Competition Commission
Victoria House
Southampton Row
London
WC1B 4AD

11 November 2011

Dear Sirs

Audit market for FTSE350 companies-summary of our views

Introduction
Mazars, the international audit and advisory firm with 13,000 staff working in 61 countries, is pleased to respond to the invitation to submit its views in order to assist the Competition Commission in its identifying of the key issues to be addressed in its recently announced market investigation into the audit market for FTSE350 companies.

Mazars is pleased to share its practical experience with the Competition Commission: We do so from a a unique position outside the big 4 firms (the dominant firms/players) as group auditor to 5 of the 100 largest global companies, including in the financial services sector. Moreover, we have attempted over the last 10 years to break into the UK large corporate audit market from our strong European platform [✂].

Support for issues identified by the Office of Fair Trading
We strongly support a number of areas of concern identified by the Office of Fair Trading in their document 'Statutory audit, Market investigation reference to the Competition Commission of the supply of statutory audit services to large companies in the UK' (October 2011). These include high concentration with the dominant players accounting for 99% of audit fees in the FTSE100 and 98% of fees paid to FTSE250 companies; even higher than normal concentration in some sectors where not all of the dominant players are present; low switching rates and low rates of tendering along with substantial barriers to entry and expansion. These challenges are aggravated by the risks associated with one or more of the dominant players leaving the market unexpectedly. Moreover, as noted in the OFT reference, market-led initiatives have had minimal impact.

Key public interest dimension to auditing
In considering the audit market, we would urge you to bear in mind the important public interest dimension of the role and the issues that arise from the auditor’s duty being to report to a company’s shareholders whilst most of their contact is with the finance director and the audit committee of the company. An issue to consider in this context is the dominant players’ lead in the provision of non-

audit services as well and their highlighting their superior non-audit capability as part of the reason for appointing them as auditors.

Low frequency of tendering and fair tendering issue
With very low rates of tendering in the FTSE350 it is, by definition, hard to obtain opportunities to present our auditing credentials to large listed companies.

It is also important for there to be fair tendering processes to ensure we and other non-dominant firms are invited to tender when we have the appropriate expertise to undertake an engagement and that if we submit the best tender that we are appointed. On rare occasions that tenders from a non-dominant firm have been sought, our experience has been that such tenders have, at least on occasion, been used to [✂]. We are, however, always very pleased to respond to requests to tender from FTSE350 companies because, at the very least, this provides an opportunity for firms like ours to present their capability and credentials and initiate a process of changing perceptions.

Some have claimed that tendering is not necessary as companies review their existing auditor periodically. We do not share this view as it does not allow alternative providers to make a presentation to the audit committee. We also understand fees are sometimes reduced significantly after such reviews leading to questions about their earlier level.

The challenges of an annual mandate
Rather than increasing the number of tenders in a given year, our experience is that in practice a system of annual mandates, as in the UK, leads to less tendering than might be expected if there were multi-year mandates. Since the company is only committing itself for a short period, it is relatively easy to decide to postpone the process to another year. On the other hand, if the mandate were to last for five or six years, each review date would be more likely to lead to a tender and this does seem to be the case in countries where multi-year mandates are common practice.

Infrequent tendering and low switching
With infrequent tendering and low switching there is limited incentive for firms which are not currently one of the dominant players to make concerted efforts to enter this market. These disincentives are likely to apply in particular to any new firms, as opposed to existing players such as ourselves, that may otherwise decide to enter the market. Furthermore, with very few players in the FTSE350 audit market and infrequent switching the risk of the 'IBM syndrome' taking hold is much increased whereby audit committees feel it safer to follow the prevailing trend and retain their current auditor for very prolonged periods.

We would also emphasise that we do not believe that we would find it difficult to access any necessary capital for further expansion within our existing partnership model.

Firms do not need to be the size of the dominant players to audit FTSE350 clients
It is sometimes suggested that two or more of the leading non-dominant players need to merge in order to be able successfully to undertake larger FTSE350 audits. We think that a number of the main alternative players could already audit many FTSE350 clients and that the dominant players do not need to be their current size in order to be able to undertake very large listed company audits. Their size conveys significant economic power and we believe the impact of this on the marketplace needs to be carefully considered.

Need to enhance innovation in audit
As highlighted in the Introduction, our firm has demonstrated its ability to audit some of the largest companies in the world whilst being of significantly smaller scale than the dominant players in the UK. There is merit in offering the market alternative business models for auditing instead of a monolithic approach, as is currently the case. Similarly, as generally happens when an ossified market becomes competitive, one would expect that more distinctive service offerings would emerge and that client service would be enhanced. One would also anticipate that innovation at the profession-wide level in the nature of auditing and the reporting of audit findings would also increase which would be beneficial as there has been relatively little in recent decades and there appears to be a significant gap between the current functions of an auditor and the expectations of many shareholders to whom audit reports are addressed.

