



**ACCOUNTANCY  
EUROPE.**

# **DYNAMICS INFLUENCING AUDITOR CHOICE IN THE PUBLIC INTEREST ENTITY MARKET**

Briefing paper

**VIEWS.**

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## HIGHLIGHTS

Auditing public interest entities (PIEs), ranging from banks and large international companies to smaller and more locally listed companies, requires significant resources and skills and is highly regulated. Having a diverse and resilient statutory audit (hereafter 'audit') market with enough audit firms active in it is crucial and in the public interest. It ensures that all PIEs' and their stakeholders' needs are served, and PIEs can choose their auditor primarily based on quality.

The limited choice of audit firms and concentration in the PIE audit market are interlinked topics that have been attracting a lot of attention from stakeholders such as academics and policymakers. This publication's aim is to contribute to the debate focusing on the aspect of auditor choice, through looking at all parties that play a role in this market – companies including their audit committees and shareholders, auditors, policymakers and audit supervisors. In particular, our aim is to:

- provide insight to policymakers about the dynamics and challenges in the PIE audit market that have led to its current structure and to the PIEs' limited choice of audit firms. This includes looking at key factors that influence how PIEs choose their audit firm and key factors that audit firms consider when deciding about their involvement in the PIE audit market
- present our ideas on the potential way forward to inform the debate and serve as a basis for further discussion with stakeholders, including policymakers

In the context of the [European Commission's ongoing initiative](#) on enhancing corporate reporting and considering the future of the audit market, we urge policymakers not to underestimate the disincentives and real challenges that audit firms face when attempting to move into or expand in the PIE audit market. We also invite policymakers to consider and explore our ideas to make PIE audits more attractive. Importantly, impact assessment of any measure under consideration will be necessary to inform future policy making.

We stand ready to continue contributing to this important debate and talking with stakeholders, as we have done through outreach when developing this publication.

We will organise an event in 2023 to enable the discussion amongst relevant stakeholders.

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## INTRODUCTION

The limited choice of auditors that the Public Interest Entities (PIEs) have is a generally well recognised market issue. Many stakeholders would welcome this choice to be greater, and there have been discussions and attempts to find solutions to this issue, both at EU level and at a national level in some countries. At EU level, this topic was discussed at the time leading to the 2014 EU audit legislation, but this legislation [did not bring any significant change](#) according to the latest European Commission's report on the audit market. Most recently, the topic was included in i) the European Commission's consultation as part of its ongoing corporate reporting [initiative](#) aiming to improve the quality of corporate reporting and ii) in the [Milieu/CEPS/Europe Economics study](#), commissioned by the European Commission, on the impact of the 2014 EU audit legislation.

This publication advocates for a holistic approach to the complex matter of auditor choice in the PIE market to respond to policymakers' and other stakeholders' concerns. The holistic approach means considering key parties and factors which are interconnected and influence auditor choice. With the term *auditor choice*, we refer to the pool of audit firms that PIEs believe they can choose from.<sup>1</sup> It is influenced by both demand (PIEs) and supply (audit firms) side factors. Main parties that play a role in this equation are companies including their audit committees and shareholders who decide on auditor appointment in case of PIEs, auditors, policymakers and public audit oversight bodies. Being aware of how the main parties and their actions influence auditor choice is crucial to recognising what encourages, and what negatively impacts, auditor choice in the PIE market.

## OBJECTIVE

With this publication, we aim to contribute to the debate on auditor choice in the PIE market. In particular, our aim is to:

- provide insight to policymakers about the dynamics and challenges in the PIE audit market that have led to its current structure, including why there may be limitations in auditor choice
- present our ideas to inform the debate and serve as a basis for further discussion with stakeholders. Afterwards, policymakers could consider and explore these ideas or some of them as potential ways to address the issue of the limited choice

A better understanding of the matter, which we aspire to contribute to, is important in the context of the ongoing [European Commission's corporate reporting initiative](#) and when considering potential legislative proposals at EU level. We continue being supportive of measures that aim to enhance audit quality and ensure auditor independence. However, unintended implications of such measures for auditor choice in the PIE market need to be assessed and considered.

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<sup>1</sup> There are two other matters that this publication does not focus on but clarifying them may be useful for the reader:

- 1) *Market concentration* in the PIE audit market is a matter interlinked with the auditor choice and therefore, this publication briefly touches on it. European PIEs' auditors are predominantly Big 4 audit firms as explained in more detail in the section *Today's audit market and its evolution*
- 2) A separate topic not subject of this publication is *competition*, i.e. the degree of competition amongst audit firms in the (PIE) audit market

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## CONTENT, STAKEHOLDER OUTREACH AND STRUCTURE

The publication is based on:

- discussions with Accountancy Europe's experts, including representatives of companies' audit committees and auditors of both PIEs and non-PIEs
- Accountancy Europe's earlier work on auditor selection and available studies by others as referred to throughout the publication
- outreach with stakeholders including:
  - audit committees' chairs in European PIEs, having a different background and being active in different sectors and sizes of PIEs
  - representatives of companies/PIEs
  - representatives of shareholders

Discussing the matter of auditor choice with stakeholders served as a sounding board for our ideas and perspective and provided us with valuable input from outside of the audit profession. This holistic approach considering other parties' views and experience helped us refine and finalise this publication.

