STATUTORY AUDIT SERVICES MARKET INVESTIGATION

The suppliers of statutory audit services to large companies

Introduction

1. This paper provides an overview of the suppliers of statutory audit services in the UK and the history of their consolidation (paragraphs 2 to 21). It then provides a brief portrait of each of nine large firms which have provided statutory audit services to large listed companies in the UK in turn: Baker Tilly, BDO, Deloitte, Ernst and Young (EY), Grant Thornton, KPMG, Mazars, PKF, and PwC.

Overview and the history of consolidation

The structure of the UK firms and their international networks

2. The four largest UK firms (Deloitte, EY, KPMG and PwC) are members of international networks of broadly similar scale. Each operating in approximately 150 territories and employing between 145,000 and 182,000 partners and staff in total. The members firms of the networks share a name, brand, a commitment to audit quality standards and common methodologies but member firms remain legally separate, and are typically independently owned and controlled. Member firms are brought together by common membership of a central network body or entity. The EY network differs through the greater level of 'global integration' and this is discussed below.

3. Most of the other large firms (Baker Tilly, BDO, Grant Thornton and PKF) are also members of networks (Mazars by contrast has adopted a global 'integrated partnership').[1] The legal structure of these networks is broadly similar to the four largest networks and are differentiated primarily by the combined size of their member firms. Geographic coverage (measured by the number of countries in which

[1] Mazars is included in the comparisons of networks.

the network is present) is less, although this difference tends to be with respect to smaller, developing economies. These networks have member firms in between 69 and 135 countries, compared with the 150 countries of the four largest networks.[2] The number of staff and partners employed globally by these networks ranges from 13,000 to 49,000 and their combined global revenues range between £815 million and £3,573 million. The individual networks and their UK firms are compared in Table 1 below.

4. For all of the firms covered by this paper, there is a central coordinating entity (herein 'network body').[3] Seven of the nine network bodies are incorporated in the UK as companies limited by guarantee.[4] A key difference between a UK company limited by guarantee and companies limited by shares is the absence of share capital.[5] Control of a UK company limited by guarantee is exercised by 'members' as it is a membership rather than ownership-based entity.[6] A company limited by guarantee is able to distribute its profits to its members, but it may not give a person a right to participate in the divisible profits of the company otherwise than as a member.

5. Eight of the UK member firms discussed here are incorporated as Limited Liability Partnerships (LLPs). The exception, Baker Tilly, operates through a group of companies limited by shares and LLPs, with the audit function contained within a specialist LLP. An LLP is a body corporate and is much like a company limited by

[2] Mazars integrated partnership is arranged around a central network entity, Mazars SCRL. In each country there will be a separate legal entity, which is owned by its partners. These local firms have signed a cooperation agreement with Mazars SRCL. The members (partners) of a firm will also be members of Mazar SRCL. The majority of Mazars UK partners are partners of Mazars SRCL, and these partners share profits with other partners globally; Mazars member firms are also members of the Praxity alliance of independent firms, which provides additional coverage.
[3] In this document, 'the network body' refers to the central entity that coordinates and provides services to firms.
[4] KPMG International is a Swiss Cooperative, which is the equivalent of a Company Limited by Guarantee and Mazars SCRL, is similarly the Belgian equivalent.
[5] In a UK company limited by shares, should the company be wound up with outstanding liabilities, the shareholders are not liable to any additional amounts, but would share in a distribution of any assets. In a UK company limited by guarantee, the members must pay up to a guaranteed amount (which is usually of nominal value).
[6] In a company limited by shares, should the company be wound up with outstanding liabilities, the shareholders are not liable to contribute any additional amounts, but would share in a distribution of any assets. In a company limited by guarantee, the members must pay up to a guaranteed amount (which is usually of nominal value).

shares, but rather than shareholders it is owned by its members (partners).[7] A partnership or members' agreement will also usually state the method by which profits will be distributed among the partners.[8] Under UK law, a member of an LLP can be an individual, a company or another LLP.

6. Individual national firms become members of the network by being members of the network body (or by contract). The relationship between the member firms and the network will be determined by a network body legal agreement between each member and the network body, as well as the constitutional documents of the network body. Pursuant to these documents member firms agree to be bound by policies set by the network body.

7. Some networks have different types of member firm. The terminology used to describe the different types of membership differs in each firm. In all of the nine networks discussed in this paper, the UK firm is a full member of the network, and is subject to all of the network's policies, branding, methodology and quality assurance requirements. Other firms, particularly in developing markets may be 'affiliate firms' which carry out audit work on behalf of the member firms, but which may not necessarily be subject to the full policies of the network.

8. There is no pooling of profits at an international level with the exception of Mazars, and to a small extent KPMG UK (see paragraph 116). The amount paid to the network body by each member firm to fund the network body's running costs is based on the level of revenue that a member firm generates.

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[7] The nature of being a 'member' in a company limited by guarantee and in an LLP differs on the point of ownership.
[8] The actual remuneration received by each partner in the firms is based on a number of elements such as the nature of the portfolio and responsibility held as well as a performance assessment based on a 'balanced scorecard' and will be subject to review by a remuneration panel of some form.

The UK firm in context

9. Table 1 shows that the UK firms each generate revenues that equate to between 8 and 16 per cent of the aggregate revenues of the member firms of their respective networks. With the exception of the Mazars network, the US member firms are significantly larger, generating approximately 30 per cent of revenues received by member firms.[9]

10. Table 2 shows a breakdown of the source of statutory audit revenue, with the four largest UK firms deriving between [✂] per cent of their statutory audit revenue from FTSE 350 audit clients, whilst the other firms derived between [✂] per cent of their statutory audit revenue from the FTSE 350.

[9] Source: review of US firms' corporate websites. Mazars UK is the second largest firm in the network after Mazars France. Mazars prior to the merger with Weiser in 2010 operated through its US firm and joint venture arrangements with Weiser and two other US firms that were members of Praxity.

