

Competition in audit and accountancy services

A statement by the OFT

22 November 2002

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There is public concern about the increased concentration in the supply of audit and accountancy services, and its implications for competition and choice. The OFT recognises that concern. But for the reasons given below we do not, at this stage, propose to launch a full-scale investigation into the sector, or to refer it for investigation by the Competition Commission.

## Background

The demise of Andersen following the collapse of Enron has resulted in a situation in which the 'Big 5' accounting firms have become the 'Big 4'. In the UK, for example, Deloitte & Touche has acquired the business of Andersen. The other large accounting firms are Ernst and Young, KPMG and PriceWaterhouseCoopers.

Increased concentration in an industry may have adverse implications for competition and choice. This is especially so in an industry where conflicts of interest might further limit client choice.

Against this background, public concern has been expressed about the provision of audit and accountancy services. Much of this concern is centred on the level of auditor independence and corporate governance issues. However questions have also been raised over the level of competition in the market.

The Co-ordinating Group on Audit and Accountancy (CGAA) was set up by the Government to ensure that there is a co-ordinated and comprehensive work programme by individual regulators to review the UK's current regulatory arrangements for audit and financial reporting. The CGAA's interim report, published in July 2002, makes comments and recommendations on a number of key areas: auditor independence, corporate governance, regulatory oversight, financial reporting, the reform of Company Law and auditing standards. In addition, the report recommended that 'the DTI and HMT should discuss with the OFT whether there are any competition implications of the high concentration in the market for audit and accountancy services and whether any of the proposals in the interim report have any competition implications'.<sup>1</sup> The CGAA are due to publish their final report early next year.

The Treasury Select Committee launched an inquiry in February 2002 to 'examine, in the light of the collapse of Enron, the arrangements for financial regulation of public limited companies in the United Kingdom'.<sup>2</sup> Their report, also published in July 2002, recommends that the Government refer the operations of the 'Big 4' accounting firms to the Competition Commission (CC).

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<sup>1</sup> Co-ordinating Group on Audit and Accountancy Interim Report, July 2002, para 1.12 (a)

<sup>2</sup> Treasury Committee report: The financial regulation of public limited companies, July 2002, para 48

## Existing and recent reviews

Apart from the work of the Coordinating Group, there are a number of reviews being undertaken by Government and other regulators in the area of accounting and audit, including:

- An FSA review of listing rules, which may address the auditor independence issues in relation to listed companies.
- The Consultative Committee of Accountancy Bodies (CCAB) is revising its ethical framework on statutory auditor independence.
- The Government's review of the regulatory framework covering the accountancy and audit professions.

The Higgs review of non-executive directors<sup>3</sup>, and a related review by a group under the Financial Reporting Council on the role of audit committees.

The professional rules of accountancy bodies were also part of the OFT's report in March 2001 on 'Competition in Professions'.<sup>4</sup> That report found some apparently anti-competitive restrictions in the rules or guidelines of the Institute of Chartered Accountants in England and Wales, the Association of Chartered and Certified Accountants, and the Association of Accounting Technicians. These restrictions involved prohibitions on advertising fee comparisons, on seeking the business of potential clients by telephone, and on making or receiving payment for referring clients to accountancy professionals. All the rules in question have now been removed by the bodies concerned.

In addition, and of direct relevance to the issue of market structure, the European Commission recently examined the state of competition in the audit and accountancy market in the UK when it cleared the merger between Deloitte & Touche and Andersens. The European Commission also cleared the merger of Andersens with other 'Big 4' firms in a number of separate European countries. While the European Commission declared the merger to be compatible with the common market, its investigation left open the question whether or not the transaction – and in particular the reduction from five to four main players – led to 'a situation of oligopolistic dominance'.<sup>5</sup>

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<sup>3</sup> Derek Higgs, Review of the role and effectiveness of non-executive directors. Commissioned in April 2002 by DTI/HMT

<sup>4</sup> Competition in the professions: a report by the Director General of Fair Trading, OFT 328, March 2001

<sup>5</sup> Case No COMP/M2810 – Deloitte & Touche/Andersen (UK), 01/07/2002

## **An OFT investigation or CC reference?**

Given the recommendations of the CGAA and the Treasury Select Committee and our own concerns about the level of competition in an increasingly concentrated market, we have carefully considered whether a full market investigation, by us or by making a reference to the CC under the Fair Trading Act<sup>6</sup>, should be launched into competition in the audit and accountancy market.

To this end we have conducted a preliminary inquiry into whether, given the current market structure, there are competition problems in this sector. We have not found evidence to suggest that firms have acted to prevent, restrict or distort competition. Nor have we had complaints that they may be doing so.

We have also discussed the possibility of an investigation with other bodies that have regulatory or competition responsibilities in the UK and also overseas – this being as much an international as a national issue.

Our conclusion is that we should not, at this point, launch an OFT market investigation or refer the market to the CC.

As noted above, the audit and accountancy market is currently undergoing a period of substantial change following the collapse of Andersens and the subsequent fall in confidence in auditing standards. The regulatory environment is in the process of change with a view to restoring confidence in audit independence and its standards. Several reviews have recently occurred or are currently under way into corporate governance and regulatory issues. Where these result in proposals for new regulations, the OFT will advise – via regulatory impact assessments and otherwise – on the competition implications of proposed regulatory changes.

## **Conclusion**

Much work is already in progress looking into this market. The market is in a period of transition. The structural change resulting from the acquisition of Andersen has recently been scrutinised by the European Commission. For these reasons we conclude that a further OFT or CC investigation at this time would not be appropriate. Rather, our approach is to keep the market under review and to examine any competition implications of regulatory proposals that may arise from current reviews of audit and accountancy services. In particular, we will be giving the CGAA our views on their additional findings on audit firm rotation, compulsory re-tendering and the role of the audit committee.

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<sup>6</sup> The relevant provision of the FTA 1973 will be replaced by those of the Enterprise Act 2002 in the Spring of 2003