The sections below of the publication present:

- what the PIE audit market looks like today, why there is a limited number of audit firms that PIEs can choose from, and why the matter of auditor choice is important
- key factors that determine auditor choice in the PIE audit market
- our ideas for policymakers' consideration to help promote auditor choice and make PIE audits more attractive

## CONTEXT

### TODAY'S AUDIT MARKET AND ITS EVOLUTION

In the 1980s, the market of the large audit firms began to become more concentrated. Between 1986 and 2002, the number of big audit firms decreased from nine to the current 'Big 4' – Deloitte, EY, KPMG and PwC. This was due to mergers among the largest firms and the collapse of one of them. At the time, the mergers were authorised by the European Commission. They were set to respond to the global market developments and needs – audit firms needed to grow to serve their increasingly international clients. Both audit firms and their clients, namely large companies, were becoming global players. This evolution is presented in more detail in the [article](#) published by Audit Analytics. Large company audits also began to coalesce around the larger audit firms over this period.

Mainly as a result of these events, in today's global market, the vast majority of large company audits is carried out by the Big 4 audit firms. In line with this, European PIEs' auditors are predominantly Big 4 audit firms, as shown in the [European Commission's latest report](#) and the [European Parliament's study](#) on the EU audit market. The Commission's report states that in 2018, the Big 4 held about 66% of all PIE statutory audits and had the market share of over 90% in terms of revenues from statutory audits of PIEs. The report also provides information on individual countries which shows some diversity of situations in a minority of countries, i.e. not all countries have the same level of concentration. The report says that overall, the number of audit firms auditing PIEs has decreased significantly following the 2014 EU audit legislation.

Only a handful of mid-tier audit firms, mainly BDO, Grant Thornton and Mazars<sup>2</sup>, are well established in the PIE audit market and can be a very good fit especially for some mid-sized PIEs. In terms of resources, market

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<sup>2</sup> The European Commission has identified these as the top three mid-tier audit firms having the largest market shares of the number of European PIE statutory audits. See the Commission's latest [report](#) on the audit market

orientation and share of the PIE audits, a considerable gap persists between the Big 4 global audit networks and other audit firms or networks.

## WHAT ARE THE ATTRIBUTES OF A PIE AUDIT FIRM?

The term 'PIE' covers very different types of entities across European countries, see [our publication on the different PIE definitions](#) applied. PIEs are not a homogenous group of companies as they range from the largest multinational companies, with worldwide operations to financial institutions and insurance companies through to smaller, more local, publicly traded entities and small local utility companies.

The attributes an audit firm needs to perform a high quality audit in this sector of the audit market may therefore vary accordingly. In some cases, an audit firm's worldwide presence may be very advantageous, in others, specific know-how and industry expertise may be essential. Smaller PIEs may require very different attributes from their audit firm. Later in this publication, we explore which attributes are generally considered to be key factors in PIEs' selection of the auditor.

## AUDITOR SELECTION PROCESS IN NUMBERS

The results of the 2020 [questionnaire](#), which the Committee of European Auditing Oversight Bodies (CEAOB) sent to selected audit committees from various sectors across Europe, indicated some issues in the auditor selection process. Based on this, the Commission's [report](#) on the audit market noted that the auditor tendering process is a challenge for audit committees and there is a need for more monitoring of how they organise this process. Related results say that in general:

- the majority of the PIEs, 75% of the studied sample, invited two to seven audit firms to tender. However, 16% issued an invitation to tender to just one (while the Audit Regulation requires at least two to be invited)
- about 55% of audit committees reported that two to three audit firms actually submitted an offer. However, 19% of audit committees received only one credible bid

## WHY IS HAVING A CHOICE OF PIE AUDITOR IMPORTANT?

Choice in the PIE audit market is important and in the public interest for a number of reasons:

- it helps ensure that companies', including their shareholders' and stakeholders', needs are served. Choice in the PIE audit market means that companies have more options and are better able to make their selection of auditor primarily based on quality and not just on availability
- with only four firms auditing the vast majority of PIEs, should there be a failure of one of these large firms, there might not be capacity in the remaining firms to take on its PIE clients
- having enough significant players that already audit, or have the required capacity and appetite to audit, a considerable share of PIEs promotes even more auditor competition
- there is more diversity in terms of thought/audit approach/culture that benefits the market as a whole

## BALANCE BETWEEN ENHANCING AUDITOR CHOICE AND AUDIT QUALITY

In the context of ensuring adequate auditor choice for PIEs and considering the European Commission's initiative on corporate reporting, there is a tension between enhancing the area of the auditor choice and enhancing audit quality. This is to the extent that measures which aim to increase audit quality in the short term run the risk of reducing auditor choice even further. As changes in both areas are interconnected, there is a need to strike a delicate balance. Single focus on measures for enhancing audit quality could have negative consequences on the attractiveness of PIE audits and therefore further decrease the number of PIE audit firms. We provide more detail on which key factors determine auditor choice and how in the next section.

## CAPACITY CONSTRAINTS IN THE AUDIT MARKET

There are already capacity constraints in the audit market that may impact PIEs' auditor choice. This results from a shortage in supply of high quality staff in the audit profession as a whole<sup>3</sup>, as is the case for many other professions and industries around the globe.