TABLE 1 **UK Firms and networks**

	Baker Tilly	*BDO*	*Deloitte*	*EY*	*Grant Thornton*	*KPMG*	*Mazars*	*PKF*	*PwC*
Revenue									
Global	£1,900m	£3,573m	£18,270m	£14,520m	£2,331m	£14,400m	£815m	£1,521m	£18,520m
UK	£179m	£280m	£2,098m	£1,465m	£377m	£1,707m	£109m	£108m	£2,461m
UK significance	9.4%	7.8%	11.5%	10.1%	16.1%	11.94%	13.4%	9.4%	13.3%
Number of staff									
Global	25,000	48,767	181,566	152,000	30,000	145,000	13,000	15,000	161,000
UK	1,844	2,615	12,761	9,500	3,692	11,230	1,209	1,500	17,079
International presence									
Countries	120	135	153	145	100	152	68(+14)	125	154

Sources: Annual reports for UK firm and International Network; Corporate websites.

Notes:
Global revenues are converted to GBP using average interbank (EUR or USD)/GBP exchange rate for the 12 months to 31/5/12 and are for a general indication of the scale of the UK firm.
Mazars is part of the Praxity alliance, which has some geographic overlap with Mazars and provides a presence in a number ofadditional countries and also a greater presence, in some countries, such asin the USA where Mazars and other Praxity firms have formed joint ventures.
The geographic coverage of individual firms varies, particularly with respect to Northern Ireland, the Channel Islands, the Isle of Man and non-UK/British Isles subsidiaries.

TABLE 2 **Statutory audit revenue 2011**

	Baker Tilly	*BDO*	*Deloitte*	*EY*	*Grant Thornton*	*KPMG*	*Mazars*	*PKF*	*PwC*
FTSE 100	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
FTSE 250	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Proportion of audit revenue from FTSE 350	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Sources: ‘Other Business Info’ submitted by parties.

Note: Baker Tilly did not supply information in the format requested. In 2011, Baker Tilly had no FTSE 350 clients.

11. The networks serve a number of large, international clients and audit work relating to subsidiaries of these clients may be undertaken on behalf of the group auditor by other member firms in the same network.[10] As a result, member firms may generate referred income as a result of another member firm winning the group audit.[11]

The emergence of the 'Big Four' audit firms

Networks

12. The international networks of the current UK firms emerged from the late 19th century through two routes:

    (a) Organic expansion. This was a strategy used by Price Waterhouse (established in the UK) and Arthur Andersen (established in the USA), which each established new, legally separate partnerships in overseas territories which were then used to service the international needs of their overseas clients. Price Waterhouse also acquired small pre-existing firms in overseas territories, which were managed by expatriate Price Waterhouse partners.

    (b) Acquisition and strategic alliances with pre-existing audit firms. Audit firms in different countries formed alliances to facilitate cooperation on behalf of their respective clients by providing international coverage without the need to finance permanent overseas operations. As each would service the other's clients on an agency basis international operations this was mutually beneficial. Over time the two firms might create form an international network.

[10] For example, half of Deloitte's FTSE 350 audit fees are paid to overseas member firms to audit the subsidiaries of Deloitte's clients (Deloitte's non-confidential initial submission, p2).
[11] However, as noted in paragraph 18, when international networks have merged, such as Deloitte Haskins and Sells and Touche Ross not all member firms have transferred into the combined network.

Merger activity—International networks and impact on the UK

13. Over the course of the 20th century, international networks developed. By the 1980s there were eight networks that were recognized as being larger than any others and were referred to as the 'Big 8'. All had member firms in the UK.[12,13]

14. A merger of two networks would require the member firms of both networks in each country to agree to create a single firm in each territory, with a new set of network arrangements.[14] If a member firm in a territory chose not to merge, it would effectively be excluded from the network.[15]

15. The most significant period of merger activity began in 1987 with Peat Marwick strengthening its position as one of the eight large firms by merging with the relatively new European network of KMG.[16] Figure 1 provides an overview of the merger activity between the international networks beginning in this period.

