

Statutory Audit Market Inquiry: conclusions following consultation on the CC's selection of subjects for case studies

1 February 2012

Introduction

1. On 17 January 2012 we published a consultation document setting out how we intended to select subjects for case studies.¹
2. We are grateful for and have considered carefully the responses that we received.

Categories

3. We now intend to ask audit firms to allocate their customers to the following categories, and to select our case studies from those categories. Changes from the categories contained in the consultation document are marked in bold.
 - (a) FTSE 350 companies whose auditor supplies the company **primarily** with statutory audit services only or with statutory audit and audit-related services, but **limited** other non-audit services. **For these purposes we plan to consider companies where non-audit fees as a percentage of audit fees are 25 per cent or less.**
 - (b) FTSE 350 companies whose auditor also supplies the company with **substantial** other non-audit services in addition to the statutory audit. **For these purposes we plan to consider companies where non-audit fees as a percentage of audit fees are more than 100 per cent.**
 - (c) FTSE 350 companies that have switched auditors within the last **five** years.
 - (d) **FTSE 350 companies that have tendered (formally or informally) their audit services within the last five years;**²
 - (e) **FTSE 350 companies where over 40 per cent of the group audit fee is earned outside of the UK. This may include companies whose shares are listed in other financial centres such as the USA or Hong Kong.**
 - (f) Entrants within the last **five** years to the FTSE 250 or FTSE 100 that have switched auditor to one of the four largest auditors, **in particular where this switch was in anticipation of entry to the FTSE 250 or FTSE 100.**
 - (g) FTSE 350 companies, the quality of whose audit **has been called into question** within the last **five** years. **These could be identified by: unsatisfactory rating by the Financial Reporting Council (FRC); finding by the Accountancy and Actuarial Discipline Board (AADB) or Joint Disciplinary Scheme (JDS) Tribunal; conclusions drawn by the Financial Reporting Review Panel (FRRP) or insolvency process which led to subsequent restatement of the accounts, where the restatement was with respect to a matter covered by the audit opinion; and court judgments against the auditor in relation to**

¹ http://www.competition-commission.org.uk/inquiries/ref2011/statutory_audit_services/pdf/case_study_consultation.pdf.

² We consider informal to cover: formal re-proposals by the incumbent.

negligence in the conduct of the statutory audit. Also companies who have gone into an insolvency/administration process within six months of receiving an unqualified audit opinion.

(h) FTSE 350 companies who have had an audit relationship extending longer than 15 years.

Notes

4. As noted in our consultation document, the case studies are not intended necessarily to be a representative sample of the market as a whole, rather they will focus on particular market features that are relevant to our analysis. As the inquiry progresses we may decide to carry out a small number of further case studies to complement the initial set, where we consider this would be of value. We shall be undertaking other work streams to gather evidence from customers of audit services.
5. Parties suggested that we should consider 'recent' as being within three to five years, rather than ten years. We accept the view that the corporate memory is likely to be greater within this period.
6. We asked for suggestions as to how to identify companies whose audits had not been of adequate quality. In looking at these, we are not trying to form a judgement of the overall quality or abilities of any particular auditor. Rather we aim to see how a company reacted when it had reason to believe that it was not receiving an adequate audit service. In the main there was a preference for us to identify these by reference to an independent view of the audit opinion. We accept that a company's insolvency or entry into administration shortly after receiving an unqualified audit opinion does not necessarily show that the audit was poor quality. However, there has been significant concern around this issue, and so we will include this in one of the categories. We have revised category (g) accordingly.
7. We do not intend to consult further on either the identity of companies selected for case study, nor on the precise questions to be put to them as there may be confidentiality considerations that we will need to take into account. Equally, we do not wish to be fettered in the questions we ask and will want to explore the issues raised in each case study. We are, however, investigating the theories of harm and issues set out in our Issues Statement,³ and our enquiries will be to that end.

³ http://www.competition-commission.org.uk/inquiries/ref2011/statutory_audit_services/pdf/111207_issues_statement_final.pdf.