

The Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

14 August 2012

Our ref: 016470/JR/SD000121

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For the attention of Dipen Gadhia, Inquiry Manager

Dear Sirs

We refer to the publication by the Competition Commission (CC) of the "PwC response to certain Third Party Submissions" which is dated 6 July 2012.

We believe that this publication (the "PwC Response") distorts and misrepresents some of the arguments made by ourselves and by other third parties, including investors. The PwC Response then seeks to rebut the distorted and misrepresented arguments, rather than the true arguments actually put forward by those third parties.

This is illustrated by the following examples:

1. Paragraph 1.4 - the claim that information asymmetries do not reduce audit quality misrepresents the issue raised by third parties. The issue, as things currently stand, is that investors do not have the wherewithal to assess audit quality. Whilst not a critical point in itself, it is relevant in the context of the PwC Response's later claim (section 4) that "*auditor reputation reflects the reality of customer experience*". The audit report is addressed to the shareholders, who are the real customer, not the audit committee or the company finance team. This asymmetry negates PwC's claim that "*market reputation over time will reflect the reality ...[which] ... may lead to a higher level of concentration*". We would not suggest that information asymmetries are anything other than neutral in terms of audit quality, but they do have the effect of preventing the real customer making judgements.
2. The segmentation, in paragraph 1.3, of the investor community is a red herring. Investment organisations participate in trade bodies and have corporate governance officers precisely to deal with matters such as those under consideration by the CC, allowing them to develop informed and consensual policies. A logical extension of PwC's argument would be that the CC should speak to each audit partner in practice in each of the firms with which it is communicating, rather than representatives of those firms who have been asked to deal with this inquiry.
3. Paragraph 1.4(b) - the PwC Response claims that there is "*no basis to suggest that higher and sustained quality would be achieved if the structure of the market were different*". This is not a claim that we (or others, to our knowledge) have made. What we have said is that an improved market structure would give more choice and would reduce the systemic dependence on the four largest firms, and could lead to more innovation in the market. We see no reason why audit quality would be lowered if the structure of the



market was different, and that seems to us to be the test that should be applied.

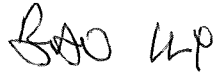
4. Paragraph 2.8 - the PwC Response claims that it is "*wholly unrealistic to suggest ... that the competitive process cannot operate effectively unless all shareholders individually and collectively ... have access to the details of internal discussions and debates between the auditors and company management*". This is a reference to section 3 of the USS submission to the Commission. Section 3 of the USS submission suggests no such thing. It states that "*investors generally have no visibility on the discussions around major assumptions in accounts, areas of disagreements/debate, or specific risk areas that the Audit Committee has explored in any detail*". It goes on to say that in that context "*investors have not been in a position to monitor audit quality ...*". It does seem to us that PwC have taken, at best, a rather bizarre reading of the USS position.
5. Paragraph 2.11 - the PwC Response claims that shareholders "*have fewer concerns*" than some submissions have suggested and that "*issues are rarely raised*". There is no evidence here to support these contentions and just because something is rarely raised it does not mean that it is not a genuine or a widely held area of concern. We suggest that establishing the actual views of investors is critical.
6. Paragraph 2.14 - PwC claim that both management and auditors have incentives to provide effective audits that are robust and independent. Management tend to be incentivised by relatively short-term earnings performance, which may often create audit risks, for example, in pursuing aggressive accounting policies. Whilst we would not suggest that it compromises the independence and robustness of audit in practice, it does have to be acknowledged that auditors' revenue does come from companies themselves, and it is not unknown for auditors to lose business because of their continuing robustness.
7. The PwC Response makes much of audit quality and claims at paragraph 3.8 that it "*would be wrong to take isolated examples of allegedly poor quality audit and use it to suggest that there is a broader market problem*". We find it surprising that PwC make this statement, given that they and their peers consistently suggest that they have higher audit quality than other market participants. Similarly their claim that it is "*meaningless*" to extrapolate AIU grading is rather curious, in that the Copenhagen Economics Report extrapolated AIU results in just this way.
8. Paragraph 3.9 - the PwC Response claims that a lack of innovation by auditors is "*misconceived*". They give a number of examples of innovation, which again focus on the efficiency area and financial reporting rather than innovation in the audit service itself. However, we acknowledge that in the last few months the major firms have shown a marked increase in interest in innovation in the audit service. This may be a welcome unintended benefit of the CC's inquiry.
9. Paragraph 4.1 - refers to the failure of Andersen. A number of our partners are former Andersen personnel. The lack of movement, both of people and clients, at the time of its collapse reflects the wholesale acquisition of Andersen's audit practice by Deloitte, which we acknowledge was very well executed.
10. Paragraph 4.2 - the PwC Response claims that we and/or others are "*suggesting a market wide level of irrationality on the part of highly experienced executives who sit on audit committees and boards*". We have not seen such a suggestion, but we have suggested that audit committees are risk averse, conservative and are inevitably influenced by

other intermediaries. The familiarity of dealing with the Big Four firms, and the reputation advantage they have, gives them comfort from a 'safety in numbers' perspective in making purchasing decisions which reflect these factors. We would not suggest this is irrational, just that it does not give rise to a competitive and effective market.

11. [Redacted]

If you would like us to clarify or expand upon any of these points, please contact James Roberts on 01293 591106 - email james.roberts@bdo.co.uk.

Yours faithfully

Handwritten signature in black ink that reads "BDO LLP". The letters are stylized and cursive.

BDO LLP