RESPONSE OF BDO LLP ("BDO") TO THE COMPETITION COMMISSION'S AUDIT MARKET INVESTIGATION ISSUES STATEMENT

1 EXECUTIVE SUMMARY

BDO considers that:

1.1 the Issues Statement correctly identifies most of the major relevant issues in relation to the supply of statutory audit services to large companies in the UK (the "**Reference Market**"), but there are several additional issues (or aspects of issues) which the CC should also consider;

1.2 the Reference Market is not operating effectively;

1.3 there are features of the Reference Market which produce adverse effects on competition;

1.4 there is no one "magic bullet" to resolve this, but there are a set of remedies which together would address and help resolve these issues and, over time, improve the functioning of the Reference Market;

1.5 the **barriers to entry and expansion** that apply in relation to the Reference Market occur earlier and apply more widely than is suggested by the Issues Statement. BDO considers that they exist and apply in relation to all listed companies, although there are lower levels of concentration in relation to the market for statutory audits of all listed companies than for the Reference Market. Barriers to entry and expansion in relation to the Reference Market should not therefore be considered in isolation. It is necessary to consider how the wider audit market operates, particularly in relation to growing companies who aspire (or could reasonably expect) to become FTSE 350 companies. These barriers and market dynamics have an upstream effect on the Reference Market, as membership of the FTSE 350 changes over time;

1.6 the four largest audit firms (the "**Big Four**") **reinforce their dominance** in the Reference Market by, among other things:

1.6.1 **acquiring firms within the international networks of BDO or Grant Thornton ("GT")**, presumably at substantial premiums, which has a major adverse effect on strategic investments made by BDO and GT, particularly in countries where BDO or GT has managed to build a market share which is larger than or comparable to that of one or more of the Big Four. Such acquisitions have the effect of reducing competition with the Big Four, both in the country of the acquired firm and internationally, though the international impact may not be fully taken into account by the relevant national competition authority. Examples include:

(a) KPMG's acquisition of BDO's Brazilian network firm, BDO Trevisan, in March 2011;

(b) Ernst & Young's acquisition of GT's Brazilian firm, Terco Grant Thornton, in August 2010;

(c) PwC's acquisition of GT's Danish network firm in May 2011; and

(d) Deloitte's acquisition of BDO's French network firm, BDO Marque & Gendrot, in June 2007;

1.6.2 using **deep discounts** to try to win audit clients from BDO and other audit firms outside the Big Four, or to try to retain audit clients on the rare occasions when those clients invite audit firms outside the Big Four to tender against a Big Four incumbent; and

1.6.3 **relying on claims of "audit quality**" to defend themselves against proposed regulatory intervention, even though:

(a) there is no clear standard definition of audit quality;

(b) AIU reports[1] make clear that BDO achieves comparable audit quality to the Big Four;

(c) as is clear from recent press reports and regulatory decisions, the Big Four are not immune from allegations or findings of audit failure; and

(d) the US PCAOB's reports found shortcomings in a sample of audits conducted by each of the Big Four;

1.7 **exclusionary behaviour by key intermediaries** (such as lawyers, brokers, and investment bankers) reinforces the dominance of the Big Four just as effectively as "Big Four Only" clauses in loan agreements. Such behaviour includes attempts to dissuade companies from using firms other than the Big Four as their auditors;

1.8 the Issues Statement does not give sufficient emphasis to companies' **lack of choice of auditor**: some companies have (or may consider themselves to have) only one or two options available to them, because of rules on conflicts of interest and concerns over auditor's independence. This issue is particularly significant because of:

1.8.1 concerns regarding the systemic risk of a failure of one of the Big Four firms, which could lead to some companies having (or believing that they have) no alternative choice of auditor; and

1.8.2 the growing importance of, and proposals to increase, regulatory requirements in relation to conflicts of interest and independence, including the European Commission's recent proposals.

Broadening choice for large companies beyond the Big Four would resolve or substantially mitigate this issue, which is particularly acute in relation to specific sectors or segments of the Reference Market, such as financial services. However, paragraphs 58 to 61 of the Issues Statement give the (perhaps unintended) impression that the issues of lack of choice and systemic risk are of secondary importance to 'standard' competition concerns of concentration, service quality and high prices.

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[1] See: http://www.frc.org.uk/pob/audit/firmreports1011.cfm.

2 THE BDO NETWORK

2.1 The BDO network:

2.1.1 is the world's fifth largest network of accountancy firms;

2.1.2 achieved combined fee income of €4.6 billion in 2011;

2.1.3 provides services in 135 countries, with almost 48,800 people working for the BDO network out of 1,118 offices; and

2.1.4 provides auditing, tax and advisory services (including accounting, corporate finance, restructuring and business advisory services - see **Attachment 1** for details of BDO's service offerings).

2.2 BDO's service offering is therefore almost identical to the Big Four, except that (unlike the Big Four) the BDO network does not provide large scale consulting advice.

2.3 BDO believes that the BDO network is large enough to audit almost all companies, including companies within the Reference Market, with the exception of the largest and most complex companies and financial institutions. With those exceptions, any technical impediment to BDO's ability to carry out larger audits is a matter of perception, not reality.

3 MARKET CHARACTERISTICS

3.1 Barriers to entry and expansion

3.1.1 As stated in the Issues Statement, there are high barriers to entry and expansion in the Reference Market. BDO considers that their effects on the Reference Market are increased and intensified because they apply to the way companies choose auditors well before they are members of the FTSE 350: see 5.1 below.

3.1.2 The creation of a strong reputation within the audit sector requires experience, a strong client portfolio, a good track record and advertising. These all take time and significant investment over a long period.

3.1.3 Within the Reference Market, barriers to entry and expansion are even higher in certain sectors or segments, including banks and financial services, utilities, major telecoms, and oil and gas[2]. This is because those sectors require (or are perceived by companies in that sector to require) greater levels of sector knowledge, specific regulatory expertise and/or international capability. As the companies operating in those sectors are, in general, particularly large, it is difficult for an audit firm outside the Big Four to acquire such expertise and/or capabilities if it does not already have a large client in the relevant sector.

3.1.4 This gives rise to a "Catch-22" situation, whereby a firm cannot gain certain knowledge and expertise (and would be reluctant to invest in acquiring them) without the experience of acting for a large client in that sector, and it cannot gain the large client as it does not have the relevant knowledge and expertise which is

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[2] The CC may wish to consider whether any of these sectors or segments should be considered as separate markets.

perceived to be necessary. In those sectors there are few, if any, small companies, so the option of auditing a small company, which can grow into a larger company, is not available. Nor is an incremental approach possible, whereby audits are carried out over time for successively larger companies, as the size range of companies in those sectors is not broad enough to permit this. While such "Catch-22" situations may also be common in other professional services, they are exacerbated in the Reference Market by significant barriers to entry and expansion and other specific features of the market, including those identified in the Issues Statement.

3.1.5 Regulatory requirements on the control of audit firms can effectively create a barrier to entry and/or expansion, given the costs of establishing an international network of firms with sufficient size, capability and reputation. Those costs are in themselves a barrier to entry. BDO does not consider this to have been a barrier to its expansion, but there is a time lag in customer recognition of the strength of BDO's international network. That network has however been damaged by Big Four firms buying selected parts of it (see 5.1 below).

