COMPETITION COMMISSION

STATUTORY AUDIT SERVICES MARKET INVESTIGATION

Market definition

24 August 2012

Introduction

1. The Competition Commission's (CC's) initial view is that the relevant market in this investigation is the provision of statutory audit services to companies that are currently, or have recently, been listed on the London FTSE 100 and FTSE 250 indices (collectively known as the 'FTSE 350'). The relevant geographic scope is the UK. This paper explains how we have reached this initial view and presents supporting evidence.

2. Defining the relevant market in a market investigation assists the CC to identify the market participants and products that might be central to the identification of features that have an adverse effect on competition. It therefore provides a framework for the assessment of the effects on competition of features of a market.[1] For example, in this investigation the distinction between the FTSE 350 and other types of company has been relevant to our approach to gathering evidence, notably the survey, the market and financial questionnaire (MFQ) and the data request. By enabling comparisons between the audits of FTSE 350 companies and large private companies, as well as those that are listed but of smaller size, it has allowed us to understand better how competition functions in the provision of statutory audits to large listed companies.

3. Market definition is not an end in itself, rather it complements our analysis of competition. The identification of the relevant market does not limit the factors the CC

[1] This is set out in *CC3, Market Investigation References: Competition Commission Guidelines*, June 2003, paragraph 2.2, as well as in our draft revised market investigation guidelines, which are currently being consulted on. See www.competition-commission.org.uk/publications/consultations-open/cc-review-of-market-investigation-references-guidlines.

considers in conducting its assessment of whether a feature or combination of features may give rise to an adverse effect on competition (within the meaning of the Enterprise Act 2002). The CC will also take into account constraints from outside the market and any segmentation within it.[2]

4. There are normally two dimensions to the definition of a market: a product dimension and a geographic dimension. Customer types and temporal factors may also be relevant in some markets.

5. The structure of this working paper is as follows:

   (a) we describe the approach taken on market definition by the Office of Fair Trading (OFT) and the European Commission;

   (b) we discuss our definition of the product market;

   (c) we assess whether there is any segmentation by customer type; and

   (d) we look at the relevant geographic market.

Previous decisions

6. By way of background, this section summarizes previous market definition decisions in two competition cases: the OFT's market investigation into statutory audit services to large companies in the UK and two European Commission merger regulation decisions involving large accountancy firms.

OFT

7. In its decision to refer the market investigation to the CC, the OFT defined the relevant product as statutory audits provided by appropriately qualified auditors in line with the Companies Act 2006.[3] In the UK, the majority of companies are required

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[2] Revised market investigation guidelines, paragraph 133.
[3] OFT, 'Market investigation reference to the Competition Commission of the supply of statutory audit services to large companies in the UK' (October 2011), paragraph 4.18. Hereafter, this report is referred to as 'OFT Reference'.

to have their financial statements audited by a qualified auditor[4] that is a member of one of six professional bodies. As the audit is a statutory requirement, there are no direct product substitutes.

8. The OFT did, however, differentiate between statutory audits for large companies and for small/medium-sized companies due to their scale and complexity.[5] This was a result of: international activity, complexity of operations, and the need for industry-specific knowledge. It also did not rule out differentiation by sector, noting that some industry sectors (for example, banking and insurance) have more complex auditing requirements.[6] The OFT's analysis found that auditor concentration is higher in some industry sectors than others, though it undertook no detailed analysis and reached no definitive conclusion. Ultimately, the OFT reference encompassed companies that 'may be listed from time to time on the London FTSE 100 and FTSE 250 indices'.[7]

9. In terms of the geographic market, the OFT noted that because statutory audit services are described in the Companies Act 2006, these specific services are provided purely within the UK.[8] However, it recognized that there are standards, rules and regulations that have been developed at an EU level as well. Further, audit firms often need a presence in many of the countries in which their clients operate and these countries will have their own legislative framework for statutory audits. The OFT said that large international companies would likely be keen to employ the same audit firm in the different countries in which they operated, whilst smaller listed companies were likely to engage only a national audit firm.[9] It recommended that further evidence should be gathered on supply-side substitution before reaching a definitive conclusion.

