the smaller audit firms have the collective scale and capacity to take on audit mandates of all of the FTSE 350 companies

that are ultimately not exempted from appointing joint auditors. We discuss this in our response to Q7 below.

6.3 In any case, we agree with the CMA that smaller audit firms currently lack the scale, capacity and capability to audit many of the larger and/or more complex companies in the FTSE 350 on an equal footing with the Big Four. We believe that it is important that a joint audit regime does not require or encourage smaller audit firms to do so until such time as they are able. Whilst we have no reason to believe that smaller audit firms would knowingly take on audits which they are not capable of delivering to the required standard, there is a risk that they may inaccurately assess the capacity and capability required to do so.

6.4 We also agree that mandating joint audit for the simplest audits would represent unnecessary intervention, and that companies that appoint a smaller firm as their sole auditor should be exempt from joint audit. Hence, we agree with the CMA's three high-level proposed exemption criteria of (i) the largest and most complex companies in the FTSE 350; (ii) FTSE 350 companies with very simple, single-entity accounts, such as investment trusts; and (iii) companies that appoint a smaller firm as their sole auditor.

6.5 Regarding exemptions for the largest and most complex companies in the FTSE 350, whilst the CMA does not set out which criteria would be applied, it suggests smaller audit firms would be expected to participate in "the majority"[19] of audits of FTSE 350 companies, and in a number of places it refers specifically to exemptions for the largest 50 of the FTSE 350 companies[20]. In our view, a criterion based on market capitalisation alone would miss relevant factors associated with size and complexity, and we believe a more nuanced approach would have to be adopted if a joint audit remedy were to be pursued. We believe the following factors would be particularly relevant:

- Size: Certain FTSE 350 company audits require such a substantial amount of time that smaller audit firms are unlikely to have the capacity to take them on at the outset or taking them on would severely limit the extent of participation of smaller audit firms in the market as a whole. In our experience, time requirements are typically proportionate to the size of the audited entity, and therefore exemptions of the largest companies (whether by reference to revenues, assets or other metrics) may be appropriate. In addition, the aggregate litigation and regulatory risks associated with auditing the largest companies may be prohibitively high for smaller audit firms to take on and they may have insufficient insurance cover to adequately de-risk themselves.

[19] CMA Final Report, paragraph 6.27(b).
[20] CMA Final Report, paragraph 6.40(b), footnote 467.

- Complexity: Smaller audit firms are unlikely to have the capability to take on audits for the most complex companies at the outset. Such complexity might arise from a number of factors, which may include whether the audited entity:
  - has dual or multi-exchange listings;
  - operates in an environment with a high level of regulatory oversight;
  - generates a material proportion of its revenue in a jurisdiction requiring special accreditation;
  - employs complex IT, billing and/or other systems across the business that require specialist expertise to audit;
  - has significant shared service centres that support a number of locations/components within the business;
  - is highly acquisitive; and/or
  - operates a complex business model, for example with significant cross-border intra-group transaction flows or international tax arrangements.
- Sector: Smaller audit firms may not have access to specialist sectoral knowledge that is required to audit companies that are active in certain sectors (such as financial services).
- Geographical spread: Smaller audit firms may not have the capability at the outset to audit certain companies with particular geographic diversity, due to their more limited international networks (in terms of geographic representation).

6.6 In our experience based on the companies that we audit, a significant number of FTSE 350 companies are likely to have one or more of these characteristics – including many outside the largest 50 of the FTSE companies which the CMA implies should be exempted – thereby reducing the population of candidate companies for which smaller audit firms may be able to deliver quality audit work on an equal footing with a Big-Four firm to a relatively small number initially and for a significant period of time. A joint audit regime, if it were to be pursued, should focus on this population.

6.7 Finally it is important to recognise that the question of size and complexity is not binary, and that applying any exemption criteria in a mechanistic way will likely result in some companies that are reasonably large and/or complex being required to appoint a smaller audit firm which may not, in spite of the intentions behind the audit criteria, be able to deliver high quality audit work on an equal footing with the Big-Four firm. It is imperative that this risk is considered carefully when exemption criteria are being designed. Similarly there may be some larger companies well suited to joint audit or sole audit by a smaller audit firm.

7 Do you agree that challenger firms currently have capacity to provide joint audit services to the FTSE 350? 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 FTSE 350?

7.1 As we explain in response to Q6, we believe that smaller audit firms are unlikely to have the scale, capacity and capability to provide joint audit services to many FTSE 350 companies on an equal footing with a Big Four auditor at present.

7.2 Thinking about the remainder of the FTSE 350 as a whole, the CMA's proposals for exemption criteria[21], work shares between auditors[22], and implementation timelines[23]; as well as its figures on current audit fees[24] and likely fee increases[25], would suggest that within 10 years, smaller audit firms may need to achieve in excess of £200m per annum in extra audit revenue from FTSE 350 companies to meet the CMA's proposed implementation timeline[26]. This would represent growth in audit revenues of smaller audit firms of as much as 50% of their 2018 audit revenues (earned across all PIEs)[27], or close to 100% of KPMG's total 2018 audit revenues from audits of FTSE 350 companies (which was based on our employment of around 100 audit partners and upwards of 3,500 audit staff).

7.3 In our view the CMA's proposals would thus appear to require an unrealistic increase in the scale and capacity of smaller audit firms over the timescale envisaged[28]. A significantly longer implementation timeline would be needed to minimise risks to audit quality.

7.4 As we discuss in response to Q6, a more realistic set of exemption criteria, based on size and complexity of FTSE 350 companies, may lead to considerably more companies being exempted from joint audits at the outset, as compared with the CMA's proposed criterion. If so, this would reduce the required growth rates of smaller audit firms over any particular implementation period. Without further clarity on what the exemption criteria may be, it is not possible to opine on whether

[21] Specifically, the largest 50 companies in the FTSE 350, as implied in footnote 467 to paragraph 6.40(b) of the CMA Final Report.
[22] Specifically, that these should be "relatively equal" (CMA Final Report, Section 6, Summary).
[23] Specifically, that non-exempted FTSE 350 companies should appoint joint auditors no later than when their next tenders arise (CMA Final Report, Section 6, Summary).
[24] Specifically, that FTSE 350 companies pay around £1 billion in audit fees at present (CMA Final Report, paragraph 2.11).
[25] Specifically, that fee increases may be in the range of 25-50% (CMA Final Report, paragraph 6.74(b)).
[26] Our calculations are as follows. The CMA Final Report suggests that the largest 50 FTSE 350 firms (by audit fees paid) account for approximately 70-75% of total FTSE 350 audit fees (see Figure 2.2). On the assumption that there is a high degree of overlap between these 50 companies and the 50 largest companies in the FTSE 350, this would imply that approximately 25-30% of current audits (by fees) would be split between joint auditors. Fee increases of 25-50% for these audits would imply that they would (after fee increases) represent 30-45% of current audit fees. Further assuming an equal split of work between joint auditors, and ignoring other drivers of fee increases such as inflation, this would imply that the smaller auditors would receive 16 to 23% of current audit fees (approximately £160m to £230m).
[27] Taking audit fee data for smaller audit firms from the FRC's "Key facts and trends in the accountancy profession" (July 2018). The companies taken as 'smaller audit firms' are those given as examples of 'Challenger firms' in the Glossary to the CMA Final report. Whilst other firms partake in audits of PIEs, we assume for the purpose of this exposition that only those firms may partake in joint audits of FTSE 350 companies within the first 10 years.
[28] The CMA states that the remedy would not require smaller audit firms to grow at an annual rate exceeding 5-10% per annum (CMA Final Report, paragraph 6.40(b)). However it does not present any analysis suggesting why this may be feasible or realistic.

the resultant growth requirements may or may not be likely to be achievable in a particular timeframe. In any case, any implementation timetable would need to be carefully considered so as not to risk audit quality.

7.5 It is not for KPMG to comment on possible development plans that the smaller audit firms might follow in order to achieve the scale, capacity and capability to provide joint audit to FTSE 350 companies in a realistic timeframe. However we believe that smaller audit firms will likely need to develop significantly in a number of areas if they are to achieve these. Such areas would include:

- the numbers of audit partners and staff they employ, both in the UK and more broadly across the world;
- their technology;
- their sector expertise; and
- the access they have to non-audit specialists.

7.6 Further, the smaller audit firms would need to have the appetite to scale up significantly, and to shoulder the inherent risks associated with taking on larger and more complex audit mandates.

7.7 It does not appear that the CMA probed in sufficient detail the ability or appetite of smaller audit firms to develop in these areas. We suggest that BEIS does so.

7.8 It is important to note that initiatives under consideration in association with, or potentially arising from, the FRC Review or the Brydon Review (such as introducing a strengthened framework around internal controls in the UK on a similar basis to the Sarbanes-Oxley regime in the US) may be burdensome on audit firms and have the potential to further affect their capacity to undertake joint audits on the scale and within the timeframe envisaged by the CMA. The potential impact of such measures should be carefully considered in the design of any joint audit regime. It may be that some prioritisation is needed if their collective implementation is not practical within the envisaged timelines.