3.1.6 Restrictions on investment, which are effectively imposed by the regulatory requirements on the control of audit firms, can also act as a barrier to entry and expansion, as they limit the methods by which audit firms may raise capital and attract investment[3]. However, BDO does not consider this factor to have restricted its expansion to date.

3.1.7 Prejudice in favour of relative size, coupled with the length of time it takes prospective customers to recognise improvements to the credentials of firms outside the Big Four, acts as a barrier to expansion for existing audit firms outside the Big Four. These attitudes are displayed both by customers and by other influential intermediaries, such as lawyers, bankers and brokers. BDO has observed these prejudicial attitudes in tender debriefings. Despite the size and scale of the BDO network, including offices in 135 countries (see 2.1 above), non-executive audit committee chairs often claim that BDO is "*not international enough*" or "*does not have sector skills*". Notes by BDO personnel (independent of the relevant bid teams) of comments made by prospective customers on debriefings following their tender decisions within the last 12 months have included:

(a) [REDACTED] (privately-owned bank; interest income [REDACTED]) - audit - lost to Big 4

'*They were not convinced to move away from Big Four. [X] said the lack of breadth was just a fact given our scale compared to Big Four'*.

(b) [REDACTED] (privately-owned investment management firm) - statutory audit and tax - lost to [REDACTED]

'[REDACTED] *were concerned about the reaction of their investors to the appointment of a non-Big Four auditor. "We run the risk that appointing a smaller firm looks like we are appointing someone we can bully – to get what we want, for example on fund valuation". [X] was clear that he didn't think this would happen with BDO, but it was all about investor perception'*.

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[3] See Oxera's 2007 study for the European Commission: http://europa.eu/rapid/pressReleasesAction.do?reference=IP/07/1570&format=HTML&aged=0&language=EN&guiLanguage=fr

(c) [REDACTED] (unlisted property development company; turnover [REDACTED]) - audit and tax - lost to [REDACTED]

'*The banks suggested that it would be to their* [REDACTED] *advantage to have a Big Four firm. [X] claimed that this wasn't a compelling issue in the decision process, however it "did influence and contribute" to the Audit Committee's decision making criteria'*.

(d) [REDACTED] (owned by [REDACTED], privately-owned; turnover [REDACTED]) - audit, tax and IPO - lost to [REDACTED]

'[REDACTED]*had had a lot of push back from lawyers and bankers, who thought that for a premium listing using a Big Four firm would be easier and less hassle'.*

(e) [REDACTED] (provider of [REDACTED]; FTSE small cap; turnover [REDACTED]) - audit and tax - lost to [REDACTED]

'They weren't convinced we work on a daily basis with complex international tax advisory projects, like the Big Four do. [REDACTED] *already do their tax work, so it was an easy decision to move the audit over to them'.*

(f) [REDACTED] (privately-owned manufacturer of [REDACTED]; turnover [REDACTED]) - audit retender - lost to [REDACTED]

'*The finance director preferred the Big Four*'.

3.1.8 These comments contrast with the views of customers who have moved their audit work to BDO. For example, [REDACTED], which recently moved its audit work to BDO, told BDO that:

'*we've found BDO offers a more personable service and is highly attentive to our needs in comparison to the Big Four. In addition, as our business has expanded internationally, BDO has strongly supported us in providing local expertise through their network of international offices.'*

3.1.9 Given the rarity of tenders for audit work and the low levels of customer switching, it is extremely difficult (and rare) for a non-Big Four firm to win an FTSE 350 company's audit work from an incumbent Big Four auditor. An audit firm outside the Big Four is more likely to have audit work from a FTSE 350 client if it:

(a) audited that client before it joined the FTSE 350; and

(b) manages to retain that work despite the efforts of the Big Four and the resistance (or even opposition) of other relevant intermediaries (such as the client's lawyers, brokers and bankers).

BDO considers that an audit firm outside the Big Four must therefore deliver outstanding customer service in order to retain an FTSE 350 client.

3.1.10 BDO's work for [REDACTED] supports this point. BDO was appointed auditor of [REDACTED], when it was a [REDACTED] company. [REDACTED]. BDO understands that [REDACTED]:

(a) was increasingly frustrated with the bureaucracy of the incumbent Big Four firm and did not feel that it was treated as an important client;

(b) conducted a review, led by its CFO, of non Big 4 firms to identify if any firm had the capability; he had fixed criteria around [REDACTED];

(c) identified BDO as the only firm to meet those criteria;

(d) has identified the attitude of BDO's senior people as a refreshing change; those people are very engaged in project delivery and have short decision making lines;

(e) [REDACTED];

(f) [REDACTED].

3.1.11 If (or when) a Big Four firm manages to win that client's audit work, it will be very difficult for the previous auditor to win that work back, because of a perception that the client would be moving "down market" if it reverts to a non-Big Four auditor. This perception is linked to the question of audit quality: see 4.2 below. BDO strongly encourages the CC to test empirically the "one-way street" whereby companies move to and stick with a Big Four firm for reasons of perception, even before they become FTSE 350 companies.

3.2 High concentration

3.2.1 There can be no doubt that:

(a) the Reference Market displays high levels of concentration;

(b) it has done so for many years; and

(c) levels of concentration are even higher in certain sectors of the Reference Market, including in particular banks and financial services.

Levels of concentration have increased due to mergers and the demise of Arthur Andersen, as set out in paragraph 9(b) of the Issues Statement. BDO considers that there is no foreseeable prospect of a significant reduction in concentration in the short to medium term in the absence of meaningful and effective regulatory intervention.

3.2.2 Concentration is higher and more pronounced for audit services to FTSE 350 companies than for the provision of other accounting related services to those companies (see 4.4 below). BDO provided services other than statutory audits to 57 companies in the FTSE 350 in 2010/11 (including 23 FTSE 100 companies)[4], but only audits six FTSE 350 companies, one of which is a FTSE 100 company. This may be because:

(a) non-audit services are largely a decision for the CFO alone rather than the (generally more conservative) audit committee; and

(b) it is easier to change supplier for non-audit services; a CFO can make a cost-benefit decision with less formality, without needing to consult with

[4] Those companies are listed in **Attachment 2**.

the company's other intermediaries. Non-audit services are more stand-alone and can be commissioned and de-commissioned more easily.

3.2.3 High levels of concentration - and the dominance of the Big Four - are not confined to the Reference Market, but occur much more widely in the audit market in the UK. The Reference Market should not therefore be considered in isolation; nor should the CC ignore the impact on the Reference Market of conduct in the wider audit market, in particular how the very high levels of concentration in the Reference Market are maintained as companies expand and contract and therefore move in and out of the FTSE 350.

4 ADVERSE OUTCOMES

4.1 Lack of innovation

4.1.1 BDO considers that:

(a) innovation is not likely to flourish in a market that exhibits high levels of concentration, such as the Reference Market;

(b) this lack of innovation operates to the detriment of customers, investors and other stakeholders, including current and prospective suppliers to, and employees of, large companies; and

(c) a more competitive market would encourage, facilitate and reward more innovation, which would in turn increase customer choice and raise quality.

