

**COMPETITION COMMISSION STATUTORY AUDIT MARKET INVESTIGATION**  
**COMMENTS ON BEHALF OF BDO LLP ON THE INITIAL REVIEW OF RELEVANT**  
**ACADEMIC LITERATURE (THE "REVIEW")**

**1 Analysis of Competition**

We do not agree with the statement on page 3 of the Review that *'from an economics perspective, the investigation of competition in the audit market is quite intractable'*. Analysing competition in the audit market is certainly not straightforward, but the Competition Commission ("CC") and other authorities have dealt with many other complex industries and markets before.

**2 Market Concentration and Audit Fees**

2.1 The Review's coverage of studies on market concentration and audit fees is rather limited, and we consider that there is no adequate synthesis of the results of the literature on this topic. For example, none of the five academic papers on this subject that were cited by Oxera (2006, section 5.2.7<sup>1</sup>) has been covered by the Review. The omitted research has typically identified results consistent with Oxera (2006), i.e. a positive link between concentration and price. More recent research such as LSE Enterprises (2008<sup>2</sup>) is also omitted, while older research such as Banker et al (2003<sup>3</sup>) is included. It is therefore not the case that the recent literature is covered by the Review, whereas the older literature is not.

2.2 Similarly, most of the papers cited by Deloitte (2012)<sup>4</sup> and by PwC (2006)<sup>5</sup> in their reports on aspects of price-concentration have not been included in the Review. Specifically, none of eleven papers cited by PwC and only two of the six cited by Deloitte have been covered by the Review.

2.3 On the basis that the CC is likely to research the link between concentration and price (or other market outcomes), the CC should note that further relevant research is available, and the Review should not be regarded as being comprehensive on this topic. It would still be desirable to have a synthesis of the literature on price-concentration, and in our view the Review has not provided this.

**3 Metrics for Audit Quality in Econometric Studies**

On pages 8-12 of the Review there is a useful discussion, and a table (Table 1 on page 9), of possible metrics for audit quality as used in econometric studies. Every metric has its shortcomings, but the overview will be useful for the CC when it is considering possible dependent and explanatory variables in its own econometric modelling.

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<sup>1</sup> Oxera, (2006), 'Competition and Choice in the UK Audit Market', April, pp. 79-80.

<sup>2</sup> LSE Enterprise, (2008), 'Concentration, Auditor Switching and Fees in the UK Audit Market'.

<sup>3</sup> Banker, RD., Chang, H. and Cunningham, R. (2003). 'The public accounting industry production function'. *Journal of Accounting and economics*, 35(2): pp.255-281.

<sup>4</sup> Deloitte, (2012), 'Audit Pricing Analysis', February.

<sup>5</sup> PwC, (2006), 'Competition and choice in the UK audit market – a review of the Oxera report', August.

#### 4 **The Financial Crisis**

There is no coverage in the Review of the role of audit firms in the financial crisis, nor of research which explicitly addresses the period of the crisis. This is perfectly understandable, given that academic research takes time, but it is an important limitation. For example, investors' views of audit quality and the purchasing behaviour of Audit Committee Chairs/Finance Directors may have changed following the crisis.

#### 5 **AIU Reports**

The academic research on audit quality should be read in conjunction with the AIU reports on audit quality, which are more relevant to the UK and are more up to date.

#### 6 **Funding of Research**

6.1 The Review does not mention (so Professor Beattie appears not to have considered) how any of the research was funded, and in particular whether it was funded or subsidised in any way by audit firms. While research ought to be judged on its merits, it is relevant to know how and by whom it was funded/supported (for example, we have been clear in saying that the LSE Enterprises (2008) paper was supported by BDO). We note, for example, that a paper by Newton et al (2011<sup>6</sup>) is written by a PhD student, an assistant Professor, and the "*PwC Teaching Excellence Professor*". This paper is cited as evidence that lower audit quality is found in areas that exhibit higher levels of competition.

6.2 If (as appears to be the case) Professor Beattie has not scrutinised the independence, nor the robustness/technical quality/peer review of the papers cited, then before the CC relies on any individual finding from (or cited in) the Review, it should make careful checks in relation to the relevant research.

#### 7 **Views of Investors**

Considering that investors are the ultimate customers of the audit product, there is relatively little research cited providing the views of investors. Given this absence, it is particularly important that the CC obtains the views of investors in other ways.

#### 8 **Auditor size is not a proxy for audit quality**

We are concerned that auditor size is sometimes mentioned, without qualification, as a measure of auditor quality. For example, in the description of the Hay et al (2006<sup>7</sup>) paper in the third paragraph of page 19 of the Review.

#### 9 **Oxera's figures**

When discussing concentration, there are some minor inaccuracies in the Review's quotations at the first paragraph on page 23 of figures from Oxera (2006). The Oxera sample for 2005 was 865, not 676 as stated by the Review, and CR4 was 92.7%, not 92.3%.

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<sup>6</sup> Newton, N.J., Wang, D. and Wilkins, M.S. (2011). 'Does a lack of choice lead to lower quality?' Evidence from auditor competition and client restatements.

<sup>7</sup> Hay, D.C., Knechel, W.R. and Wong, N. (2006). 'Audit fees: a meta-analysis of the effect of supply and demand attributes.' *Contemporary Accounting Research*. 23(1): pp.141-191.