COMPETITION COMMISSION

STATUTORY AUDIT SERVICES MARKET INVESTIGATION

Summary of hearing with Mazars held on 13 February 2012

1. Mazars gave a presentation at the start of this hearing and a non-confidential copy can be found on the CC's website: Presentations to the CC. This summary sets out additional points made by Mazars.

Overview of Mazars

2. Mazars said that it was operating within an unhealthy market structure and this structure had not emerged naturally from competitive market forces. Mazars did not consider that vigorous competition existed. It also did not consider that the structure of the marketplace was in the interests of shareholders. Mazars did not consider the current structure to be inevitable but thought that an open vibrant market, with significantly greater competition, could be created within a reasonable timescale if there was regulatory intervention.

3. Mazars was an international, integrated and independent organization which worked in two main corporate marketplaces: the public interest entity and the entrepreneurial marketplace, which included smaller entities. It also had some dealings with high net-worth value individuals. One of its distinguishing features was that in addition to being an international business, its member firms were bound together into a single, integrated global partnership. This was very important as this structure was unique to Mazars and it enabled much closer relationships between the member firms of Mazars. The alternative network or alliance structures were much easier for member firms to leave. From a client's perspective Mazars' type of integrated structure provided a much higher level of continuity and provided a seamless service across international boundaries. As part of its integrated structure, Mazars had international profit sharing, which meant it could drive higher quality levels. It also enabled Mazars to determine a global strategy.

4. Throughout its history Mazars had invested and had demonstrated a willingness to invest in the future of its business. It operated under a partnership model which meant that globally it was operating to common values and culture. Each country within Mazars subscribed to the same values allowing a seamless client service across international boundaries.

5. Mazars said that it was one of the fastest growing global firms of accountants and one of the fastest growing firms within the UK. It was present as an integrated single partnership in countries representing 90 per cent of global GDP and had looser arrangements in other countries so that it could serve the vast majority of countries. Virtually all of its offices throughout the world had the primary purpose of undertaking large corporate work and the substantial majority of offices were accustomed to working for global clients.

6. Mazars had grown internationally by opening offices to service the local work of its CAC 40 clients and had taken this approach in the UK market, where its team of approximately 40 to 50 staff initially only serviced its global clients. However, as its clients grew and demand increased, it beceme necessary to increase the depth and scale of its teams. It had an office in the USA for more than 20 years, which had not undertaken any local activity. It had sought to increase the size of this business by merging with Weiser in 2010 after previously being in a joint-venture arrangement .It

considered that the liability risk had become more manageable in the USA. It had arrangements in other parts of the world beyond the Mazars global partnership which it could access should that be necessary to serve its clients.

Capability to audit large companies

7. Mazars considered that it had very significant expertise and capability in auditing large companies, as demonstrated by its French client base and the number of mandates it held in the CAC 40 market. This client base provided Mazars with a very deep and wide sector of expertise, covering three of the key sectors with distinguishing features: banking, insurance and energy.

8. Audit was a complex arrangement and involved project-managing relationships between many participants. This was why the one firm model employed by Mazars was so important, as this ensured that many of these relationships were within the same firm. Mazars had a top-down approach to large public interest entity audits, defining the approach and method at group level and disseminating this to its subsidiaries. This meant that a substantial presence on the ground was not necessary in order to carry out a major group audit. Although language and local understanding were both still required, the core audit work could be driven from the top without a significant presence in local jurisdictions. Mazars did not need to be the size of one of the largest four auditors in order to be an active participant in the large audit market.

9. The quality of the audit could be enhanced by using fewer people but ensuring that they had a strong expertise in the necessary area. For example, its firm in Africa covered the neighbouring countries along the Ivory Coast with one core team very capable of servicing large companies. Instead of buying local firms without the necessary experience of auditing large companies, Mazars, at least in part, preferred to transfer experienced staff to that country or complement local teams with its more experienced staff from throughout the world. Mazars tended to be more top-heavy than other firms and considered that it was very important to have very senior involvement in audits.