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?

8.1 In principle, we agree that for joint audit to work effectively, joint and several liability is the most appropriate framework. Specifically, each auditor should be responsible for different parts of the audit work but both should sign off on and assume liability for the overall report (where, in the absence of any agreement to the contrary, the joint auditors share any assessed liability equally). Indeed, this is a key reason why we believe that joint auditors should apportion the work

involved in a joint audit on as equal footing as possible, as they would share the liability of the work.

8.2 However, notwithstanding that joint and several liability might be the most appropriate basis, there are likely to be challenges for both large and smaller audit firms. For smaller audit firms, the equal sharing of liability for claims based on the financial resources of the larger audit firm may be challenging. Conversely, larger audit firms are likely to be concerned about the ability of smaller audit firms to finance their share of any liability and the consequent potential that the larger audit firm effectively remains liable for any amount that the smaller audit firm is unable to meet.

8.3 An alternative, where the liability of each of the joint auditors is apportioned based on the culpability of the relevant firm, could be considered - but to the extent the liability being apportioned remains on an unlimited liability basis, the quantum of the liability could still be significant and, in effect, a deterrent to smaller audit firms from participating in the large audit market on a joint basis.

8.4 To manage these challenges, a further alternative could be to introduce a statutory capping of liability (whether on the current joint and several or proportionate basis between the joint auditors), rather than retaining the current unlimited liability basis. The CMA did not explicitly consider this proposal in its report, and in KPMG's view there is merit in examining this further as we explain in the following paragraph.

8.5 It is worth noting that the current unlimited liability regime for audit has historically been seen as a mechanism to ensure that individual auditors undertake the work diligently (notwithstanding the professional requirements to do so and the professionalism of individuals and firms). However, it pre-dates the significant scrutiny (in the UK by the FRC) which exists today over auditors and which provides the 'assurance' that auditors are undertaking their work to the expected standards. In addition, the amount of insurance cover available even to the largest firms is likely to represent only a tiny percentage of the market capitalisation of the largest UK or international companies.

8.6 A change in the liability regime might (a) encourage smaller audit firms to become more willing to invest in the capabilities they would need to become credible auditors of larger companies, in support of greater choice, and (b) increase the resilience of the market. On the latter point of resilience, it will always be within the power of the regulator to remove the licence of a firm or individuals and therefore changing the liability regime would not result in moral hazard.

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

9.1 In light of the capacity and capability gaps faced by the smaller audit firms of the kind mentioned above, we believe that a pilot programme of joint audits, for

example over a 5 year period (which would be aligned to the typical tenure of the lead audit partner), would be very helpful in order to test: (i) whether the introduction of joint audit on a macro scale is realistic; (ii) the practical difficulties that may need to be surmounted; (iii) coordination issues that may exist between joint auditors; and (iv) the existence of any unforeseen consequences.

9.2 Such a pilot programme may dispel some of the concerns about joint audits and result in them being more widely embraced on a voluntary basis. It would also provide an opportunity to assess the challenges of the widespread implementation of joint audits and how these challenges might be resolved, and potentially to address associated concerns of other stakeholders.

9.3 Clearly the scope and scale of any pilot programme would need to be carefully considered and designed in order to ensure that it has credibility. For example, a representative cross-section of between 10 and 20 FTSE 350 companies might be included in the pilot programme, allowing the Big Four and a further three or four smaller audit firms each to be involved in up to five joint audits (which should be manageable and should provide meaningful outcomes). KPMG would be happy to participate in any pilot programme of the type outlined above, alongside other willing and credible participants.

9.4 We believe that it would also be beneficial for the ARGA to develop guidance on the application of current Auditing Standards to joint audits. This could include, for example, how joint auditors should agree on work allocation; how joint audit of the group element of an audit should be conducted given the additional complexity and scope for duplication of this aspect (see paragraph 10.2 below); how cross-reviews of files should be undertaken and whether each firm would need to maintain its own files where work is shared. Such guidance could be developed in light of lessons learned from a pilot programme, though this would require the ARGA to adopt a flexible approach during a pilot to allow different models to be tested.

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?

10.1 Joint audits can be expected to increase total audit costs for a variety of reasons, including due to the increased complexity of a joint audit and the consequent duplication of work, in particular in the form of dual work on certain audit areas, the need for auditors to review each other's work, and overlap in meetings.

10.2 The extent to which this is the case, and the corresponding cost increases that may arise, will likely depend on an array of factors, including:

- the proportion of total audit fees that are attributable to audit at the group level, as opposed to the group's components (for those companies that prepare consolidated accounts). We would expect that there would be very

significant if not near-total duplication between joint auditors at the level of the group audit. This proportion will on average be greater for the smaller and less complex FTSE 350 companies, i.e. those that are more likely to be within the scope of the remedy from the outset, and in our experience it is not unusual for the group audit to account for a substantial proportion of total audit fees of smaller FTSE 350 companies;

- the presence of company-wide systems such as ERP or billing systems, shared service centres or other such systems which relate to the audits of multiple components, and thus which may not be possible to split easily between joint auditors (making duplication potentially inevitable);
- the nature of components which smaller audit firms are best suited to audit and/or where larger audit firms may place limited reliance on the smaller audit firm's work. For example, both firms may conclude that they need to undertake their own work at individually complex or material operations, or those parts of the business relating to significant audit risks leading to duplication in effort;
- the presence of other complexities of the types mentioned in our response to Q6, to the extent that they are not reflected in exemption criteria. As explained above, in these cases we believe that smaller audit firms lack the capability to partake in a joint audit, and if they were to do so, it is likely that the Big Four auditor would need to duplicate the work of the smaller audit firm; and
- the liability regime that is in place (see Q8).

10.3 We are not in a position to estimate the impact of the CMA's proposals on audit fees for FTSE 350 companies, given the uncertainty around important factors such as exemptions, timescales, and the capability of smaller audit firms to partake in joint audits. However we note that if it were to be assumed that audit work at the group level (only) were to be largely duplicated – an assumption we believe to be reasonable – fee increases in some cases could exceed 40%, on the basis of comparing estimated group versus component audit fees for a selection of companies that we audit. If there was duplication and/or rotation of work at a component level then fee increases could be greater still.

10.4 We note that the 25-50% range set out by the CMA appears to be based on estimates of audit fee premia associated with joint audits in (i) Denmark[29] and (ii) France[30]. These may not necessarily be meaningful comparisons for the regime proposed by the CMA, due to different design features (for example, in both cases, joint audits by two Big Four firms were permitted) as well as other country-

[29] Calculated by analysing fees before and after the abolishment of the mandatory joint audit regime in 2005 (Lesage, C., N. V. S. Ratzinger-Sakel, and J. Kettunen (2017) Consequences of the Abandonment of Mandatory Joint Audit: An Empirical Study of Audit Costs and Audit Quality Effects, European Accounting Review, 26(2), 311-339).
[30] Calculated by comparing France with the UK and Italy between 2007 and 2011 (Andre, P., G. Broyne, C. Pong, and A. Schatt (2016) Are Joint Audits Associated with Higher Audit Fees?, European Accounting Review, 25(2), 245-274). ('Andre et al review').

specific factors[31] which may limit the extent of duplication of work or increase auditor risk and therefore lead to fee increases. Where such differences are accounted for (albeit to a limited degree[32]), estimates appear to be at the upper end of the CMA's reported range – and more consistent with our high-level observations above. Fee increases to this extent are also consistent with estimates of a recent paper produced for the European Parliament's Committee on Economic and Monetary Affairs[33], which finds that non-financial PIEs appointing joint auditors pay around 50% higher fees than those appointing a single auditor.

10.5 In any case, the 25-50% range presented by the CMA is wide and represents a sizeable uncertainty around the cost implications of a joint audit regime. We believe that this uncertainty should be factored into any cost-benefit analysis of the CMA's recommendation.

10.6 In addition to fee increases we note that joint audit would likely lead to considerable costs to companies themselves, relating for example to being required to appoint and oversee the work of two sets of auditors, rather than one.

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

Market share caps

11.1 As we expressed to the CMA[34], we believe that a market share cap for a finite period of time is a better option than joint audit.

11.2 We recognise the challenges in introducing a regime of market share caps. In particular, such a system has the potential to deny companies the freedom to appoint an auditor of their choosing (if in so doing that firm would breach the regulatory cap).

