



Financial Reporting Council

Aldwych House, 71-91 Aldwych, London WC2B 4HN

Telephone: 020 7492 2300 Fax: 020 7492 2301

www.frc.org.uk

Chairman: Baroness Hogg

Chief Executive: Stephen Haddrill

Company Secretary: Anne McArthur

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

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Dear Sir/Madam

Competition in the audit market

The Financial Reporting Council (FRC) welcomes the Office of Fair Trading's decision to refer the audit market to the Competition Commission.

The FRC has been concerned about the extent of concentration in the audit market for a number of years and we previously sought solutions via our Audit Choice project and, in particular, the creation of a Market Participants Group (MPG). The MPG made a total of 15 recommendations, which were based around voluntary action by listed companies, audit firms and the professional bodies. All but one of these recommendations has now been implemented but there is no evidence that they have had a significant impact on market concentration.

We also note that DG Internal Market & Services within the European Commission has consulted on a number of audit-related issues, including those around competition and market concentration. DG Internal Market and Services does not have the same remedies as a competition authority to address these issues and as a result is likely to propose a number of audit regulatory measures, including joint audits and the creation of audit-only firms. We are concerned that if implemented these will have a negative impact on audit quality, as well as potentially leaving the very largest companies without an auditor.

Our experience with the Audit Choice project has taught us two things. Firstly, that audit regulators do not have the tools to address effectively concentration in the market. Secondly, that voluntary action by market participants is insufficient. It is for these reasons that we believe that the issue of concentration is best looked at by

competition authorities. In identifying possible remedies to the issues with the market, we would ask that the Competition Commission remains alert to risks to audit quality and to unintended consequences.

Concentration in the large company audit market is an international issue. However the UK is one of the largest audit markets in the world and a major centre of thought leadership for audit and accountancy. We believe therefore that action by the Competition Commission in the UK is likely to have significant influence on the rest of the world.

In setting the scope for its inquiry, we would suggest that the Competition Commission consider the following issues in particular:

- The infrequency of audit tenders in the listed market;
- Ownership rules which prevent audit firms from raising external capital;
- The practice of the Big Four networks acquiring smaller rival firms, particularly in developing markets;
- Hyper-concentration in the audits of certain industries, eg banks, insurance companies and utilities; and
- The likely impact of a major firm leaving the market.

In respect of this last point the FRC is in discussions with the firms and with other national regulators regarding the development of a contingency plan to be activated in the event of a major firm finding itself in difficulty. An unequivocal statement from the Competition Commission that there are no circumstances in which it would sanction a market with three or fewer large firms would assist greatly in the development of this contingency plan.

The FRC stands ready to provide any assistance which the Competition Commission requires. Please address any queries to Paul George, Director of Auditing, on 020 7492 2340 or p.george@frc-pob.org.uk.

You sincerely,
Stephen Haddrill

Stephen Haddrill
Chief Executive
DDI: 020 7492 2390
Email: s.haddrill@frc.org.uk