STATUTORY AUDIT MARKET INVESTIGATION

Profitability – part 2

Introduction

1. This paper follows on from, and should be read in conjunction with, the 'Profitability – part 1' paper.[1]

2. In this paper we review profitability on the basis of:

   (a) Total profits per partner; and

   (b) Assurance versus other business units.

3. In addition, we present more detail on the assessment of service line profitability in the Annex.

4. We present our initial views on the assessment of profitability in paragraph 46 drawing on work from both this paper and the Profitability – part 1 paper. A key finding is that contrary to some suggestions received, assurance (including audit) does not appear to be a 'loss leader' for the firms. The firms' Assurance divisions are often not the lowest margin service line.

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[1] http://www.competition-commission.org.uk/assets/competitioncommission/docs/2011/statutory-audit-services/profitability_part_one.pdf

Review of measures of profitability

Profits per partner

5. As noted in paragraph 9 of the Profitability – part 1 paper, in a market investigation the CC will often consider how the firms measure profitability. Much of the benchmarking between the audit firms is undertaken on the basis of 'profit per partner' (at a firm level). The 'profit' used in these calculations is the total remuneration of the partners (ie it includes both the salary and return on investment elements).

6. In the Market and Financial Questionnaire (MFQ) we asked parties to provide information on the total remuneration/profit per partner as set out in Table 1 below.[2,3,4]

TABLE 1 **Total remuneration/profits per partner by firm (and for some by audit/non-audit)**

								£'000
	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
Deloitte - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
Deloitte - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂
EY - Partner	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂
KPMG - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
KPMG - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂
PwC - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
PwC - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂
BDO - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
BDO - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂
GT - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂
GT - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂

Source: MFQ other business information responses.

Note: Profit per partner has generally been calculated as total remuneration per partner.
N/A = Not available. EY provided data only on partners as a whole.

[2] Whilst it is possible to identify remuneration for Responsible Individuals (who are authorised by their respective firms to sign audit reports) as 'audit partners', in practice, non-audit partners (from both assurance and non-assurance service lines) will also contribute to engagements and 'audit' partners will similarly spend time on non-audit work. Different firms may have interpreted 'audit partner' in different ways. For example: PwC used Responsible Individuals to assess 'Audit partner' total remuneration.
[3] ✂
[4] Note. Non-audit partners may include any partners who form part of the senior management structure.

7. Table 1 shows that the difference between the average audit and non-audit partner total remuneration/profits at Deloitte LLP (Deloitte), PricewaterhouseCoopers LLP (PwC) and BDO LLP (BDO) were not significantly different (ie less than £✄). But at Deloitte and PwC (the two largest firms by revenue) the total remuneration/profits per audit partner were on average higher than the total remuneration/profits per non-audit partner. At KPMG UK (KPMG) and Grant Thornton (GT) the total remuneration/profits per audit partner were £✄ and £✄ lower (on average over the period) than for their non-audit colleagues.[5]

8. PwC noted that the change in the relative levels of average audit and non-audit partner remuneration over the period reflected, amongst other factors, the relative growth in the different lines of service and changes in the partner seniority mix within the service lines.

9. The total remuneration/profits per partner at the non-Big-4 firms were generally less than half that of those at the Big 4 firms.

10. Table 2 shows the total remuneration/profit per partner in real terms (2011 prices). ✄ and ✄ achieved real increases for both audit and non-audit partner remuneration of ✄ to ✄ per cent a year over the period driven by increases between 2004 and 2006 or 2007.[6] Ernst & Young LLP's (EY's) firm-wide performance ✄. GT's remuneration per partner showed a ✄.

[5] Note that this difference is in nominal terms. ✄
[6] CAGR presents an annualised growth figure for the period as a whole and as a result may mask long periods of stagnation or large increases followed by similar decreases.

TABLE 2 **Total remuneration/profits per partner by firm (and for some by audit/non-audit). Real terms (2011 prices)**

£'000	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*	*CAGR* %*
Deloitte - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
Deloitte - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂	✂
EY - Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂	✂
KPMG - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
KPMG - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
PwC - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
PwC - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂	✂
BDO - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
BDO - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂	✂	✂	✂
GT - Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂
GT - Non-Audit Partner	✂	✂	✂	✂	✂	✂	✂	✂	✂

Source: MFQ other business information responses .