## KEY FACTORS DETERMINING AUDITOR CHOICE IN THE PIE AUDIT MARKET

This section presents the key factors that influence i) how companies/PIEs choose their auditor and ii) how audit firms decide on their involvement in the PIE audit market.

Points included below seem to be recurring matters in many research studies available on the topic. This shows that the issue of auditor choice, including factors that influence it, is not new and continues attracting attention of both researchers and policymakers.<sup>4</sup>

Besides these more objective factors listed below, the human factor plays an important role in the auditor selection process. This means that both PIEs and audit firms also consider how it would be to work with each other. This is usually based on the experience from the tendering process, especially the part that includes personal interaction between the company's and audit teams.

### KEY DEMAND SIDE FACTORS: HOW DO COMPANIES/PIEs CHOOSE THEIR AUDITOR?

In general, large companies/PIEs not only in Europe but around the globe seem to favour auditors that serve their needs based on the below key factors, whether these reflect facts or are companies' perceptions. These factors are generally considered together but some may play a bigger role than others, depending on an individual company's needs and situation. Our outreach with representatives of audit committees has helped us complete and confirm these key factors.

#### REPUTATION AS PROXY FOR CAPABILITY AND QUALITY

Reputation often serves as a proxy for information on capability and quality. These are both difficult to observe directly and timely, before a company appoints an auditor. Audit supervisors in most European countries are yet to help bridge that information gap. In the majority of European countries, audit oversight bodies publish only aggregated results of their audit quality reviews, with no data available on individual audit firms. The same holds for audit supervisors' reporting on sanctions where the sanctioned auditor remains unidentified in most countries. See our [recent publication](#) for more details on the transparency of audit oversight bodies' work.

Reputation is an important driver of choice, favouring the Big 4, whether this is based on real or perceived differences with other audit firms. As illustrated in the above mentioned Commission's report on the EU audit market, Big 4 firms are generally well established in the PIE audit market. They are also well-known brands. All this reinforces that they are perceived to be of the desired quality and having the desired capacity and capability, including expertise to tackle the complexity of the accounting framework and the increasingly needed technology and sustainability expertise.

#### EXPERIENCE

Experience of the incumbent auditors, being predominantly Big 4 firms, in the PIE audit market further reinforces PIEs' demand for their services. Potential entrants may find it hard to enter the PIE market or be appointed a PIE auditor in a specific industry as the absence of adequate experience may create a vicious circle: the lack of

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<sup>3</sup> See, for example, the following articles [Accountant shortage, resignations fuel financial reporting risks](#), [Decline in applicant numbers raises alarm for recruiters](#) and [Accountants work to shed 'boring' tag amid hiring crisis](#)

<sup>4</sup> For example, the UK government's Competition Commission's study [Barriers to entry: reputation and experience](#), the study [Competition and choice in the UK audit market](#) and [discussions on 'barriers to entry'](#) preceding the 2014 EU audit legislation

critical mass of a PIE audit client base leads to the lack of experience in PIE audits, and the lack of experience in turn stands in the way of being appointed as a PIE auditor.

### **INTERNATIONAL PRESENCE**

Many large international companies/PIEs have a global policy for selecting one auditor to create efficiencies in the process, reduce costs for the company and ensure consistency of the provided service. International presence of certain audit firms therefore also contributes to the PIEs' demand for them. This enables a company to have the same firm as their auditor around the world. The recently published [Milieu/CEPS/Europe Economics study](#) on the impact of the 2014 EU audit legislation confirms this – the large majority of the studied companies indicated a preference to have the same audit firm for the companies in their corporate group. To some extent, this may also be a supply side matter as some audit firms demand to audit all PIE's material subsidiaries.

### **AUDIT APPROACH AND STRATEGY**

The audit firm's overall strategy and approach to audit, for example methodology applied, structure of the audit team including experts and level of involvement of the lead partner, coordination with the auditors of subsidiaries, all play an important role in the auditor's selection process. PIEs also consider the audit firm's proposed strategy for the hand-over from the previous auditor and the first year audit.

Naturally, the largest multinational PIE may prefer an appropriately large multinational auditor, with global geographical coverage. Equally, some other PIEs, especially mid-sized ones, may prefer a mid-tier audit firm and its approach which they may find well suited for their size, governance structure and business type.

### **CAPACITY TO PROVIDE ASSURANCE SERVICES**

Some PIEs may perceive Big 4 firms as better placed to offer related assurance services on top of the audit. This is another reason for the demand for them as auditors. See [our publication](#) which explains why auditors are requested or required to provide other assurance services to their audit clients.

### **MAKING A 'SAFE' CHOICE**

Considering the above factors *Reputation* and *Experience*, audit committees in PIEs may continue favouring Big 4 auditors as they perceive this to be a 'safe' choice. When selecting the auditor, their risk of being challenged by shareholders or criticised in hindsight is often reduced if they choose an established market participant. This in itself can curtail demand for the services of new entrants and be a significant barrier to entry to the PIE audit market.