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[4] See Law and Regulation working paper, section 3.
[5] OFT Reference, paragraph 4.20.
[6] OFT Reference, paragraph 4.27.
[7] OFT Reference, Annexe C.
[8] OFT Reference, paragraph 4.33.
[9] OFT Reference, paragraph 4.35.

10. The OFT said that it received a small number of responses that argued for an international market in audit. However, the OFT noted that in previous decisions (see paragraphs 11 to 14) the market had been defined as national in scope and did not consider there to have been sufficient changes in regulation, legislation or supply and demand-side substitution which would mean that the geographic market was now wider than previously stated. The OFT also said that it had not analysed the boundaries of possible local and regional markets, noting that it was for the CC to consider whether to undertake a more detailed market definition exercise.[10]

European Commission

11. This section draws on the European Commission's investigation into the merger between Price Waterhouse and Coopers & Lybrand.[11] An investigation was also carried out into the later merger between Deloitte & Touche and Andersen UK[12] although this used the same market definition as the Price Waterhouse/Coopers & Lybrand case.

12. As a merger between two large accountancy firms, the European Commission looked at a range of professional services, one of which was audit and accounting. Within this service, it identified two distinct markets: *(a)* provision of audit and accounting services to medium- and small-sized companies, which consist mainly of national companies, and; *(b)* provision of audit and accounting services to quoted and large companies.[13] This distinction stemmed from the fact that only the larger firms (Big 6 in 1998 and Big 5 in 2002) were able to satisfy the requirements of large listed companies,[14] namely to have:

[10] OFT Reference, paragraph 4.39.
[11] Case No IV/M 1016—Price Waterhouse/Coopers & Lybrand (20 May 1998).
[12] Case No COMP/M 2810—Deloitte & Touche/Andersen UK (1 July 2002).
[13] Case No IV/M 1016, paragraph 22.
[14] Case No IV/M 1016, paragraph 32.

(a) their audit and accounting services provided by a firm with the necessary reputation in the financial markets (in the case of quoted companies);

(b) the geographic breadth to cover their companies' needs worldwide (in the case of multinationals);

(c) the depth of expertise in their particular sector (large companies in general and, in particular, regulated sectors such as banking and insurance); and

(d) significant resources (all large companies required this to complete their audits).

13. The European Commission also considered if there were relevant product markets in certain sectors given that some sectors appeared particularly complex and required significant specialist expertise. It concluded that there were potentially two sectors with their own relevant product markets: banking and insurance.[15] Further analysis of the demand for audit services in these sectors showed that price considerations were of relatively low importance for companies compared with reputation, sectoral expertise and the auditor's knowledge of the business. Based on this, the European Commission identified two key issues for banking and insurance companies: the time needed for an alternative firm to reach the same level of competence as its incumbent auditor ('start-up' period, estimated to be two to three years); and the company's reluctance to change auditors, which was stronger than in other sectors. The European Commission subsequently decided that both of these issues could be considered within the broader picture of any auditor/client relationship. Similarly, on the supply side, although firms acknowledged that banking and insurance required special expertise and carried a high degree of risk, the European Commission found that all large firms possessed (or could easily acquire) the necessary capabilities to

[15] Case No IV/M 1016, paragraphs 34 & 35.

carry out a banking or insurance audit. Thus, the European Commission concluded that there was no separate product market for the banking and insurance sectors.[16]

14. In terms of geographic markets, the European Commission noted that statutory audit services were primarily regulated at the national level but that there was also an important international dimension for multinational companies. It concluded in both merger cases that national markets were the relevant geographic markets, principally due to national regulatory requirements that affected both the demand and supply side and the need for the auditor to have a local presence.[17]

Relevant product market

15. We consider the relevant product market to be the supply of statutory audit services to companies that may be listed from time to time on the FTSE 350. In particular, it is our initial view that the provision of statutory audit services to these companies constitutes a separate market from the supply of the same services to private and smaller listed companies. Further, we consider the provision of statutory audit services to be a separate market from the provision of other services that might be provided by audit firms.