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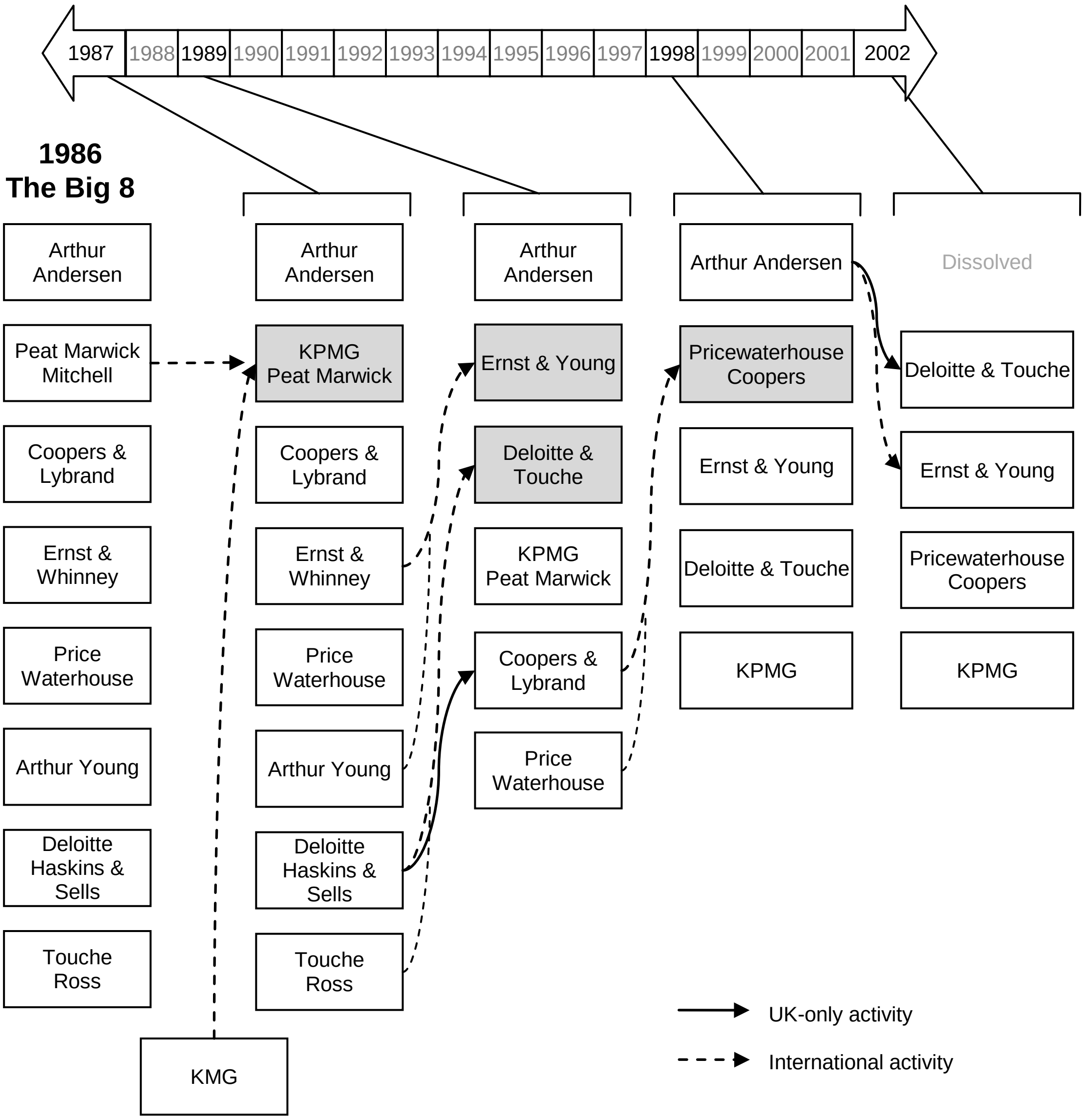
[12] The eight were Peat Marwick, Ernst & Whinney, Deloitte, Haskins & Sells, Arthur Young & Co, Touche Ross, Price Waterhouse, Coopers & Lybrand and Arthur Andersen. A significant element of the Arthur Andersen practice was devoted to servicing UK subsidiaries of US companies, rather than UK owned companies.
[13] Deloitte was established in the UK in1845 and opened a New York office in 1880.
[14] Prior to the advent of LLPs in 2000, a merger of partnerships would essentially require a redrafting of a partnership agreement to decide on the respective value of capital introduced by each of the firms and the subsequent division of profit. There would not necessarily need to be any financial consideration paid.
[15] Deloitte in the UK joined Coopers & Lybrand rather than merge with Touche Ross into a combined network.
[16] KMG were not one of the Big 8.

FIGURE 1

Merger activity of International Networks



Source: Adapted from Figure 1, GAO, *'Audits of Public Companies',* 2008.
Note: In the UK the member firm of the Deloitte network traded as Touche Ross between 1992 and 1996.

16. All of the 'Big 8' international networks, with the exception of Arthur Andersen and Arthur Young, originated from a founding firm in the UK.[17] The Arthur Andersen, Arthur Young, and Ernst and Whinney networks developed from a US base, expanding through their cooperation with pre-existing UK firms before continuing international expansion elsewhere.

[17] Ernst & Whinney resulted from a UK and a US firm cooperating, with the establishment of the UK firm predating the US firm, Ernst & Ernst by some 50 years.

17. Mergers between the ‘Big 8’ began in 1989 with the creation of the present day Deloitte network, followed a few months later by the EY network, creating a period in which there were the ‘Big Six’ firms, which lasted until 1998.[18]

18. The Deloitte & Touche network was formed from the merger initiated in the USA, of the firms of Deloitte, Haskins & Sells and Touche Ross. The merged international network was named DRT International (Deloitte Ross Tohmatsu International). Most of the member firms in both networks followed suit and merged their own practices in their domestic territory. However, several firms chose not to merge. The UK firm of Deloitte Haskins & Sells chose not to merge with the UK Touche Ross firm, but instead merged with Coopers & Lybrand (which initially traded as Coopers & Lybrand Deloitte, and did not drop the ‘Deloitte’ from its name until June 1992). Touche Ross was not allowed to use the Deloitte name in the UK until 1 February 2006 when it was renamed Deloitte & Touche. The international network changed its name in 1992 from DRT International to DTTI (Deloitte Touche Tohmatsu International), and in 1998 to DTT (Deloitte Touche Tohmatsu). In September 1997, the international networks of Coopers & Lybrand and Price Waterhouse announced plans to merge, and as a result the member firms in each network (including in the UK) made preparations to merge. The EC began a merger inquiry.[19]

19. In October 1997, EY and KPMG announced plans to merge, apparently in reaction to the threat of a very large combined rival. A combined EY and KPMG would have been larger than the proposed merged Price Waterhouse/Coopers & Lybrand. However, the planned EY/KPMG merger was abandoned by the networks.

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[18] Deloitte, EY, KPMG, Arthur Anderson, Coopers & Lybrand and Price Waterhouse.
[19] Case No IV/M.1016—Price Waterhouse/Coopers & Lybrand.

20. The Price Waterhouse/Coopers & Lybrand merger received approval from the EC, and the PricewaterhouseCoopers network was created.[20]

21. The last major structural change in the large company audit market occurred in the aftermath of the collapse of Enron in 2002 and the breakup of Arthur Andersen. The actions of Arthur Andersen, both in its audit procedures and subsequent actions (such as allegations of destruction of evidence) led clients to desert and member firms to leave the Arthur Andersen network.[21] Initial discussions for Arthur Andersen member firms to join the KPMG network ultimately failed. Most international member firms of Arthur Andersen then joined the EY network, merging with local member firms. In the UK, however, Deloitte & Touche acquired the assets and some of the partners and staff of Arthur Andersen.[22]

22. The Baker Tilly, BDO, Grant Thornton, Mazars and PKF networks have not been created as the result of any significant international merger activity between existing networks, with their geographic expansion being driven by identifying independent firms in countries without a network presence to join the network, or creating new practices in those countries.