The regulator's/supervisor's pressure to make a (perceived) 'safe' choice may further contribute to this pattern as demonstrated, for example, in the latest UK [Financial Reporting Council's report](#) on audit quality reviews. The report states that "The FRC believes that higher risk entities must be audited by audit firms with the resources and robust quality control procedures to deliver a high quality audit. It is not in the public interest if the most challenging audits are undertaken by firms without the capacity and skills...".

### **REGULATORY COMPLIANCE: RULES ON TACKLING CONFLICTS OF INTEREST AND AUDIT FIRM ROTATION**

Finding an auditor while complying with all applicable rules can at times be challenging for companies. This is especially true for regulated industries such as the financial or energy sectors where industry expertise can be rare amongst audit firms. It is also the case when changing an auditor is not planned but needs to be done due to some reason, for example to respond to stakeholder or shareholder demands or in case a legal or independence issue arises.

Specific rules for PIE audits aiming to tackle potential conflicts of interests, such as not allowing to appoint as an auditor an accountancy firm that already provides non-audit services to the company, are an important factor here. Companies also need to comply with the rules on mandatory audit firm rotation when selecting an auditor. Both sets of the rules and even more so their combination, while strengthening auditor independence, inherently limit the choice of auditor for PIEs. Below we expand on this issue when talking about the factors that influence audit firms' decision about auditing PIEs.



## **PRICE**

The price of an audit is another factor that is considered when selecting an auditor. To ensure that the quality of the audit is not compromised, it is in principle not the lowest price that decides but the ‘most economically advantageous offer’ – see [our publication](#) for more details on this concept in the context of auditor selection.

## **KEY SUPPLY SIDE FACTORS: HOW DO AUDIT FIRMS DETERMINE THE EXTENT OF THEIR INVOLVEMENT IN THE PIE AUDIT MARKET?**

In general, audit firms decide about their involvement in the PIE audit market based on the below key factors, whether these reflect facts or are audit firms’ perceptions. These factors are generally considered together but some may play a bigger role than others, depending on an individual audit firm’s/network’s situation.

## **REGULATION**

Requirements for PIE auditors and audit firms aim to ensure quality of audits which ultimately promotes confidence in capital markets. Having adequate rules in place is therefore in the public interest. However, the rules need to be proportionate and conducive to the smooth functioning of the single market, otherwise they run the risk of serving as barriers/limiting factors to auditor choice.

Overall, in the context of the European Commission’s initiative on corporate reporting, we support enhancing audit quality and having measures in place that ensure auditor independence, see [our response](#) to the related European Commission’s consultation for more details. But without proper impact assessment, unintended consequences of certain measures, or a combination of measures which we outline below, may have a counterproductive impact and lead to less auditor choice in the PIE market.

### **Rules on tackling conflicts of interest**

Under the [Audit Regulation \(EU\) No 537/2014](#), the statutory (i.e. financial statements) auditor or accountancy firm carrying out statutory audits are already prohibited from providing most consulting services to PIE companies that they audit. This means that firms already providing non-audit services to a PIE cannot be in the pool of possible auditors for that entity. Firms which recently provided some of these services to the PIE are also excluded from this pool if they are still under the one year ‘cooling in’ period as per the Regulation.

In this regard, the EU legislation is already preventing potential conflicts of interest between the statutory audit and consulting services, although the implementation of the rules varies across countries, see [our recent publication](#) for more details. The current different regimes in countries pose additional costs and operational difficulties for internationally operating PIEs and audit firms. This can deter audit firms from joining the PIE market altogether or simultaneously in multiple countries with different regimes.

Making the rules stricter and adding prohibitions on services, including assurance services, that the auditor cannot carry out for the audit client, although they do not pose significant threats to the auditor’s independence, could further decrease the auditor choice.

### **Rules on mandatory audit firm rotation**

The 2014 EU Audit Regulation, which applies to PIE audits, introduced measures limiting the statutory auditor’s tenure. The measure’s aim has been to address the familiarity threat, reinforce auditors’ and audit firms’ independence, and to contribute to more market diversity, i.e. less concentrated market. The implementation of the rotation regimes varies greatly across European countries, for details refer to [our publication](#) on this topic.

On the one hand, mandatory rotation limits the choice of auditors for companies, insofar as it takes out the incumbent auditor from the pool of possible future auditors for a set period of time. On the other hand, mandatory rotation of auditors ensures that auditors are more regularly changed and so there is more opportunity for other firms to take on the audit.

In general, there is a need for a mandatory audit firm rotation regime in all countries to be adequate, considering also the cost of tendering for both companies and audit firms. This means balancing the need for reinforcing

auditors' independence and ensuring sufficient auditor choice for PIEs. The current different regimes in countries pose additional costs and operational difficulties for internationally operating PIEs and audit firms. As in the case of different regimes for the provision of non-audit services, this can deter firms from joining the PIE market altogether or simultaneously in multiple countries with different regimes.

### **Insurance and liability costs**

Audit firms need to be covered by insurance like other businesses. However, with more regulation and related liability risks<sup>5</sup>, insurance becomes more costly in the PIE audit market and even more so in jurisdictions with stricter auditor liability regimes. Note that currently, different rules apply in European countries when it comes to auditor liability.<sup>6</sup> This increasing cost can i) be passed on to audited companies in the form of increased cost of audit and ii) even prompt some audit firms' departure from the PIE audit market or deter audit firms from joining it. This way, the matter of market concentration and auditor choice are linked with auditor liability.

