

6 September 2011

Mr Peter Hill
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Dear Mr Hill

Consultation on the provisional decision to make a market investigation reference to the Competition Commission of the supply of statutory audit services to large companies in the UK

In response to the consultation of the Office of Fair Trading (OFT) on the proposal to refer the supply of statutory audit services to large companies in the UK to the Competition Commission (CC), I am writing to bring to your attention information about the wider audit market which the OFT, and any subsequent investigation by the CC, may wish to consider.

The Audit Commission's remit relates to statutory audits of local public bodies in England (mainly local authorities and local NHS bodies) and so we are not commenting formally on the proposal to refer the supply of statutory audits of large companies to the CC, as this is outside our remit. However, we share many of the concerns that are summarised in the consultation document and which underpin the proposal to make a referral. In particular, as a commissioner and purchaser of statutory audits of local public bodies we agree that the effectiveness of the audit market is of vital importance to the health of the UK economy including the public sector.

In August 2011 the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission and put in place new arrangements for the audits of local public bodies. Under current arrangements the Audit Commission appoints auditors to local public bodies. Appointed auditors are either Audit Commission employees (the in-house audit practice) or one of the audit firms. In future, subject to the necessary legislation, local public bodies themselves will have a duty to appoint their own auditors.

The in-house audit practice currently undertakes the majority of audits for local public bodies. In July 2011, Ministers in the Department for Communities and Local Government (DCLG) confirmed their preference for transferring this work to the private sector by outsourcing contracts, and the Audit Commission is now carrying out a procurement process to give private sector bidders the chance to compete for the Commission's audit work. This will mean all of the Commission's in-house work will be outsourced in time for the audit of 2012/13 accounts.

The Audit Commission will remain in place to oversee the contracts and other statutory functions and continues to work with DCLG on its proposals for the future of local audit.

In March 2011, DCLG issued a consultation document on the future of local audit. The Audit Commission welcomed the consultation and published both a summary and a detailed response which are available on our website at:

<http://www.audit-commission.gov.uk/aboutus/future/pages/responsetodclg.aspx>.

DCLG's consultation on the future of local audit highlighted a range of issues some of which we believe are relevant to considerations about addressing audit market concentration. In particular, we have referred in our full response to DCLG's consultation to:

- the debate about whether to strengthen audit arrangements for public interest entities such as listed companies, and, in this context, the issues raised in the recent EU paper *Audit Policy: Lessons from the Crisis* (see paragraph 18 of our full response);
- the need to consider the impact on competition. In particular, we noted that moving away from a managed market, in which competition is secured through nationally conducted commissioning and procurement of audits, to one in which local public bodies appoint their own auditors is likely to increase market concentration, which may in turn impact on the level of audit fees (see paragraphs 86 to 94);
- the experience of enabling NHS Foundation Trusts (FTs) to appoint their own auditors which suggests that market concentration would be a risk in the public audit market as well as the larger companies audit market (see paragraph 93). In the FT sector, the market has concentrated around three suppliers: the Audit Commission's in-house audit practice, KPMG and pwc. Four other firms (Baker Tilly, Deloitte, Grant Thornton and PKF) have only a few appointments each; and
- the House of Lords' Select Committee on Economic Affairs' 2nd Report of Session 2010/11 on *Auditors: Market Concentration and Their Role* which also highlighted concerns about market concentration and saw the transfer of the Audit Commission's in-house audit practice into the private sector as an opportunity to help reduce market concentration by forming the basis of a 'new competitor to the Big Four'. At paragraph 97 of our response we noted our view that a managed transfer of the in-house practice into the private sector, and centralised procurement of a mix of suppliers including some non-Big Four firms, represents the most effective way of avoiding further market concentration, and encouraging new suppliers of public audit.

We recognise that the scope of the proposed investigation into the supply of statutory audit services to large companies in the UK will not include the market for statutory audits of public bodies. However, we believe it would be useful to consider the impact on market concentration of moving away from centralised procurement of local public audit in England, and we would be pleased to discuss with you further the points that we have highlighted if that would be helpful.

Yours sincerely

A handwritten signature in black ink that reads "Martin Evans". The signature is written in a cursive, flowing style.

Martin Evans
Managing Director, Audit Policy