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Competition Commission
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Dear Mr Gadhia

**Audit market concentration**

Aware of the Competition Commission's inquiry into the above, I am writing on behalf of the Group A firms (the immediate grouping of firms which follow in size the Big 4, Grant Thornton, and BDO).

Lacking the lobbying presence that any one of the Big 4 possesses but wishing to project (i) their interest in the market concentration debate, and (ii) their capacity to comply with and fulfil any market-intervention mechanisms the Commission deems appropriate in the final analysis, we hope that you may find the following representations helpful. We hope that what we have suggested will, apart from serving any narrower self-interest, coincide with what we believe should be public policy imperatives too.

The Group A firms believe that an examination of the public interest in this context will lead to the conclusion that there are aspects of how the present audit market structure works that are inimical to competition objectives and inhibit end-user behaviour. In this letter, we initially point out the features of that market that are counter-intuitive to competition, explaining why, before offering suggestions that ought definitively to address the situation.

First, there are, on any view, extremely high levels of concentration in the FTSE350 audit market with very rare changes of auditor and very infrequent tendering of audits, especially in the FTSE100. The dominant players use a superficially seductive argument that the market is competitive when what they mean is that it is competitive on the rare occasions a competitive tender arises, *inter se*. Measures which might result from the European Green Paper on *The Future of Audit* and the Commission's inquiry that bring about only a tad more competition, and in only that stratum will not achieve purposeful change.

The largest firms are themselves on record as saying that they would welcome more competition, so that the fact of over-concentration at present is almost self-evident. Moreover, the barometer of opinion that is the investors who are making submissions to the Competition Commission, expressing significant concerns about how things stand presently, form a persuasive bank of opinion. If a breaking down of current concentration is accepted as the overriding policy imperative, then it follows that it can only be accomplished through a new interface between market and regulatory conditions that secures (a) more market-players, and (b) a significant-enough market share to sustain their participation.

We stress the relevance of the simultaneous application of the principles of competition *and* an appropriate regulatory context, because they must be harmonised to maximum effect: initiatives in one which are not matched by the other will cause the objective of loosening concentration to fail.

If additional players are not forthcoming, the consequences may be:

- **one of the Big 4 leaving the market**: having only three dominant players which will virtually guarantee regulatory capture;

- **even competition among the Big 4 becoming illusory: in some sectors (e.g. Banking) not all four players have a significant presence in the large listed audit market; and the Big 4 will often forfeit tendering for the audit if the consequence is loss of the opportunity to undertake lucrative consultancy work**;

- **loss of an opportunity to introduce innovation into the market**: as this is far more likely to come from the non-Big 4 players as the dominant players have had a significant time to contribute innovation and do not have a strong record in doing so.

If it is accepted that the policy-objectives we have referred to above will not be served by maintenance of the status quo, then some measures that reach the top end of the FTSE100 market will need to be introduced. After all, that is where the systemic risks posed by the quadropoly are greatest.

The *Barnier* draft proposal(which did not appear in the final text of the proposed Regulation following extensive lobbying) for joint audit for the largest listed entities, with one of the joint auditors being from outside the Big 4, would (on any view) have made real inroads into addressing the key issues. By any perspective, this measure would, virtually of itself, have addressed all three policy-objectives. The Group A firms subscribe to either Joint Audit or to *shared* audit, shared audit being where a percentage of the subsidiary undertakings of a larger listed entity are audited by a firm other than the parent company auditor, thereby enabling the building of experience. We are also concerned that although this is permitted by the International Standards on Auditing, misperceptions can abound that it is not. Joint/shared audit must not be allowed to elide from the debate and we would welcome the opportunity to provide the Commission with evidence of how each works.

We believe that the political debate has not hitherto been well-informed about their merits and that that in turn has caused proper debate to have been stifled.

The only other provision in the proposed EU audit regulation that would meaningfully reduce concentration may share the same fate: requiring the Big 4 to shed listed audit engagements where they cumulatively account for more than a third of their audit practice, or face becoming audit-only firms, is suffering intense lobbying pressure.

We also encourage the Competition Commission and others to be aware that there are carefully cultivated myths being perpetuated that:

- audit quality is a function of size of audit firm: the truth is that most FTSE350 audit clients could be audited by non-Big 4 firms *at present*
- that there is a lack of appetite amongst non-Big 4 firms to undertake FTSE350 audits
- that non-Big 4 firms lack the necessary expertise or methodology, and
- that tendering is very expensive when in fact it habitually leads to significant fee savings (the empirical evidence for this is in the hands of the FRC already).

The Group A firms are eager to play their part in creating an open vibrant audit market for large listed companies that better meets the needs of clients and better serves the public interest.

Yours sincerely

T M McMorrow

**Tom McMorrow**
**Secretary, the Group A firms**