Baker Tilly

History

23. The UK firm of Baker Tilly was formed in 1988 on the merger of Baker Rooke, and Howard, Tilly & Co, with the two predecessor firms tracing their respective roots to firms established in 1901 and 1865 respectively. The UK firm subsequently merged with a number of smaller firms in the 1990s and 2000s and, as a consequence of one

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[20] As part of its inquiry, the EC had considered the merger in conjunction with the KPMG/EY merger and its preliminary findings suggested that had the EY and KPMG merger not fallen through voluntarily, the proposed transactions together would be 'consistent with a hypothesis of collective dominance' (paragraph 110 of EC findings).
[22] The transaction was subject to EC scrutiny: http://ec.europa.eu/competition/mergers/cases/decisions/m2810_en.pdf.
[22] The transaction was subject to EC scrutiny: http://ec.europa.eu/competition/mergers/cases/decisions/m2810_en.pdf.

of those mergers (with Casson Beckman in 1997), joined its current network (then known as Summit International but subsequently rebranded as Baker Tilly International in 2002).

24. Between 2002 and 2011, the Baker Tilly International network increased in size significantly, increasing the number of countries it operates in from 59 to 125, through identifying 42 new firms to become members, and increasing network revenue from $1.4 billion to $3.2 billion.

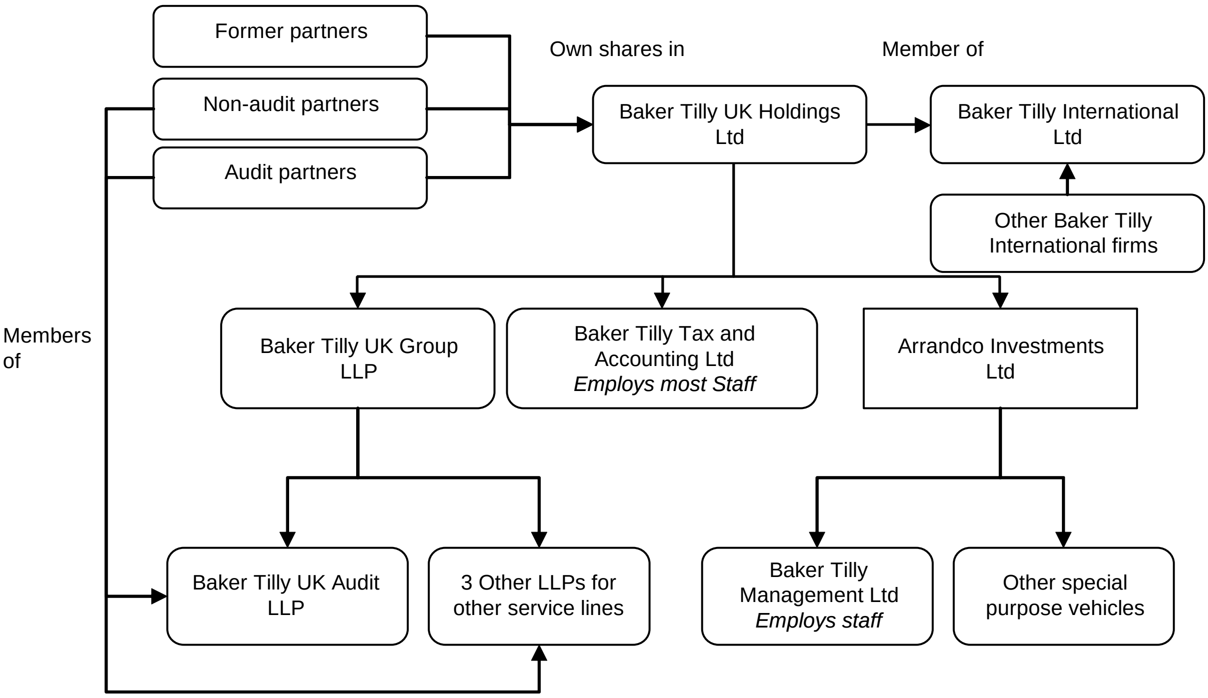
Legal and operational structure

25. Since 2007, Baker Tilly UK has operated through a group of companies limited by shares and LLPs, of which Baker Tilly UK Holdings Ltd is the ultimate holding company. Baker Tilly UK Holdings Ltd is owned by a number of shareholders, who are either current or former partners of Baker Tilly UK.

26. The business of Baker Tilly UK is divided into four main service lines, each of which is delivered through a separate legal entity as follows: Audit and Assurance (Baker Tilly UK Audit LLP), Corporate Finance (Baker Tilly Corporate Finance LLP), Restructuring and Recovery (Baker Tilly Restructuring and Recovery LLP) and Tax and Accounting (Baker Tilly Tax and Accounting Ltd/Baker Tilly Tax and Advisory Services LLP). The partners involved in the delivery of each service line are members of the relevant LLP(s). An intermediate holding entity, Baker Tilly UK Group LLP, is also a member of each of the LLPs.

FIGURE 2

Organizational structure of Baker Tilly UK



Source: Baker Tilly UK Transparency Report.

Legal and operational structure

27. The Baker Tilly network body is Baker Tilly International Ltd, which is a UK company limited by guarantee. The staff of Baker Tilly UK are predominantly employed through Baker Tilly Tax and Accounting Ltd.

28. The governance of Baker Tilly UK is structured as follows:

(a) The Managing Director of Baker Tilly UK Holdings Ltd is appointed by the shareholders and appoints the remainder of the Board. The Board of Baker Tilly UK Holdings Ltd appoints the National Management Team (NMT) of Baker Tilly UK Group LLP.

(b) The NMT is responsible for setting the group's overall strategy and driving it forward.

(c) The Baker Tilly UK Audit LLP Management Board is the specific management body responsible for the management and governance of the audit practice.

Members of the Management Board are elected by the individual members of Baker Tilly UK Audit LLP with the prior approval of the corporate member (Baker Tilly UK Group LLP). There is an Audit Management Team that reports into the Management Board.

29. The Baker Tilly International network is managed through the following structures:

(a) The International Board of Directors is composed of 15 elected Directors, who are elected from the senior partners of the member firms. The Board sets the network body's strategy and policies. The Board chooses a Chair from its members.

(b) The Chief Executive Officer and President (CEO) is responsible for managing the Baker Tilly network on a day-to-day basis and is supported by a Chief Operating Officer and the staff employed by Baker Tilly International Ltd.

