MAZARS

The Director
Market Investigation into Statutory Audit Services
Competition Commission
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Dear Sir

Audit Market Investigation - Descriptive statistics

1. Introduction

Mazars, the integrated international audit and advisory organisation with 14,000 professional staff in 69 countries, is pleased to submit its views on the above working paper.

We would particularly draw your attention to the serious flaw in the methodology used for determining audit tenure, as set out in paragraph 24 of the working paper, which will lead to it being substantially understated.

2. Big 4 annual shares of audit fees not clearly stated

The working paper indicates in paragraph 12 that 'Figures 1 and 2 both show that the Big 4 firms consistently earned over 90% of total real audit fees among both all companies and FTSE350 companies'. The figures in fact show it was well above 95% in both instances and barely distinguishable from 100% in the case of FTSE350 companies especially from 2005 onwards. We believe it would be helpful to show the full extent of concentration in audit fees especially amongst FTSE350 companies.

3. Rise in FTSE100 fees in real terms

The really noticeable figure or table from this working paper is figure 3 showing a substantial rise in median real audit fees for FTSE100 companies between 2002 and 2010. The rise is far higher for FTSE100 companies than for FTSE250 companies or other listed, all of whom were required to move from UK GAAP to IFRS in the period. Given that switching rates are lower in the FTSE100 than the FTSE250, and the opportunities for switching auditors generally thought to be less, the rise in fees might be thought to be the result of high concentration and low competition that is most marked in the FTSE100 than other parts of the listed market.

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4. Serious flaw in methodology for determining audit tenure

Paragraph 24 indicates that there is a serious flaw in the methodology used for determining audit tenure and explains the concerns we have previously communicated to you around the figures previously given for audit tenure in the FTSE350.

Table 10 of the working paper *'Evidence relating to the selection process : tendering, annual renegotiations and switching'* indicates that the average switching rate per year from 2000-2011 was 2.5% for the FTSE350 comprising 2.8% for the FTSE250 and an even lower figure of just 1.8% for the FTSE100. An average annual switching rate of 2.5% for the period 2000-2011 implies that at most 30% switched auditors in this period (assuming it to be a 12 year rather than an 11 year period). This means that at least 70% appointed their current auditor before 2000. An annual average switching rate of 2.5% implies, if constant over time, that a FTSE350 auditor could on average expect a 40 year tenure and the Oxera figures highlight that there were comparably low figures back into the mid-1990s. Yet paragraph 24 reveals that where data relating to the year of initial engagement was missing you have assumed it to be the year 2000 or the first year for which data was submitted (a later date) even though your own data shows 70% were appointed before 2000. Moreover, it is more likely that the ones for which data will be missing were those appointed many years ago highlighting that almost inevitably a serious underestimation in average tenure will have resulted from the methodology adopted. We would urge you to restate your calculations as a matter of priority.

The evidence clearly highlights that switching rates in the FTSE350 have been very low for a prolonged period and, within that, even lower for FTSE100 companies than those in the FTSE250. As we have previously indicated, the most reliable figures to use in relation to switching and auditor tenure will be those taken from the financial statements, including those contained in the public dataset for recent years, as opposed to relying on the recollections of board members or unreliable assumptions in the case of missing data.

Incidentally, in paragraph 26, we think the working paper means to say that the tenure of the current auditor decreases (rather than increases as stated) as one moves from FTSE100 companies to FTSE250 companies to other listed companies to private companies.

5. Comparative audit fees after switching

Great care is needed in interpreting Table 6 on comparative fees after switching, Figure 3 highlights that, in real terms, fees are higher in 2010 at the end of the period under review in that analysis than they were at the beginning of it in 2002, notwithstanding that there was a spike in 2006 presumably linked to the introduction of IFRS. Table 6 shows real fees per £1m of turnover being less than they were pre-switch in years 1, 2 and 4 after the switch and about the same as the pre-switch ones in year 3 after the switch only rising to be higher in year 5. The rise in fees in year 5, compared to year 0, may be due to the general rise in fees in real terms in the FTSE350 rather than to the effects of switching itself. It is also noticeable from figure 10 that the audit fee per hour remains significantly lower in the first four years after an auditor switch when compared to the fee rates for the previous auditor.

6. Ratio of non-audit service fees to audit fees

Figure 8 shows the annual ratio of real NAS fees to real audit fees earned by all audit firms in each index. The ratio has declined significantly for all categories between 2002 and 2010, including private companies. Whilst some of this is likely to be due to a change in sentiment on the extent to which the auditors should be asked to provide non-audit services, another important factor in the latter part of the period covered is the sharp decline in M&A and related transactions as a result of the economic downturn.

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We believe it would be helpful to show the range of NAS to audit fees within each of the FTSE100 and FTSE250 as the averages are likely to mask some instances where the proportion is much higher.

7. Caution over reliability of audit fee per hour disclosures

Figure 10 indicates the audit fee per hour in years before and after switching and suggests that the average audit fee per hour in the FTSE350 is just over £50 giving a daily rate of well under £400 based on a standard 7 hour day or around £400 based on a standard 8 hour day. These are not credible current rates. Given such limited switching if it includes data going back a decade along with more recent data the resultant figures will not be meaningful. We would urge you to re-examine Figure 10 very carefully.

8. Further discussion

If there are any issues in this letter which you would like to discuss further , please do not hesitate to contact David Herbinet, Global Head of PIE Audits, on 0207 063 4419 or Anthony Carey on 0207 063 4411.

Yours faithfully

Mazars LLP

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