### **AUDIT OVERSIGHT**

Approach, educational dimension and culture of the audit supervisors are crucial in determining whether the PIE market is an attractive and acceptable proposition for new entrants. Currently, how audit oversight is carried out across European countries varies. This leads to additional costs for internationally operating audit firms, see [our publication](#) for more details.

The following are the main deterrents to enter/remain in the PIE audit market linked to audit oversight:

- different national oversight rules and approach
- significant additional time, effort and costs for audit firms, i.e. lengthy and demanding inspections, to respond to PIE supervisors' demands
- concerns over the lack of focus on fostering learning and development of the audit profession through the oversight system's educational and remedial dimension, i.e. in case of an issue, the focus should be on what should have been done differently to support learning. In the case of the new entrants to the PIE audit market, there are concerns about supervisors' lack of awareness of the 'learning curve' that new entrants go through and lack of supervisors' support in this process

### **COMMERCIAL ASPECTS**

As in any type of business, profitability comes into consideration in the case of audit. Costs – including litigation risks, insurance costs, tendering costs, PIE audit license cost, investments to scale up and foregone profits from non-audit services are weighed against benefits – audit fees – by audit firms when deciding on:

- entering/remaining in the PIE market
- becoming or not an auditor of a certain PIE

Capital, technology and staffing are all areas where some potential new entrants may need to scale up if they want to undertake PIE audits. All these factors come into equation when audit firms are evaluating the business opportunity, i.e. deciding whether or not to enter the PIE audit market. However, lack of actual opportunities often leads to lack of investment and vice-versa, creating a vicious circle. Moreover, for an audit firm to become profitable in this market segment, it needs a critical mass of PIE audit clients.

### **HUMAN ASPECTS AND ATTRACTIVENESS**

As mentioned earlier, in general, finding and retaining high quality staff in audit firms has become more challenging, like it is the case in many other professions and industries too. Therefore, audit firms have become more concerned about where and how they allocate their resources. They became more selective when it comes

<sup>5</sup> In addition, the European Commission noted in the past the issue of limited access to insurance coverage, see [Commission's Recommendation](#) concerning the auditors' liability. See also the [highlights of the study](#) on this topic carried out for the Commission at the time

<sup>6</sup> For details on country regimes, refer to page 23 in [our response](#) to Sir Donald Brydon's Independent Review into the Quality and Effectiveness of Audit

to which companies they audit, considering their resources but also other key supply side factors, such as the risk associated with a potential client.

Audit partners weigh up expected risks and benefits of auditing a certain audit client. The outcome of this also determines whether they find undertaking PIE audits attractive. On the plus side, there are career growth and learning opportunities through auditing PIEs. On the minus side, PIE audits present additional regulation and demanding oversight which means an increased workload, costs and a potential litigation risk.

### **LEVEL OF INTEGRATION WITHIN AN AUDIT FIRM NETWORK**

All Big 4 and a few mid-tier audit firms' organisational structure can be characterised as very well-integrated networks, in which certain strategic decisions are made at the top and apply to all member firms. Such networks' member firms have to adapt to their different national legal and economic environment. Other mid-tier audit firms are generally less integrated networks or even organised as looser associations.

To serve especially large PIEs, which are part of a well-integrated international group of companies, an audit firm network often needs to be highly integrated too on top of its international presence. This facilitates, for example, the same audit approach globally, the network's agility in decision making in tendering for a multinational client etc. This might be less the case for most mid-tier firms. Nevertheless, mid-tier firms and their approach might be a very good fit for many mid-sized PIEs.

### **RISK MANAGEMENT AND AUDIT QUALITY**

Audit firms may decide, based on a prior assessment, not to take on certain audit clients if they consider them too risky. In this decision, audit firms consider the liability risks and any existing constraints they face. Such procedures contribute to upholding the public's trust in audit as well as in audit quality. Nevertheless, this can pose a dilemma for audit firms, considering on the one hand their overall public interest role of auditing companies and on the other hand the reality of being able or not to complete the task to the required standard of audit quality.

The matter of risk assessment of a potential client has become even more important and scrupulous with the Covid-19 pandemic. In this context, good governance and adequate rules for companies, considering also their respective sector, are crucial. They ensure quality of corporate reporting and thus help avoid that companies cannot find an auditor.

## **EXPLORING HOW TO PROMOTE AUDITOR CHOICE AND MAKE PIE AUDITS MORE ATTRACTIVE**

Finding ways to promote auditor choice and make PIE audits more attractive is not straightforward. Given the number of years that the issue of concentration and the lack of auditor choice in the PIE market have existed, it is clear that there is no silver bullet to solve it. It is nevertheless important to keep looking at how PIE market needs can be met best, i.e. having available PIE audit firms which provide quality audit, have the coverage for PIEs operating globally, have the needed sector specific expertise etc.

Therefore, to contribute to the debate, we present several ideas below that are considered to potentially be a step in the right direction. However, none of these can be a standalone solution as the matter of auditor choice requires a holistic approach, building on a package of different measures which address both demand and supply side issues. We invite policymakers to consider these ideas holistically in the context of the European Commission's corporate reporting initiative and potential legislative proposals at EU level and considering also the wider future of the audit market.