(c) Regional Chairs. The network is managed as four regions, with the CEO appointing a Chair for each region, responsible for managing relations between firms in that area.

30. The network is funded through three sets of charges: a fee on joining; an annual fee based on firm revenue; and a fee based on the level of referred fees a member has benefited from as a result of membership of the network.

UK firm revenues

31. The UK firm's revenue in 2010/11 was £179 million and was generated through the following services:

(a) audit and assurance (34 per cent);

(b) corporate finance (8 per cent);

(c) restructuring and recovery (17 per cent); and

(d) tax and accounting (41 per cent).

BDO

History

32. The BDO network was established in 1963 when independent firms from the UK, Netherlands, Germany, USA and Canada formed an alliance to service their international clients. The network was initially known as Binder Seidman International, and changed its name in 1973 to BDO (Binder Dijker Otte & Co). The founding UK member firm was Binder Hamlyn, which itself was established in 1918.[23]

33. In 1994, Arthur Andersen UK acquired seven of Binder Hamlyn's UK offices to expand its UK client base, with these offices continuing to trade as Binder Hamlyn in the UK until 2002, when they rebranded as Arthur Andersen.[24] The rest of Binder Hamlyn fractured, with 13 of the remaining offices and half of the Bristol office joining Stoy Hayward.[25] Stoy Hayward then assumed the position of UK member firm of the BDO network.

34. Stoy Hayward was established in 1903 by AF Stoy as Stoy & Co and became Stoy Hayward & Co in 1919, and then Stoy Hayward in 1988. In 1994, prior to its acquisition of the Binder Hamlyn offices, the firm expanded by merging with Finnie & Co. In 2009, the firm, (along with all members of the BDO network), renamed itself to BDO to create a single international brand.

35. Prior to joining the BDO network, Stoy Hayward had been the UK member firm of the Horwath network and its departure left the Horwath network without a UK member firm, which in turn led the smaller firm Clark Whitehill to join the Horwath network.[26]

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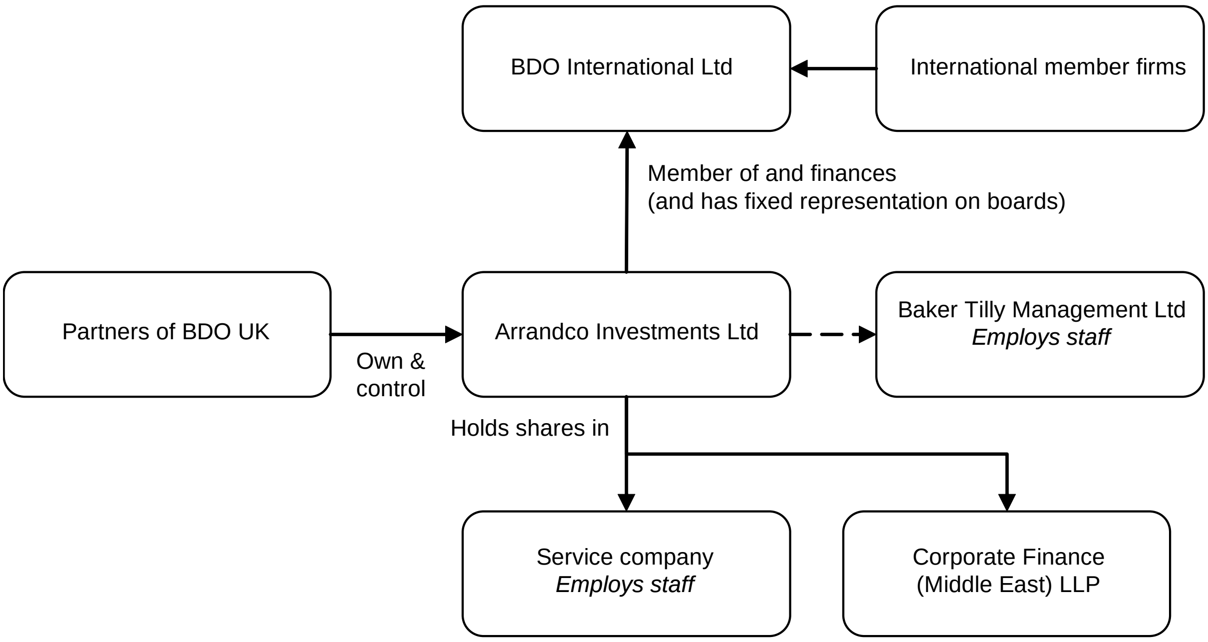
[23] www.bdocareers.co.uk/page.aspx/BDO-History.
[24] On the collapse of Arthur Andersen in the USA, Andersen UK merged with Deloitte.
[25] The Birmingham office and the other half of the Bristol office joined Touche Ross. Two further offices joined Grant Thornton.
[26] www.accountingweb.co.uk/sites/default/files/siftmedia-accountingweb/old_downloads/accounting_brand_value.pdf.

Legal and operational structure

36. BDO LLP, is a limited liability partnership and is the UK member of the BDO network, which is legally structured on membership of BDO International Ltd. Arrangements with the network are discussed below (see paragraph 41ff). BDO LLP operates in Great Britain and licenses an independent partnership to trade using the name BDO Northern Ireland in Northern Ireland.

FIGURE 3

Ownership and structure of BDO UK



Source: Analysis of BDO transparency report and annual report.

37. The staff of the firm are employed through a subsidiary, BDO Services Ltd. The firm has overseas operations through a wholly-owned subsidiary that provides corporate finance advice in the Middle East.

38. BDO partners do not have direct voting control over the decisions of the network; rather the UK has the right to a seat on a number of the network's governance committees, with the UK firm choosing its representative. This is discussed in more detail below from paragraph 41.

39. BDO UK is managed on the basis of geographic location of clients and its three service lines (Audit, Advisory and Tax).

40. The governance structures of BDO UK are as follows:

(a) The Managing Partner is elected by the partnership as whole for a term of four years. The Managing Partner is responsible for appointing a leadership team.

(b) The Senior Partner is elected by the partnership to act as a figure head for the firm and to oversee corporate governance.

