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11 November 2011

Dear Sirs

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

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to provide the Competition Commission (CC) with a summary of its views on the forthcoming investigation into the market for the supply of statutory audit services to large companies in the UK.

We agree with the view of the Office of Fair Trading (OFT) that there are features of the large company audit market which prevent, restrict or distort competition (competition issues). We also consider that there are a range of potential remedies available which are both reasonable and practicable to address these competition issues, which would enhance competition in the UK large company audit market for the benefit of companies and their shareholders.

As one of the leading UK audit firms, Grant Thornton has a particular viewpoint and interest in the debate regarding audit market competition and we are well placed to understand and articulate the competition issues that face audit firms outside of the largest four firms in the supply of audit services to large companies. As part of the wider debate, Grant Thornton has previously submitted its views to the House of Lords select committee and to the OFT, in addition to submissions to the European Commission in response to its concerns surrounding the structure of the large company audit market within a number of other European Member States.

We have set out below the primary features of the current large company audit market which we believe indicate that the market may not be operating effectively:

- there is significant concentration in the market. At present 99 companies in the FTSE 100 are audited by just four audit firms, with the leading supplier of audit services having over 40% of the market share by number of audits. The situation is only marginally better in the FTSE 350 where four audit firms have a market share of approximately 95%. The OFT's reference decision confirms that the four largest audit firms accounted for 99% of audit fees paid by FTSE 100 companies and 98% of fees paid by FTSE 250 companies in 2010;

- the high level of concentration amongst the four largest providers of audit services to large companies in the UK has persisted for a significant period of time. Grant Thornton and the other suppliers of audit services have been unable to break the stranglehold that the four largest suppliers of audit services have on the market;

- there are high barriers to entry and expansion in the market. The reputation of the four largest firms, due to their size and dominance in the market, and the low level of auditor switching (as mentioned further below), is such that it is particularly difficult for a smaller player or new entrant to the market to build market share or to build relationships with key management in large companies. This creates a vicious circle as the four largest firms conduct the vast majority of the audits of large firms in the UK, which reinforces their reputation;

  In addition, restrictions over the appointment of auditors currently exist both in written form and, equally importantly, in unwritten form. The effect is that only prescribed firms may be appointed as auditor. In other cases lending agreements "pre-approve" firms from prescribed audit networks which, while not overt restrictions, often have the same impact in practice. The above practice is also applicable in the case of companies aspiring to be public interest entities, where auditors outside of the largest four can be precluded from acting for them.

  The reputational barriers and restrictions over the choice of auditor are demonstrably not related to capability or quality of the audit firms involved, as supported by inspection reports issued by regulators, but are sweeping and often impenetrable barriers which reinforce concentration;

- there are very low levels of auditor switching. Grant Thornton's research into corporate reporting within the FTSE 350 "Moving Beyond Compliance, Embracing the Spirit of the Code" indicated that in the period from May 2009 to April 2010, only two FTSE 100 companies and eight companies in the FTSE 350 changed auditor. A report by the Economics Affairs Committee entitled "Auditors: Market concentration and their role" also showed that a FTSE 100 auditor remains in place for 48 years on average, with a FTSE 250 auditor having an average tenure of 36 years.

  Such low levels of switching make it extremely difficult for Grant Thornton and other suppliers of audit services to destabilise the position of the four largest audit firms and grow market share;

- the size of the largest four firms is such that they are perceived by large listed companies as having stronger resources and carrying levels of insurance which are far higher than those carried by other audit firms; and

- most Audit Committees of large corporate entities are unwilling to appoint an audit firm outside of the largest four for fear of criticism by investors and analysts. Whilst this fear may be unfounded it remains a powerful disincentive and most companies in the market are reluctant to change the status quo.

In our view, the existence of the above factors combine to prevent, restrict and distort competition in the large company audit market in the UK, such as to constitute an adverse effect on competition pursuant to Section 134(2) of the Enterprise Act 2002.

We believe that improved competition could be expected to bring a range of benefits to customers (i.e. companies and their shareholders).

For example, improvements in competition will (i) result in large companies having greater choice over the provider of audit services; (ii) lead to improvements in the quality and efficiency of conducting audits as greater competition should be expected to ensure that auditors continue to build audit quality over time; (iii) potentially result in lower prices if there are more competitive tenders for audit services; and (iv) reduce the systematic risk of competition being further adversely affected if one of the four largest auditors were to exit the market.

Principles to be adopted in enhancing competition in the UK large company audit market

As one of the leading UK audit firms, enhanced competition would be likely to benefit our firm (and some other market participants) as a commercial organisation, but will also benefit customers. The principles and potential remedies described below reflect concerns raised by other stakeholders about the structure of the UK large company audit market. The policy proposals we highlight are ones which we believe would bring about enhanced competition and facilitate an increase over time in the number of audit firms with meaningful market share while having at least a neutral and possibly beneficial impact on audit quality.

We believe that in seeking to address the prevention, restriction or distortion of competition in the large company audit market the following principles should be adopted and could form part of the Competition Commission's work:

- there should be a level playing field for all market participants;
- actions should be carefully targeted on clearly identified market failings to avoid unintended consequences;
- correction of competition issues through market forces is preferable to regulatory intervention but the evidence to date is that audit buying practices in the UK will not change without stimuli. Consequently the legislators or regulators must guide the market to a more competitive structure;
- a constructive sustainable evolution is preferable to an abrupt intervention (which risks similar damage to market confidence to failure of one of the largest audit firms). Actions to enhance competition (and potentially reduce market concentration) should recognise that auditors outside the largest firms will take time to build capacity and increase their share of audits of the largest listed entities; and
- the characteristics of a more sustainable and competitive audit market structure should be described clearly, which would enable the likely effectiveness of proposed remedies to be benchmarked.

Remedies to facilitate a more competitive UK large company audit market

Even at this early stage, there are a number of proportionate and appropriate regulatory options available to address the prevention, restriction or distortion of competition in the UK large company audit market. These include:

- incremental market share caps
- abolish restrictive covenants
- discouraging or restricting the provision by the auditor to a FTSE 350 company of non assurance services
- public bodies facilitating a lowering of the size differentials between the four largest UK audit firms and other large firms through public procurement; and

- regular retendering by FTSE 350 companies and greater use of consortia audits by FTSE 100 companies using the comply or explain framework.

These proposed remedies are not mutually exclusive and after a detailed investigation the Competition Commission may consider that a combination of some of these proposed remedies (or indeed others) may be the best way to address competition issues in the large company audit market.

Grant Thornton will continue to contribute to the development of policies to enhance competition in the large corporate audit market and to address audit market structure and we would be pleased to have further dialogue with you to explore the comments made in this letter.

If you have any questions on this response, please contact either Martin Drew (Direct T: +44 (0)1865 799914; E: martin.s.drew@uk.gt.com) or me.

Yours sincerely

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