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Grant Thornton Response to the Competition Commission ("CC") working paper entitled "Descriptive statistics"

1 Introduction

1.1 This memorandum sets out the response by Grant Thornton to the Competition Commission's ("CC") working paper entitled "Descriptive statistics" ("the working paper") which was issued on 28 September 2012.

1.2 We comment below on a specific point raised by the CC regarding auditor tenure, which we believe merits further investigation.

2 Auditor tenure

2.1 In paragraph 24 the CC sets out the basis on which it has calculated average auditor tenure, noting that "*Where the year of initial engagement was missing, we assumed it to be either the first year for which data was submitted or the year 2000 where data was submitted for each year. This could lead to tenure being underestimated for company's audited by the same auditor pre-2000*". The CC's calculation arrives at an average auditor tenure of 11 years for the FTSE 350 and 13 years for the FTSE 100.

2.2 We note that the CC's assumption regarding the year of the last auditor change creates a significant bias in the average auditor tenure calculations. It has been widely discussed and reported that many auditor tenures in the FTSE 350 are significantly in excess of 11 years, with some companies not having changed their auditor for in excess of 100 years. We therefore consider that the assumption adopted by the CC in it's analysis results in the average auditor tenure being significantly understated by failing to accurately take into account those audits which have been in place for much longer than the period under consideration.

2.3 The analysis set out in paragraph 24 is also inconsistent with the levels of switching shown in Figure 5 of the working paper (which is also based on the CC's own analysis). In particular, Figure 5 shows that around 2.5% of FTSE 350 companies and around 2.7% of FTSE 100 companies switch annually. This implies an average audit tenure of around 40 years for FTSE 350 companies and 37 years for FTSE 100 companies. The CC's working paper entitled "Evidence relating to the selection process: tendering, annual renegotiations and switching" also states that "*Only 4 percent of FTSE 350 companies (both FTSE 100 and FTSE 250) tender their audit each year*" (paragraph 2(b)), which also implies an average tenure of very considerably in excess of that set out in paragraph 24.

2.4 In paragraph 26 the CC states that, "*the tenure of the current auditor increases moving from FTSE100 companies to FTSE250 to other listed companies to private companies*". However we note that Figure 7 of the working paper shows that the opposite is in fact true.

2.5 Grant Thornton's own research into corporate reporting within the FTSE 350 "A Changing Climate, Fresh Challenges Ahead" indicated that in the period from May 2010 to April 2011, only five FTSE 350 companies changed auditor (indicating a change rate of 1.4% of FTSE 350 companies per year). A report by the House of Lords 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. These statistics are calculated on what we consider to be a more

realistic basis and we encourage the CC to discount the calculations referred to in its working paper in favour of statistics which do not include the assumption referred to in paragraph 2.1 above.

2.6 We note that 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, particularly when FTSE 350 audits are tendered infrequently. However the periods referred to in the CC's working paper materially underplay the extent of this barrier to entry.

3 Other points

3.1 Figure 10 of the working paper provides a strong demonstration of the benefits from switching, especially in the FTSE 350. It shows that even four years after switching, fee rates per hour are substantially lower than in the year prior to switching. This suggests the benefits from switching are not merely short-term. Although the working paper does not draw any conclusions, the CC should take this evidence into account along with other evidence on the benefits of switching, and the finding that current levels of switching are very low.