(c) The Leadership team (LT) is appointed by the Managing Partner and approved by the Partnership Council. The LT meets monthly and is responsible for the strategic and operational leadership of the firm. It also includes two independent, non-executive members who have the ability to consult the Partnership Council.

(d) The Partnership Council represents the interests of the partnership, including admissions to the partnership and remuneration and profit-sharing arrangements. It is composed of the Managing Partner, Senior Partner and another representative of the LT and has 12 members elected by the partnership and meets monthly. It is also responsible for approving the leadership team and independent non-executives.

Relationship with network

41. BDO describes itself as the fifth-largest global professional services network, with 48,800 staff in 1,118 offices in 135 countries.[27] BDO International Ltd, a UK company limited by guarantee is the network body. Services to the network and member firms are provided through Brussels Worldwide Services BVBA (a Belgian private limited company). The trademark of BDO is owned by Stichting BDO, a 'Dutch Foundation', whilst use of the trademark and the network's intellectual property (such as

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[27] www.bdointernational.com/AboutUs/Pages/default.aspx.

methodology and software) is licensed by BDO IP Ltd, a company registered in Bermuda.

42. Membership of the network is through membership of BDO International Ltd, as either a voting or non-voting member.[28]

43. In addition to having full member firms, member firms can also enter into ‘alliances’ in their local territories with other firms. BDO provide the example of Spain and the USA, where other independent firms are used to increase the capacity of the BDO member firm to undertake work.[29]

44. The principal governance structures of the network are:

(a) The Council, which meets annually to approve budgets and any changes to the operation of the network, and appoints the Policy Board. Its membership is drawn from one representative from each voting member of BDO International Ltd.

(b) The Policy Board acts as a Board of Directors and sets policies and priorities for the network and supervises the Global Leadership Team. It is composed of one member from each of the five largest member firms. It elects the CEO and meets at least quarterly.

(c) The Global Leadership Team is led by a CEO and a number of executives (including Global Heads of Audit and accounting, and Tax). Membership is chosen by the CEO and it meets monthly.

45. The UK firm is the largest employer by number of staff in the network with 7 per cent of the combined total of staff employed by member firms.

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[28] Non-voting membership is necessary where in a given country a firm is composed of separate legal entities; one entity will have voting rights, the rest do not.
[29] www.cpaadmin.org/pdfs/firm_affiliations/BDOSeidmanAllianceBringingMoreToClients.pdf.

UK firm revenues

46. Revenues from BDO's service lines in 2011 were:

(a) audit—£91 million (31 per cent of firm revenue);

(b) advisory, comprising:

(i) business restructuring—£42 million (14 per cent);

(ii) corporate finance—£34 million (12 per cent);

(iii) forensic services—£36 million (12 per cent); and

(c) tax—£80 million (28 per cent).[30]

47. Statutory audit has accounted for [✄] per cent of the firm's revenue since 2004. In BDO's 2011 transparency report, BDO stated that 31.3 per cent of firm revenues were from statutory audit, with an additional 17 per cent from non-audit services provided to audit clients.

48. Table 3 summarizes the sources of statutory income for BDO.

TABLE 3 **BDO UK revenue from statutory audit**

£'000

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]
FTSE 250	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]
Other	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]
Total	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]	[✄]

Source: BDO 'Other business info'.

Deloitte

History

49. The present Deloitte network, was created on the merger of the networks of Deloitte, Haskins & Sells and Touche Ross in 1989, which was initiated by the US member

[30] BDO Transparency Report July 2011. Includes the Belfast firm of BDO which is a licensee of BDO UK.

firms.[31] Both of the previous networks had developed from two UK firms that had been established in the 19th Century (one founded by William Welch Deloitte in 1845 and the other by George Touche in 1898) which had opened offices in the USA by the turn of the 20th Century.[32]

50. Both networks had grown through a number of arrangements and alliances with other firms, most notably the US merger of Deloitte Plender Griffiths & Company with Haskins & Sells in 1952 which followed on from a 'co-partnership' established in 1925, which operated in a number of countries under the name Deloitte, Plender, Haskins & Sells.[33]

51. The UK member firm of the present day Deloitte network is the continuation of the original UK Touche Ross firm and has no link with the original UK practice of Deloitte Haskins & Sells. As noted, the 1989 merger of the Deloitte Haskins & Sells and Touche Ross networks had been instigated by the US firms, and while the majority of international member firms chose to merge in their respective territories (most likely because of the size of the US firms), Deloitte Haskins & Sells in the UK declined and instead negotiated a merger with the UK firm of Coopers & Lybrand, leaving Touche Ross UK as the UK member firm of the newly enlarged Deloitte & Touche network (at the time known as DRT International).

52. Since a number of Deloitte network member firms had not merged with their local Touche Ross firm, it was not immediately possible for the new network to use the name Deloitte, and was forced as an interim measure to refer to the network as 'DRT'. In 1993, the network was able to readopt the Deloitte name and the network

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[31] On merger, the network was known as DRT, and subsequently changed name when it was legally free to use the name Deloitte.
[32] Office is used to describe the initial expansion overseas, based on terminology used in sources.
[33] www.deloitte.com/view/en_GX/global/about/overview/history/index.htm.

became known as Deloitte Touche Tohmatsu, and subsequently has traded as Deloitte in the UK.