10. There were joint audit arrangements in place with a number of Mazars clients. Typically in joint audits, the central audit work was split equally between the two joint auditors and local work was allocated to one of the joint auditors. Mazars referred to the example of a major global insurance company [✂] for which it acted in 31 countries. Through its audit of this company, Mazars had built significant insurance auditing expertise in Mexico. It had also invested significantly in its in-house actuarial capabilities globally. Mazars also acted in 35 countries for a large global bank [✂] and its work for this client had enabled it to invest in its banking capability in the UK market. It also acted for a major defence business [✂] in 32 countries. It had discussions with this joint audit client when Andersen collapsed because the company had a major presence in the USA. Mazars was able to very quickly take on the audit of all of its US operations, as it had detailed knowledge and understanding of the company's operations. It had been so successful in its audit work that it was still the auditor of this company in the USA. This example illustrated that it was possible to switch quickly between auditors and that a large presence in the country was not always necessary in order to carry out large audits.

11. Mazars considered joint audit to be an important vehicle both for enhancing competition and quality. It had facilitated the emergence of new challengers in the large audit market as demonstrated by the emergence of Mazars as an important competitor in France. It also allowed for more tendering and switching than had taken place in other markets. Both firms were responsible for the whole opinion on a

company's accounts, therefore it bypassed the dilemma that 'no one had ever been fired for hiring IBM'. Other firms had emerged through joint audit in France but these had been acquired by the dominant players. Had it not been for that, then there would be even more players in that market. Despite this, there were still more than 100 firms involved in the audit of the top 250 listed companies that were capable of growing their market presence. Mazars emphasized that there was modest additional time required in undertaking joint audits, and such additional review work provided extra quality. Joint audit also facilitated debate on technical issues between the two auditors before forming a joint view on issues, giving additional reassurance to investors. Disagreements between the auditors could always be resolved through further discussion, rather than by relying on the audited entity to resolve any difficulties. Different opinions could be expressed in the audit report but Mazars was not aware that this had ever happened. There was a strong incentive for the audit firms and the company to agree a sensible way forward.

12. There was more interest in joint audits than ten years ago and this also now had support from firms outside the largest four auditors, who had previously been sceptical. There was also some support for this among institutional shareholders and investors. The four largest auditors were strongly opposed to this, which Mazars believed highlighted that they saw it as a key risk to their dominance. It believed that the market expected change but needed a catalyst to ensure such change happened. The concept of joint audit was gathering momentum.

13. Mazars said that it would be capable of auditing the large majority of FTSE 350 companies on a sole basis and all others, with the exception of one or two of the very largest companies, on a joint basis. Mazars was capable of undertaking such sole audits, as there were a number of companies it audited in the CAC 40 where it already undertook a very significant share of the work and it would be more than capable of doing this on a sole basis if the joint audit arrangements were not in place.

Mazars UK development

14. Mazars had invested significantly in the UK market and had available funds to do so, but the majority of growth was outside both audit and the FTSE 350. The marketplace itself had been the constraining factor in the growth of its audit business. After its merger with Neville Russell, there was a strong belief and expectation that it would be able to transfer its capabilities and credentials into the UK market. However, it subsequently lost one of its major FTSE 250 insurance clients [✂] as the audit committee chairman, who was a former Big 4 partner, said that if anything went wrong he would be criticized for not having a Big Four auditor. Mazars was advised to focus on the AIM market which it considered surprising given that its capabilities were more suited to the large corporate market. Mazars started to press for regulatory intervention in the market as it had become very clear that there were significant barriers in the market preventing open competition. Mazars had since had some success in penetrating the audit market, but thought that there was a ceiling halfway through the FTSE small caps index where companies were not systematically accessible through competitive tendering. It was, however, continuing to spend time, effort and money in promoting Mazars' capability in the FTSE 350 market, primarily through non-audit work. This was where the market appeared more ready to accept other players. It had set up an initiative called 'threefifty' which brought together investors, companies and auditors to discuss current issues. However, despite its efforts to engage with the FTSE 350 market, Mazars had not been invited to tender for one single FTSE350 audit in the UK in the last five years.

Competition in the audit market

15. The key stakeholders in the audit market had differing expectations in terms of competition, choice and quality. Mazars thought that the key factor was competition rather than choice. Stakeholders had very different views on quality, for example regulators associated quality with compliance with standards. Mazars noted that the 2010 Inspection Report, from US regulator PCAOB, found faults in 45 per cent of the audits carried out by Deloitte and 39 per cent by PwC. There were also issues over whether audit could be considered a commodity or a valued service, and Mazars strongly considered it to be a value service.