4.1.2 In particular, the lack of innovation in the Reference Market is illustrated by the fact that statutory audit has remained largely unchanged for a long period, while companies' communications have changed considerably. Communications by listed companies which move markets (i.e. affect their share prices) are generally not audited: these include trading updates and briefings to analysts and/or investors. In contrast, the audited annual report and accounts have become more peripheral in corporate communications; they are increasingly seen as being "of record" and read only when something goes wrong. Additionally, the increasing complexity of business has led to demands for change in audit scope in areas such as "going concern", risk management and the effectiveness of financial controls.

4.1.3 However, despite such changes in the corporate environment, there has been little innovation in the provision of audit services for many years. BDO considers that this may be a consequence (albeit unintended) of a mindset which is influenced by experience and outlook of the Big Four, in particular because of the number of Big Four alumni within professional bodies and regulators; those who have trained and worked only in the Big Four will tend to have a common outlook and approach. In BDO's view, this produces a tendency to favour the continuation of established procedures and processes and therefore to discourage innovation. The audit profession has effectively endorsed the status quo. This is to the advantage of the established market leaders, i.e. the Big Four.

4.1.4 This was also highlighted in the Oxera Report, which stated[5] that:

> *"several investors that Oxera interviewed raised concerns about the structural links between the Big Four via institutions that regulate audit*

[5] At page 91.

and accounting, complaining that the influence of the Big Four on rules-setting has led to an audit product which does not meet the needs of investors, and which benefits the Big Four, to the possible exclusion of the mid-tier firms…this issue…does seem to be of crucial importance from a public policy perspective."

4.1.5 Given this disconnect between the evolving nature of corporate communications and the relatively static nature of the audit product, BDO - like the European Commission - considers that there is an "**expectation gap**" between what users of audited accounts expect to receive from (or assume is provided by) the audit and what is actually provided by the auditors. This expectation gap means that users may well take more reassurance from an audit than they should do.

4.1.6 BDO considers that, for the largest companies, the requirement for assurance goes beyond statutory audit: it could usefully include specific assurance on narrative in the annual report and be extended to other communications with users of financial information. BDO attaches as **Attachment 3** a copy of BDO's March 2011 publication entitled: "*The Future of Corporate Reporting and Assurance*", which sets out BDO's views on this topic more fully.

4.1.7 Moreover, although (as stated above) the form of statutory audit has not greatly changed over many years, there are now - following the financial crisis - signs that the audit profession understands and accepts the need for change.[6]

4.2 Suboptimal audit quality

4.2.1 For the reasons set out in 4.1 above, BDO considers that the CC should be sceptical of claims in relation to "audit quality" which focus purely on existing statutory audits, whilst ignoring the need for changes to be made to the substance of the audit itself, including an extension of assurance to other important corporate communications which are currently unaudited.

4.2.2 Moreover, so far as **audit quality** is concerned, BDO notes that the Big Four rely on claims of "audit quality" (thereby implying that they provide a service which is superior to all other audit firms) to defend themselves against proposed regulatory intervention, even though:

(a) there is no clear standard definition of audit quality;

(b) AIU reports[7] make clear that BDO achieves comparable audit quality to the Big Four;

(c) as is clear from recent press reports and regulatory decisions, the Big Four are not immune from allegations or findings of audit failure; and

(d) the US PCAOB's reports found shortcomings in a sample of audits conducted by each of the Big Four[8].

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6 James R. Doty, the Chairman of the US Public Company Accounting Oversight Board ("**PCAOB**"), recently stated that "*our audits and audit reports ought to better reflect the needs of dispersed owners",* and referred to *"investors' call for more insights based on the auditor's work*". See: http://blogs.law.harvard.edu/corpgov/2012/01/08/auditing-in-the-decade-ahead-challenge-and-change/

7 See: http://www.frc.org.uk/pob/audit/firmreports1011.cfm.

8 See the comments of James R. Doty, Chairman of the PCAOB, at the Harvard Law School Forum on Corporate and Financial Regulation, http://blogs.law.harvard.edu/corpgov/2012/01/08/auditing-in-the-decade-ahead-challenge-and-change/, which included: "*PCAOB inspectors have conducted inspections of portions of*

4.3 Higher prices and costs

4.3.1 BDO considers that the high levels of concentration in the Reference Market, coupled with the barriers to entry and expansion into the Reference Market, lead to higher prices and costs for auditing services to large companies than would be the case in a more competitive market. This is consistent with: the findings of LSE Enterprise,[9] who (among other things) confirmed that the largest firms charge a fee premium; the Oxera Report; and academic studies.[10] BDO strongly encourages the CC to carry out its own econometric analysis of pricing, examining relationships across time, relationships across sectors and (potentially) exploring variation across countries. BDO and its advisers (including Oxera) would be happy to assist the CC in the design of such an econometric analysis.

4.3.2 In particular, as part of the CC's scrutiny of audit pricing, BDO strongly encourages the CC:

(a) to compare audit pricing following tenders:

(i) in which only the Big Four firms participated, in comparison with those tenders in which BDO and/or other firms outside the Big Four also participated (BDO suspects that prices in the former category will be higher);

(ii) where the incumbent auditor is a Big Four firm, in comparison with those where the incumbent auditor is BDO or another audit firm outside the Big Four (BDO suspects that prices in the former category will again be higher);

(iii) where the company's choice of auditor is further restricted by independence or conflict considerations (e.g. its choice is effectively limited to only two firms), compared to tenders where the company has a wider choice (BDO suspects that prices in the former category will again be higher); and

(b) to compare audit prices over time following a competitive tender, as LSE Enterprise research found that the Big Four put their prices up within three years of winning a competitive tender.[11]

4.3.3 BDO notes that the Big Four have much higher levels of profitability than other audit firms, which may be consistent with excessive pricing and/or an indication of excess profits. BDO acknowledges that:

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approximately 3,000 audits by major firms, and they have found hundreds of audit deficiencies. The case is similar at small firms." See: http://pcaobus.org/Inspections/Reports/Documents/2011_Deloitte.pdf; http://pcaobus.org/Inspections/Reports/Documents/2011_Ernst_Young_LLP_US.pdf; http://pcaobus.org/Inspections/Reports/Documents/2011_KPMG_LLP_US.pdf; and http://pcaobus.org/Inspections/Reports/Documents/2011_PricewaterhouseCoopers_LLP.pdf

9 LSE Enterprise Report: "*Concentration, Auditor Switching and Fees in the UK Audit Market*" (February 2008)

10 See, for example, "*The effect of large audit firm mergers on audit pricing in the UK*", by Kevin P McMeeking of Exeter University and Ken V Peasnell and Peter F Pope of Lancaster University, which found that "*Our pooled models suggested that concentration ratios are associated with higher audit fees…auditees are likely to pay higher fees if their auditor merges with a larger counterpart.*"

11 LSE Enterprise Report: "*Concentration, Auditor Switching and Fees in the UK Audit Market*" (February 2008).

(a) there may be economies of scale, particularly where an auditing firm has an extensive consulting operation; and

(b) higher leverage (i.e. a higher ratio of staff to partners) in the Big Four's business models will have a significant impact on measured profitability, albeit at the possible expense of service quality.

4.3.4 However, BDO considers that these attributes alone may not explain such a large divergence in profits per partner. BDO therefore strongly encourages the CC to investigate the relative profitability of the Big Four. BDO and its advisers (including Oxera) would be happy to assist the CC develop potential methodologies for measuring profitability. BDO also attaches as **Attachment 4** a copy of a data analysis report prepared (based upon publicly available information) by Experian for BDO, which analyses the volume of audit clients and value of audit fees attributable to the Big Four and certain mid-tier firms.

