



Competition Commission Audit Services Market Inquiry

29 July 2013

Deloitte response to the Competition Commission's working paper "Evidence on trends in audit fees"

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1. Introduction

1.1 Deloitte is grateful for the opportunity to comment on the paper published by the Competition Commission (the **CC**) on “Evidence on trends in audit fees” (the *Working Paper*).

2. Evidence that the market is competitive

2.1 The CC states that in a competitive market it would expect to see marginal cost savings achieved by suppliers being passed on to their customers¹. We agree, and this is what the CC’s analysis does demonstrate. The total fees charged to FTSE 350 companies have fallen over the period since 2006 based on the mean total audit fee, and since 2004 based on the median². Sustained price pressure of this type ought to be highly persuasive evidence. This overall reduction is due to reductions in the average number of hours per audit and a reduction in the real cost per hour charged for that time³.

2.2 This evidence supports the evidence that Deloitte has previously put to the CC that companies receive good outcomes in this market⁴. Efficiencies achieved by the firms (in terms of hours spent on an audit and in the cost per hour of delivering the work) have been passed onto clients rather than retained as increased profits. The CC’s concern that reductions in marginal costs which are (at least in part) passed on to customers could also be consistent with market power⁵ is not borne out by the facts – leading to the obvious conclusion that the best explanation for the outcomes generated is that it is caused by competition between suppliers.

2.3 It is notable that the trend is consistent across all of the top tier firms and both FTSE100 and FTSE 250 indices⁶, highlighting the persuasive nature of this evidence. The evidence is not consistent with the provisional conclusion reached by the CC that bargaining power resides with the auditor rather than the company outside of a tender year⁷.

2.4 Given the strength of this evidence, the CC should draw the obvious conclusion that the market is competitive and it is competition that has been driving these efficiencies. The undue tentativeness in the paper should not be replicated in the CC’s findings.

3. Evidence of benefits to audit clients

3.1 The evidence that consumers have benefited from these efficiencies is clear and appears at times to be understated by the CC in the Working Paper.

3.2 The CC has found that the hourly staff costs in nominal terms for firms remains stable over the period⁸. This represents a decrease in the cost per hour in real terms, which is the metric that is most relevant to assessing whether there is real consumer benefit. The CC’s analysis shows that this saving has been passed onto companies rather than retained by the audit firm through higher

¹ Paragraph 4

² Paragraph 11 and Table 1

³ Paragraph 20

⁴ See paragraph 3.1 *et seq* of Deloitte’s response to the Issues Statement.

⁵ Paragraph 4

⁶ Paragraph 8(b)

⁷ Paragraph 9.262 of the Provisional Findings

⁸ Paragraph 8(c)

profits. The CC's stress on nominal costs thus understates the extent to which a real benefit has been delivered through the reduction in costs in real terms.

4. Reduction in total hours

4.1 The CC suggests that a reduction in M&A volumes could be a principal contributory factor to the reduction in the number of hours spent on an audit⁹. We have previously provided the CC with a detailed description of the changes in the demands that auditors have had to face over the recent years including the impact of the financial crisis, increased complexity of financial standards and auditing standards as well as the countervailing demands from companies to reduce audit reporting timetables and improve efficiency¹⁰. Each of these has *increased* demands on auditors, who have nonetheless, by becoming more efficient, been able to reduce the total number of hours.

4.2 It is thus unduly selective to consider only M&A as a driver of number of hours in an audit and we do not believe that the CC should place any weight on this without a full econometric analysis. It is Deloitte's commercial view that this is just one of many factors – which have very different effects – which has contributed to the actual number of hours spent on audit. Increased efficiency, driven by competition and client demands, has been central to these factors.

5. Reduction in fee per hour

5.1 The CC states that there is no strong evidence for a reduction in the nominal cost per hour of staff. This does not dilute the fact that through a reduction in the *real* cost per hour, firms have increased the value offered to their audit clients and the shareholders of those clients.

6. Implications for the Provisional Findings

6.1 In the Provisional Findings the CC notes that it did not place weight on evidence that prices had reduced in real terms in the period between 2005 and 2011 because of concerns over robustness of the evidence¹¹. Now that it has investigated the trends in more detail, appropriate weight must be placed on this evidence to reassess the CC's provisional conclusions as to the outcomes for consumers in terms of price, and, in turn, in terms of the effectiveness of competition in the market.

⁹ Paragraph 38

¹⁰ See paragraph 6.17 et seq of Deloitte's response to the Working Paper on "The Framework for the CC's Assessment and Revised Theories of Harm"

¹¹ Paragraph 7.32 of the Provisional Findings