At the same time, we see the need to acknowledge that market forces - supply and demand - will continue playing some part and influencing the auditor choice as is natural in a market economy. It should therefore be considered that the impact of any measure on the PIE audit market composition will not only take time to bring change but that the potential for change has its limits. Importantly, impact assessment of any measure under consideration will be necessary as they may bring benefits but also challenges.

## ENHANCE CORPORATE GOVERNANCE TO REDUCE RISKS

As stated in [our recent publication](#), robust corporate governance with stronger internal controls could significantly improve the quality of financial reporting and thus help further mitigate corporate risks. In the context of PIEs' auditor choice, this would have a positive effect as it would help with de-risking some PIEs and thus enabling them to find an auditor more easily. Below we propose two important ways how PIEs' corporate governance and reporting can be improved.

Entities designated as PIEs by the EU legislation should have a separate audit committee with enough members competent in accounting and auditing. In the most important companies, an independent internal audit function and well-established whistleblowing structures should support the audit committee. Legislators should abolish provisions that allow EU Member States to derogate from such requirements.

EU-level PIEs should be required to establish a system of internal controls for financial reporting and issue a public statement about its effectiveness. Such a statement would include, for example, details about how the company's risk management programs on fraud and going concern function. In the future, this will be crucial also to mitigate risks of fraud related to sustainability reporting.

## ENSURE A CONSISTENT APPROACH AND OVERSIGHT OF AUDIT COMMITTEES

As said earlier, the results of the 2020 [CEAOB questionnaire](#) to audit committees showed some issues and divergence of practice related to the auditor selection process. We concur with the European Commission's [report](#) on the audit market concluding that there is a need for more monitoring of how audit committees' organise this process.

Although audit committees' supervision is required, according to the Commission's report, it is currently done in 21 Member States and with a variety of approaches. We believe that there should be a certain level of harmonisation across Europe in this regard. Having harmonised EU performance standards for audit committees that are monitored by an independent authority is desirable and would improve the understanding of expectations from audit committees, their functioning, transparency of their work and their accountability, all also in relation to auditor selection.

Any policymakers' initiative in this context should also reflect how to support greater audit market resilience and diversity. An example of such approach can be seen in the UK where the FRC plans to introduce a minimum [standard for audit committees](#). In its draft standard, the FRC considers and links with tendering the existence of "a strong public interest in audit market diversity and the market as a whole having sufficient resilience, capacity and choice".

## STRENGTHEN SHAREHOLDER ENGAGEMENT

The proper exercise of stewardship by shareholder engagement with audit committees on the matter of auditor selection needs to be ensured. Currently, in line with the [EU Audit Regulation](#), shareholders vote on the auditor appointment, generally following the audit committee's recommendation of at least two choices of an audit firm with a duly justified preference for one of them.

Given the fact that the auditor's job is to act in the interest of shareholders, their input in audit matters including auditor selection is important. We encourage policymakers to explore how to make the best use of the powerful tool of shareholder engagement in the auditor selection process and consider how this could support audit market diversity. This could be done, for example, through expanding related audit committee reporting to shareholders or via expanding shareholders' engagement on the matter with the audit committee. This would ensure that shareholders are well informed and better involved in the auditor tendering process. More involvement would provide useful information and thus also help tackle shareholders' perceptions of the different audit firms which, in some cases, are the basis of the before mentioned stakeholders' pressure to make a certain choice.

## ENSURE PROPORTIONATE AUDIT REGULATION

When assessing the need for enhanced audit regulation to promote PIE audit quality, policymakers need to consider the increasingly evident risk that as a direct result of even more and increasingly demanding regulation, some firms outside the Big 4 firms would make strategic commercial choices to leave or stay out of the PIE audit market. Therefore, as a general principle and in accordance with the EU's own [Better Regulation](#) principles, policymakers need to ensure that the regulation is proportionate, considering that PIEs are not a homogenous group of companies, not exceeding what is necessary or being overly costly to achieve its goals.

Proportionate rules help relieve the precious resources both on the side of PIEs and audit firms. Any (proposed) regulation should be subject to an impact assessment to determine its impact and risk of unintended consequences, including on auditor choice.

There is also a need to revisit some of the existing rules to consider whether they can be made proportionate to encourage PIE auditor choice, for example by providing a transitional period or certain transitional rules that would apply for new entrants to the PIE audit market.

## ENSURE CONSISTENT AUDIT RULES ACROSS COUNTRIES

Regulatory inconsistency across European countries and related additional costs for internationally operating audit firms deter new entrants to the PIE audit market. The magnitude of requirements together with regulatory inconsistency may also pose challenges and additional costs for PIEs, especially those that operate internationally, in selecting their auditors.<sup>7</sup> Some mid-sized PIEs even need the support of an external advisor to ensure that they comply with all the requirements in this process.

Pan-European streamlining is required especially in the following areas:

- rules on mandatory audit firm rotation
- rules on non-audit services

See our publications for detailed proposals on how to achieve a level playing field through more streamlined regimes on [audit firm rotation](#) and [non-audit services](#) in European countries.