4.4 Reduced competition in non-auditing markets

4.4.1 BDO considers that there is more competition in the provision of non-auditing services (such as accounting, tax advice, consultancy, corporate finance and other advisory services) to FTSE 350 companies than there is in the market for the provision of statutory audit services to such companies. Nevertheless, the market for the provision of non-auditing services to such companies is highly concentrated. BDO understands that the great majority of FTSE 350 companies purchase all or most of their requirements for such services from the Big Four. This is, to a considerable extent, a consequence of the high levels of concentration in the market for audit services.

4.4.2 Firms outside the Big Four are at a reputational disadvantage in winning non-audit work from FTSE 350 companies. Their reputation can lag behind the reality, as shown by the comments quoted at 3.1.5 above. The Prime Minister, at a recent CBI event, was reported in the Evening Standard on 22 November 2011 as saying "*no-one ever got fired for hiring Pricewaterhouse Coopers*" (CBI conference, London, 21 November 2011). BDO lost a recent bid for outsourcing work where the customer "*felt that PwC were a safe bet because they're such a big name".*

4.4.3 When retaining a Big Four firm for audit services, some companies may consider that this makes the relevant firm better placed to advise on non-audit services (subject to rules on independence and conflicts); indeed, the decision to hire a Big Four firm for the audit may also be based on a perception that the firm is better placed than a firm outside the Big Four to provide a fuller range of services.

4.4.4 Accordingly, while BDO acknowledges that there is more competition in the provision of non-audit services to FTSE 350 companies than in the provision of audit services, there is a "spillover" effect resulting from the Big Four's dominance in the audit market. BDO considers that measures intended to remedy adverse effects on competition which exist in the Reference Market would therefore have the additional benefit of enhancing competition in the provision of non-audit services.

5 THEORIES OF HARM

5.1 High concentration and barriers to entry/expansion

5.1.1 BDO agrees with paragraphs 25, 26, 29 and 30 in the Issues Statement. However, BDO considers that the **barriers to entry and expansion** that apply in relation to the Reference Market occur earlier and apply more widely than is suggested by

paragraph 27 of the Issues Statement. BDO considers that they exist and apply in relation to all listed companies, although the levels of concentration in relation to the market for statutory audits of all listed companies are not quite as high as they are in the Reference Market. Barriers to entry and expansion in relation to the Reference Market should not therefore be considered in isolation. It is necessary to consider how the wider audit market operates, particularly in relation to growing companies who aspire (or could reasonably expect) to become FTSE 350 companies. These barriers and market dynamics have an upstream effect on the Reference Market, as membership of the FTSE 350 changes over time.

5.1.2 Paragraphs 9(a) and 27 of the Issues Statement correctly refer to certain lenders' insistence that companies appoint a Big Four auditor. But lenders are not the only intermediary whose exclusionary conduct reinforces the dominance of the Big Four and operates as a barrier to entry or expansion into the Reference Market. **Other intermediaries**, such as brokers, lawyers and investment banks, also reinforce the dominance of the Big Four by recommending or insisting that their corporate clients use a Big Four auditor, often on the basis that using any other auditor would be "going down market". This is illustrated by the following extracts from notes made by BDO personnel on debriefings after tender decisions within the last 12 months:

(a) [REDACTED] (statutory audit and tax) - lost to [REDACTED]

'[REDACTED] *were concerned about the reaction of their investors to the appointment of a non-Big Four auditor. "We run the risk that appointing a smaller firm looks like we are appointing someone we can bully – to get what we want, for example on fund valuation". [X] was clear that he didn't think this would happen with BDO, but it was all about investor perception'*.

(b) [REDACTED] (audit and tax) - lost to [REDACTED]

'*The banks suggested that it would be to their* [REDACTED] *advantage to have a Big Four firm. [X] claimed that this wasn't a compelling issue in the decision process, however it "did influence and contribute" to the Audit Committee's decision making criteria'*.

(c) [REDACTED] (audit, tax and IPO) - lost to [REDACTED]

'*[REDACTED]had had a lot of push back from lawyers and bankers, who thought that for a premium listing using a Big Four would be easier and less hassle'.*

5.1.3 In another recent case, a company[12] moved its audit work to BDO from [REDACTED]. The company then considered moving its audit to a smaller audit firm. However, BDO understands that the company's broker told its CEO that it could not be seen to be "going downmarket" [REDACTED]. The company subsequently moved its audit to [REDACTED], on the basis that it would "*have to eventually*" (move to one of the Big Four) and "*might as well do it now*".

5.1.4 A non-Big Four firm, such as BDO, must therefore overcome resistance or even opposition from a company's other advisers, as well as competition from the Big Four, in order to win and retain that company as an audit client, whether that

[12] [REDACTED]

company is then a FTSE 350 company or aspires to be. That resistance or opposition represents just as considerable a barrier to entry or expansion as a "Big Four Only" clause, though the latter has attracted much more attention to date.

5.1.5 The Big Four have reinforced their dominance in the Reference Market (and reinforced and/or increased barriers to entry and expansion) by **acquiring selected firms from the international networks of BDO or GT**, presumably at substantial premiums. Because network firms are local partnerships, Big Four firms can tempt partners in such firms to join them in return for the promise of higher income and enhanced brand reputation.

5.1.6 This has had a major adverse effect on strategic investments made by BDO and GT, particularly in countries where BDO or GT has managed to build a market share which is larger than or comparable to that of one or more of the Big Four. (For example, BDO's network firm in Brazil had a strong reputation and was able successfully to compete with the Big Four for clients in the publicly traded market and among state owned enterprises.) Such acquisitions have the effect of reducing competition with the Big Four, both in the country of the acquired firm and internationally (in particular, in relation to group-wide audits for multinationals), though the international impact may not be fully taken into account by the relevant national competition authority. Examples include:

(a) KPMG's acquisition of BDO's Brazilian network firm, BDO Trevisan, in March 2011;

(b) Ernst & Young's acquisition of GT's Brazilian firm, Terco Grant Thornton, in August 2010;

(c) PwC's acquisition of GT's Danish network firm in May 2011;

(d) Deloitte's acquisition of BDO's French network firm, BDO Marque & Gendrot, in June 2007; and

(e) Deloitte's acquisition of BDO's office in Melbourne, Australia in July 2006.

BDO would be happy to provide the CC with more details of the acquisitions of parts of the BDO network; so far as acquisitions of parts of the GT network are concerned, BDO only has information which is in the public domain.

5.1.7 BDO International submitted a Complaint to the Brazilian System of Competition Defence against KPMG Risk Advisory Services Ltda, BDO Auditors Independentes and BDO Consultores Ltda on 10 May 2011. The SEAE has been reviewing KPMG's acquisition of BDO Trevisan since April 2011. Once the SEAE has issued its Opinion, CADE will then review the transaction.

5.1.8 This issue was recognised by the House of Lords Select Committee on Economic Affairs:

> *"[t]he Big Four continue to strengthen their position by using their financial muscle to acquire significant parts of the home and international networks of next-tier firms. There have been several notable acquisitions in recent years in, for example, France and Brazil. These takeovers limit the scope*

for smaller competitors to develop international networks. The effect seems anticompetitive."[13]

5.1.9 Paragraph 28 of the Issues Statement therefore does not fully reflect the issues arising in relation to **international networks**. The final sentence of paragraph 28 also implies, incorrectly, that it is only the Big Four which have an extensive and integrated international network. As stated in 2.1.3 above, the BDO network provides services in 135 countries, with almost 48,800 people working out of 1,118 offices. This is, by any measure, an extensive and integrated international network.