53. In 2002, the UK firm of Deloitte & Touche acquired some of the assets, partners and staff of Arthur Andersen after initial negotiations between Arthur Andersen and KPMG failed. This transaction was subject to EC merger control, which allowed the transaction on the basis that the UK firm of Arthur Andersen was economically separate from other members of the network.[34]

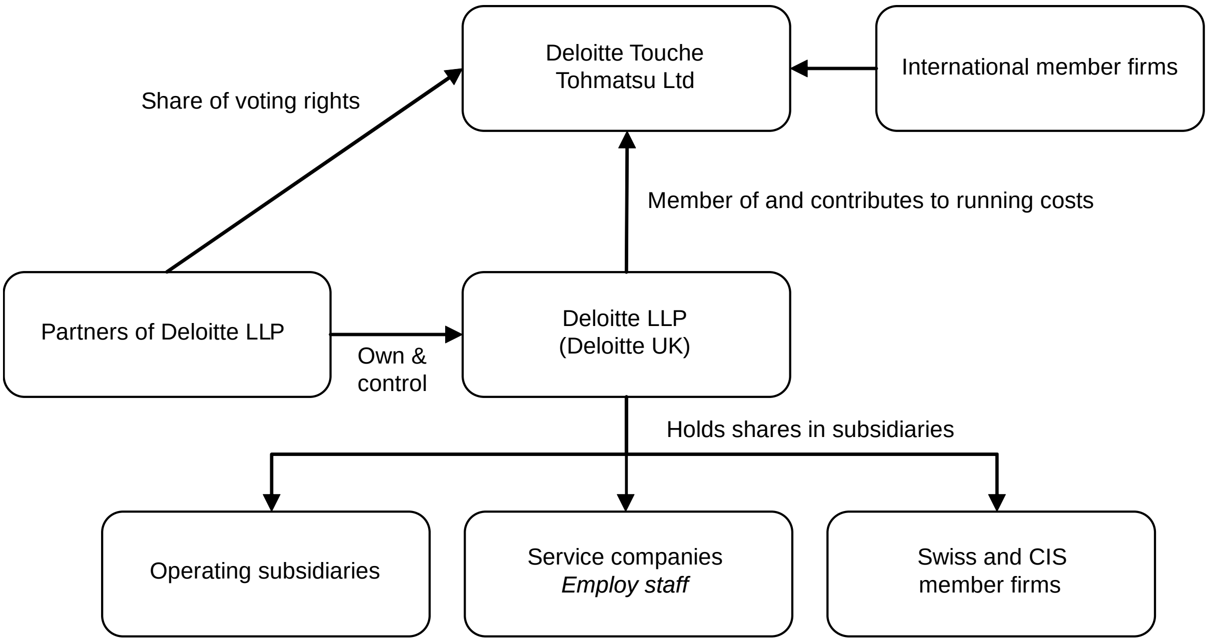
Legal and operational structure

54. Deloitte Touche Tohmatsu Limited (DTTL), the network entity, is a company limited by guarantee, incorporated in the UK.[35] The UK member of the network is Deloitte LLP, which is incorporated as a Limited Liability Partnership.[36] As an LLP Deloitte UK is owned by its members (partners), who retain control of the firm. Its corporate structure is similar to the other large firms, with a series of subsidiaries that employ the LLP's staff and act as operating companies for the different service lines.[37,38] Figure 4 provides a simplified overview of Deloitte UK's legal structure.

[34] Case No COMP/M.2810. Andersen's corporate restructuring and legal practices did not merger with Deloitte.
[35] Prior to 2010, the network was structured as a Swiss verein, which is an unincorporated association (intended for use by sports clubs etc).
[36] See part one for a discussion of the nature of being a member.
[37] A special purpose vehicle is a subsidiary created for a specific purpose, in this case, the partnership does not employ any staff. Any professional services engagement can be between either the LLP or one of its subsidiaries. By creating a subsidiary, the LLP is protected from financial risk as it is only the subsidiary that legal action can be taken against.
[38] One new avenue for increasing the non-audit business has been Ingeus UK Ltd, a joint venture with Ingeus International to run part of the Government's Work Programme.

FIGURE 4

Ownership of Deloitte LLP



Source: CC analysis of financial statements and material provided by Deloitte.

55. As a member of DTTL, Deloitte UK has voting rights in DTTL. The membership of the DTTL Board is determined through an allocation of seats to member firms, based on size, revenue, geography and client base, with each firm choosing its own representatives. The arrangements of the network are established by an agreement between each member firm and DTTL. The governance arrangements of DTTL are discussed in paragraph 62.

56. Deloitte UK is relatively unusual in that it controls other European member firms of the network. The firm has subsidiary operations in Switzerland providing a full range of professional services. In addition, it has a strategic investment in Deloitte CIS (Commonwealth of Independent States), through Deloitte CIS Limited, a UK holding company.[39] Deloitte UK provides professional support to the Deloitte CIS member

[39] Deloitte CIS Limited is a holding company and was incorporated in 2010.

firm. Deloitte UK is a partner in a joint venture which provides corporate finance services in the Middle East.

57. Management of the UK firm is based on a matrix structure with the business divided into:

(a) industries;

(b) service lines (see paragraph 71 below); and

(c) geographies (regions, Switzerland).

58. The firm is managed on a day-to-day basis by the Senior Partner and CEO, and supported by the Executive Group, which is appointed by the CEO. The Executive group is responsible for implementing policies and strategies decided by the Board and planning the firm's future development.

59. Overall oversight is through the Board of Partners which 'promotes and protects partners' interests' and approves long-term strategy. Both the Chairman and CEO are elected by the partners of the firm and they attend the Board with ten elected partners, three independent non-executives and three partners from the Executive group. The Board has oversight of risk and quality in the firm.

60. Subcommittees of the Board have been established for specific oversight of compensation, remuneration, nomination and public interest issues. No members of the Executive group sit on these committees. Additionally there is an Audit Committee with at least three non-executive Board members who are not also members of the Executive group.

61. Delivery of audit services (including various assurance activities) is overseen by the Managing Partner Audit, supported by the Audit Executive*.* The Audit Executive

meets monthly and is composed of representatives from the different areas of the audit service line.

Relationship with network

62. The member firms of the DTTL network operate in 153 countries and are supported by DTTL, which has a number of governance structures:

(a) The Board of Directors (DTTL Board) is the highest governing body in the network and approves the policy and strategy of the network. It is led by the DTTL Chairman and has 32 Board members including the CEO. Member firms and regions are allocated a number of seats on the board based on the size, revenue, geography and client base of those firms. Representatives of each member firm are chosen by that member firm's partners. Three seats are allocated to regions to allow a representation of smaller firms.

(b) The DTTL Governance Committee (a subcommittee of the DTTL Board) includes representatives from the largest member firms and the CEO and has oversight responsibility for DTTL's management and focuses particularly on 'major strategic issues facing DTTL and the member firms'.