11.3 A system of market share caps may also require significant ongoing regulatory intervention in order to ensure that the larger and/or more complex companies that smaller audit firms do not currently have the scale, capacity or capability to audit (see our response to Q6 above) are able to have a reasonable choice of (Big Four) auditor. For example, if three of the Big Four are close to or have reached their respective caps, it may be that a large or complex company

[31] Such as the regulatory and litigation environment, as discussed in Andre et al review, section 2.1.
[32] The Andre et al review notes that country-specific differences may play a role in explaining audit fee differentials, and for a range of reasons considers its comparison of France vs Italy (55% audit fee premium) to be on a more like-for-like basis than its comparison of France vs the UK (27% joint audit fee premium). See Andre et al review, Section 2.1 and Table 3.
[33] See Willekens, M., Dekeyser, S., and Simac, I., EU Statutory Audit Reform: Impact on Costs, Concentration and Competition, Study for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg, 2019, p72.
[34] KPMG Response to CMA Update Paper, paragraph 5.1.

tendering its audit would only have an effective choice of one Big Four auditor, unless the ARGA were to permit a temporary exemption to other Big Four firms.

11.4 Furthermore there may also be challenges in accounting for inherent volatility in "market shares", depending on how they are defined in this context. For example, if market shares were determined by market capitalisation of audited entities then firms could find themselves regularly fluctuating between being in breach and in compliance with their respective cap. As we explained to the CMA[35], this challenge could be overcome by basing any cap(s) on a simple measure of market share such as the number of audited entities.

11.5 We believe however that a market share cap may have the ability to achieve an increased participation of smaller audit firms in audits of FTSE 350 companies whilst avoiding some of the potentially significant costs and burdens associated with joint audit, such as those associated with duplication of work (see our response to Qs 5 and 10 above) as well as those risks to audit quality that may arise from joint or shared audits (see paragraph 5.9 above).

Shared audit

11.6 We set out our view on the relative merits of shared audit versus joint audit in our response to the CMA's Invitation to Comment on its Market Study (CMA Invitation to Comment)[36]. In our view, a shared audit – where one audit firm (the statutory auditor) takes sole control, responsibility and liability for the audit, and another audit firm either (i) supports the statutory auditor on certain aspects of the audit or (ii) undertakes audits of the separate statutory accounts of legal entities which are components of the group – may be a preferable alternative to joint audit as the associated challenges to audit quality, audit costs, and auditor incentives (relating to liability) may be more manageable. For example, a shared audit regime may be expected to result in less duplication of work and therefore a lesser impact on the cost of audit to the entity. Likewise a shared audit regime may reduce the risk of a joint audit that each auditor has only partial oversight leading to issues being missed.

11.7 We recognise that shared audits may not provide the same visibility of the work of the smaller audit firms to ACs, and therefore not result in the opportunity for smaller audit firms to build credibility with ACs. However, we think shared audit may still facilitate growth and build capability of the smaller audit firms, provide an opportunity for smaller audit firms to dispel issues of perception of quality differentials, and at the same time avoid some of the significant practical implementation challenges with joint audit.

[35] KPMG Response to CMA Update Paper, paragraph 10.3.
[36] KPMG response to CMA Invitation to Comment, Section 2.3.

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?

12.1 As we told the CMA[37], we believe that competition in the audit market is generally strong, with the vast majority of companies having a choice of high-quality offerings, and switching levels within FTSE 350 firms being very high. We explained that the current structure of the UK statutory audit market has been shaped by competitive forces, with competition having led to considerable investment which has benefitted audit quality, but which has also driven a certain level of concentration in the market. Therefore, the recommendations made by the CMA aimed at increasing choice should be pursued only if very carefully designed and progressively implemented to minimize unintended consequences in relation to quality.

12.2 Furthermore we perceive that the evidence from comparable jurisdictions is not supportive of a conclusion that joint audits will improve competition. As we discuss in paragraph 5.6, the CMA cites the case of France as supportive of a conclusion that joint audits would reduce market concentration[38]. However we do not believe that this is borne out by the evidence, which suggests that only Mazars outside the Big Four has any significant scale.

12.3 We also note that a joint audit regime risks undermining the aims of the resilience recommendation in the event that an audit failure threatens the viability of both auditors (rather than only one firm as would be the case with a sole auditor), and may therefore lead to reduced choice. If a joint audit regime is to be introduced, care should be taken to minimise this risk.

12.4 Notwithstanding these observations, we are generally open to measures to improve choice in the market, provided that the ultimate solutions do not jeopardise audit quality now or in the future. We are not in favour of the CMA's recommendation and in particular the rapid and widespread implementation of joint audits that that recommendation would involve, for the reasons set out in our responses to the questions above. If joint audits are to be pursued, we will of course respond positively and do everything we can to make them work effectively.

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

13.1 We are not opposed in principle to peer review for companies exempted from mandatory joint audits, notwithstanding that it would represent an additional cost

[37] KPMG response to CMA Update Paper, paragraphs 2.7-2.12.
[38] CMA Final Report, paragraph 6.48.

(the size of which would depend on the scope of the review), which would, ultimately, need to be borne by companies[39].

13.2 However, we believe that the aim of a peer review should be more focused than the CMA recommends, and should be undertaken only in cases where there are particular concerns about a company or its audit. In our view, it should be seeking to identify where the audit has not detected material errors or disclosure omissions in the financial statements of the audited entity, as any broader assessment of audit quality can be dealt with through routine monitoring on a non-timely basis. Clarity on this objective would define the precise extent of work to be undertaken, and other aspects of the design. By introducing peer review on a more focussed, risk assessed, basis, this will also mitigate potential capacity issues which might arise with a mandatory requirement for all companies within a specific population such as the FTSE 350.

13.3 We agree with the CMA that the peer reviewer should be appointed by, and accountable to, the regulator. It would be important to define the extent to which the peer reviewer needed to be independent of the company for which the audit was being reviewed: requiring a similar level of independence to that required for the auditor (which we would suggest is unnecessary) may restrict choice and competition.

13.4 If the objective of peer review is an additional independent quality check (as the CMA states[40]), we do not believe that the peer reviewer should always be a smaller audit firm.

13.5 Finally we note that the CMA proposes that peer reviews would be conducted prior to the signing of the audit report, on a real-time basis. If this were to be the case, there is a risk that they may have an impact on company reporting timelines, as it can be the case that there is a limited amount of time between finalisation of audits and corporate reporting.

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

14.1 We commented on a range of potential measures, including those not consulted on by the CMA[41], in our engagement with the CMA during its Market Study[42].

14.2 It is also important to consider potential unintended consequences for competition of other measures that have been referred to by the CMA as worthy of consideration. In particular, the introduction of 'cooling-off' periods, during which non-audit services continue to be prohibited once an audit engagement has

[39] KPMG response to CMA Update Paper, paragraph 25.1.
[40] CMA Final Report, paragraph 6.78.
[41] See for example KPMG response to CMA Invitation to Comment, Section 2.14.
[42] See KPMG response to CMA Invitation to Comment and KPMG response to CMA Update Paper.

ended, would pose significant risks to choice and to competition. Given the increased restrictions on the non-audit work that can be delivered to (previously) audited entities – both restrictions undertaken voluntarily by audit firms as well as likely to be imposed as a result of the recent consultation launched by the FRC on revisions to the Ethical Standard[43] – extending the period for which these restrictions would apply increases the likelihood that audit firms do not participate in audit tenders, and therefore might restrict choice. We discuss cooling-off periods further in our response to Q22.

[43] Revised Ethical Standard 2019 – Exposure Draft – consultation launched July 2019.

CHAPTER 3 - MEASURES TO MITIGATE THE EFFECTS OF DISTRESS OR FAILURE OF A BIG FOUR FIRM

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

15.1 As set out in KPMG's response to the CMA Update Paper[44], the underlying cause of any potential audit firm distress or failure will have important implications for the design of an effective resilience regime. For example, depending on the underlying cause of audit firm distress (e.g., loss of licence from the global network or audit firm failure as a result of major litigation), it may be very challenging for the regulator to seek to encourage major companies to retain the distressed audit firm as their auditor.

15.2 This is therefore a complex question, which requires consideration of the potential strategies for regulatory intervention in order to meet the objective of ensuring that the entities audited by a distressed Big Four firm are not transferred to another Big Four provider. A number of issues would need to be considered in determining the likely most effective regulatory strategy, including:

- whether the distressed audit firm has the funding to stabilise the business, retain partners and staff, avoid client "flight" and reassure external stakeholders;
- the likelihood of partners supporting any proposed strategy given the provisions of the partnership deed, their potential liabilities to the failing audit firm, and the fact that many (and often key) partners could rapidly leave if they saw better prospects and greater certainty elsewhere;
- the likelihood of staff supporting any proposed strategy;
- how to deal with the non-audit as well as the audit part of a distressed firm.

15.3 The CMA's recommendation is at this stage specified only at a very high level, instead suggesting that the regulator should now consider how it might best achieve the CMA's objective. The complexities of the underlying challenges will therefore need to be considered by BEIS and by the ARGA if this measure is to be taken forward. We would welcome the opportunity to engage further as the ARGA takes this initiative forward.