5.1.10 Contrary to recent comments made by some Big Four firms, BDO, GT and other firms have made significant investments in recent years in broadening and strengthening their international networks. For example, BDO's UK firm invested substantially in BDO's Indian network firm and more recently has invested in expansion in the Middle East.

5.1.11 There appears to be a widespread myth that BDO is not international; such comments are sometimes made to BDO by non-executive directors who chair audit committees at prospective clients. Such mythology may help perpetuate the Big Four's dominance of the Reference Market, but it is at odds with the facts. BDO's offices outside the UK have similar capabilities to BDO's UK offices. BDO considers that it is particularly well represented in China, where members of the BDO network have around 7,000 people.

5.1.12 The final sentence of paragraph 28 of the Issues Statement also implies that the Big Four offer a fuller **range of services** than other firms. As stated above, with the exception of largest scale consultancy, this is not the case, though some companies may assume, incorrectly, that the Big Four can offer a fuller range of services than any other firms. Services provided by BDO include: accountancy, audit, tax (including private client and tax investigations), corporate finance, business restructuring, dispute advisory, investment management, forensic accountancy, advice on preventing fraud and financial crime, risk and advisory, share and business valuations, technology advisory, and UK and global outsourcing. BDO's service offerings are listed at **Attachment 1**.

5.1.13 Paragraph 31 of the Issues Statement suggests that the barriers to entry associated with reputation may be due to investment by the Big Four "*through years of competition*". As noted in 5.1.5 to 5.1.7 above, investments by the Big Four in strategic acquisitions of parts of competitors' networks have had a negative impact on competition at both a national and international level, including undermining competitors' ability to enter or expand into markets and damaging their investments in those networks.

5.1.14 Paragraph 29 of the Issues Statement refers to the market power of the Big Four. That market power can be (and is) used by the Big Four to enable them to use **deep discounts** to try to win audit clients from BDO and other audit firms outside the Big Four, or to try to retain audit clients on the rare occasions when those clients invite a firm outside the Big Four to tender against a Big Four incumbent. BDO believes that the Big Four are willing to cross-subsidise certain clients' audit work for a period in order to try to win those clients from BDO and/or other firms outside the Big Four, or to try to retain audit clients when they are considering moving to BDO or another firm outside the Big Four. For example:

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[13] See Volume I of the Report by the House of Lords Select Committee on Economic Affairs, "*Auditors: Market concentration and their role*", at paragraph 94.

(a) in a recent tender for the [REDACTED] audit, in the face of deep discounting by Big Four firms ([REDACTED]), BDO was only able to retain the client (a FTSE 350 company) by [REDACTED]; and

(b) in a recent tender for [REDACTED], BDO were replaced as auditor by [REDACTED], who BDO understands quoted [REDACTED], well below normal rates for this work.

Such conduct reinforces and increases barriers to entry and expansion; it is anti-competitive and exclusionary. BDO strongly encourages the CC to investigate audit pricing, as set out in 4.3.2 above, including in particular whether the Big Four's audit prices for listed company audits (including but not limited to those companies in the FTSE 350) are higher if no Big Four firm is included in the tender and whether the Big Four price audit services below cost.

5.1.15 BDO considers that companies in the Reference Market are caught in a "vicious circle", because they are unwilling to consider audit firms outside the Big Four, yet see little point in changing from one Big Four firm to another, as they regard such a change as producing "more of the same thing". This is self-perpetuating, which reinforces the dominance and profitability of the Big Four firms. This is illustrated by comments made by [REDACTED]on a recent audit pitch, which BDO lost to [REDACTED]. According to notes made by BDO at the debrief, the client was:

> "*concerned we couldn't be as current on regulatory and technical issues owing to size and inability to borrow from our experience of working with other FTSE [100] clients (comparatively to Big Four)".*

5.2 Potential for bundling by the Big Four

5.2.1 So far as the potential for bundling by the Big Four is concerned, BDO considers that the Big Four benefit from **information asymmetry** as between Big Four firms and companies which are growing and ambitious, but whose perceptions lag behind the regulatory reality, e.g. in relation to requirements on independence and conflicts of interest. This is particularly true for companies which are growing and aspiring, who are often attracted by claims of sector knowledge, and experience in audit and non-audit services, perhaps believing (incorrectly) that the Big Four offer them a "one-stop shop" for all these services. This is consistent with paragraph 36 of the Issues Statement. This is one reason why BDO considers that barriers to entry and expansion apply in relation to all listed companies. Barriers to entry and expansion in relation to the Reference Market should not therefore be considered in isolation. It is necessary to consider how the wider audit market operates, particularly in relation to growing companies who aspire (or could reasonably expect) to become FTSE 350 companies. These barriers and market dynamics have an upstream effect on the Reference Market, as membership of the FTSE 350 changes over time.

5.2.2 Audit partners are not permitted to be rewarded for selling other services to audit clients, but they can tell audit clients when they might need such services. Ironically, it appears that audit committees value auditors' perceived capabilities in non-audit services, just as the likelihood of their provision is being cut back by regulatory proposals. Most audit proposals in which BDO are invited to participate are outside the FTSE 350, where emerging developments in corporate governance may hold less sway.

5.2.3 The desire for non-audit services from auditors is illustrated by the following extracts from BDO personnel's notes of tender debriefings within the last 12 months:

(a) [REDACTED] - audit and tax - lost to [REDACTED]:

'They weren't convinced we work on a daily basis with complex international tax advisory projects, like the Big Four do. [REDACTED] *already do their tax work, so it was an easy decision to move the audit over to them';*

(b) [REDACTED] (privately-owned supplier of [REDACTED]; turnover [REDACTED]) - audit & tax - lost to [REDACTED]:

'*There were still questions from some of the board members on the panel regarding our credentials versus the Big Four'*

5.3 Customer conduct

5.3.1 BDO considers that customer conduct does limit competition in the Reference Market, in particular because of the low frequency of tenders and low levels of switching. On average, according to the Oxera Report[14], less than 3% of FTSE 350 companies switch auditors each year and a significant proportion of switching is driven by company mergers.

5.3.2 The CC should however bear in mind that the corporate customer, while legally obliged to have its accounts audited, is of course not the ultimate or only consumer or user of the audit service. Those relying on the audit will include current, future and potential investors, lenders, suppliers, employees and officers, as well as the tax authorities and other regulatory and governmental bodies. The term "customer" must therefore be used with some caution in this context. Audit services are unusual in that the company paying for the service is obliged to obtain and pay for it both on its own behalf and - in effect - on behalf of others. Indeed, the auditors are formally appointed by shareholders, to whom they owe their duty of care, and companies are effectively selecting auditors on their behalf.

5.3.3 BDO considers that **customer switching costs** can be overstated. The main costs of switching for a company are:

(a) the additional time of the audit committee and management in selecting an audit firm; and

(b) the time of staff, generally in the finance department, in explaining the operations and systems of the company to prospective auditors, and in more depth when a new auditor carries out its first audit.