*Compound annual growth rate.
Note: Figures adjusted using CPI All Items Annual Average for the calendar year of the reporting date.
N/A = Not available. EY provided data only on partners as a whole.

Views of the parties

11. PwC said that profit per partner 'or more precisely total remuneration per partner' was used by PwC as a key financial performance metric for the overall firm (ie it was not specific to audit).[7]

12. PwC said that it considered the following as potential benchmarks: management consultancies; actuarial and benefits consultancies; engineering and other consultancies (tax, recruitment, pricing, security, project management etc); media firms; architect and design firms; property/chartered surveyors; and GPs, dentists and other healthcare practices. However, it found it difficult to obtain reliable UK financial data on these potential benchmarks, mainly because: *(a)* some businesses were partnerships but did not have an LLP structure, so the company did not have to disclose the number of partners; and *(b)* partner remuneration was often not disclosed. The one

[7] PwC: observations on the assessment of audit profitability, 7 August 2012, paragraph 2.4.

exception to this was law firms, for which there appeared to be more publicly available profitability data.[8]

13. PwC considered top UK law firms to be sufficiently comparable to PwC (on a firm-wide rather than an audit basis) to provide a sense check of the profitability findings of its economic profit margins analysis. This was because they:

(a) were generally organized in partnerships;

(b) relied heavily on intellectual property, brand, reputation and other intangible assets in the provision of their services;

(c) served broadly the same UK client base as the large audit firms, and provided similarly high-value-added professional services;

(d) had a mix of client and project tenures; and

(e) operated in unconcentrated markets.[9]

14. PwC provided analysis of the profit per equity partner over the last three years for the top 10 UK law firms and PwC UK, as shown in Figure 1.[10]

FIGURE 1

Profit per equity partner—top 10 UK law firms and PwC UK, 2009 to 2011

[✂]

Source: PwC Law Firms' Survey 2009–2011, PwC data and analysis.

15. PwC and Deloitte considered that their profit per partner ranked lower than Magic Circle law firms.[11,12] Deloitte provided analysis to suggest that on both a net margin

[8] ibid, footnote 16.
[9] ibid, paragraph A 3.4.
[10] ibid, Figure 4.
[11] ibid, paragraph 2.7.
[12] Summary of Deloitte's response to the MFQ, paragraph 7.4(c).

and profit-per-partner basis the profits of the Silver Circle law firms were higher than those of Deloitte in 2006 to 2008 and were below those of Deloitte for 2009 to 2011.

16. Deloitte said that the profitability of its audit services was commensurate with that of other high-quality professional services firms such as law firms. It considered that the premium returns of its audit services relative to that of Mid Tier audit firms was commensurate with the premium that Magic Circle law firms were able to sustain over Silver Circle law firms.[13]

17. Deloitte said ‘the substantial market and business risk of providing audit services are difficult to quantify but if successfully mitigated would result in correspondingly higher levels of profitability for those, generally larger, firms that are both willing and able to take on the higher risk associated with larger more complex clients’.[14]

CC discussion—profits per partner

18. We accept PwC’s submission that finding an appropriate benchmark for audit profits per partner is difficult. We consider that whilst data on law firms is more readily available than for other professional partnerships, legal and auditing returns should not necessarily be equivalent. For example, the level of equity injected and the relative roles of partners in different professional service firms may differ and may indicate different levels of risk incurred. It is not clear that the volatility of earnings from audit and law businesses is comparable.

19. What is clear is the large difference between the profits per partner earned by the Big 4 firms compared with BDO and GT.

[13] ibid, paragraph 7.4.
[14] ibid, paragraph 7.4.

20. We considered the data provided to us by PwC from which it benchmarked audit partner salaries (as discussed in paragraph 43 of our Profitability - part 1 working paper). By deducting these notional 'salaries' from total partner remuneration we are then left with a residual value which we understand to represent a return on capital. On this basis, returns on capital per partner for the Big 4 in 2011 were between £✄ and £✄ (excluding employers NI)[15] and for BDO/GT £✄ and £✄ respectively (excluding employers NI).[16]

21. We are considering whether such returns on capital are commensurate with the levels of capital invested by individual audit/assurance partners.

