



Tel: +44 (0)20 7486 5888  
Fax: +44 (0)20 7487 3686  
DX 9025 West End W1  
www.bdo.co.uk

55 Baker Street  
London W1U 7EU

The Inquiry Manager  
Audit Market Investigation  
Competition Commission  
Victoria House  
Southampton Row  
London  
WC1B 4AD

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Our ref: 011695/JR/SD001643

Email: james.roberts@bdo.co.uk

Dear Sir

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

There is one important feature of the relevant market which has not been addressed in the initial submissions which have been made to the Competition Commission ("CC"), but which should be reflected in the CC's issues statement. This is the impact of conflicts of interest and the need for independence on the extent of competition in relation to the supply of statutory audit services to large companies in the UK (the "Market"). This issue was identified by the Office of Fair Trading and the House of Lords Select Committee, but has not been addressed by the initial submissions of the four largest auditing firms.

Competition in the Market - in particular, competition between the four largest auditing firms - is considerably restricted as a result of conflicts of interest (both legal and commercial) and the need for auditors to be independent.

The larger auditing firms supply a range of services to large companies, including tax advice, corporate finance services, forensic services and strategic consultancy, as well as audit. A large company may therefore obtain tax advice from one firm, corporate finance services from a second firm, with a third conducting its audit. That company may not be willing to consider either of the first two firms as potential auditors: audit committees increasingly regard the supply by auditors of non-audit services as unacceptable. Where the relevant company is a multi-national, the USA's Sarbanes-Oxley Act of 2002 limits its choice of auditors by reference to the type of non-audit services provided to the company. The audit firms themselves may prefer to continue to supply a company with non-audit services, rather than seek to become the company's auditor and risk losing the non-audit work.

In certain sectors, one or more firms may not have a significant presence. For example, there are only three firms which supply statutory auditing services to large banks in the UK. Moreover, the need for independence means that, for example, an audit firm could not audit a bank which acted as a supplier of financial services (e.g. as banker) to that firm.

Commercial conflicts of interest can also be relevant: a company may not wish to be audited by the auditor of its principal competitor, and may regard the competitor's auditor as conflicted; the relevant firm may be unwilling to risk upsetting its existing client by seeking appointment as its competitor's auditor.

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The combined effect of these factors is considerably to narrow what is already a very restricted field in terms of choice of auditor. Oxera's 2006 Report found<sup>1</sup> that:

*“On the question of choice, Oxera has found that a limited number of UK-listed companies, primarily 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.”*


The House of Lords Select Committee on Economic Affairs found<sup>2</sup> that:

*“Most witnesses believe that the dominance of the Big Four limits competition and choice in the audit market. Ethically, audit firms are unable to accept work which would place them in conflict with other work for the same or other clients. This is a special problem in the UK banking sector, where only three of the Big Four are active. Banks' choice of auditor is sometimes limited by the need to avoid using a firm engaged by another bank.”*

These factors seem to us to be a key issue in relation to the restriction of competition and choice in the Market. Indeed, any assessment of the extent of competition for statutory audit services in the UK must take full account of the impact of these factors.

We would be happy to discuss these and any other relevant issues with the CC at the earliest opportunity.

Yours faithfully



BDO LLP

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<sup>1</sup> See the Executive Summary, page (v) and paragraphs 5.3.3 and 5.3.4 of the Oxera Report, “Competition and Choice in the UK Audit Market”, April 2006

<sup>2</sup> Auditors: market concentration and their role’, volume 1 (report), Select Committee on Economic Affairs, 2<sup>nd</sup> Report of Session 2010-11, Para. 26 at p.12, repeated in Para. 170 at p.47.