5.3.4 In contrast, the costs to audit firms of participating in a tender can be significant and will typically be equivalent to the first year's fees, largely in the time cost of the firm's personnel. An incoming audit firm will also spend more time conducting its first audit of its new client, while it familiarises itself with the business of that client. This means that its margin on that first audit will be considerably lower.

5.3.5 In BDO's view, the infrequency of tendering and low levels of switching are consequences of:

(a) the difficulties customers face in judging audit quality;

[14] Oxera Report, Table 3.7.

(b) the conservatism of audit committees; and

(c) the lack of choice available;

but BDO would not expect companies to change auditors every year.

5.3.6 There can however be considerable benefits to a company from switching auditors. **Attachment 5** sets out a selection of comments received by BDO from customers who have recently switched their audit to BDO from a Big Four firm.

5.3.7 BDO provided services other than statutory audits for 57 FTSE 350 companies in 2010/11 (including 23 FTSE 100 companies).[15] BDO currently audits one company in the FTSE 100 and five companies in the FTSE 250. BDO believes that it has acted (in a non-audit capacity) for more than [REDACTED] of companies in the Reference Market over the last three years. BDO is therefore favoured more for non audit services than for the provision of audit services to FTSE 350 companies. BDO believes that the reason for this is not BDO's fundamental capability, but conservatism by FTSE 350 companies, and by their audit committees in particular, in ensuring that any suggestion of risk in relation to the audit appointment is avoided by going to a Big Four firm. This is illustrated by feedback from tender debriefings - see, for example, comments quoted at 5.2.2 above.

5.3.8 Audit committees are chaired by able and experienced businessmen or women, largely towards the end of their successful careers. They will generally have had long-lasting relationships with Big Four firms. They do not want to risk blighting their reputations by being seen to be party to any appointment that may be seen as higher in risk. The underlying assumption is that an audit failure by one of the largest four audit firms would be less likely to expose the audit committee to criticism than one which involved another audit firm.

5.3.9 Paragraph 40 of the Issues Statement includes in the second sentence a restatement of the arguments made by the Big Four to the CC that companies have the option of appointing an alternative supplier, there is a credible threat of switching and companies are aware of alternative suppliers' prices without a formal tender. Those arguments are **entirely unconvincing and without merit**, because:

(a) companies face restricted choice due to conflicts of interest and independence requirements; this reduces the credibility of a threat to switch, particularly in sectors where concentration is highest, such as banking;

(b) threats lack credibility where there is little or no history of those threats being acted upon. The levels of switching in the Reference Market have been so low for so long that threats of switching lack credibility;

(c) the pressure associated with the "threat" of a tender cannot be equated with the competitive dynamics of an actual tender process. Unless and until a tender process is conducted, as opposed to informal discussions with one or two selected Big Four firms, a customer cannot genuinely be aware of alternative suppliers' prices. At present, not every large company will be fully aware of what other auditors, particularly auditors outside the Big Four, could do. In contrast, a properly conducted tender process

[15] Those companies are listed in **Attachment 2.**

would enable auditors outside the Big Four fully to set out their credentials and offerings as potential suppliers;

(d) the apparent willingness of Big Four firms to price more aggressively in tenders where they face genuine competition from other audit firms may indicate that they are not exposed to real competition for other business, in particular where one of them is the incumbent auditor and no firm outside the Big Four is being considered for the work;

(e) although the audit fee charged to listed companies is publicly reported:

(i) price comparisons between different companies for audit services are not necessarily appropriate, as audit services need to be tailored to the relevant company's activities, transactions and operations; and

(ii) because of the extent of concentration in the market, such disclosure does not give an indication of the fees which could be charged by auditors outside the Big Four; and

(f) the present operation of the Reference Market, with very low levels of tendering or switching, is delivering very high levels of profitability for the Big Four in comparison with other audit firms; preservation of the status quo would therefore be greatly beneficial to the Big Four. Their claims that the status quo represents anything like a properly functioning competitive market should therefore be regarded with considerable scepticism.

5.3.10 Customer conduct also limits competition because it takes some time for customers, particularly audit committees, to recognise the credentials of firms outside the Big Four, such as their capabilities and the size and coverage of their international networks. There is therefore a time lag between an enhancement of a firm's ability to compete and the market's recognition of that enhanced ability.

5.3.11 An October 2008 survey in Accountancy Magazine found that 61 of the 66 chartered accountant finance directors in the FTSE 100 were alumni of Big Four firms. The preponderance of Big Four alumni amongst finance directors in the Reference Market, together with the relationships that audit committee chairmen will inevitably have built with one or more Big Four firms, must have a marked impact on customer buying behaviour. While this impact may be difficult to measure, BDO considers that:

(a) it operates in favour of Big Four firms, on both a conscious and unconscious level; and

(b) this will reinforce the sense of closeness between auditor and company, which may concern the ultimate client, the shareholders.

5.4 Risks of regulatory failures leading to reduction or distortion of competition

5.4.1 BDO considers that the CC is right to raise this issue (paragraphs 42 to 45 of the Issues Statement).

5.4.2 BDO's views in relation to the lack of innovation are set out at 4.1 above.

5.5 Tacit coordination between the Big Four

5.5.1 BDO agrees with the comments in paragraphs 46 and 47 of the Issues Statement, subject to the comments made above about customer switching costs and price transparency.

5.5.2 As noted at 4.3.2 above, BDO urges the CC to **scrutinise audit pricing**, in particular:

(a) to compare audit pricing following tenders:

(i) in which only the Big Four firms participated, in comparison with those tenders in which BDO and/or other firms outside the Big Four also participated (BDO suspects that prices in the former category will be higher); and

(ii) where the incumbent auditor is a Big Four firm, in comparison with those where the incumbent auditor is BDO or another firm outside the Big Four (BDO suspects that prices in the former category will again be higher); and

(b) to compare audit prices over time following a competitive tender, as LSE Enterprise research[16] found that the Big Four put their prices up within three years of winning a competitive tender

and consider whether this gives any indication of tacit co-ordination between the Big Four.

5.5.3 BDO encourages the CC to consider whether the Reference Market displays conditions facilitating coordinated effects.

5.6 Information asymmetries

5.6.1 BDO broadly agrees with paragraphs 50 to 57 of the Issues Statement.

5.6.2 For any listed company, there are information asymmetries as between:

(a) shareholders and the board of directors;

(b) the audit committee and the CFO (the CFO works most closely with the auditors);

(c) the audit firm and shareholders (communication between the audit firm and shareholders is limited to a short section in the annual report); and

(d) the audit firm and the CFO or audit committee (see 5.2 above).

5.6.3 The larger the company and the more widely its shares are held, the greater the information asymmetries, particularly as regards (a) and (c) above.

5.6.4 The appointment and review of auditors is relatively opaque. The people the auditor reports to (the shareholders) are not the people who appoint the auditor in practice. Audit committees have relatively little to do with the detailed conduct of

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[16] LSE Enterprise Report: "*Concentration, Auditor Switching and Fees in the UK Audit Market*" (February 2008).

the audit; they therefore do not get to have much visibility of the degree of professional scepticism demonstrated by the audit firm. A company's auditor would typically meet the audit committee two or three times a year. In contrast, CFOs and their teams have much more contact with the audit firm, but a high degree of professional scepticism on the part of the auditors is not in the interests of the CFO or the finance team[17]. Shareholders will, almost invariably, have no contact whatsoever with auditors, either individually or as a body, except at AGMs, which are rarely forums for discussion.