16. There was a very high concentration of audit fees at the top end of the FTSE 100, ie the top 20 companies accounted for 40 per cent of the total fees in the FTSE 350. Therefore any remedies needed to take account of the need to be effective at the top end of the market if they were to impact on the levels of concentration. It also noted there was a particularly high concentration of fees in certain sectors, such as banking and oil and gas.

17. In terms of comparing switching figures between the UK and France, in France there was a six-year audit mandate, as compared with an annual renewal mandate in the UK. Figures demonstrated that approximately one-fifth of companies in the CAC 40 had changed its auditor in the last six years. This was significantly different from the UK market. In relation to tendering, Mazars said that there was a no-win situation with regards to pricing tenders. When it quoted a low fee, companies had questioned its capabilities and understanding of the market. However, if it pitched at a more reasonable and supportable level, more often those companies would ask its current auditor to match that level. Companies were also very influenced by the range of services provided, and Mazars had recently lost a tender because its corporate finance capability in the south-east of Asia was not considered to be strong enough. This was a key factor in that particular company's choice of auditor.

18. Mazars said that a very significant set of audit standards had been developed over the last ten years, which although had brought benefits also meant that there was very little room for interpretation or judgement. This benefited firms, since in risk management terms it offered them greater protection. Mazars did not necessarily consider that this was in the best interests of the clients. These standards and rules had also enabled firms to develop automated processes and brought cost savings, as the more commoditized the service became the more work could be completed by junior staff. Mazars thought that these developments went against the role of auditors, and the judgement and scepticism which auditors could offer. Mazars thought that as a result of these types of changes, the audit partner was at risk of becoming less of a key player from a technical perspective and more important in terms of the commercial and sales side of auditing.

19. Mazars said that the standard ISA 600 had a very significant effect on competition in the market as there was a perception that the four largest auditors had interpreted this standard as requiring the auditor of the group audit to also carry out all the audits of subsidiaries. This was not what the standard in fact set out. However, this misinterpretation was becoming more widespread in the market (and appeared to be promoted by the four largest firms).

20. Mazars said that, although not necessarily intentional, there was an institutional bias in favour of the four largest auditors. In the UK, as opposed to a number of other countries, many accountants on the boards of large companies would have been trained by the four largest auditors and therefore they had a shared belief in the value of those firms and had established strong alumni links. A number of the board

members and senior staff at the FRC had come from the four largest auditors. As another example, the chairman of a key Faculty of the ICAEW, to the best of Mazars' knowledge, had always been drawn from one of the four largest auditors. [✂] The Big Four auditors also provided various secretariat support to a number of other bodies, such as the group representing the finance directors of the largest one hundred listed companies or so and the Corporate Reporting Users' Forum which brought together investors. In combination, this meant that there was a whole network of relationships which gave the Big Four firms a more dominant presence than others.

21. Mazars' key distinguishing feature in the audit market was the integrated nature of its organization, which brought real value to its clients. It was clear that the lead partner on an audit had full control over the whole team, wherever they were based. However, this advantage was difficult to demonstrate in a tender process. Mazars engaged with most FTSE 350 companies in some form, corresponding regularly with them. Over the last 12 months Mazars had met with 15 to 20 key executives of the FTSE 350. It had recently set up an Advisory Board with senior non-executives to facilitate meetings with audit committee chairmen and this had been very successful. It was also approaching FTSE 350 companies to offer niche services in non-audit. [✂] Mazars typically sought to introduce its capability to the key executives of large companies to explain what services it could offer. However, although firms were receptive to non-audit work, many companies would not want to consider a non-Big Four auditor for their group audit. Mazars was regularly seeking to confront this kind of prejudice.

Profitability and competition

22. Mazars said that it was very difficult to attract audit teams as the audit partner was unwilling to transfer to another firm if they were not going to be offered similar audit opportunities and could not necessarily transfer their clients. Market power also enabled firms to take over emerging firms from other networks thereby reducing the strength of competitors, as had been seen in France, Brazil and Denmark.

International networks and new entrants

23. Mazars said that the concept of networks of firms made it more difficult to increase competition as this effectively prevented firms in different countries from competing with each other cross-border. New players were emerging in China as the Chinese authorities were keen to prevent the Big Four firms from developing too fast at the expense of local players.