The product

16. The majority of companies in the UK have a statutory obligation to have their financial statements audited every year.[18] There are some differences in reporting requirements between listed and non-listed companies, for example the former have a shorter reporting timetable and must issue quarterly updates and interim results. However, for both public and private companies there are no substitutes for a statutory audit.

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[16] Case No IV/M 1016, paragraphs 36–49.
[17] Case No IV/M 1016, paragraphs 55–63.
[18] See Law and Regulation Working paper, section 3.

17. We note that auditors provide a number of services that are categorized as 'audit-related services'. The Auditing Practices Board defines these as 'non-audit services that are largely carried out by members of the (audit) engagement team and where the work involved is closely related to the work performed in the audit and the threats to auditor independence are clearly insignificant...'.[19] Such services include reviews of interim financial information, reporting on regulatory returns and reporting to a regulator on client assets.

18. The financial information we have on audit fees and hours worked includes those relating to both the supply of statutory audit services and audit-related services. Firms were not able to provide this information for statutory audit services only, ie excluding fees and hours worked for audit-related services.

19. In their responses to our MFQ, firms were asked to produce estimates of the proportion of 'full audit service' that is accounted for by audit-related services. All firms said that this varied significantly by client and so it was not possible to produce a reliable figure. Estimates for a small sample of FTSE clients were provided by each firm and the proportion of audit hours and/or fees accounted for by audit-related services ranged from 0 to around 30 per cent, with averages between 10 and 20 per cent.[20]

20. For this reason we are unable to analyse in both this and other working papers audit engagement fees and hours worked for the delivery of the statutory audit excluding audit-related services unless stated otherwise. Nevertheless we do not consider the initial views given in this working paper to be sensitive to the treatment of audit-related services and our analysis of competition would not be materially different if we included audit-related services within our market definition. In particular we

[19] APB Ethical Standard 5 (Revised), paragraph 54.
[20] Responses to MFQ, question 51 (for Big 4) and question 36 (for other firms).

consider that audit-related services are complementary to the statutory audit and note that, in many cases, companies are likely to find it cost-effective to have their auditor provide both. Further, given that the work is closely related to the work performed in the audit, a company is likely to have a similar choice of suppliers.

Customer segmentation

21. The CC has considered whether markets need to be defined according to different types of customer.

FTSE 350 and non-FTSE 350

22. In our MFQ, we asked audit firms a series of questions about the differences between auditing FTSE 350 and other types of company. We were particularly interested in comparisons with large non-listed companies and those which are listed but smaller (eg in the FTSE Small Cap).

23. The four largest firms all said that the audit requirements of large listed companies were different from others.[21] They noted that such audits were generally more complicated, often due to: complex business models (eg shared service centres, cross-border operations); the international scope of the audit; scale of the organization and its operations; number of different business activities; different governance structures; complexity of underlying transactions; the need for specialist expertise; the involvement of different stakeholders, and/or; regulatory requirements.[22] Some of the parties also said that an important difference between listed and non-listed companies was that the audit occurred in a different context because there was more distance between shareholders and management in a public

[21] This paragraph summarizes Big 4 responses to MFQ, questions 59–61.
[22] KPMG told us that as a generality, larger clients tended to be more international and had more complex business models and processes, thus requiring more audit resources and specific capabilities. Reporting requirements for listed (including FTSE 350 and FTSE Small Cap) and large non-listed entities may also be more challenging. KPMG response to MFQ question 57. Deloitte also said that differences in complexity are not necessarily a reflection of the listed status of the companies, but arise from their specific characteristics and circumstances.

company.[23] The latter was also said to be subject to higher levels of public scrutiny and reputational risk. Another difference between the two was that listed companies had shorter reporting timelines and more reporting requirements than non-listed companies.