5.6.5 For large or growing companies, each group concerned (shareholders, audit committee, board of directors, other advisers) appears to be likely to believe that another group would prefer the company to use a Big Four firm, even if that group does not itself have such a preference. Each group believes (or appears to believe) that there will be less need (or no need) to explain or justify a decision to appoint or retain a Big Four firm. See (for example) customer feedback from tender debriefings at 3.1.7 and 5.2.2 above, particularly the comments made by [REDACTED]. BDO suggests that the CC tests for this in its surveys.

5.7 Lack of Choice of Auditor

5.7.1 BDO considers that the Issues Statement does not give sufficient emphasis to companies' lack of choice of auditor: some companies have (or may consider themselves to have) only one or two options available to them, because of rules on conflicts of interest and concerns over auditor's independence. This issue is particularly significant because of:

(a) concerns regarding the systemic risk of a failure of one of the Big Four firms, which could lead to some companies having (or believing that they have) no alternative choice of auditor; and

(b) the growing importance of, and proposals to increase, regulatory requirements in relation to conflicts of interest and independence, including the European Commission's recent proposals.

5.7.2 Broadening choice for large companies beyond the Big Four would resolve or substantially mitigate this issue, which is particularly acute in relation to certain sectors or segments of the Reference Market, including banks and financial services, utilities, major telecoms, and oil and gas. Oxera found[18] that:

> *"… a limited number of UK-listed companies, particularly in the financial services sector of the FTSE 100, have no effective choice of auditor in the short run. This elimination of choice is driven by high market concentration, auditor independence rules, supply-side constraints, and the need for sector expertise."*

5.7.3 The Oxera Report also stated[19] that:

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[17] James R. Doty, the Chairman of the PCAOB, recently referred to the "*bias of the payment model: the auditor is hired and fired by the company itself. This creates perverse incentives for the auditor not to call the fouls*". See http://blogs.law.harvard.edu/corpgov/2012/01/08/auditing-in-the-decade-ahead-challenge-and-change/

[18] "*Competition and Choice in the UK audit market - prepared for DTI and FRC*", Oxera, April 2006 (the "**Oxera Report**").

[19] At page 91.

> *"A wider range of UK-listed companies have a choice of auditor that is circumscribed by auditor independence rules and the prevalence of the Big Four, such that they face an effective choice of only two or three audit firms … around one in eight FTSE 350 companies have two audit firms conflicted out as alternatives to their current auditor, leaving them only one alternative among the Big Four in the event of an audit tender."*

5.7.4 For example, the Head of Corporate Governance at Standard Life Investments told the House of Lords Select Committee that:

> *"it is the lack of choice that is the area of particular concern … we are no longer comfortable with relying on market forces to create the resolution … there has to be some … intervention."*[20]

5.7.5 With the increasing emphasis on audit independence arising through corporate governance and a focus on the provision of non audit services, it is increasingly likely that larger companies will use separate firms from their audit firm for tax, corporate finance and/or consultancy services. This emphasis is likely to continue, with a proposed EU Regulation effectively banning the provision by major audit firms of non-audit services. In the UK, the Financial Reporting Council ("**FRC**") appears to be moving in favour of much greater restrictions on the provision of non-audit services by auditors than those presently in force. This would restrict companies' choice of auditor very significantly.

5.7.6 However, paragraphs 58 to 61 of the Issues Statement give the (perhaps unintended) impression that the issues of lack of choice and systemic risk are of secondary importance to 'standard' competition concerns of concentration, service quality and high prices. BDO considers that the risk of failure of one of the Big Four is in itself a feature that already adversely affects competition in the Reference Market[21]. In any event, BDO encourages the CC to carry out the three analyses proposed in paragraph 61 of the Issues Statement at an early stage and with due weight.

5.8 Failure of exit of a Big Four firm

5.8.1 The failure or exit of a Big Four firm is not inconceivable, given (for example) the risk of a substantial negligence claim by the creditors or administrators of a large company against its former auditors.

5.8.2 The failure or exit of a Big Four firm would further increase concentration. In BDO's view, such an increase in concentration would be unacceptable in terms of the further reduction in customer choice and the likely increase in prices and/or reduction in service that would be expected to result from it.

5.8.3 BDO broadly supports the proposals put forward by the European Commission as regards contingency planning[22] for audit firms. However, any "living will" in relation to a Big Four audit firm should facilitate the transfer of parts of the exiting firm to non-Big Four firms, rather than to a surviving Big Four firm, to avoid a further

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[20] See evidence given by Mr Guy Jubb to the House of Lords Select Committee on Economic Affairs as part of its Inquiry on Auditors: market concentration and their role: http://www.parliament.uk/documents/lords-committees/economic-affairs/auditors/ucEAC110111ev9.pdf at page 5.

[21] See further evidence given to the House of Lords Select Committee on Economic Affairs as part of its Inquiry on Auditors: market concentration and their role at pages 4-5.

[22] In Article 43 of the draft Regulation of the European Parliament and of the Council (2011/0359).

increase in concentration. The division on national lines of an exiting Big Four firm among the surviving Big Three would not (in BDO's view) be an acceptable outcome.

5.9 Other points

5.9.1 Big Four commentators regularly suggest that mergers amongst the "next tier" of audit firms might create a "Big Five". However, BDO considers that such mergers would not address the fundamental issues in the Reference Market.

5.9.2 In any event:

(a) It would be very difficult in practice to obtain agreement across global networks, since each relevant firm's network comprises many firms;

(b) since the BDO network has turnover of around €4.6 billion, it is large enough independently to audit FTSE 350 clients, most of whom have much smaller worldwide turnover; and

(c) a combination of audit firms ranked fifth to tenth in size would still be smaller than any Big Four firm.

6 REMEDIES

6.1 BDO believes that while there is no one "magic bullet" remedy to resolve the adverse effects on competition which exist in relation to the Reference Market, a carefully constructed package of remedies, including but not limited to the introduction of shared or joint audits, greater transparency and regular retendering (as opposed to mandatory rotation, where the incumbent cannot bid to retain the work) could make a very substantial difference and create a more competitive market. BDO looks forward to discussing these with the CC at a later stage.

6.2 Although BDO continues to invest in its network, a more competitive market would enable BDO to justify larger investment - e.g. in hiring sector specific teams in anticipation of a more open market.

7 NEXT STEPS

BDO therefore strongly encourages the CC to:

7.1 **investigate audit pricing**, including in particular:

7.1.1 to compare audit pricing following tenders for listed company audits (including but not limited to those in the FTSE 350):

(a) in which only the Big Four firms participated, in comparison with those tenders in which firms outside the Big Four also participated;

(b) where the incumbent auditor is a Big Four firm, in comparison with those where the incumbent auditor is not a Big Four firm; and

(c) where the company's choice of auditor is further restricted by independence or conflict considerations (e.g. its choice is effectively limited to only two firms), compared to tenders where the company has a wider choice;

7.1.2 to compare audit prices over time following a competitive tender;

7.1.3 to examine relationships across time, relationships across sectors and (potentially) exploring variation across countries;

7.1.4 to investigate whether the Big Four price audit services below cost; and

7.1.5 to consider whether the Reference Market displays conditions facilitating coordinated effects;

7.2 **survey investors, audit committees and other corporate advisers** as to whether they believe that another group would prefer the company to use a Big Four audit firm, even if that group does not itself have such a preference;

7.3 **test empirically** the "one -way street" whereby companies move their audit to and stick with a Big Four firm for reasons of perception; and

7.4 **carry out the three analyses** proposed in paragraph 61 of the Issues Statement at an early stage and with due weight.

