

Understanding the BEIS consultation

‘Restoring trust in audit and corporate governance’

*Non-Executive Director (NED) focus group:
Managed Shared Audits*

Managed shared audits – NEDs are concerned that the proposed regime would be difficult to implement and would increase costs, without ultimately improving choice and resilience in the audit market

On 18 March 2021, the Government (BEIS) published its long-awaited consultation on reforms aimed at ‘restoring trust in audit and corporate governance’. It is a significant consultation with 98 consultation questions covering almost all 155 recommendations from the Kingman, CMA and Brydon reviews. The deadline for responses to the consultation was 8 July 2021.

PwC focus groups

During the consultation period PwC convened a series of focus groups to serve as an open forum for Non-Executive Directors (NEDs) to discuss the Government’s proposals. On 20 May 2021, two groups met to talk about the proposal for a managed shared audit regime for the UK.

These focus groups were conducted under the Chatham House Rule so quotations in this article are unattributed.

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Some of the key questions around the introduction of a managed shared audit regime discussed were:

Do you believe the proposals will increase choice and resilience in the audit market?

Several participants were sceptical as to whether the proposals would lead to challenger firms gaining the quality and quantity of experience required to significantly improve choice at the larger company end of the audit market. Participants agreed that the lack of industry expertise is currently a significant barrier for smaller firms, and as a result audit committees would be more likely to assign the “least risky areas” to challenger firms in a managed shared audit, limiting their opportunities to develop the necessary experience to compete in the market.

“Audit committee chairs will choose to give the less risky areas to challenger firms, and will take comfort that the main areas are being covered by the lead firm. This won’t really improve [challenger firms’] experience.”

While many participants challenged the assumption that challenger firms are not currently as capable of quality audit work on the largest companies as the larger auditors, most agreed that it remains unclear if challenger firms want to significantly invest in increasing their capacity, and whether the introduction of a managed shared audit regime would sufficiently incentivise them to do so.

“There isn’t universal agreement among the challenger firms that this is a good idea or not, and whether they have the capacity, or money to invest.”

A number of participants drew comparison with the implementation of the joint audit regime in France, highlighting that it created a new market for a single supporting auditor, rather than creating many challengers to the larger firms.

Others felt that given the global nature of the audit market, making changes in the UK alone would not increase choice in a meaningful way. Participants also suggested that if a large audit firm was to fail in an important territory, such as the US, changes to the UK regime are unlikely to make a significant difference to overall audit market resilience.

“This is not an agenda item for UK legislators alone, this is a global issue. If the world decides it needs more than four large audit firms then it should find a way to change the status-quo. Altering the UK market alone is not right.”

Do you envisage any practical challenges for companies adopting the proposed regime for managed shared audit?

A number of participants raised concerns about the practicality of determining a ‘meaningful proportion’ of a company’s audit based on a subsidiary or a collection of subsidiaries, as put forward in the consultation. It was highlighted that many large, integrated companies are not organised by statutory entities, and that their structures are divided more on an operational basis, making the proposed proportioning of a shared audit problematic. The common use of large shared services centres was also believed to make it particularly difficult to define an appropriate scope for each firm involved in a shared audit.

Similarly, participants from international businesses listed in the UK highlighted that to audit a “meaningful proportion” of their group would require the challenger firms to operate in several geographies where they currently may not have a presence.

“My UK subsidiary accounts for less than 20% of turnover, if they wanted to audit 20% of the group they would need to do so outside of the UK.”

What impact do you think a shared audit regime would have on audit costs?

The potential increased costs associated with the shared audit regime was cited by a number of participants as an area of concern. The duplication of audit work that would be required under the proposed regime, where the lead auditor is required to oversee the challenger firm’s audit work, was highlighted by participants as an obvious area where costs would increase. The increased workload for audit committees having to manage two auditor relationships and help to bring the challenger firm “up to speed”, was also identified, as was the increased costs for management teams having to work with two separate audit teams.

Do you think there will be an impact on audit quality?

Participants with experience of joint audits were sceptical about whether a managed shared audit regime would lead to any improvements in audit quality. An emphasis was placed on the challenges faced by audit committee chairs when managing a relationship with two audit partners simultaneously, and the risk that auditors can be played off against one another.

“My experience of joint audits has been that while on the surface they appear to have merit, in practice they are pretty poor. Joint audits are less effective and not cost effective, which makes it hard to be positive about shared audits”.

Some participants questioned whether there was any evidence to suggest shared audits that we have today, have increased audit quality in the jurisdictions that have adopted them. Others felt that attempts to increase choice through shared audits could in fact adversely impact audit quality.

“The regulator's ambition to promote quality and competence is inconsistent with its desire to drive forward a segment of smaller firms.”

Are there any alternative proposals you believe can help grow capacity and choice in the large company audit market?

Several participants voiced support for a more “imaginative” solution to developing the capacity and experience of challenger firms by encouraging the larger audit firms and challenger firms to “buddy up” when bidding for work.

“You can't force a commercial enterprise to do what they don't want to. So we need to be more creative and work out how to get the willing participants to buddy up with the big players.”

There was also support for incentivising challenger firms to develop capabilities in the other forms of assurance covered by the new Audit and Assurance Policy proposed in the consultation, such as ESG metrics. It was agreed that this could be an avenue for growing the profile of smaller audit firms amongst larger businesses.

Conclusion

There was near universal concern about the potential consequences of introducing the proposed regime for managed shared audits. Participants were doubtful it would improve choice in the audit market, were worried about its cost, and dubious as to how widely it could be practically applied. Comparisons drawn with the joint audit regime in France left many concerned that the proposals would be detrimental to audit quality.

Questions as to the willingness of challenger firms to make the investments necessary to drive increased choice, led to calls from participants for a rethink of the proposal.