24. Responding to the same questions,[24] non-Big-4 audit firms said that each company required a specific audit strategy. Some submitted similar views to the Big 4 on the nature of audits for FTSE 350 companies. However, responses from BDO and Grant Thornton indicated that defining a market purely for the FTSE 350 may not be appropriate. BDO said that being listed did not necessarily equate to being large in size or having extensive operations. For example, the firm acts for a number of private companies that are of a much bigger scale that some FTSE 350 companies. Grant Thornton also made the point that a company's size was not always proportional to complexity and that a number of factors had to be considered, such as: maturity of the company and its finance function; the complexity and location of its IT systems; governance structure; existence of complex financial instruments and capital structures; and the impact of mergers, acquisitions and other reorganizations. Grant Thornton said that, in some cases, this could mean that a large well-organized and well-run FTSE 350 company could be less challenging to audit than, for example, a smaller AIM company or a large private business because the audit risks were easier to identify.

25. In order to further our understanding of the potential differences between the audits of FTSE 350 and non-FTSE-350 companies, the CC has drawn on evidence obtained from its survey and the public and engagement databases on companies in

[23] KPMG said that the interaction with stakeholders of large non-listed companies was generally similar to that for listed companies. However, there may be direct interaction with shareholders which would not be the case for listed companies. Such interaction may either arise due to one or more of the shareholders being on the board of the company or involved in the management of the company, or simply as a consequence of their financial interest in the company. Some listed companies may also have representatives of a significant shareholder on the board. Response to MFQ, question 84.
[24] This paragraph draws on non-Big-4 responses to the MFQ, questions 41–43.

the following segments: FTSE 100; FTSE 250; FTSE Small Cap/Fledgling; AIM; Top Track 100;[25] and Top Track 250.[26]

26. Analysis of the public and engagement databases suggests a number of differences between 'FTSE 350'[27] and 'non-FTSE-350' companies with respect to the supply of statutory audit services over the period 2000 to 2011. These included:

(a) FTSE 350 companies were more likely to have a longer relationship with their auditor. For example, 51 per cent of FTSE 100 companies and 37 per cent of FTSE 250 companies have a tenure of more than ten years compared with 31 per cent of other listed companies and 25 per cent of private companies.

(b) Audit fees paid by FTSE 350 companies tend to be higher than those paid by other listed companies and larger private companies. For example, in 2010, the median total fee for audit and audit-related services was £579,000 for FTSE 350 companies, compared with £193,000 and £245,000 for other listed and private companies respectively.

(c) The fee per hour for FTSE 350 audits tends to be higher than for other listed company and private company audits. For example, for audit work conducted in the UK, in the financial year 2010 for FTSE 350 audits the average fee per hour was £87, compared with £79 per hour for other listed companies and £77 per hour for private companies.

27. The survey results suggest that FTSE 350 companies are also more likely to require an audit of international scope. In particular, for around a half of FTSE 100 companies, and 33 per cent of FTSE 250 companies over 40 per cent of the audit

[25] The Top Track 100 ranks Britain's biggest private companies by sales. Further details can be found in the 2011 research report www.fasttrack.co.uk/fasttrack/downloads/2011toptrack100rep.pdf whilst historic lists can be found at www.fasttrack.co.uk/fasttrack/leagues/top100programme.html.

[26] The Top Track 250 ranks Britain's leading mid-market private companies by sales. Further details can be found in the 2011 research report www.fasttrack.co.uk/fasttrack/downloads/2011toptrack250rep.pdf.

[27] In both the survey and much of the CC's quantitative analysis, we define 'FTSE 350' as any company that has been in the FTSE 350 during the period 2006–2011. This takes into account the fact that the FTSE 350 is a dynamic index and changes every quarter.

was accounted for by non-UK activities, compared with 14 per cent for non FTSE 350 companies.

28. The survey also found differences between FTSE 350 companies and other listed and large private companies in terms of what the FDs and ACCs seek in an audit and their auditor, for example:

(a) FTSE 350 finance directors were more likely to consider the following to be important in assessing the quality of the audit: a high degree of challenge by their auditor; an ability to detect mis-statements; independence of the audit firm; and the reliability and usefulness of the audit reports;

(b) more FTSE 350 finance directors and audit committee chairs considered the strength of the international network and the ability of the auditor to be able to ensure a consistent worldwide delivery to be important; and

(c) fewer FTSE 350 finance directors and audit committee chairs considered price to be an important factor when selecting an auditor.