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

16.1 The CMA suggested that the ARGA be given powers to obtain various forms of information from the Big Four audit firms, as well as requiring non-Big Four audit

[44] KPMG response to CMA Update Paper, paragraph 15.3.

firms to draw up plans on how they could incorporate migrating audited companies or staff from a distressed Big Four[45]. We support the regulator having such powers (although in practice we believe the ARGA could obtain such information at present), as well as the CMA's suggested tasks for the regulator to undertake as part of its ongoing monitoring[46]. These recommendations should help the ARGA to gain insight as early as possible into any potential audit firm distress, thereby maximising the chances that support can be given to either prevent failure (where appropriate) or allow for an orderly transition.

16.2 These powers do not, of course, ensure that the ARGA would be able to intervene in such a way as to prevent the entities audited by a distressed Big Four audit firm transferring to another Big Four audit firm[47]. As discussed in response to Q15 above, designing an effective regulatory strategy to achieve this objective is a complex question which would require careful further consideration. Some potential high level routes for achieving this aim are set out in KPMG's response to the CMA Update Paper[48], but the regulatory powers that would need to underpin such intervention, if desired, would need significant further development.

16.3 Some important considerations in relation to this, as set out in KPMG's response to the CMA Update Paper, include[49]:

- Any regulatory intervention should take place only through an accepted and well-understood regulatory framework. Otherwise, the risk of a regulator mandating, outside of such a framework, that some companies remain with a distressed firm as their auditor while a turnaround is sought, is likely to exacerbate problems for the distressed firm and reduce market stability, with greater risk of contagion.
- A turnaround of a distressed audit firm is more likely to be achieved by early regulatory intervention in private, to ensure that the firm has appropriate turnaround experience within the leadership team, rather than allowing the situation to deteriorate to the point where a more formal process is required.
- The success of other potential CMA recommendations (for example those that increase market participation by non-Big Four firms) would reduce the significance of the CMA's concerns in relation to resilience, and any regulatory powers should therefore be kept under review (although, conversely, other potential measures such as separate economic profit pools might decrease resilience of audit businesses - see our response to Q18).

[45] CMA Final Report, paragraph 7.17.
[46] CMA Final Report, paragraph 7.19.
[47] The CMA instead suggests that the regulator consider how it might achieve this, through measures such as incentivising audit teams to move to non-Big Four firms, discouraging audit contacts transferring to the remaining Big Four, etc. (CMA Final Report, paragraph 7.21).
[48] KPMG Response to CMA Update Paper, paragraph 17.1.
[49] See KPMG Response to CMA Update Paper, Q17.

16.4 We believe that any such powers invested in the ARGA should apply in relation to all firms auditing PIEs, rather than just Big Four firms as the CMA's recommendation appears to envisage[50].

[50] CMA Final Report, paragraph 7.16.

CHAPTER 4 - OPERATIONAL SPLIT BETWEEN AUDIT AND NON-AUDIT PRACTICES

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?

17.1 In our view, the quality of our audit work, and the incentive to focus on audit quality are not diminished by our audit business operating within a larger, multi-disciplinary firm. Instead, the multi-disciplinary firm generates significant benefits to audit quality, in particular through the ability to easily access a range of high quality, independent, specialist expertise for audit work. We explained the benefits of our multi-disciplinary model to the CMA[51], and we note that our observations are consistent with recent independent research commissioned by the FRC and the Institute of Chartered Accountants of Scotland (ICAS)[52]. We believe that the CMA's evidence and analysis in this regard does not demonstrate the link it claims.

17.2 However, we recognise and understand the current scepticism as to whether large multi-disciplinary firms can be sufficiently focused on audit, and we agree with the CMA that there is scope for enhancements to the governance and performance management of audit businesses within multi-disciplinary firms in order to increase trust in audit.

17.3 With that in mind, we have taken steps to strengthen the governance and the performance management of our audit business which we consider, especially if implemented on a market-wide basis, would be an effective way of increasing trust in audit. These measures are summarised further in response to Q18 below. In addition, we have taken steps to discontinue the provision of non-audit services (other than those closely related to the audit) to FTSE 350 entities we audit, thereby addressing what we understand to be one of the key concerns of shareholders.

17.4 We note that the FRC has gone further in its proposed revisions to the Ethical Standard, and beyond the recommendations of the CMA, by prohibiting virtually all non-audit services to PIEs and "other entities of public interest" (which the FRC defines as being entities included in the scope of the Audit Quality Review)[53]. Whilst we believe this change is premature in advance of considering measures

[51] See, for example, KPMG Response to CMA Update Paper, paragraphs 2.34-2.35.
[52] For example the paper 'Skills, Competencies and Sustainability' of the Modern Audit', Turley S., Humphrey C., Samsonova-Taddei , Siddiqui J., Woods M ., Basioudis I and Richard C (2016) notes (p24) that "*One pressure point that is universally seen as being of critical importance for the delivery of high quality audits is the manner in which general auditing expertise is combined with other sectoral or industry specific expertise in order to address reporting and other business risks specific to the audited entity*". The paper 'The Capability and Competency Requirements of Auditors in Today's Complex Global Business Environment', Barac, K., Gammie, E., Howieson, B. and M. van Staden (2016) notes (p9) that the traditional nature of an auditor may be changing, requiring skills including in-depth industry knowledge, business acumen skills, data analytical skills and forensic skills. These are skills that can readily be found in a multi-disciplinary firm.
[53] See Revised Ethical Standard 2019: Exposure Draft, paragraph 5.42.

in relation to audit and the audit market more holistically, it would very clearly be a significant step in removing even the perception of conflicts. In particular, notwithstanding that audit is not used as a loss-leader for the sale of non-audit services to an audited entity (as the CMA has acknowledged[54]), this measure would remove any perception that this could be the case.

17.5 We believe that our auditors are objective in carrying out their work, driven by their professionalism, qualifications and training, and supported by the standards with which they have to comply. Moreover, and critically, there are strong disincentives to the delivery of audits which are not of the quality required – most notably the serious financial and reputational consequences for individuals and firms alike. KPMG's significant investment in transforming and improving the quality of its audits[55] – which has started to lead to significant improvement in KPMG's AQR scores[56] – is evidence of these strong incentives at work.

17.6 In this context, operational and strategic separation between audit and non-audit businesses needs to be carefully designed, balancing the need to provide greater transparency and address perceptions of conflict while at the same time avoiding any aspects which put audit quality and the resilience of audit firms at risk.

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?

18.1 The CMA Final Report notes that the high-level aims of the CMA's operational split remedy are twofold: first, to reduce auditor interest in non-audit work; and second, to provide the ARGA with greater transparency of audit businesses to enable effective performance monitoring[57]. We agree that achieving these aims can be effective in improving trust in audit and in alleviating those concerns around any underlying tensions between audit and non-audit parts of the firms to which the CMA refers.

18.2 We also agree with the CMA's conclusion that a legal separation of audit and non-audit businesses would not be required for its recommendation to be effective[58], and would be more onerous than necessary,[59] for example by increasing costs

[54] See CMA Final Report paragraph 3.267.
[55] See, for example, KPMG Response to CMA Invitation to Comment, Section 1.8.
[56] See https://www.frc.org.uk/getattachment/32926b7f-2d1d-47d8-a797-67f69b00e38d/KPMG-LLP-Public-Report-2018-19.pdf for our 2018/19 AQR scores.
[57] CMA Final Report, paragraphs 8.3-8.4.
[58] CMA Final Report, paragraph 8.39.
[59] CMA Final Report, paragraph 8.51.

affecting both our audit and non-audit businesses significantly, and by creating implementation challenges[60].

18.3 The CMA's operational split recommendation appears to have four core features:

- Enhanced governance and performance management of the audit business.
- Enhanced transparency and reporting of the performance of the audit business.
- Separation of economic interests between the audit and non-audit businesses.
- Exemption from the above for audit firms other than the Big Four.

18.4 We discuss each of these in turn below.

Enhanced governance, performance management, transparency and performance reporting of the audit business

18.5 We agree that both enhanced governance and performance management, and transparency and reporting thereof, is essential to ensure confidence in audit firms and audit and can be effective in achieving the CMA's aims. As we noted to the CMA[61], we have already taken a number of steps in this regard. Furthermore, a number are consistent with the way we currently operate.

18.6 Regarding audit quality, as we told the BEIS Parliamentary Select Committee (BEIS Committee) during its Inquiry into the Future of Audit[62], all of the targets set for our audit partners and staff which determine progression and remuneration are grounded, directly or indirectly, in audit quality. This is embedded into our Audit Quality Matrix scorecard, which is the basis on which we assess and record quality performance.

