

The Inquiry Manager
Competition Commission
Audit Market Investigation
Victoria House
Southampton Row
London
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Dear Sir

Investigation into the supply of statutory audit services to large companies in the UK

We refer to the publication of the working paper "*The Framework for the CC's Assessment and Revised Theories of Harm*" (the "Working Paper") by the Competition Commission ("CC") on 10 August 2012.

We broadly concur with the substance of the Working Paper and, in particular, with the principal theories of harm currently being pursued by the CC in its investigation into the market for statutory audit services to large companies in the UK (the "Market").

However, although we agree with the issues discussed under "*Customer behaviour and market structure producing adverse outcomes*", we are concerned that such a heading is not sufficiently comprehensive in terms of encapsulating all relevant factors that we consider should be incorporated into the CC's thinking at this stage, including the acquisition of network firms, pricing, the role of intermediaries and reputational advantages. Accordingly, we would like to draw to the CC's attention the following issues (certain of which were raised previously in the Issues Statement) which are not expressly set out in the Working Paper:

1. We are surprised that paragraph 83(a) of the Working Paper does not deal with potentially exclusionary behaviour by intermediaries. Where, for example, a third party has a contractual right in respect of the appointment of a statutory auditor, we consider this to be a substantial and widely-recognised barrier to competition.
2. There is no mention of the potentially adverse outcomes which might result from one of the four largest audit firms leaving the market, which were described in paragraphs 58 - 61 of the Issues Statement: these paragraphs set out in some detail how the CC proposed to approach its work in this respect, including making a decision as to whether the risk of failure or exit of one of those firms in itself represented an adverse effect on competition.
3. Although the CC does not appear at this stage to be focusing upon a theory of harm based upon the risk of regulatory failures, we suggest that much of the evidence, including the CC's recent survey of chief financial officers and audit committee chairs, supports the position that customers may well be biased towards the 'safe choice', as set out in paragraph 45 of the Issues Statement.



4. The Working Paper does not describe how legal and/or commercial conflicts may result in a reduced choice of auditor, even within the four largest audit firms, although this was raised in paragraph 30 of the Issues Statement.
5. The Working Paper does not refer to the four largest audit firms' targeting of growing companies before they enter the FTSE 350, creating incumbency: in our view this is inextricably linked with the theories of harm involving barriers to entry and expansion that apply in relation to the Market.
6. The Working Paper does not mention how the four largest firms have reinforced their market power through acquiring selected firms from the international networks of mid-tier firms, including BDO: again, we consider this to increase barriers to entry/expansion in the Market.
7. The Working Paper does not directly refer to a potential lack of innovation in the Market: we assume, however, that the CC intends to develop this further as part of its theories of harm.
8. In relation to paragraph 90 of the Working Paper, we consider that the reputational advantage of the four largest audit firms is not derived from "*excessive investments in marketing*", but rather from a combination of other factors, including: familiarity; custom and practice; history; relationships with alumni and intermediaries; and conduct, such as acquiring network firms and deep discounting. Although the Working Paper does not mention most of these, we again assume that the CC will develop these other factors further as part of its theories of harm.

Finally, for the avoidance of doubt, we do not consider potential theories of harm focusing upon the bundling of services and/or tacit co-ordination as integral to our conviction that the current restrictions of choice and competition in the Market result in adverse effects on competition.

If you would like us to clarify or expand upon any of these points, please contact James Roberts on 01293 591087 - email james.roberts@bdo.co.uk

Yours faithfully



BDO LLP