Assurance versus other business units

22. Among the closest comparators for the Assurance businesses are the accounting firms' other service lines. We consider the relative profitability of each firm's service lines in detail in the Annex.[17]

23. In paragraph 12 of Profitability – part 1, we explained that the firms' Assurance businesses comprise different service offerings; however, the majority of Assurance business for all firms is audit and/or audit related. PwC said that in 2011 there was a difference of 6 per cent between its net audit margin of [✄] per cent and its assurance margin of [✄] per cent: we recognise this but note that it is only one year's data and it is not clear similar differences would prevail across the firms. For these reasons we consider review in aggregate to be acceptable for our purposes and consider the Assurance margins to be indicative of audit margins.

[15] Calculated as the highest and lowest audit partner salaries in 2011 less £473,000 assumed average salary based on Profitability –part 1 paragraph 43.
[16] Calculated as the highest and lowest audit partner salaries in 2011 less £264,000 assumed average salary based on Profitability –part 1 paragraph 43
[17] Note that Deloitte's service line figures in this paper include the results of its Swiss firm and its Middle East joint venture

24. As explained in the Annex there are two ways of considering margins:

(a) gross margin—net revenues less direct costs; and

(b) net margin—net revenues less all costs attributable or apportioned to a service line.

We consider both measures to be of interest. In this analysis, both of these measures exclude any notion of partner salary costs.

25. We also consider profit per partner by Assurance and non-Assurance in paragraphs 45 to 47. This has been calculated using the firms' management accounts data at a gross and net margin (pre-partner salary costs) divided by the number of partners in each category.[18]

Gross margins

26. In Table 3 we set out by firm the gross margins (pre-partner costs) of their Assurance and non-Assurance businesses.

[18] We note that PwC undertook an internal reorganisation in 2009 in which Transaction Services was moved from Assurance to Advisory: as such the trends in Assurance and Non-Assurance margins and profit per partner are not strictly comparable over the period.

TABLE 3 **Gross margin (pre partner costs) by service line**

Firm	*2007*	*2008*	*2009*	*2010*	*2011*	*Average**
						per cent
Assurance						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂
Non-Assurance						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

* Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

27. There was no overall trend in whether Assurance or non-Assurance as a whole generated higher gross margins. Comparison of the gross margins achieved by individual service lines demonstrated a significant level of variation between the gross margins achieved. Variation in gross margins between the best and worst performing service lines for each firm in a given year ranged from ✂ to ✂, see the Annex, Table 4.

28. With the exception of ✂, there were no service lines for any of the Big 4 firms that had shown improvement in 2011 relative to their first year's data point (2007 or 2008). However, changes in the nature of service lines may mask individual services within the firms that showed improvements in profitability.

Assurance

29. The range of Assurance gross margins achieved by the Big 4 firms each year was between ✂ and ✂ percentage points and each firm's gross margin fluctuated within

a range of ✂ percentage points across the period. ✂ gross margins increased (from ✂ to ✂ per cent) over the period. ✂ gross margin in 2011 was ✂ per cent.

Non-Assurance

30. Gross margins for non-Assurance work showed a general downward trend, for all firms, with the exception of ✂ whose margins had remained largely steady and ✂, whose margins had generally increased. ✂.

31. ✂.

Net margins

32. Table 4 sets out the net margin for the firms over the period 2007 to 2011. It shows that the net margin for Assurance is the lowest margin service line for ✂ and that for the other firms Assurance is sometimes higher margin and sometimes lower margin than the other lines of service.[19]

[19] Where firms have not fully recharged central costs, the net margin has been calculated by the CC by allocating these costs on the basis of revenue of each service line.

TABLE 4 **Net margins (pre-partner costs) by firm by year and by service line**

					per cent
	2007	*2008*	*2009*	*2010*	*2011*
Deloitte					
Assurance	✂	✂	✂	✂	✂
Consulting	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂
Advisory	✂	✂	✂	✂	✂
Business Advisory	✂	✂	✂	✂	✂
Risk Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transaction advisory	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂
Advisory	✂	✂	✂	✂	✂
Performance & technology	✂	✂	✂	✂	✂
Risk & compliance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transactions & restructuring	✂	✂	✂	✂	✂
PwC					
Assurance	✂	✂	✂	✂	✂
Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Forensics	✂	✂	✂	✂	✂
Business Restructuring	✂	✂	✂	✂	✂
Other	✂	✂	✂	✂	✂
GT					
Assurance	✂	✂	✂	✂	✂
Advisory	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Forensics	✂	✂	✂	✂	✂
Outsourcing	✂	✂	✂	✂	✂
Restructuring & reorganisation	✂	✂	✂	✂	✂
Tax and pensions	✂	✂	✂	✂	✂

Source: CC analysis.