18.7 As a consequence, audit quality is the primary determinant of how we measure the performance of our audit partners, and it is the primary determinant of both our audit partners' discretionary remuneration, and of career progression within the audit business. As we explained to the CMA[63], whilst audit partners do share in the profits of the business as a whole, the difference an individual audit partner can make to the profitability of non-audit services is marginal, and would be spread over all partners in KPMG. By contrast, any actions taken by an audit

[60] KPMG Response to CMA Update Paper, paragraphs 21.10-11 and 21.16.
[61] See KPMG Response to CMA Update Paper paragraphs 2.23-2.48 and 21.1-21.9, KPMG Response to CMA Invitation to Comment pp36-37.
[62] BEIS Committee Inquiry into the Future of Audit: KPMG response to further information request 6, March 2019, available at https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/correspondence/KPMG-Response-letter-06.03.19.pdf.
[63] KPMG response to CMA Update Paper, paragraph 2.45.

partner that result in poor audit quality would have a direct and substantial impact on their remuneration.

18.8 Therefore audit partners are strongly incentivised to prioritise audit quality above any other consideration.

18.9 We have taken other steps, and/or currently operate, consistent with the aims and elements of an operational split envisaged by the CMA:

- We have taken significant steps to improve our governance and performance management, including the establishment of a new Chair of Audit role on our UK Board; an Audit Executive Committee led by our Head of Audit which has assumed executive responsibility for the Audit business's performance management, risk management and controls; and a Board subcommittee providing governance and oversight of the Audit business with a particular focus on audit quality (Audit Oversight Committee).
- Moreover every member of the Board and every member of the Executive must actively contribute to the delivery of our Audit Quality Plan, and performance objectives related to the improvement of audit quality are set for each of them at the start of each year. These measures are enhancing further the special status that audit has within our firm, which the CMA notes as one of the core aims of its recommendation[64]. It is also our intention to transition the Audit Oversight Committee to an Audit Board with enhanced responsibilities.
- We have in place transfer pricing arrangements for partners and staff from one business unit working for another business unit, and as we demonstrated to the CMA, on 1 October 2018 we changed the method of allocating costs in order to provide greater transparency of the profitability of our audit business[65].
- Consistent with the CMA's recommendation that audit firms produce an audit annual report with reporting on quality measures[66], we (and other firms) produce annual Transparency Reports which include extensive descriptions of our audit quality and our governance and performance management (whilst also providing information on the financial contribution of our audit business).

Separation of economic interests of the audit and non-audit businesses

18.10 We disagree with the CMA that a separation of economic interests including a separation of profit pools would be effective or proportionate in achieving the CMA's aims. As we told the CMA[67], such a measure would not in our view lead to an improvement in audit quality, given the strong incentives of audit partners

[64] CMA Final Report, paragraph 8.4(a).
[65] See response to CMA Update Paper paragraph 2.43.
[66] CMA Final Report, paragraph 8.17(b).
[67] KPMG Response to CMA Update Paper paragraphs 21.2-21.7 and 21.10-21.11.

to focus on audit quality at present (see also paragraphs 18.6-18.8 above). However, it would be likely to lead to a range of significant costs and unintended consequences.

18.11 At the outset, it is worth noting that the "true" profitability of our audit and non-audit businesses may be difficult to calculate given that our firm's most significant assets are intangible (such as our brand), not quantified and currently excluded from the charges between the audit and non-audit businesses. The establishment of intangible assets created by the audit and non-audit businesses, and therefore the related charges that should apply, would be extremely complicated - but any consideration of profitability without taking such assets into account would be likely to lead to an erroneous view of the "true" profitability of the two businesses. In addition, the impact on profitability of taking into account such charges could differ between different audit firms.

18.12 However, even were it practicable to determine the relative profitability of businesses sharing a common brand, we consider that a number of adverse consequences would flow from separating the economic interests of the audit and non-audit businesses, in particular:

- *Increased costs for audited entities* - As we set out in our response to the CMA Update Paper[68], operational separation carries significant incremental costs which would need to be borne by audited entities and this would be exacerbated if full arms-length (rather than a cost based) pricing is introduced for specialist staff of the non-audit business used on audit work.
- *Significant challenges to audit partner recruitment and retention, putting audit quality at risk* - Increased volatility in audit partner remuneration and uncertainty in relation to the ability of an economically separated audit business to be able to offer competitive partner remuneration risks making the audit profession much less attractive to audit partners who typically will have alternatives in the form of moving to advisory work or seeking roles outside the audit firm which would be considerably less risky.
- *Reduced audit quality-enhancing investment, for example in technology* - With lower (or negative) and more volatile profitability, it may not be possible for our audit business to maintain its current levels of investment.
- *Risks to resilience* - An audit business that could not pool profits in any instance by the international network or the non-audit business would be subject to greater volatility and risk, both because revenues (and costs) would be spread over a smaller base of engagements, and because our audit business, unlike most of our non-audit business – in effect operates on an unlimited liability basis. It would therefore be more at risk of failure, for example in the context of an economic downturn or a large claim.

[68] See KPMG Response to CMA Update Paper, paragraph 21.11.

- *Skewed incentives* - The reliance on a smaller number of large engagements may pose greater risks for independence and objectivity, as the CMA acknowledges elsewhere in its analysis[69].

18.13 As a result of these impacts, in order for an economically separate audit firm to be sustainably profitable, audit prices would have to increase. The CMA has explicitly recognised this prospect[70].

Restriction of operational separation to the Big Four

18.14 Finally we disagree that any operational split should be restricted only to the Big Four in the first instance. We consider that this would be inconsistent with the concerns raised by the CMA (which are not specific to the Big Four but rather to all multi-disciplinary audit firms). We also believe that the CMA's justification for this proposed restriction – that if subject to operational separation, smaller audit firms would be unable to secure the investment required to meet the CMA's joint audit recommendation[71] – is inconsistent with the CMA's position that the Big Four would not face challenges in delivering the required investment[72].

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

19.1 In addition to the steps we have already taken and which are currently underway as set out above in response to Q18, we believe that the CMA's concerns around the incentives of multi-disciplinary firms can be addressed through the cessation of the provision of non-audit services (other than those closely associated with the audit) to FTSE 350 companies which are audited by the same firm. The CMA acknowledged that this would address some of the issues that it identified, and we believe that this could be more effective and less onerous in increasing trust in audit and reducing perceptions of conflicts of interest than economic separation. As noted in our response to Q17 above, a prohibition of virtually all non-audit services to PIEs and "other entities of public interest" is currently being proposed by the FRC, in a move which goes beyond any of the CMA's own recommendations.

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

20.1 In the CMA Final Report, the CMA recommends that if an operational split were not effective, "*a re-examination of the merits of a full structural split in the UK would be necessary*"[73]. Whilst we do not agree that a full structural split is either

[69] For example when concluding that there may be "*incentives for auditors not to challenge company management for fear of losing [future] non-audit work*" (CMA Final Report paragraph 3.221).
[70] As the CMA recognises: see, for example, CMA Final Report paragraph 6.74.
[71] CMA Final Report paragraph 8.27.
[72] CMA Final Report paragraph 8.55(e).
[73] CMA Final Report, Section 8 Summary.

necessary or desirable, such a measure would always remain a theoretical option open in future. As such, we do not believe it is appropriate for a full structural separation to be considered as "in reserve".

20.2 We believe however that any measures (including a full structural separation) that the CMA does not conclude to be effective or proportionate at the current time should be considered in future only in the context of a comprehensive review based on the state of the market at the time, and we believe the only suitable way to do so would be in the context of a formal CMA market investigation (or equivalent).

20.3 It is important to note that the analysis in the CMA Final Report does not, by the CMA's own admission, conclude or demonstrate that a full structural separation would be effective, reasonable or proportionate[74] in addressing any competition concerns. The CMA postulates that a full structural separation "*could*"[75] be an effective remedy, but that it would "*have to be carried out internationally to be effective … [h]owever, the majority of conflict rules apply to the international network, so a unilateral separation in the UK would not improve choice*"[76]. The CMA also notes that it has not undertaken a proportionality assessment[77].

20.4 In any case, we believe that a full structural separation is highly unlikely to be proportionate. Setting aside our concerns about the CMA's analysis of the incentives of multi-disciplinary audit firms and the effectiveness of any separation remedy (operational or structural), we have provided substantial evidence to the CMA demonstrating that the challenges of full structural separation would likely be insurmountable[78]. For example, we noted that structural separation would be associated with:

- significant detriment associated with accessing specialists required to undertake high-quality audits, and the ability to invest given the smaller scale of audit-only firms;
- a range of substantial costs associated with tax increases, pensions, splitting and maintaining separate operational systems, the transfer of staff and various other factors;
- significant challenges to the recruitment and retention of staff; innovation, auditor independence; and the ability to ensure third-party firms supply high quality and independent non-audit services; and
- challenges in implementing full separation in an effective manner only in the UK given that this may result in only one of those businesses remaining within the KPMG network.

