COMMENTS OF BDO LLP ("BDO") ON THE

COMPETITION COMMISSION'S EVIDENCE ON SWITCHING COSTS

WORKING PAPER[1]

1 EVIDENCE ON SWITCHING COSTS (AND IMPLICATIONS FOR BARRIERS TO ENTRY)

1.1 Summary

BDO considers that switching costs for the client company should not be exaggerated, particularly by those companies who have not actually experienced tenders or switching, and the benefits of switching should not be understated.

1.2 Survey evidence

1.2.1 There is a clear contrast between the actual experiences of companies which have switched auditors and the preconceptions of those who have not done so and are looking to justify their failure to conduct tenders. Companies who have conducted tenders and switched auditors have not found this a very expensive or disruptive process (see, for example, the experience of Company E in the CC's case studies), whilst some of those who have not tendered their audit in the last five years refer to "*disruption and costs*" in tendering audits and changing auditors as a reason why they have not done so (see Paragraph 11). As those firms have, by definition, no recent experience of this process, their preconceptions or prejudices should not be treated as evidence of the reality of switching costs.

1.2.2 Paragraph 72(f) notes that "*the perception that switching causes upheaval is widespread, and appears sufficient to deter tendering.*" BDO considers that this perception is not justified, as indeed paragraph 72(e) appears to acknowledge, but it is in the Big Four's interests to maintain and reinforce that perception.

1.3 Audit firm evidence

It is in the Big Four's interests to emphasise and exaggerate switching costs. We note EY's advice to partners and staff at paragraph 16, which demonstrates this.

1.4 Role of intermediaries

Paragraph 27 (regarding Company H) shows that intermediaries play an important role in company's choice of auditors.

1.5 Case studies

1.5.1 Paragraph 34 quotes Company G's ACC's reference to research by Bocconi University. However, BDO understands that:

(a) the research to which he was referring related to switching auditors following **mandatory** rotation; and

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[1] Reference to paragraph numbers are to paragraphs of the relevant working paper ("WP") unless stated otherwise.

(b) subsequent research by Bocconi University[2] into switching auditors **voluntarily** (i.e. after tendering rather than mandatory rotation) shows that such changes produced enhancements in service and audit quality.

1.5.2 BDO therefore considers that it is important to distinguish switching after a mandatory tender from mandatory rotation. Mandatory tendering would be a sound remedy, which does not have the disadvantages of mandatory rotation.

1.6 Academic literature

1.6.1 BDO's understanding is that the academic literature is divided on the benefits and costs of switching auditors. We refer to BDO's comments of 18 May 2012 on the CC's academic literature review.

1.6.2 Paragraph 35 refers to Jackson et al (2008), but BDO considers that the propensity to issue a going-concern opinion is not an appropriate measure for audit quality. The propensity to issue such an opinion may depend on other factors, such as the quality of a firm's client base, the economic activities undertaken by those clients, the spread of industries or sectors in which those clients operate and/or general economic trends, rather than the quality of the auditor alone.

1.7 Quality of advice

1.7.1 The CC's survey results found that for many companies, switching resulted in lower fees and/or improvements in quality. 90% of those companies who switched and found a difference in quality said that quality had gone up (paragraph 185 of the CC's Working Paper on the Nature and Strength of Competition). This finding does not appear to be noted in the CC's Working Paper on Switching Costs, though it is consistent with paragraph 72(e).

1.8 Transitioning experience

Paragraph 65 states that "*The Big 4 Firms tended to have more thorough transition plans, and also were able to point to a broader range of experience in transitioning companies".* BDO considers that this comment is unjustified. Non FTSE 350 clients switch auditors more often than FTSE 350 clients. BDO has thousands of clients; the management of transition is a core activity of any audit practice and BDO does it on a daily basis.

1.9 "IBM effect"

The Working Paper does not mention the "IBM effect", i.e. that no-one ever lost their job for hiring a Big Four firm, as it is the "safe option". As is clear from the CC's case studies (for example: Case Study D, paragraphs 29 and 66; and Case Study E, paragraph 54), this is an important reason why FTSE 350 companies do not switch to mid-tier audit firms. It is notably absent from, for example, paragraph 7.

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[2] "*We also examine the effects of voluntary auditor change vs. those resulting from mandatory auditor changes. Our results suggest that, in a mandatory rotation setting, a voluntary change of the auditor tends to improve audit quality while a mandatory change tends to hamper audit quality.*"

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