Note: Unallocated overheads have been allocated across service lines on the basis of revenue.
N/A = Not applicable.

Assurance

33. The net margins achieved by the Big 4 firms from their Assurance service lines vary to a greater extent than their respective gross margins, with the range between the

highest and lowest net margins for each year varying by between ✂ and ✂ percentage points, compared with ✂ to ✂ percentage points for gross margins.

34. The net margin of (✂) remained within a band of two to four percentage points across the period. ✂ net margin has declined consistently since 2007, falling ✂ percentage points (✂), with a ✂ percentage point fall in 2011.[20] This fall in net margins contrasts with ✂ gross margins (which have been relatively steady over the period, remaining in a narrow band of ✂ percentage points).

Non-Assurance

35. The margins achieved by the Big 4 firms have differed by at least ✂ percentage points over the period, with ✂ achieving the lowest margins. ✂.

36. As shown in Table 10, the lowest net margin recorded was in Business Advisory (✂) and the highest in Corporate Finance (✂). Consulting, corporate finance and advisory tended to have the most variation in net margins across the period. For example; service lines that had greater than 10 per cent range in margin across the period were: ✂. For Assurance the ranges in margin were ✂ Profit per partner by service lines.

37. Table 1 above showed that at the largest two firms (Deloitte and PwC) the total remuneration per audit partner was on average slightly higher than the total remuneration per non-audit partner. This supports the view that audit is not a 'loss leader' or an unprofitable part of the accounting firms' businesses.

[20] This was due largely to a ✂ per cent increase in its allocation of central costs. The proportion of central overheads allocated to assurance is greater than the proportion of revenue generated by audit, meaning that when central overheads increase, assurance is disproportionately affected. Controllable margin (immediately before central overheads are apportioned) was only ✂ percentage points lower.

38. We consider the profits per partner from Assurance and non-Assurance business in more detail below (and in the Annex, where we set out the gross margin per Assurance and non-Assurance partner by firm).

Net profit per Assurance partner

39. There is no clear trend as to whether firms have increased or decreased net profit per Assurance partner across the period 2007 to 2011(Table 5).

TABLE 5 **Net profit per Assurance partner**

					£ million	
	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Net profit per non-Assurance partner

40. There is no clear trend as to whether firms have increased or decreased net profit per non- Assurance partner across the period 2007 to 2011. ✂.

41. There is no clear trend whether the Assurance or non-Assurance business generates a greater level of profit per partner.

TABLE 6 **Net profit per non-Assurance partner**

					£ million	
	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Views of the parties

42. Deloitte said that the profitability of its audit services had been less over the last five years than for its non-audit services and that the profitability of its audit services had varied significantly which meant that any profitability analysis needed to take into account the macroeconomic environment and the susceptibility of margins to changes in the volume of work due to the higher proportion of fixed costs in the business.[21]

43. Deloitte said that the overlap of the range of gross margins between audit and non-audit provided some evidence that audit prices and profits were not excessive since the provision of non-auditor services occurred in multiple, highly competitive markets.[22]

CC discussion—profitability by service line

44. The analysis above indicates that Assurance (which is largely comprised of audit services) is not a loss leader. Relative to other service lines it is profitable—generally less so than tax, but (except at ✄) it is not consistently the lowest margin work undertaken by the firms. Assurance margins are generally more stable than the other lines of service. Deloitte's view that audit is competitive as it has overlapping margins with non-audit (competitive) markets holds if we believe the risk profiles are the same. However, it can be argued that the risk profile of audit is lower than that of consulting—the income stream is less lumpy, and the costs base is fairly stable, there is a high proportion of repeat business and significant long-term clients.

45. There is no general trend as to whether profits per partner are higher or lower for Assurance compared with the firms' other lines of business.

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[21] Summary of Deloitte's response to the MFQ, paragraph 7.4.
[22] ibid, paragraph 7.12.