## CONTINUE ALLOWING ASSURANCE SERVICES TO AUDIT CLIENTS

PIEs should continue being allowed to choose their existing auditor as the provider of assurance and related services, such as comfort letters and agreed upon procedures, as these services do not pose a threat to the auditor's independence, see [our publication](#) for further details. In addition, these services are often linked to the statutory audit, building on the auditor's knowledge acquired through the audit. This may create synergies both in terms of audit quality and costs for the company of having the auditor perform these services. Any further restrictions in this regard would very likely further reduce the number of auditors available to PIEs.

There could also be benefit in encouraging audit committees to employ other audit firms to perform allowed non-assurance work. This would serve as a way of getting to know other firms which may be considered as potential statutory auditors in the future.

## ENSURE PROPORTIONATE LIABILITY REGIMES

There is a need for proportionate and adequate liability regimes that do not make PIE audits unattractive by adding discouraging or even prohibitive insurance costs and liability risks.

In a market environment in which auditors and audit firms are punished for making a mistake in their work, the liability regime should be set in a way which does not increase the risk that another large audit firm could fail. It should also not serve as a deterrent for mid-tier audit firms who may be unwilling to take on the risk of a PIE

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<sup>7</sup> This has also been noted, especially in relation to the different rotation regimes in countries, in the recent publication [The audit tender process](#) by the European Audit Committee Leadership Network

audit despite having the necessary skills and resources. The liability regime should rather reflect the auditor's apportionment of responsibility in case of any issues or an incident.

## **ENSURE PROPORTIONATE AND CONSISTENT AUDIT OVERSIGHT ACROSS COUNTRIES**

For PIE audits to be attractive, there is a need for proportionate audit oversight. Especially the regulatory burden relating to the investigations and sanctioning should be proportionate and not act as a disincentive to auditors and audit firms as that could lead to less auditor choice and further concentration in the already heavily regulated PIE audit market.

How audit oversight bodies operate needs to be streamlined across European countries. This will remove additional costs for internationally operating audit firms as these costs may currently deter potential new entrants to the PIE audit market. A more robust audit coordination body with adequate powers at EU level is needed to achieve further oversight convergence across the EU. See [our publication](#) with detailed proposals on the areas that need more streamlining and how to achieve more streamlined audit oversight regimes in European countries.

## **ENHANCE THE EDUCATIONAL DIMENSION AND TRANSPARENCY OF AUDIT OVERSIGHT**

The educational and remedial aspect of audit oversight needs to be enhanced. This can be done, for example, through always including in the inspection reports information on what should have been done (differently), following a root cause analysis looking at all the relevant parties in the corporate reporting ecosystem. This will help enhance the quality of audits and ensure the creation of an environment that fosters learning and development of the audit profession. In case of new entrants into the PIE market, supervisors also need to consider and be of support in the learning curve that an audit firm needs to go through at first – see, for example, the UK regulator's initiative to introduce [support measures](#) through 'Audit Firm Scalebox'.

To ensure that companies have access to reliable information on quality when selecting an audit firm, audit oversight bodies across the EU need to enhance transparency of their work. They need to make relevant information available, for example by publishing the results of quality reviews on individual audit firms, and clearly differentiating the relative severity of findings. This will help bridge the information gap on audit firm quality which we refer to earlier and which is an important factor when selecting an auditor.

To help national audit oversight bodies accomplish all of the above, the role of the CEAOB needs to be strengthened.

## **SUPPORT CAPACITY AND EXPERTISE BUILDING IN AUDIT FIRMS**

The capacity constraints underline the need to keep PIE audits attractive – not only for potential new entrants but also to support all audit firms in attracting quality staff.

Policymakers could look into ways to support capacity and industry expertise building in audit firms, especially in mid-tier audit firms as potential entrants to the PIE audit market. This could be done, for example, through encouraging and exploring the impact of:

- establishment and facilitation of knowledge and experience sharing, including on specific industries, amongst all the firms. Professional institutes for auditors could help with this
- more participation of mid-tier firms in auditing the public sector, especially PIEs, incentivised through public procurement. In the public procurement, the lowest price should not be the criterion that decides but rather the most economically advantageous offer should be considered when selecting an auditor
- cooperation or some form of partnership between audit firms. For example, the established PIE audit firms and mid-tier audit firms as potential entrants to the PIE market could engage in on-the-job collaboration in the performance of PIE audits, where a large firm as the sole appointed PIE auditor

would make use of a mid-tier audit firm's services and staff<sup>8</sup>. Another example of an idea that could be explored is the creation of a sort of consortium of two-three smaller/mid-tier audit firms or between a large and mid-tier firm, potentially working under one lead partner

- joint audit or some form of managed shared audit.<sup>9</sup> These models have been used as a common practice<sup>10</sup> or explored only in a small number of countries until now. Further evidence would be needed on the impact of joint/managed shared audits on PIE market concentration and auditor choice, audit costs and especially on audit quality. Available studies published recently do not provide conclusive answers, see for example [Joint audit and audit quality](#) and [Effects of and experiences with joint audit](#)

Audit firms that have the appetite to enter into or expand in the PIE audit market naturally also need to invest to grow. This will improve their position when it comes to having the required technology, staff including the increasingly needed experts on digitalisation and sustainability, presence, etc. Such audit firms' access to finance is important.