ATTACHMENTS

Attachment 1 - BDO's service offerings

Attachment 2 - list of FTSE 350 companies to whom BDO provided non-audit services in 2010/11

Attachment 3 - "*The Future of Corporate Reporting and Assurance*", BDO, March 2011

Attachment 4 - data analysis report prepared by Experian for BDO

Attachment 5 - comments received from companies who switched their audit to BDO from a Big Four firm

ATTACHMENT 1

BDO's Service Offerings

BDO Assurance Services

Advice on complex issues

- Business combinations
- Financial instruments
- Share schemes
- Pensions
- Capital transactions
- Liquidity issues

Regulatory compliance

- Compliance assurance
- Evaluation of new regulation
- Authorisation and approval advisory
- Remedial regulation advisory
- iXBRL
- Pension scheme assurance
- Company secretarial services

Governance

- Governance structure framework advisory
- Risk management process review
- New listings
- Audit committee support
- Performance measurement and reporting
- Emissions reporting and sustainability assurance

Financial statement assurance

- Statutory audit
- Accountants' reports
- Special purpose financial statements
- Financial covenant compliance
- Service charge audits
- Commission and royalty reporting
- Grant body reporting
- Completion accounts

Controls and risk assurance

- Technology assurance
- Control and process design, implementation and testing
- Risk evaluation and measurement

Non-financial reporting

- Internal Audit: outsourcing, co-sourcing and advisory SAS70/AAFD1/06
- Project review and assurance
- Best practice benchmarking
- Operating and financial review advice and assurance
- Best practice benchmarking
- Business review advice and assurance

Compliance and regulation

- Review of IFRS
- GAAP conversion and reporting
- Sarbox and Turnbull reporting

BDO Other Services

Tax Services

Corporate clients

- Corporate and M&A
- Corporate International
- Real Estate tax planning
- Transfer Pricing
- Human Capital
- Tax investigations
- VAT and Customs Duty
- Valuations

Private clients

- Tax planning
- Personal tax
- International tax
- Inheritance tax
- VAT
- Tax investigations

Public sector

- Employment tax
- Tax investigations
- VAT

Tax Support for Professionals

- Corporate tax
- VAT
- Property tax
- Employment tax
- Personal tax
- Inheritance tax and estate planning
- Tax investigations
- Valuations

Private Clients

- Inheritance Tax planning
- Offshore Tax planning
- International Tax planning
- Capital Gains Tax planning
- Image rights structuring
- Wealth management
- Private equity
- Divorce/matrimonial
- Yacht and plane structuring
- Succession planning and family governance
- Personal tax returns
- Family office (monthly accounts, bank statement reconciliation, etc)
- Trust returns, accounts and administration
- Partnership tax planning and compliance

Tax Investigation Services

- Disclosure facilities
- Personal accountability

Advisory

Business Restructuring

Corporate Finance

- Mergers and acquisitions
- Due diligence
- Capital markets
- Raising finance
- PLC advisory
- Financial modeling
- Government and infrastructure

Dispute Advisory Services

- Commercial dispute resolution
- Expert witness services
- Professional negligence services
- Share and business valuations

Fraud and Financial Crime

- Fraud and financial investigations
- Fraud investigation and prevention
- Anti corruption and money laundering
- Asset investigation and recovery
- Forensic technology

Risk and Advisory Services

Share and Business Valuations

Technology Advisory Services

- IT director service
- IT risk assessment
- Managing bespoke software development projects
- IT strategic planning
- Packaged software implementation
- Resolving supplier disputes
- Reviewing internal business processes
- Specification and selection of business software

UK and Global Outsourcing

- Global outsourcing: accounting and compliance in 145+ countries
- UK outsourcing services: inward investment
- Local compliance in global business

ATTACHMENT 2

FTSE 350 companies to whom BDO provided non-audit services in 2010-11 (FTSE 100 companies are in bold)

[REDACTED]

ATTACHMENT 4

Data analysis report prepared by Experian for BDO

[REDACTED]

ATTACHMENT 5

COMMENTS FROM CUSTOMERS WHO SWITCHED THEIR AUDIT TO BDO FROM A BIG FOUR FIRM

1 [REDACTED] (real estate and construction; privately owned; turnover [REDACTED]):

"*BDO have been my auditors and tax advisors from* [REDACTED] *since moving from a Big 4 firm. What impressed me more than anything … was that they are a team of advisors that very quickly got up to speed with understanding my business and its needs. They work well as a team and bring me ideas and opportunities as well as solutions to problems. For this reason, I believe they stand out above their competition. Through the property sector events they hold and meetings I have had with them you can see that they are genuinely interested in me and my business, wanting it to succeed and trying to find ways of helping me achieve that. In a short space of time they have become part of my team and I am very pleased I appointed them.*";

2 [REDACTED] (technology; privately owned; turnover: [REDACTED]):

"*BDO understands our business; their advice takes into account both the technical solutions and the practical implementation. Bolstered by their much quicker turnaround time and an outstanding technical knowledge, we've found BDO offers a more personable service and is highly attentive to our needs in comparison to the Big 4. In addition, as our business has expanded internationally, BDO has strongly supported us in providing local expertise through their network of international offices.*"

3 [REDACTED] (manufacturing; privately owned; turnover: [REDACTED])

"*We appointed BDO in* [REDACTED] *as our auditors and tax advisers, making what seemed a difficult decision to move away from a Big 4 firm. We decided to appoint BDO given their good reputation particularly in our sector, their pragmatic and tailored approach as well as the fact they are a good fit with our business. Fifteen months into our working relationship I am very pleased to say it was the right decision to appoint BDO, they have invested a lot of time and effort into understanding how our business operates which has helped ensure a smooth and efficient audit. The BDO team have built an excellent relationship with us; they are always quick to respond and they do what they say they will.*"

4 [REDACTED] (technology, media & telecoms; privately owned; turnover [REDACTED]):

"*Having appointed BDO to undertake the group's audit and tax services after being with a big 4 firm for many years, we could have been forgiven for perhaps expecting a lesser quality of service or a reduction in the expertise available to us. Nothing could have been further from the truth, as BDO listened to our requirements and clearly focused on delivering a high quality of service through teams that place a real value in fostering excellent working relationships and clearly understand our business and its needs.*"

5 [REDACTED] (real estate and construction; privately owned; turnover [REDACTED]):

"*We appointed BDO in* [REDACTED] *following a number of years with a Big 4 firm. Having recently completed the audit process one of the key benefits I noted was the speed of turnaround from BDO once information had been provided to them, and how easy it was to pick up the phone for some guidance on specific points without feeling like it would result in additional fees. I have found that BDO are focused on providing commercial advice and helping us find solutions. I also appreciated the co-ordinated approach between audit and tax, with the tax team timing their visit to coincide with the main audit work in order to share relevant information, which gave me greater time to concentrate on running the business without feeling detached from the process.*"