29. Information extracted from the public dataset and the survey results also suggest differences in the tendering and switching behaviour of FTSE 350 companies compared with other listed and private companies. In particular:

(a) over the period 2001 to 2011 we estimate that switching rates were lower among FTSE 350 companies (an average of 2.5 per cent a year) than other listed companies (an average of 4.7 per cent a year) and private companies (an average of 5.5 per cent a year); and

(b) The survey results suggest that FTSE 350 companies tender their audit engagements less often than other companies. We found that 23 per cent of FTSE 350 compared with 46 per cent of ‘other’ companies had tendered their audit in the last five years, and that 49 per cent of FTSE 350 and 35 per cent of

'other' companies had either tendered the audit more than five years ago or have never tendered the audit.

30. We consider that the difference in company characteristics described above are likely to be factors in explaining differences in the levels of audit concentration that we see today. Table 1 gives the shares each audit firm has of audit clients by company type in 2010. In terms of listed markets, the Big 4's share of the market clearly increases as one moves from smaller listed to FTSE 250 and then to the FTSE 100. The table also shows that the provision of audit services to large private companies, defined as the Top Track 100, is less concentrated than it is for the FTSE 350 (though the Big 4 are still the largest suppliers).

TABLE 1 **Percentage share of audit clients by company type (2010)**

Firm	*FTSE 100*	*FTSE 250*	*Other listed*	*Private*
PWC	38	29	23	30
KPMG	22	23	27	23
Deloitte	21	27	24	17
Ernst & Young	18	17	15	11
BDO	1	2	3	4
Grant Thornton	0	2	4	6
Others	0	0	4	8
Big 4	**99**	**96**	**89**	**81**

Source: CC.

31. Given these findings, it does appear that the characteristics of an average FTSE 350 company are sufficiently different from other companies, such that supplying statutory audit services to them constitutes a separate market. We are aware that the FTSE 350 is dynamic and changes every quarter and so we include in our definition companies that are both currently and have recently been in the FTSE 350. For the purposes of our evidence gathering, this captured all companies that had been listed

in the FTSE 350 at some point during the period 2006 to 2011—in total this amounts to 542[28] companies.

Segments within FTSE 350

32. We also considered whether certain segments of the FTSE 350, based on size and sector, constitute separate markets.

33. On the supply side, the CC asked audit firms to provide an assessment of their ability to carry out audits in each sector, in particular asking which sectors they are active in and whether they would be able to expand into those sectors where they are not currently active.

34. All of the largest four auditors said that they organized their activities to some extent according to sectors.[29] They acknowledged that certain sectors required particularly complex audits, for example banking and certain utilities. Generally, however, each of the Big 4 auditors stated that they were able to provide audit services to companies in all industry sectors. Where a firm is currently not active in a sector in the FTSE 350, the skills developed from auditing other large companies were transferrable (particularly those in a similar sector[30]) whilst the specialist knowledge could be obtained via non-audit staff or from within the firm's international network. Further, sector expertise would most likely be available given that firms will audit smaller or non-listed companies in the same sector.

35. Other auditors responded that they could audit companies across a broad range of sectors. However, most acknowledged that, in the short term at least, they would not

[28] Datasets in the Market Inquiry for Statutory Audit Services working paper, to be published shortly.
[29] This paragraph draws on Big 4 responses to the MFQ, questions 56–58. KPMG does not use any standard sector classifications to manage its business—no specific sector classification is fully informative of client characteristics nor an audit firm's ability to compete for clients in that sector. KPMG response to MFQ, question 56.
[30] For example, using expertise in fixed-line telecommunications to win work in the mobile telecommunications sector.

be able to audit the largest firms in certain sectors. BDO said that it could not currently audit the largest financial institutions, pharmaceutical companies and oil companies in the FTSE 100[31] whilst Grant Thornton told us that auditing the 'dozen or so' systemic banks and insurance companies would represent an unreasonably large portion of the firm's audit practice.[32] Mazars said that it would currently be difficult to accept an audit appointment for FTSE 350 companies in the pharmaceuticals and oil & gas sectors on a sole audit basis.[33] PKF stated that it could not audit companies in certain highly specialized sectors where it was not currently represented, eg banking.[34]

36. Using the public dataset, we estimated the shares that audit firms have had of FTSE 350 audit engagements in each of ten industrial sectors, by the number of clients and audit fees, over the period 2001 to 2011. We found that each of the Big 4 firms has had a presence in each of these sectors over a number of years. We also found that there are several sectors where non-Big-4 firms have had no presence (or, at least, a very limited presence) over this period, in particular in health care, telecommunications, utilities and technology companies.

