

## **Auditors: market concentration and their role**

Additional submission to the House of Lords Select Committee on Economic Affairs

2 March 2011

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1. This additional submission is made by the Office of Fair Trading (OFT), further to its submission of 24 September 2010 and its appearance before the Committee on 9 November 2010. The OFT is grateful to the Committee for this opportunity to give an update on its work in relation to the market for audit services<sup>1</sup>.
2. The OFT gave oral evidence at a relatively early stage of the Committee's evidence gathering. On 9 November, the OFT indicated that competition in the market for the provision of audit services to large companies in the UK may be limited. This additional submission gives an update on recent developments and a summary of the OFT's thinking about ongoing and potential future work in relation to the audit market.
3. Since 9 November 2010, the OFT has submitted a response to the European Commission's Green Paper on audit policy. The OFT has also liaised with other bodies, including the Financial Reporting Council and the Department of Business, Innovation and Skills (specifically on audit-related elements of the current joint HM Treasury and BIS-led Growth Review). During these bilateral discussions, the OFT has continued to suggest an exploration of the possibility of a reduced form of statutory audit (which might give greater scope for voluntary forms of assurance) and queried whether the current statutory audit framework is suitable for SMEs.
4. At European level, the OFT attended the Brussels audit conference on 10 February 2011. DG MARKT has received a very large number of submissions in reply to its Green Paper. The European Commission's response to the consultation will, therefore, continue to take shape over the coming months, with further developments not now expected until the autumn.

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<sup>1</sup> Please note that throughout this document 'audit' refers to external audit only.

5. In actively keeping the audit market under review, the OFT has also considered possible targeted interventions by the OFT itself against an over-arching principle of what the UK competition regime can effectively resolve, which will not duplicate existing efforts by others - what can be called a principle of 'unilateral decidability'.
6. While the OFT wishes to remain actively engaged, it recognises that many possible issues related to audit market concentration cannot be resolved effectively by a UK competition authority acting alone. The regulatory and supranational character of many of the discrete issues in this market means that, although certain improvements might be sought through regulatory intervention or legislative change, such changes would likely need to be international in scope and application to be successful.
7. With these points in mind, the OFT is currently giving further consideration to more formal project work, such as a targeted Market Study, and is undertaking the initial steps in scoping such a potential study. At present, we consider that further examination of the existence and effect of bank covenants (which potentially limit companies' auditor appointment choices) might be warranted. Where any other aspects of the audit market satisfy our principle of 'unilateral decidability', the scope of our potential study might be expanded as necessary. Any such work would be subject to Board approval.
8. The OFT will continue, on other matters, to input into the debate around European regulation of statutory audit, including its form and framework. Further, the OFT remains alert to the potential issues regarding systemic risk posed by audit market concentration. The OFT has continued to push for consideration of this issue in international fora (principally the OECD). In particular, the OFT has sought to raise the issue of how merger regimes in different countries might react to a scenario involving the failure of a large audit firm and the disposal of its assets, given the prospect of a 'four to three' increase in concentration. In this context, the OFT will continue to work to promote such merger regime discussion and preparedness.
9. The OFT will update its website<sup>2</sup> with further information on its work in the audit market as it becomes available.
10. The OFT would be happy to provide any further information that the Committee may find useful.

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<sup>2</sup> See: <http://www.offt.gov.uk/OFTwork/markets-work/othermarketswork/accountancy-audit>