Profitability assessment: overall initial view

46. We are not currently able to conclude as to whether there are excess returns in the FTSE 350 audit market. We do not consider the data currently available to be sufficiently reliable to estimate return on capital employed or adjusted return on sales accurately. Profit per partner shows that Assurance/audit is profitable and there is no clear trend as to whether it is more or less profitable than the firms' other businesses. For the largest two firms, total remuneration per audit partner is slightly higher on average than for non-audit partners. Whilst our review of the profits by service line is subject to the cost allocation choices of the parties, we note that Assurance/ audit work is rarely the lowest margin service line (except at ✂).

Assessment of service line performance using management accounting information

1. This annex examines the management accounts of the six largest firms to assess their relative financial performance in a number of metrics.

Financial performance of audit firms

2. We extracted data on revenue and costs from the six largest firms' management accounts and processed it into a standardized format to make the reported financial performance of each firm and its service lines more comparable.[1] However, there are some limitations to this approach which we have considered.[2]

3. For the purposes of this analysis, gross profit and margin are calculated as being the difference between 'net revenue' and client service staff costs.[3] Net profit and margin[4] is calculated as the difference between 'net revenue' and all costs attributable or apportioned to a service line.[5] Where any central overheads were not allocated by the firm, our analysis allocated them between client service lines (ie not over support or admin business units) on the basis of net revenue.

4. Firms are managed in different ways and through different service lines. Those service lines clearly similar in nature to 'assurance', 'tax' and 'corporate finance' were labelled as such, with others grouped as appropriate as 'consulting'.[6]

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[1] The standardized measures were: revenue being net of all discounts, disbursements and other adjustments; gross margins calculated using only staff costs; where firms did not allocate all overheads any unallocated element was allocated on the basis of revenue.
[2] These are discussed in paragraph 119 onwards.
[3] Support staff may be included if included in 'staff costs'.
[4] In assessing profit, margins have been used (profit expressed as a percentage of revenue), to allow a relative comparison, rather than the absolute level of profit generated.
[5] Partner costs other than expenses are excluded.
[6] Services labelled as 'advisory' are included within consultancy.

5. Accounting measures of profitability such as gross and net margins are difficult to compare because of the exclusion of partner costs. Accompanying analysis is required which includes a consideration of per partner measures of financial performance (ie the amount of net profit divided by the number of partners).

Accounting measures of profitability

Revenue

6. In 2011 the firms generated between ✂ and ✂ per cent of their revenue from Assurance (Table 1).

7. ✂

8. ✂.

9. ✂.

10. ✂.

TABLE 1 **Revenues**

£ million

	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
Assurance						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂
		✂	✂	✂	✂	✂
Non-Assurance						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂
						✂
All service lines						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂
				✂	✂	✂
Assurance as a proportion of firm revenue						
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: FY 2008 was the first year after GT merging with Robson Rhodes.
N/A = Not available.

Gross profit margins

Assurance

11. Table 2 sets out the gross margins (pre-partner costs) achieved from Assurance.

TABLE 2 **Gross margins (pre-partner costs) achieved from Assurance**

per cent

	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: KPMG management accounts not provided for 2007. All gross margins are stated before partner costs.
Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

Non-Assurance

12. Table 3 sets out the gross margins (pre-partner costs) achieved from non-Assurance. ✂.

TABLE 3 **Gross margins (pre-partner costs) for non-Assurance**

per cent

	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

13. Direct year-on-year comparison of each service line's profitability is difficult as the structure of service lines (✂) changes in the period, as well as non-observable reallocations of different services between different service lines.

14. ✂.

TABLE 4 **Gross margins (pre-partner costs) from individual non-Assurance service lines**

per cent

	2007	*2008*	*2009*	*2010*	*2011*
Deloitte					
Consulting	✂	✂	✂	✂	✂
Corporate finance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
EY					
Advisory	✂	✂	✂	✂	✂
Business Advisory	✂	✂	✂	✂	✂
Risk Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transaction advisory	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
KPMG					
Advisory	✂	✂	✂	✂	✂
Performance & technology	✂	✂	✂	✂	✂
Risk & compliance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transactions & restructuring	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
PwC					
Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
BDO					
Tax	✂	✂	✂	✂	✂
Restructuring	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Forensic	✂	✂	✂	✂	✂
Other	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
GT					
Advisory	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Forensic and Investigative Services	✂	✂	✂	✂	✂
Outsourcing	✂	✂	✂	✂	✂
Restructuring and reorganisation	✂	✂	✂	✂	✂
Tax and Pensions	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

All service lines

15. ✂.