37. On the demand side, our survey found that FTSE 350 finance directors and audit committee chairs in the finance industry were more likely to value an auditor's sector-specific expertise than counterparts in other sectors including industrial, consumer good, consumer services and technology sectors.[35] Generally, however, the sample sizes are not sufficient for us to investigate differences in demand-side behaviour and preference by sector using the survey data.

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[31] BDO response to MFQ, question 69.
[32] Grant Thornton response to MFQ, question 40.
[33] Mazars response to MFQ, question 69.
[34] PKF response to MFQ, question 38.
[35] CC survey: CC survey tabulations, sheet FD/CFO only, question B3_03, line 1282; CC survey tabulations, sheet AC only, question B3_03, line 1302

38. Our case studies included a bank (Company G) and insurance company (Company C), both of which expressed a view that one of the large four firms was weaker than its competitors. If this is a representative view, it would mean that the choice available to firms in these sectors is significantly different to others in the FTSE 350, though we note that the Audit Committee Chair of Company C still thought that all the four largest firms could compete for its audit.

39. In addition to potential segments by sector, the CC also notes that there is significant variation in the FTSE 350 in terms of company size and complexity. In particular, we estimate that in 2010:

(a) the average turnover of FTSE 350 companies was £4,473 million with a minimum of £0.3 million to a maximum of £207 billion.

(b) the average value of total assets of FTSE 350 companies was £24 billion with a minimum of £0.3 million to a maximum of £1,359 billion.

40. Table 2 shows the share that each Big 4 firm had in 2010 of audit clients among the largest 20 per cent of FTSE 350 companies, measured by company turnover, and then the next 20 per cent etc. These results show that each of the firms had a substantial share of audits in each segment. The only exception to this is Ernst & Young, which had a smaller share of the largest companies compared with the other Big 4 firms and its own share of the smaller companies.

TABLE 2 **Percentage share of FTSE 350 audit clients segmented by total company turnover (2010)**

	Total company turnover quintile (1=smallest, 5=largest)				
	1	2	3	4	5
PwC	24	25	34	31	44
KPMG	26	22	24	18	25
Deloitte	19	34	24	25	25
Ernst & Young	21	16	19	24	6
Other	10	3	0	3	0

Source: Public dataset.

41. In this respect, we note that BDO and Grant Thornton have said that they would currently be unable to audit every company in the FTSE 350. BDO suggested that there were around 35 FTSE 100 companies that they would currently be unable to audit due to the companies' significant international and global dimensions and/or the degree of specific-sector knowledge required.[36] Mazars identified a similar number (30) of FTSE 350 companies in its MFQ response for which they would currently find it difficult to accept an audit appointment on a sole audit basis, particularly companies with UK audit fees in excess of £5 million and a geographic presence in over 50 countries.[37] In a presentation to the CC, Grant Thornton indicated that there were around 60 companies for which the firm would presently be unlikely to tender.[38] The firm also accepted that the very largest global organizations, with operations in more than 150 countries, were of a scale that was currently beyond Grant Thornton UK.[39]

42. The survey results showed that around three-quarters of finance directors and audit committee chairs in the FTSE 350 would only consider the Big 4, with size and geographical coverage being the most important reason for excluding mid-tier firms

[36] BDO response to MFQ, question 69.
[37] Mazars response to MFQ, question 69, and response dated 21 August 2012 to market definition working paper putback.
[38] Grant Thornton presentation to the CC, slide 20.
[39] Grant Thornton hearing summary paragraph 10.

as an option.[40] Of those FSTE 350 companies that had tendered their audit in the last five years, 30 per cent had invited at least one non-Big-4 firm to tender. Our case studies found similar evidence, with seven of the ten firms we interviewed believing that only a Big 4 firm could audit their accounts.