[74] CC3, Competition Commission, Guidelines for market investigation, p.71-73.
[75] CMA Final Report, paragraph 8.51.
[76] CMA Final Report, paragraph 8.7.
[77] "We would also need to consider one-off costs associated with a structural split", CMA Final Report, paragraph 8.7.
[78] See KPMG Response to CMA Update Paper, Q19.

20.5 These and other possible costs and implementation challenges would have to be reflected in any future assessment of the proportionality and effectiveness of a full structural split.

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

21.1 We believe that if BEIS were to pursue the CMA's operational split recommendations, it will need to be mindful of the associated significant implementation challenges and cost implications. We highlighted many of these in our responses to the CMA[79].

21.2 In respect of timescales, as we noted to the CMA[80], we believe that arrangements to enhance the governance and performance management of audit businesses within firms, as well as move to a basis where the financial management of the audit business is managed and reported on an arms-length basis, could be implemented in a relatively short timeframe. However if economic separation were mandated, we believe that it would take considerably longer for the market to adjust in order to address the consequences set out in our response to Q18 above. Legal separation (whilst not recommended by the CMA) of the audit and non-audit businesses (whilst remaining within the same network) would in our estimation take at least five years.

[79] See for example KPMG Response to CMA Update Paper, paragraph 21.11.
[80] See KPMG Response to CMA Update Paper, paragraphs 21.14-21.16.

CHAPTER 5 - OTHER POSSIBLE MEASURES

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?

22.1 This question relates to two groups of additional measures: first, a five-year review of progress by the regulator; and second, a series of "other measures" which do not form part of the CMA's central recommendations.

Five year review

22.2 With regards to a five year review of progress, we agree with the CMA that the ARGA should continually review the progress of any measures that it implements, and such a formal review might reasonably be scheduled for five years after the date of full implementation. However it would be important for any such review to be carefully scheduled and scoped.

22.3 In relation to timing, this should be considered in the context of specific measures ultimately proposed by BEIS. As we explain above, we consider that if joint audits are mandated it is likely to take considerably longer than envisaged by the CMA for smaller audit firms to enhance capability and capacity to take on large numbers of new audit mandates of FTSE 350 companies. A five year review would be likely to involve reviewing progress before these firms have had the opportunity to develop their business and before the market has had the opportunity to adopt a measure such as joint audit. The date of "full implementation" and defining the subsequent time period to be allowed for the measures to take effect will therefore be critical.

22.4 We believe several key points should be considered in determining the scope of any such review:

- *Limited weight should be placed on the CMA's current evidence base and analysis* - As we noted during the Market Study, whilst we agreed with the broad direction of the CMA's study, we considered that it lacked the analysis and evidence that is typical of such reviews.[81] This concern remains following the publication of the CMA Final Report and is particularly relevant to the possible interventions such as a full structural separation and independent appointment of auditors, for which the CMA has not conducted a full proportionality assessment that would be required in a full market investigation[82].

[81] See KPMG Response to CMA Update Paper, p.2.
[82] See for example CMA Final Report paragraph 8.7, which notes that the CMA "*would …need to consider one-off costs associated with a structural split* [but has not done so]". The CMA Final Report also contains no proportionality assessment of independent appointment of auditors, which is surprising given its potential inconsistency with current EU legislation and the strong opposition of shareholder groups.

- *Any future remedies should be supported by the appropriate evidence base at that time* - Measures such as a full structural separation and independent appointment of auditors should be considered only if there is compelling evidence that they would be effective and proportionate in addressing competition concerns at the appropriate point in time. We believe the appropriate forum to conduct such an assessment is a full market investigation of the kind ordinarily contemplated under UK competition law where the CMA considers, following a market study, that a market may have features that are likely to have an adverse effect on competition.[83] . It is not clear that the ARGA would have the statutory powers or competence to carry out such a review[84], and no other sectoral regulator currently has this power. In any case any such a review would need to consider the market facts and state of competition at the time, and we note in this respect that the statutory audit market may change significantly in the next five years as a result of a combination of the introduction of the new regulator, the CMA's proposed remedies, the conclusions of BEIS' FRC Review Consultation and the outcome of the Brydon review, and measures we are taking voluntarily as noted in our response to Q18.

22.5 In any case we believe both a full structural separation and independent selection of auditors could lead to significant detriment to competition and audit quality. We comment on the former in response to Q20.

Other measures

22.6 One measure referred to in the CMA Final Report is the introduction of 'cooling-off' periods, during which non-audit services would continue to be prohibited once an audit engagement has ended[85]. We comment on potential risks to choice and to competition in response to Q14 above. However, more importantly we do not consider such a measure to be necessary in the context of other measures such as those relating to operational separation (and in particular the basis on which audit partners are assessed and incentivised, discussed in response to Q18) and the prohibition on the provision of non-audit services to PIEs and "other entities of public interest" proposed by the FRC. We can, however, see merit in a prohibition on an individual audit partner being performance managed or incentivised for the sale of non-audit services to a former audited entity in the immediate period following the audit firm being auditor of the specific entity. In this context, it is important to note that (a) in any case auditors cannot be remunerated for the sale of non-audit services to an entity which is an entity audited by the firm, and (b) within KPMG, audit partners for PIEs are not involved in either the selling or provision of non-audit services to non-audited entities. A measure such as the one we refer to above would therefore simply address the situation where an audit partner transferred to the non-audit business following

[83] Section 131, Enterprise Act 2002.
[84] KPMG's response to the BEIS FRC Review Consultation dated 11 June 2019 noted that ARGA is unlikely to have expertise in competition policy and therefore that formal reviews should be left to the CMA itself (paragraph 11.4).
[85] CMA Final Report, paragraph 8.58.

completion of his / her own, and the audit firm's, tenure as auditor of the relevant entity.

22.7 With regards to the "Other measures", we comment on each possible measure in our responses to Qs 23 to 29 below. We note as an overarching point that whilst the CMA suggests that the ARGA or the government may want to consider these options, it does not recommend that they are pursued, nor in most cases does it present any assessment of the effectiveness or proportionality of these options. In this context it is not therefore straightforward to answer whether we "agree with the CMA's suggestions", as is asked in several of the consultation questions.

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

23.1 We do not believe that the introduction of any remuneration deferral and clawback arrangement would significantly enhance the already strong incentives for partners and senior audit staff to deliver high quality audits.

23.2 Whilst we have not undertaken any substantive work to compare the specifics of the arrangements in the banking sector referred to by the CMA, we consider it likely that there are significant differences between the banking and audit sectors, including:

- firstly, the nature of existing incentives where, in the audit sector, the primary objective for audit partners is (at least for KPMG) audit quality; and
- secondly, a higher variable proportion of remuneration in the banking sector than in the audit sector.

23.3 We acknowledge, however, that the fact that there may be differences between sectors does not of itself mean that the application of a similar scheme is without merit. However, in this instance we are not convinced that the introduction of a scheme whereby remuneration of senior staff is subject to deferral or clawback would have significant benefit for the reasons set out below.

Incentives

23.4 In banking, deferral and clawback applies to "Material Risk Takers" who, by definition, are incentivised to take risk and are rewarded accordingly.

23.5 Conversely, audit partners and senior audit staff already have strong incentives to deliver high quality audits, including strong disincentives to deliver poor quality audits. As we explain in paragraphs 18.6-18.8 above, audit quality is the primary determinant of our audit partners' discretionary remuneration, and actions taken by an audit partner that result in poor audit quality would have a direct and substantial impact on their remuneration. In addition, audit partners are increasingly subject to financial (and other) sanctions imposed by regulators for

poor quality work[86], and risk significant personal reputational damage as a consequence of association with poor quality audits. Moreover, auditors are instilled with a sense of personal pride and professionalism, from the commencement of their professional training and continued through commitment to compliance with the ICAEW's Code of Ethics.

Relative significance of variable reward

23.6 On the question of the element of audit partner remuneration which is variable, ultimately *all* payments to partners are variable in that they depend on the level of pre-partner distribution profits. This could mean that even those elements of reward which are "fixed" may be reduced if pre-partner distribution profits are insufficient to cover the "fixed" element in any particular year. This differs to a bank where payments to staff could be made even if that resulted in a loss for the business.

23.7 Notwithstanding the above, the element of audit partner remuneration that is variable according to individual performance will be significantly lower, as a proportion of the other, non-variable element of their remuneration, than for material risk takers (MRTs) in the banking sector. Although we have not systematically analysed data in relation to banks, we note as an illustration that in 2017 and 2018 on average the element of our audit partners' remuneration that varied with individual performance was around 25% of non-variable reward; the equivalent figures for MRTs at HSBC Holdings PLC and Lloyds Banking Group[87] appear to have been around 100%[88] and 90%[89] respectively.

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

24.1 Notwithstanding our views above, we have included below some comments on the practical application of any deferral and clawback mechanism under a Limited Liability Partnership (LLP) structure.