16. ✂.

17. ✂

TABLE 5 **Gross margins (pre- partner costs) achieved by all client facing service lines**

per cent

	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: KPMG management accounts not provided for 2007.
Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

Net profit margins

Assurance

18. ✂.

19. ✂.

TABLE 6 **Net margins (pre-partner costs) achieved from Assurance**

	per cent 2007	2008	2009	2010	2011	Average
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: KPMG management accounts not provided for 2007. All unallocated costs in firms’ management accounts have been apportioned on the basis of revenue.
Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

Non-Assurance

20. ✂.

TABLE 7 **Net margins (pre-partner costs) achieved from non-Assurance**

					per cent
	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PWC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
21.	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Average calculated on an aggregate basis for the period 2007-2011
N/A = Not available.

22. Table 8 displays the net margins achieved from individual non-Assurance service lines for the firms. The difference between the best and worst performing service lines for each firm, each year, varied from ✂.

23. ✂.

24. ✂.

25. ✂.

TABLE 8 **Net margins (pre-partner costs) achieved from individual non-Assurance service lines**

					per cent
	2007	*2008*	*2009*	*2010*	*2011*
Deloitte					
Consulting	✂	✂	✂	✂	✂
Corporate finance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
EY					
Advisory	✂	✂	✂	✂	✂
Business Advisory	✂	✂	✂	✂	✂
Risk Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transaction advisory	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
KPMG					
Advisory	✂	✂	✂	✂	✂
Performance & technology	✂	✂	✂	✂	✂
Risk & compliance	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
Transactions & restructuring	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
PwC					
Advisory	✂	✂	✂	✂	✂
Tax	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
BDO					
Tax	✂	✂	✂	✂	✂
Corporate Finance	✂	✂	✂	✂	✂
Forensics	✂	✂	✂	✂	✂
Business Restructuring	✂	✂	✂	✂	✂
Other	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂
GT					
Advisory	✂	✂	✂	✂	✂
Corporate finance	✂	✂	✂	✂	✂
Forensic and Investigative Services	✂	✂	✂	✂	✂
Outsourcing	✂	✂	✂	✂	✂
Restructuring and reorganisation	✂	✂	✂	✂	✂
Tax & Pension	✂	✂	✂	✂	✂

Source: CC analysis.

All service lines

26. ✂.

27. ✂.

TABLE 9 **Net margins (pre-partner costs) achieved by all client facing service lines**

					per cent
	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
High	✂	✂	✂	✂	✂	✂
Low	✂	✂	✂	✂	✂	✂
Range	✂	✂	✂	✂	✂	✂
	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: KPMG management accounts not provided for 2007. All unallocated costs in firms' management accounts have been apportioned on the basis of revenue.
N/A = Not available.

Comparison of cost base

28. The firms' management accounts indicate that firms achieve a broadly similar gross margin for their respective Assurance service lines and for the firm as a whole. However, there is greater variation in the net profit margin achieved. By comparing the gross and net profit margins, it is possible to compare the cost base of the firms relative to revenue, excluding client-facing staff costs.

Assurance

29. ✂

30. ✂.

31. ✂.

TABLE 10 **Difference between gross and net margins for Assurance (pre- partner costs)**

per cent

	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Non-Assurance

32. ✂,

TABLE 11 **Difference between gross and net margins for non-Assurance (pre- partner costs)**

per cent

	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

All service lines

33. The cost base of the firms' Assurance practice will be affected by the method in which indirect costs are apportioned to each service line.

34. Table 12 shows the difference between net and gross margins for the firms as a whole. Whilst there are some differences between the figures in Table 10 and Table 12, there is no consistent pattern. ✂.

TABLE 12 **Difference between gross and net margins for the firm**

						per cent
	2007	*2008*	*2009*	*2010*	*2011*	*Average*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Partner-centric measures of financial performance

35. Because of the difficulty of identifying an appropriate cost of employment for partners, the analyses above do not include any element of partner cost in them. To allow some consideration of the relative structure of the firms and the number of partners that share in the results of the firms, we have performed some analyses that look at performance on a 'per partner' basis. If certain firms achieve a greater net profit margin than others, we may find that because of the different number of partners, the 'per partner' profit may exhibit a different trend.

36. These analyses thus need considering with respect of the number of partners (Table 13). ✂.

37. ✂.