43. Our initial view is that whilst some FTSE 350 audits may be more complex than others and some will require certain sector or other expertise, we cannot define separate markets within the supply of audit services to FTSE 350 companies. In particular, we do not have the evidence to suggest that there are segments of FTSE 350 companies (possibly defined by sector, company size or the extent of international operations) for which the choice of potential auditor is different from those of other FTSE 350 companies.

44. With regard to the choice between Big 4 firms, our analysis suggests that whilst some firms may have a stronger position than others in certain sectors, generally all the Big 4 firms have broad-based experience across the FTSE 350. In the survey we asked finance directors and audit committee chairs whether there were factors that would limit choice between the Big 4 firms. For FTSE 350 companies, 60 per cent of finance directors and 65 per cent of audit committee chairs said that there were no factors limiting choice between Big 4 firms. For those that did, the most frequently mentioned factor is conflict of interest arising from the provision of non-audit services. Although this is more of an issue in the financial services sector, this is not a consideration that would exclude particular firms from supplying audit services to particular segments of FTSE 350 companies.

[40] CC survey: CC survey tabulations, sheet FD/CFO only, question C9, line 8395, CC survey tabulations, sheet FD/CFO only, question C10, line 8568; CC survey tabulations, sheet AC only, question C9, line 8531, CC survey tabulations, sheet AC only, question C10, line 8696.

45. With regard to non-Big 4 firms, the evidence suggests that non-Big 4 firms may be an option for some FTSE 350 companies. We have not, however, identified particular segments of FTSE 350 companies that can only be audited by the Big 4 and others that have the option of a non-Big-4 firm.

46. However, our decision on market definition does not preclude us from assessing competition within sub-segments of the FTSE 350. Therefore, we will consider these whenever they are relevant. In particular, we will consider groups of companies of different size and complexity and we also note that banking and insurance are two sectors that may require separate analysis, depending on the issue.

47. We are also aware that, for some companies, certain competitive constraints in the provision of audit services may start to take effect when a company becomes fully listed (as opposed to when it becomes a member of the FTSE 350), for example due to external pressure from financial advisers or lenders. This will also be considered in our analysis of competitive effects.

Relevant geographic market

48. We consider the relevant geographic market to be national. By this, we mean that UK-based firms are not generally competing with audit and accountancy firms based outside of the UK for the supply of statutory audit services to FTSE 350 companies. The exception to this is FTSE 350 companies that are not based in the UK. These tend to be audited by a firm based in the company's country, supporting our view that markets are national. This does not, however, preclude such cross-border competition taking place and we will consider this if it is appropriate to do so.

49. One of the principal reasons for defining a national market is that the statutory framework is set by UK legislation. The Companies Act 2006 sets out the requirements as

to accounts and reports in relation to each financial year of a company and it also provides for the auditing of those annual accounts.[41] Furthermore, audit firms that wish to be appointed as a statutory auditor must be registered with a Recognised Supervisory Body and individuals responsible for audit must hold an audit qualification from a Recognised Qualifying Body. This makes it very difficult for a non-UK firm to audit the UK operations of a company, and vice versa.

50. However, whilst the statutory framework is set by UK legislation, the actual audit sometimes needs to be delivered across a number of countries. This particularly applies to FTSE 350 companies, many of which have extensive international operations. For some of these, the UK audit fee will represent less than half of the total. However, although many companies prefer to have the same auditor for the parent and subsidiaries, evidence from the CC survey shows that FTSE 350 finance directors and audit committee chairs value the strength of an auditor's network.[42] This suggests that companies generally require an auditor presence in many of the countries in which they operate, a point reinforced by our case studies. This is consistent with the fact that countries have different legislative frameworks for statutory audits and, as such, the audit will need to take account of this.

[41] See Law and Regulation working paper for further details.
[42] CC survey: CC survey tabulations, sheet FD/CFO only, question B3_05, Table 30, CC survey tabulations, sheet AC only, question B3_05, Table 30