



Chartered Institute of Management Accountants
Response to the
Competition and Markets Authority
statutory audit market study
invitation to comment
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1 Introduction

The Chartered Institute of Management Accountants (CIMA) thank the CMA for the opportunity to offer a response to its invitation to comment (ITC) on its review of the statutory audit market.

1.1 About the Chartered Institute of Management Accountants

CIMA, founded in 1919, is the world's leading and largest professional body of management accountants, with members and students operating in 184 countries, working at the heart of business. CIMA members and students work in industry, commerce, the public sector and not-for-profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially-trained business leaders.

Chartered Global Management Accountant (CGMA), awarded to members of CIMA, is the most widely held management accounting designation in the world. It distinguishes more than 150,000 accounting and finance professionals who have advanced proficiency in finance, operations, strategy and management. The CGMA designation is underpinned by extensive global research to maintain the highest relevance with employers and develop competencies most in demand. CGMAs qualify through rigorous education, exam and experience requirements. They must commit to lifelong education and adhere to a stringent code of ethical conduct. Businesses, governments and nonprofits around the world trust CGMAs to guide critical decisions that drive strong performance

CIMA is a founder member of The Association of International Certified Professional Accountants (the Association) is the most influential body of professional accountants, combining the strengths of the American Institute of CPAs (AICPA) and CIMA to power opportunity, trust and prosperity for people, businesses and economies worldwide. It represents 667,000 members and students in public and management accounting and advocates for the public interest and business sustainability on current and emerging issues. With broad reach, rigor and resources, the Association advances the reputation, employability and quality of CPAs, CIMA and CGMA designation holders and accounting and finance professionals globally.

1.2 Perspective of this response

Our response is in the context of these comments, and from the perspective of the Professional Accountants working in business both as members of corporate boards and audit committees, and as CFOs and those working in the finance functions.

To enable a proper functioning market economy requires effective governance, including effective finance functions, and quality audits. Our response focuses on improving the effectiveness of these activities.

2 General Comments

We agree with the comments made in 1.1 of the summary of the ITC, specifically:

- Tens of millions of ordinary people depend in some way on independent audits
- The availability of trustworthy financial information on the performance of companies is important to providing the confidence that is necessary for the proper functioning of a market economy

We believe it is important to avoid unintended consequences, for example:

- Changes to the audit market should not negatively impact the reputation of the UK public markets and the underlying quality of the audits of complex companies. The extent of the globalisation of public markets and the complexity of business over the past forty years has been significant. The international networks of the large accounting firms and their investment to audit complex companies has also been significant and needs to be maintained and developed further.
- Market reform should not reduce the attractiveness of the firms as employers for high quality individuals
- Structural reform should not lead to the withdrawal of a major firm from providing audit services.

2.1 Evolution of the markets

Over the past forty years there has been a massive shift in the constituents of market value of the public markets. In excess of 80% of the market value was historically recorded on the balance sheet. Today that figure is less than 20%, with the balance related to the value of the brand, the workforce, intellectual property and other intangible assets. There is an increasing demand for assurance of these intangible assets.

The Strategic Report, Viability Statement, and Extended Audit Report have all been recently introduced. These are all significant changes and have been introduced to strengthen the quality of reporting in the public markets. They have led to improved corporate reporting and we believe it is important to avoid unnecessary further change allowing companies to continue to develop the quality of these reports.

The opportunity is to develop processes around Strategic and Viability reporting similar to those that have been developed over many decades for financial reporting. Multi-disciplinary firms are important to provide assurance of such reports.

2.2 Increased audit regulation is not a solution to corporate failure

Enterprises fail regularly. Even large enterprises and public companies fail. The danger is when corporate failure is equated to audit failure and the two are not synonymous.

In most corporate failures there are many factors that contribute to the ultimate demise of the enterprise. These relate to external as well as internal pressures on the organisation. There are always lessons to be learned from failure and these disruptions can lead to increased innovation.

The UK public markets and their governance and assurance are highly respected globally. There are failures and those involved in shortcomings in governance and audit need to be held accountable. However, failures also provide an opportunity for innovation.