Linked with the above, monitoring of mid-tier audit firms' access to finance, growth and investment plans may be helpful to policymakers to assess progress in the area of capacity and expertise building.

## HELP MID-TIER AUDIT FIRMS WIN PIE AUDIT CLIENTS

Mid-tier audit firms that already have the needed capacity to audit PIEs need to see real chances of succeeding in winning PIE audit clients. This will help motivate them to enter the PIE market or try to expand their PIE portfolio. Policymakers could consider ways to encourage both:

- greater participation of these mid-tier audit firms in PIEs' auditor tendering
- PIE audit committees' consideration of the mid-tier firms as auditors

This could include, for example, developing ways to ensure that PIE audit committees properly consider, and possibly have to report on how they have considered, mid-tier firms in the audit tender process. PIEs and their audit committees have to be ensured that there is no regulator's/supervisor's pressure to make a perceived 'safe choice' which limits the real openness of the process. In addition, audit committees' transparent feedback to the tender participants, especially the unsuccessful ones, indicating the reasons for not being selected, would help audit firms learn and further improve.

Monitoring audit firms' participation in PIE auditor tendering and how the mid-tier firms are considered in the process could help policymakers to:

- assess the openness and competition in the tendering process and identify issues, if any
- understand whether there is a sufficient number of adequate bidders, including whether and why certain audit firms have not accepted to tender after having been invited
- understand whether mid-tier firms are approached and if so, how they are considered in the process
- assess progress if any issues have been identified

## IMPLICATIONS OF SUSTAINABILITY ASSURANCE FOR THE AUDITOR CHOICE

This publication focuses on the statutory (financial reporting) audit market and its dynamics related to PIEs' auditor choice. Looking towards the future and at the wider market, it will be interesting to see the implications of sustainability assurance on choice and selection of auditors and sustainability assurance providers. The newly

<sup>8</sup> See, for example, [this study](#) from the Netherlands for more details on such collaboration

<sup>9</sup> Find details on what joint and shared audits are in the publication [Shared and joint audits: are two auditors better than one?](#)

<sup>10</sup> According to the latest [European Commission's report](#) on the EU audit market, joint PIE audits represent only 9% of PIE statutory audits. Of the 10 Member States that reported joint audits, France again had the most (86% of the EU-28 total)

introduced EU-wide requirement on assurance of companies' sustainability reporting, as per the [EU Corporate Sustainability Reporting Directive](#) (CSRD), may indeed change the dynamics in the statutory audit market.

In this context, the [European Commission noted](#) that it plans to work “to create a more open and diversified audit market”. In this spirit, the CSRD gives Member States the option that the assurance of sustainability reporting can be done by the statutory auditor, another auditor or an independent assurance service provider.

Audit firms will need to have both audit and sustainability capabilities in-house to be able to provide assurance on sustainability information. This requires further effort and investments into building a sufficient base of sustainability experts who are currently in high demand. Accountancy Europe's dedicated [webpage](#) showcases how our Member Bodies have integrated sustainability into their professional education frameworks to help respond to the demand.

What is clear for now is that with more resources needed to provide sustainability assurance, having more capacity, audit firms and quality staff in the audit market as a whole becomes even more relevant. This is important to ensure that all PIEs and their stakeholders' needs are served, and PIEs have sufficient auditor choice.

## CONCLUSION AND NEXT STEPS

This publication demonstrates how the main parties and their approaches influence the choice of audit firms that PIEs have. We have looked at the key factors that companies consider when selecting their auditor, and the key factors for audit firms when deciding on their involvement in the PIE audit market. This helps to understand what has led to the current structure and limited choice of PIE audit firms in European countries. It needs to be considered that while some audit firms do not aspire to expand into the PIE audit market, others have the appetite but are disincentivised as they face barriers.

Making PIE audits more attractive will require a combination of efforts by all parties, including:

- change of mindset – companies, including their audit committees and shareholders, and policymakers with audit supervisors need to be more open to enable and support diversity in the PIE audit market
- lowering the existing barriers, especially in regulation, and avoiding the creation of new ones
- policymakers exploring steps that could help create a PIE audit market as an environment that is an attainable and attractive proposition for new entrants
- capacity and expertise building, especially in mid-tier audit firms as potential entrants to the PIE audit market

Further research on the EU audit market is needed to clearly define the issues and explore existing barriers to more auditor choice, appetite of audit firms to audit PIEs<sup>11</sup> and PIEs' appetite to appoint mid-tier audit firms as their auditor. Gathering facts and stakeholders' input are crucial to inform any future policy making.

Looking forward, and at the wider market, it will be interesting to see the implications of sustainability assurance on choice and selection of auditors and sustainability assurance providers. What is clear for now is that with more resources needed to provide the newly required sustainability assurance, having more capacity in the audit market as a whole becomes even more relevant.

While we are aware that there are different views on the matter, we believe that the only way forward is to continue discussions with relevant stakeholders. In this spirit, we plan to organise an event with key parties to enable a public dialogue.

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<sup>11</sup> For example, the UK's Financial Reporting Council is currently undertaking such [study](#) to inform its work in this area





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