24.2 The implementation of any deferral and clawback mechanism under an LLP structure is likely to have challenges which are incremental to those that would apply to an equivalent arrangement by a corporate entity on the basis of taxation of LLPs.

24.3 LLP members are taxed on profits as they arise, regardless of whether or not they are distributed. Therefore, under current tax rules, any deferral of profit share would be ignored for tax purposes. This is in contrast to the tax treatment of the

[86] See table of *Financial Sanctions - Audit Partners* on page 37 of the FRC's *Annual Enforcement Review 2019*.
[87] For MRTs in senior management positions and below. This comparison assumes that the large majority of variable reward to MRTs in banks varies with individual performance, which we understand to be the case.
[88] 97% in 2018 and 100% in 2017; see HSBC Holdings plc Annual Report and Accounts 2018, pp203-204 and HSBC Holdings plc Annual Report and Accounts 2017, pp162-163.
[89] 84% in 2018 and 97% in 2017, see Lloyds Banking Group Annual Report and Accounts 2018, p103 and Lloyds Banking Group Annual Report and Accounts 2017, p106.

largely equity-based, long term rewards that are paid to executives in the corporate sector. Individual partners would therefore be liable for tax on profits which they had not received in cash.

24.4 Moreover, the tax treatment of clawbacks is problematic for LLP members since in general tax legislation does not equitably deal with future reductions in reward once they have been earned and taxed. Whilst in a corporate structure, clawback of employees' remuneration is generally dealt with via deferral and conditional vesting mechanisms such as negative ratchets, these structures do not exist for LLP members profit shares.

24.5 As a secondary issue, there would be some practical difficulties as to what would happen to any profit allocation subsequently clawed back, in terms of to whom it would belong.

25 Do you agree that liberalising the ownership rules for audit firms would reduce barriers for challengers and entrants to the market? What positive and negative impacts would this have? Do you have any specific proposals for a reformed ownership regime?

25.1 The case for liberalising ownership has been made comprehensively by Paul Boyle, former CEO of the FRC, in his report on behalf of the Centre for Financial Information (the Boyle Report)[90]. We note that in reaching his conclusions in favour of liberalisation, Mr Boyle also considered the remedies put forward by the CMA in the CMA Update Paper and concluded that "*There is a real danger that the package of remedies proposed by the CMA will cause more harm than good. It should therefore reconsider its proposals*".

25.2 We are not convinced that the current rules are creating barriers in practice, but nevertheless we are not opposed to liberalisation of the relevant rules in principle, providing that changes do not inadvertently create market conditions which might undermine the achievement of audit quality as the overriding objective of audit firms. However, ensuring this would not be without challenge, and we agree with the CMA's view that the costs would exceed any benefits that might arise.

25.3 At the outset, it is important to understand that the restriction in relation to the ownership of audit firms is via a restriction on the voting rights in audit firms, a majority of which must be held either by audit firms approved in any EU Member State or by natural persons satisfying certain conditions (in relation to being fit and proper persons, education, training and experience which must be met by qualified auditors)[91]. External equity is therefore limited by reference to voting rights, although this depends on the extent to which the proportion of external voting rights is aligned with the proportion of equity. For the remainder of our

[90] *Making the Audit Market Work: the case for liberalising ownership.*
[91] *Article 3(4)(b) of EU Audit Directive 2006*, as amended by other audit directives in 2008, 2013 and 2014.

response to this question, we assume that the proportions of equity and voting rights between partners in the firm and external capital providers are equal.

25.4 At present we understand that most audit firms have not sought to introduce external equity, instead relying on working capital, contributions from partners and from debt.

25.5 Our position on liberalising audit firm ownership is based on a number of factors set out in the following paragraphs.

25.6 Firstly, we are not aware of any evidence of either the smaller audit firms or potential new entrants asserting that access to capital is a barrier to entry. There is therefore a risk of a solution being designed which not only is not used, but also diverges the UK from European law (albeit that the UK may, in a post Brexit environment, not be obligated to follow such law).

25.7 Secondly, to the extent that external capital is intended to provide a more resilient capital base for an audit firm, an inference might be that this is to support or even invite larger civil claims against audit firms in an environment where liability is unlimited - which would appear unlikely to represent a compelling risk-reward vision for potential external investors.

25.8 Most importantly, such a remedy would appear to be at odds with criticism underlying the current audit firm (multi-disciplinary) structures. One of these criticisms is that the incentives an audit business and its audit partners have to deliver quality audits may be undermined as a consequence of both the influence and undue focus on the success of the larger non-audit businesses within an individual firm. Whilst we do not agree with this assertion, were it to be the case it is not clear why external investors would be any less inclined to exercise an influence which would be subject to lesser potential conflicts. Potentially the conflicts would be greater, depending on the other interests of the providers of external capital (and may often preclude ownership of an audit firm under international and UK ethical standards). At the same time, the external investors may not be subject to the professional requirements of the ICAEW's Code of Ethics which apply to all partners in an audit firm, regardless of whether or not they are current or former auditors.

25.9 We do, however, accept that there may be some circumstances where the latter scenario could be avoided - for example where external capital was provided by one or more institutional investors whose objectives either would, or at least, should be aligned with ensuring high quality audits. Nevertheless, such a situation might create other conflicts, for example in seeking to have "their own" auditor

appointed in companies in which they had a significant investment and therefore potential implications for market concentration.

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?

26.1 As noted in our response to the CMA Update Paper, we support measures that address issues relating to skills and resources of smaller audit firms. However, in relation to technology licensing, we note the CMA's finding that "*…some Challenger firms have indicated that they did not have an interest in these [technology sharing] measures and that their technology was state of the art*"[92]. In our response, we noted that we are not in a position to agree or disagree with this view but that it would not be efficient to create a solution for which there is no demand. We concluded that a critical first step would therefore be to establish the precise nature of any needs of smaller audit firms in relation to technology[93]. We remain of this view.

26.2 Our support for such measures would include making technology available on a reasonable commercial and practicable basis, provided that this could be achieved in a way that preserves the incentives on all audit firms to invest and compete on audit quality and innovation. Pricing would need to be at reasonable cost – and therefore not impact either buyers' or sellers' incentives to invest in innovation. It is likely that setting out appropriate contractual provisions and prices will take time and incur additional costs (for example, when the ownership of technology is held by an associated international entity and not by the UK firm).

26.3 Further, sharing of technology is not without its own challenges - for example in relation to the ongoing training which might be required. In addition, our technology is often linked to our audit methodology. In one sense it might therefore be beneficial if, for example, a smaller firm involved in an audit with a Big Four firm on a joint or shared basis used the same technology, but on the other hand this would only be relevant in a proportion of such joint / shared audits or else the smaller audit firm would need to work with the technologies of each of the Big Four firms which would likely be impractical and almost certainly inefficient.

26.4 Furthermore, in a process led by the ICAEW, KPMG, other audit firms and other companies and stakeholders are in discussions relating to a potential alliance aspiring to deliver more efficient and effective access to much of the data required to deliver audits ("Engine B"[94]). A primary objective of this potential alliance would be to facilitate the introduction of common data models and standards for companies, while at the same time giving those companies the ability to retain their data and better control access to it. It is expected that the technology and

[92] CMA Update Paper, paragraph 4.100.
[93] KPMG response to CMA Update Paper, paragraph 14.2.
[94] www.engineb.com.

operational model developed through Engine B would allow for more efficient access to companies' data for a wider range of audit providers, and potentially allow for new models of audit delivery in relation to data processing elements. It is in the interest of the audit market and corporate Britain more generally that this type of initiative is incentivised, and that incentives are not diluted by having to provide the resulting innovative solutions to competitors at prices that do not guarantee a sufficient return.

26.5 KPMG agrees in principle with the CMA's suggestions regarding technology licensing, provided the conditions outlined above are satisfied, and would be happy to explore a more detailed proposal on such a measure. However, it is difficult for KPMG to comment on the extent to which a technology licensing framework would be required by smaller audit firms in order to reach sufficient scale or capability, nor how much they would benefit from such a regime.

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?

27.1 A key question is the usefulness of such information. In our view, the starting point should be to identify information which may be of use to shareholders (and, potentially, other stakeholders) recognising that the ARGA will already have unfettered access to such information. If there is a valid need, then consideration can be given to how that need could best be met. On the other hand, simply providing information for information's sake would not appear to have much value.

27.2 There were two specific elements to the CMA's suggestion, namely additional information in relation to (a) audit fees, costs and hours and (b) the identification of audit partners and audit firm information. We comment on these separately below.

Audit fees, costs and hours

27.3 The CMA references a recommendation by the BEIS Committee that the regulator "*….require[s] greater reporting on audit fees, potentially including the disclosure of audit hours, staff mix, and rate per hour. Auditors should also report instances where they have performed additional procedures but have been unsuccessful at increasing their fee*"[95].