We **recommend** that the focus be on improving the quality of the audit rather than increasing regulation. There have been no suggestions or evidence to say that the cause of the corporate failures lies in inadequate audit standards.

2.3 Effective finance function

The basis of a successful finance function is one that is both effective and efficient. This is a major contributor to audit efficiency and success.

On October 22, 2018 the FRC sent an open letter to finance directors of public companies warning that it had found an increase in the number of “lower level errors” in company accounts, warning that these can “detract from the integrity of the company’s report and accounts and trust in management”.

The Global Management Accounting Principles, developed by CIMA, define the framework for an effective finance function. The four principles are:

- **Information is relevant:** Management Accounting makes relevant information available to decision-makers when they need it. This information includes financial and non-financial data from internal and external sources.
- **Impact on value is analysed:** Management Accounting connects the organisation’s strategy to its business model. By modelling the impact of opportunities and risks, the effect on strategic outcomes is quantified, and the likelihood of a given outcome to generate, preserve or destroy value is assessed.
- **Stewardship builds trust:** Accountability and scrutiny make the decision-making process more objective. This Principle involves being alert to potential conflicts of interest and not putting personal or short-term commercial considerations before the longer-term interests of the organisation or its stakeholders. It requires accounting professionals to behave with (and to encourage colleagues to behave with) integrity, objectivity and to constructively challenge any decision that does not align to corporate values.
- **Communication provides insight that is influential:** By discussing the needs of decision-makers, the most relevant information can be sourced and analysed. This means recommendations will be useful to the decision-maker and achieve influence. A central role for management accounting is to make relevant information available to decision-makers on a timely basis.

We **recommend** that the Audit Committee should be required to independently assess the effectiveness of the company’s finance functions on a regular basis, just as Boards are required to assess their effectiveness on a regular basis.

2.4 The importance of audit committee independence

Audit committees are comprised of a majority of independent directors as mandated by the governance code. They are by definition independent of both management and shareholders. This independence allows them to take a multi-stakeholder view of the organisation and to consider the interests of shareholders, pension fund trustees, employees and creditors in the performance of its duties

The audit committee already has a clear responsibility over the financial statements and annual report of the company. Investors in the company are required to approve the appointment of the auditors on an annual basis.

We **do not recommend** replacing the audit committee with another type of independent body.

2.5 Definition of audit

There is a clear difference in the view of the public markets and those of the general public of the role of audit. The current definition meets the requirement for the availability of trustworthy financial information on the performance of companies.

The focus should be on meeting the developing demand for the wider assurance of the Strategic Report, addressing unsatisfactory audit performance, and education of some of the media and politicians, together with general public on the role of audit.

2.6 People competency

Good quality audits rely on highly competent people performing the audits. There is a large amount of resource invested in training in the Big 4 – from staff selection through to on-the-job training and continuous professional development.

With the increasing use of integrated reporting and a multi-capital world, along with increasing demand for a strategic report, the skillset of the auditor is changing. In addition to strong technical audit skills, there is a need to have the skills to understand the whole business and not just the financial aspects. These skills are more likely to be developed in a multi-disciplinary firm.

It is equally important that the Financial Reporting Council have staff of a calibre as high, as if not higher, than those of the audit firms it reviews. These staff will also need to be competitively remunerated to ensure retention.

We **recommend** that consideration be given to adequate resourcing and funding of the FRC review team.

2.7 Restructuring suggestions in the ITC

We agree with the concerns set out in the consultation regarding audit-only firms, breaking up the Big 4 firms, breaking the link between company management and the auditor, a national auditor, and insurance-based system for audit. Specifically, we do not agree

- With the introduction of audit-only firms. The multi-disciplinary firms have the skills to support the wider assurance relevant to Strategic Reporting.
- With the concept of joint audits. This reduces the accountability of both the firms involved, is inefficient, and provides the opportunity for management to exploit the division between the areas being audited by each firm.
- With an increase in the frequency of the tendering of audits. Tendering is an expensive and disruptive activity and the current ten years seems reasonable. The requirement to tender is relatively new and it is important to establish what this development has achieved.
- That the audit committee should consult with stakeholders beyond investors. As stated in the introduction to the CMA consultation, the focus is on the availability of trustworthy financial information on the performance of companies.