Need for non-dominant firms to access the upper end of the FTSE100
In view of the concentration of audit fees within the top 20 or so FTSE100 audits, it is vital that this part of the market also be opened up to competition. At present over 50% of FTSE100 audit fees are accounted for by the top 20 companies by market capitalisation and these generally will be systemically significant to the economy. In a number of cases, not all of the dominant players would be potential auditors for the companies concerned due to lack of sector presence or conflicts of interest arising by virtue of other work done for the client or as a result of a given firm auditing a key global competitor. It is therefore essential to increase the number of players able to participate in audits at the top end of the FTSE350 market.

The risk of a dominant player leaving the market unexpectedly
The OFT, government and the Financial Reporting Council are all rightly concerned about the risk of a dominant player leaving the market unexpectedly. Were this to happen the likelihood of regulatory capture would be very high and, as discussed in the previous paragraph, would impact on systemically important companies. In addition, the process of transition would be very likely much more difficult than was the case when Andersen left the market as their share of large listed audits was relatively modest. The concept of living wills is untried and very different to that in the banking sector where assets are less likely to be subject to reputation impairment than in the case of a failing audit firm. Were one or more firms to be deemed too big to fail this would, of course, create a very uneven playing in favour of the firms concerned relative to the rest of the market.

Difficulty to engage with FTSE350 companies to present alternative service offerings
We are committed to getting to know FTSE350 audit committees and finance directors. [✂]. If competition is to increase and additional providers are to come into this upper end of the listed market then it will be essential that audit committees and Finance Directors get to know non-dominant firms better. This process could also help eliminate some misconceptions that currently seem to exist around the capabilities of non-dominant players.

Institutional bias in the marketplace
We consider this to be a major issue which needs to be addressed and has yet to receive sufficient attention. There are two key forms of bias to be discussed, namely that directly within the marketplace and that involving regulators, professional bodies and other representative groups

Within the marketplace, the problem arises from the predominance of chartered accountants trained with the dominant players who may have been with their original or another firm for a number of years prior to moving to a FTSE350 company in a senior managerial capacity. In a number of instances they will have been partners in their firms. In addition, many members of FTSE350 boards, especially those on audit committees, which of course are pivotal to the selection of auditors, have links with the dominant players, in many cases having been longstanding partners in one of the firms concerned.

In addition to the individual relationships mentioned above, there are the close ties between the dominant players as firms and brokers, large banks and leading law firms. There seems to a strong preference amongst some of these advisers in favour of the dominant players and one would expect significant cross-referral of work between them. Not only does this make it more difficult than it should be to win such audits but it also means smaller listed companies aspiring to be in the FTSE350 are likely to seek to switch to one of the dominant players reducing the opportunities for us to grow with our clients. We have heard unhelpful messages from some advisers, and dominant players, to the effect that a signature from a non-dominant player has a negative effect on share price. We do not believe this position to be supported by academic research.

Institutional bias in the regulatory and professional environment

The pervasive influence of the dominant players in regulatory, professional and other key organisations such as groups representing leading finance directors and major investors, sometimes by way of secondments or providing secretarial support, has been very noticeable in recent times during the discussions on issues related to competition and choice. Given the fixed nature of many costs related to lobbying, in the sense they do not vary with the firm's turnover, the dominant players have a substantial advantage relative to all other firms as they are being spread over a larger turnover. We believe the impact of this influence on views expressed by various organisations needs to be fully understood. We would particularly draw your attention to what we consider to be misplaced attempts to try to link firm/network quality with firm/network size and to provide unfounded views on the cost/benefit analysis of potential remedies. Reports from global regulators, especially in the US, highlight that quality is not necessarily synonomous with size.

Oligopoly premium?

We note the significant difference between average partner remuneration in the dominant firms and that in other players-and how the gap has grown in recent years- restricting the ability of non dominant players to build capability. It is also our experience that the partners' earning differential between firms, which many may consider to be an oligopoly premium, is one of the highest in the developed economies.

Potential remedies

We have, given the stage of the market investigation, focussed on the challenges or concerns that we have in relation to competition in the audit market for FTSE350 companies. We would also wish to emphasise, however, that we do believe solutions to these problems exist through the introduction of an integrated programme of reforms encompassing, among other measures, the introduction of joint audits for larger listed companies, regular and fair tendering, the abolition of restrictive contractual terms limiting which firms may be appointed as auditors and the elimination of institutional bias in favour of the dominant players.

Further discussion

11 November 2011

If you would like to discuss further any of the issues in this letter, please do not hesitate to contact [✂].

Yours faithfully

Mazars LLP