27.4 The recommendation appears to be in response to concerns that audits are either consciously under-priced and / or that auditors seek to limit additional audit work

[95] BEIS Committee report on *The Future of Audit*, paragraph 150.

out of concern that they may not be able to agree additional fees with the company.

27.5 We do not agree that either concern is borne out in practice in any systemic form, but equally would not be averse to disclosure of such information providing that disclosure is valuable to shareholders rather than simply of passing interest to that group or others. However, we are not convinced that this would be the case.

27.6 The usefulness of such detailed information may be undermined without an equally in-depth understanding of the specifics of a company's business which would not necessarily be apparent from public information. Audits are complex and the amount of work depends on a variety of factors including, *inter alia*, the industry, the scale and geographic diversity of operations, the structure and business model of the entity and the capabilities of the company and its staff in accounting and reporting. These factors can be difficult to understand and whilst transparency of fee, cost and hours information may provide some insight in relation to an individual company over time, comparison of such information between companies is likely to be of limited value without a full understanding these factors.

27.7 There is also some danger that transparency of such data undermines competition in any tender process. Market transparency is highlighted in the CMA's market investigation guidelines as a feature that can heighten the risk of coordinated conduct between competitors, at the expense of effective competition[96]. Because of such risks, exchange of commercially sensitive information between competitors can in some circumstances be in breach of UK and EU competition law[97]. Whilst we believe that audit firms would not seek to co-ordinate their conduct, the fact that the CMA and the law recognises this as a danger could inevitably result in a perception that this could be the case, and therefore this risk should be considered when determining whether the disclosure of this information should be mandated.

Audit partner and audit firm information

27.8 The CMA also suggested that consideration be given to providing a public database of audit partners and firms, similar to that maintained by the US' PCAOB, to make it easier to identify where a partner was responsible for another audit where there were concerns.

27.9 In the US, the PCAOB established such a database "*…to improve transparency regarding the engagement partner and other accounting firms that took part in the audit*"[98]. This database contains details of (a) engagement partner signing the

[96] CMA *Market Investigation Guidelines*, paragraph 254.
[97] See, for example, *Guidelines on the applicability of Article 101 of the Treaty on the Functioning of the European Union to horizontal co-operation agreements*, European Commission, 2011, Section 2.
[98] See https://pcaobus.org/Standards/Implementation-PCAOB-Standards-rules/Pages/form-AP-auditor-reporting-audit-participants.aspx.

audit opinion and (b) other accounting firms that participated in the audit of public companies.

27.10 For UK companies, the audit opinion already provides the name of the Senior Statutory Auditor (SSA), the individual signing the audit opinion, and details of all Statutory Auditors are available on a register of statutory auditors[99]. However, unlike the US' database, the identity of entities for which audit opinions have been signed by a specific SSA are not available through searching the register. We have some concerns that this information may simply be used to identify other engagements for which a SSA who has responsibility for a specific audit engagement with reported quality issues and taking action on that single piece of information. The existence of quality issues on other engagements is undoubtedly a consideration for an audit firm and a regulator (as to whether that individual should continue to be licensed / allowed to sign audit opinions) and for an AC (to make an assessment that the relevant SSA is still an appropriate individual to continue to act as an SSA on their own audit) but in both cases this should be based on a wide range of facts rather than the single piece of information available through such a database.

Other information

27.11 We note the recommendations of the FRC Review in relation to transparency of the results of AQR inspections (Recommendation 20). In our response to BEIS' FRC Review Consultation, we expressed support for the immediate step of providing anonymised (and probably summarised) reports (subject to the ARGA giving very careful consideration to the form of these reports and the language used to prevent unintended reactions) and in the ARGA being explicit about whether any deficiencies identified in the audit call into question either the audit opinion or the accuracy of the financial statements and being explicit where this is not the case. However, we are more cautious about the publication of un-anonymised reports which, as far as we are aware, is a practice not adopted by other audit regulators around the world. Whilst this might increase transparency, before implementing such a regime careful consideration should be given to the form of reporting which would need to take into account (i) the need for ACs of audited entities to be fully aware of the details of the inspections' findings; (ii) genuine concerns in relation to the price sensitivity of confidential information; and (iii) the needs of a wide range of potential readers and commentators. Developing a summary suitable for public consumption and a fuller version for ACs might be a workable solution[100].

28 Do you agree with the CMA's suggestions regarding notice periods and non-compete clauses? Do you agree that the regulator should consider

[99] See http://www.auditregister.org.uk/Forms/Default.aspx.
[100] KPMG response to BEIS FRC Review Consultation, paragraph 7.10 of Appendix.

whether Big Four firms should be required to limit notice periods to 6 months?

28.1 As stated in our response to the CMA Invitation to Comment[101], it is not clear to us that the current situation regarding barriers to senior staff switching between audit firms requires any intervention. Other than existing notice periods, it is not apparent what barriers to switching exist in practice, or indeed, whether notice periods even present a barrier to switching.

28.2 Whilst we agree with the CMA that the introduction of measures to reduce notice periods or the use of non-compete clauses would not be the most effective or proportionate remedy, in order to address any perceived concern in this regard, we would be prepared to waive the restrictions which we have in place in relation to moving to non-Big Four audit firms for audit partners.

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

29.1 As we have discussed in response to the CMA Invitation to Comment[102], KPMG has observed significantly increased tendering, churn and switching, particularly amongst listed companies, as a result of mandatory tendering / rotation requirements introduced by the Competition Commission and the EU Audit Regulation. We consider that the current rules on audit tendering and rotation are working effectively and strike an appropriate balance between the benefits to audit quality of a deep understanding of an entity / its business model and a fresh pair of eyes.

29.2 In addition, the introduction of tendering and rotation requirements was aimed at reducing audit partner and audit firm familiarity with a particular entity which undermined an auditor's objectivity and independence. It is worth noting that other initiatives with similar aims (and reflected in the FRC's Ethical Standard) have also been brought in over a similar period.

29.3 In our view, the more frequent tender and rotation requirement of seven years, as proposed by the BEIS Committee and noted by the CMA[103], poses the following substantial risks:

- For those companies where the current auditor is best-placed to perform the audit, mandatory rotation requirements prevent the current auditor's reappointment, directly reducing audit quality. This risk increases with the frequency of the rotation requirement. Moreover, given that audit risk is purported to be the highest during the first years of an engagement, requiring more frequent rotation increases the risk that recently appointed audit firms do not understand the audited entity in enough detail as they do not have

[101] KPMG response to CMA Invitation to Comment, section 2.5.
[102] KPMG response to CMA Invitation to Comment, section 2.9.
[103] See CMA Final Report, paragraph 6.93.

sufficient time to build up the necessary in-depth knowledge of the business and cannot benefit from the knowhow that comes with continuity. Ultimately, this would drive a deterioration in audit quality.

- More frequent tendering would increase the amount of time and attention from senior professionals in responding to those tenders which would therefore be diverted from carrying out and overseeing audits.
- A lessening of AC flexibility, including the scope to manage conflicts (as more frequent rotation would mean more providers would not be "clean").
- An increase in tender costs for audit firms, which would either need to be passed on to the companies being audited or would result in lower investment.

29.4 In addition, as we stated in our response to the Competition Commission's market investigation on statutory audit services Provisional Findings, there is no evidence linking outcomes to the longevity of tenure[104]. Similarly the CMA provides no evidence to suggest improved outcomes. This is confirmed by the recent paper by Willekens et al which notes that *"[m]ost research studies do not find support for the argument that longer tenure periods are associated with impaired audit quality"* [105].

29.5 Given the above risks, with the lack of evidence of any need for the measure or benefits which might be derived from it, we are opposed to shortening the period between mandatory tenders and rotations.

29.6 If the CMA's other recommendations are pursued, these risks would occur at the same time that other significant changes – in particular a joint audit regime – are also being implemented, further increasing the risks to audit quality from the set of proposals. Given the above, we agree with the CMA's decision not to recommend this at this time and strongly believe that BEIS should not pursue this further.

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.

30.1 As noted in response to Q12 above, we explained to the CMA that in our view, competition in the audit market is generally strong. We have commented on

[104] KPMG response to the Competition Commission Provisional Findings, paragraph 74.

[105] See Willekens et al, "*EU. Statutory Audit Reform: Impact on costs , concentration and competition"*, Study for the Committee on Economics and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament, Luxembourg (2019), p28.

measures to enhance choice in our responses to Qs 5-14. We have no further comments to make.

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

31.1 KPMG has already taken a number of initiatives to which seek to help address the concerns of the CMA and other commentators. We discuss the range of enhancements we have made and are making to the governance and performance management (and transparency thereof) of our audit business in response to Q18 above. We also discuss in response to Q19 that we believe all multi-disciplinary audit firms could commit to discontinuing the provision of non-audit services (other than those closely related to the audit) to companies within the FTSE 350 which they audit.

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

32.1 We summarise key considerations in our covering letter. We have nothing further to add.