2.8 Segregation of audit and non-audit services

On a related note, it is important to carefully define what would fall into audit and non-audit services in order to avoid unintended consequences which may weaken financial controls and investor confidence.

For example, many companies have their audit firms review (but not audit) their interim statements prior to public release. This gives Boards, management and the markets a level of confidence in the interim results. It also allows some preparatory work to be done for the year-end audit. It is possible, if the definition of audit services were not carefully delineated, interim audits could be stopped.

Further, it would seem a real challenge to segregate audit and non-audit service given the increasing diversity of audit requirements beyond the financial statements and moving into areas such as environmental and sustainability auditing. The skills to develop this level of audit competence would be difficult outside of a multi-disciplinary firm.

Another possibility is that multi-disciplinary firms could withdraw from their listed company audit practice in favour of providing non-audit services to those companies. This could further concentrate the market for the provision of audit services.

Given the international nature of the large audit firms, it may prove challenging to have firms being restricted in service provision in one jurisdiction but not in another. We would **caution** the CMA as to the risk of firms dropping audit and concentrating the audit market even more.

2.9 Firm governance

There are governance codes for public companies and the Wates Review is developing one for private companies. However, there is no standard code of governance for firms. The code could apply to all firms above a certain size so that unnecessary burdens are not placed on small practices.

We **recommend** that consideration be given to developing a code of governance for large firms.

2.10 Mandatory audit firm rotation

CIMA firmly believes MAFR is not in the public interest, risks harm to audit quality, would impose significant costs on businesses and shareholders without commensurate benefit, would be economically disruptive and create other negative consequences.

It limits the Audit Committee's ability to determine the best audit firm for the company. Along with the rest of the company's board of directors, the audit committee acts as a watchdog of management's actions, protecting investors. The chief function of an audit committee is to oversee the external audit process, including the selection of the appropriate audit firm to conduct the audit. MAFR undermines this key audit committee responsibility and specifically eliminates the one firm that the audit committee previously decided was best able to provide the audit services needed by the company. Constraining audit committees in their selection of audit firms is counter to enabling them to do their most important work – obtain the highest quality audit in the most efficient way.

2.11 Length of consultation period

Changes to improve effectiveness need to be evidence based, and carefully considered to ensure there are no unintended consequences. In that regard, we are concerned that the consultation period is only 21 days compared to the customary 90 days. This short period risks that there will be a lack of proper consideration.

2.12 Perception gap

We would agree and support the view of the CMA that the assurance of the company's accounts is important to the broader public. However, the ITC does not provide any evidence to show that successful audits are not, in fact, being delivered.

There is evidence to suggest that the public at large believes that the purpose of an audit is to detect fraud. But in fact, that is the role of internal audit. The role of the auditor is to comment on whether the financial statements of a company fairly represent the financial position of a company on a given date.

One should not seek to restructure the audit market based on a perception of the role of an audit. The definition of an audit is well outlined by the International Audit Standards produced by the International Audit Setting Board, part of the International Federation of Accountants. It has global applicability.

We would **recommend** that a communication and education campaign is funded to ensure that the role of audit is properly understood by journalists and the public at large.

2.13 Technology and regulatory obsolescence

In addition, new technology and automation will change the nature of the work of an audit. We would caution against regulatory solutions applicable to today's audit environment which could be made irrelevant by technological changes.

3 Conclusion

The more effective the finance function of an organisation is, the better able the audit committee is to carry out its mandate and ultimately the better the audit quality.

Audit quality is what is important to protect the public interest in public companies. There are international audit standards which are fit for purpose. Audit failures have not arisen from problems with shortcomings in the standards but rather from the application of those standards.

This speaks to the need to have highly trained and skilled auditors. These skills are difficult to develop without exposing individuals to multifaceted development opportunities both pre and post qualification. The importance of continuous development cannot be overstated in the complex and rapidly evolving environment within which large firms and their large clients operate.

Ultimately, a high-quality finance function, audited by highly skilled auditors will operate in the public interest and maintain trust in the financial markets.