38. Table 13 sets out the number of partners by firm split between Assurance and non-Assurance.

TABLE 13 **Number of partners by firm**

	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*	*Period growth %*
Deloitte							
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂
39. *EY*	✂	✂	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂
PwC		✂	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂	✂
Assurance	✂	✂	✂	✂	✂	✂	✂
Non-Assurance	✂	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: GT and BDO figures taken from 'Other business info' submissions.
N/A = Not available.

Revenue per partner

Assurance

40. Table 14 presents revenue divided by the relevant number of Assurance partners.

✂.

41. ✂.

TABLE 14 **Revenue per Assurance partner**

				£ million	
	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Note: GT data is from 'Other Business info', other figures from management accounts.
N/A = Not available.

Non-Assurance

42. ✂.

43. ✂.

TABLE 15 **Revenue per non-Assurance partner**

					£ million	
	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

All service lines

44. Table 16 shows the revenue per partner for each firm between 2007 and 2011.

TABLE 16 **Revenue per partner**

	2007	*2008*	*2009*	*2010*	*2011* (*£ million*)	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Gross profit per partner

Assurance

45. ✂

46. ✂

47. ✂.

TABLE 17 **Gross profit per Assurance partner**

	2007	*2008*	*2009*	*2010*	*2011* (*£ million*)	*CAGR %*
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Non-Assurance

48. ✂.

TABLE 18 **Gross profit per non-Assurance partner**

	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
					£ million	
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

All service lines

49. ✂.

TABLE 19 **Gross profit per partner**

	2007	*2008*	*2009*	*2010*	*2011*	*CAGR %*
					£ million	
Deloitte	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

N/A = Not available.

Net profit per partner

50. Details of the net profit per partner split between Assurance and non-Assurance are shown in the main text.

All service lines

51. ✂.

TABLE 20 **Net profit per partner**

	2007	*2008*	*2009*	*2010*	*2011* *£ million*	*CAGR %*
DEL	✂	✂	✂	✂	✂	✂
EY	✂	✂	✂	✂	✂	✂
KPMG	✂	✂	✂	✂	✂	✂
PwC	✂	✂	✂	✂	✂	✂
BDO	✂	✂	✂	✂	✂	✂
GT	✂	✂	✂	✂	✂	✂

Source: CC analysis.

Caveats on use of the data

52. The data used for this assessment of financial performance has been taken primarily from management accounts data. The different firms report performance in different ways including by geography and by service line. ✂. For the firms which do not report primarily on a service line basis we contacted the firms and sought additional or clarifying information.

53. The main areas that need to be considered when comparing firms are:

(a) Grouping of products into service lines—the ‘products’ included by a firm in a given service line will vary and the margins attracted by each product will vary and as a result, will affect the relative margins of service lines.

(b) Products offered by different firms—it may be the case that different firms offer different products such as some niche areas of consulting or advisory work. This paper does not seek to consider the effect of the non-audit profit mix.

(c) Cross-service line working—staff which are nominally allocated to service lines may work on occasion in assisting other service lines. Examples with respect of audit include reviews of tax liabilities and actuarial valuation of pension and other

provisions. The method that is used to measure this cross-service line work may vary between firms, and this will affect margins.[7]

(d) The ratio of partners to staff—as discussed elsewhere, the difficulty in establishing an appropriate employment cost for partners has meant we have had to exclude their costs from our assessment of gross and net margins. If firms have different ratios of partners to staff, differences in underlying profitability will be masked.

(e) Allocation of indirect costs—firms will allocate (or may not allocate totally) indirect costs incurred in the course of running their business to service lines. To capture the financial performance of service lines, these costs will need to be fully allocated to a service line. If the basis of allocation used by each firm differs, margins may not be fully comparable.

54. Management accounts are prepared on a number of different bases, and may or may not include the impact of accounting estimates, such as provisions. Because of this, further analysis will be necessary to compare the figures included for all service lines and the financial statements of the firms to ensure that the margins discussed in this document are consistent with final, audited data prepared in accordance with financial reporting standards.

[7] For instance, the treatment of tax staff working on an audit could be either to *(a)* allocate some audit revenue to the tax service line (where the cost of employing the staff sits) or *(b)* allocating the staff cost to audit. Furthermore both measures may include some allocation of financial contribution and above the direct cost of employing a member of staff.