(c) The DTTL Chief Executive Officer is approved by the DTTL Board, subject to two-thirds of the partners of member firms participating in a ratification vote with a requirement that 50 per cent of the partners must participate for the vote to be valid. The CEO serves a four-year term with a limit of two terms.

(d) The DTTL Executive is led by the DTTL CEO. There are 19 members of the DTTL Executive (plus 2 ex officio members) who are chosen by the CEO, subject to approval of the Governance Committee of the DTTL Board. Its responsibilities

include 'fostering a common vision and helping to develop and direct DTTL's strategies'.[40]

63. The voting rights of member firms are determined by two factors: revenue and professional headcount (with each having an equal rating). Deloitte UK holds approximately 10 per cent of the voting rights in the network.

64. The Deloitte UK transparency report states that the function of DTTL is 'to coordinate [member firms'] approach to client service, professional standards, shared values, methodologies, and systems of quality control and risk management'.[41]

65. DTTL manages the international brand and puts in place policies for member firms to ensure consistency (such as audit methodology), but implementation of policies is controlled at a member firm level.

66. The current Chairman of the DTTL Board is Steve Almond, Managing Partner for Deloitte UK's International Markets, who succeeded John Connolly, the former UK Senior Partner in this role. The DTTL Executive is headed by the DTTL CEO, Barry Salzberg, who is the former CEO of Deloitte USA.

67. Deloitte UK's financial contribution to the DTTL network since 2007 has been in the order of 2.3 to 2.4 per cent of net revenue each year.[42]

68. DTTL does not directly incur any expenditure; rather it is supported by another company, Deloitte Global Services Ltd (DGS), which provides services to the

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[40] Deloitte UK 2011 Transparency Report, p22.
[41] Deloitte UK 2011 Transparency Report.
[42] Commentary accompanying Deloitte's management accounts indicate that the contribution is linked to revenue.

member firms.[43] DGS recorded revenue from membership fees of $532 million (approx: £337 million) in FY 2011 with an additional $197 million (approximately £125 million) of additional direct charges to member firms. There is also a US company Deloitte Touche Tohmatsu Services Inc, which provides services to some member firms (and charges DGS a management fee of approximately $21 million (approximately £13 million)). Staff costs of running the network were $113 million (approximately £71 million).

69. DGS's financial statements show that there are outstanding loans of some $95 million (approximately £61 million) made to member firms, with interest charged at DGS's own borrowing rate.

70. DGS is also responsible for developing the network's technology platform and holds an asset with a carrying value of $97 million (approximately £62 million) relating to software development and in 2011 spent $32 million (approximately £21 million) on development costs for software of which $14 million (approximately £9 million) was not-capitalized.[44]

UK firm revenues

71. Deloitte UK's gross revenue in FY 2011 from all service lines was £2,098 million. The firm structures its business into four service lines which in FY 2011 generated the following levels of revenue:

(a) audit (31 per cent of revenue);

(b) tax (25 per cent of revenue);

(c) consultancy (25 per cent of revenue); and

[43] Prior to 2010 this activity was undertaken by a Swiss verein.
[44] Capitalization is the recognition of an asset on the balance sheet. Not all costs of developing an asset can be capitalized, because they are not directly related to the use of final asset (such as research costs).

(d) corporate Finance (19 per cent of revenue).[45]

72. Audit and directly related services accounted for 24 per cent of total gross revenue in 2011.[46] Non audit-work for audit clients generated 9 per cent of revenue, with the remaining 67 per cent relating to non-audit clients. This was at a similar level in 2010 and 2009.[47] This indicates that 33 per cent of total revenue came from audit clients.

73. Table 4 summarizes the sources of audit and directly related services net revenue for Deloitte UK.

TABLE 4 **Deloitte UK revenue from statutory audit**

£'000

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
FTSE 250	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Deloitte 'Other Business Info'.

Notes: Deloitte have not been able to produce data for 2004 and 2005.

EY

History

74. The Ernst and Young network was created in 1989 on the merger of two of the 'Big 8' networks, Ernst & Whinney and Arthur Young. Both Arthur Young and Ernst & Ernst (one of the two founding firms of Ernst & Whinney) were established in the USA in the 1900s.

75. In the UK, Ernst & Whinney was formed in 1979 by the merger of Ernst & Ernst (established 1903) and the UK firm of Whinney, Smith & Whinney (a successor partnership to one founded in 1849).[48] The two networks had worked with each other

[45] Initial submission to CC, Deloitte.
[46] Deloitte 2011 Transparency report.
[47] Deloitte, 2009, 2010, 2011 Transparency reports.
[48] The partnership changed its name several times and successor and predecessor firms are hereafter referred to as Whinney for simplicity.

previously; Whinney had opened a New York office in 1914, solely for the purpose of servicing the Midland Bank which was increasing the level of its engagement with US banks (an example of client-driven expansion).[49] The office closed in 1917 as an impact of the First World War, and Ernst & Ernst were approached in 1918 to undertake this work on behalf of Whinney.

76. A formal alliance was made between Ernst & Ernst and Whinney in 1924 and led to Whinney representing Ernst & Ernst in Europe.[50] Whinney's growth in the UK in the interwar years was driven by work performed for American clients introduced to it as a result of its arrangement with Ernst & Ernst. This relationship continued to develop with cross-partnership agreements until the international partnership was formed in 1979.[51]

77. Similarly, Arthur Young entered into a formal alliance with the UK firm of Broads Paterson & Co in 1924 with a full amalgamation of the two firms in 1966. The 1924 alliance appears to have been based on Broads Paterson & Co supervising a 'branch office' for Arthur Young in the UK. As with Ernst and Whinney, the relationship between Broads Paterson & Co and Arthur Young predated the formal arrangement, extending back to 1904, when the two firms had undertaken a joint audit of one of Broads Paterson's clients.

Legal and operational structure

78. EY UK is a Limited Liability Partnership, owned by its members (the partnership). EY UK is a subsidiary of a European entity, EY Europe LLP which was created in conjunction with the EMEIA Area in 2008 (see paragraph 83 below). The UK partners

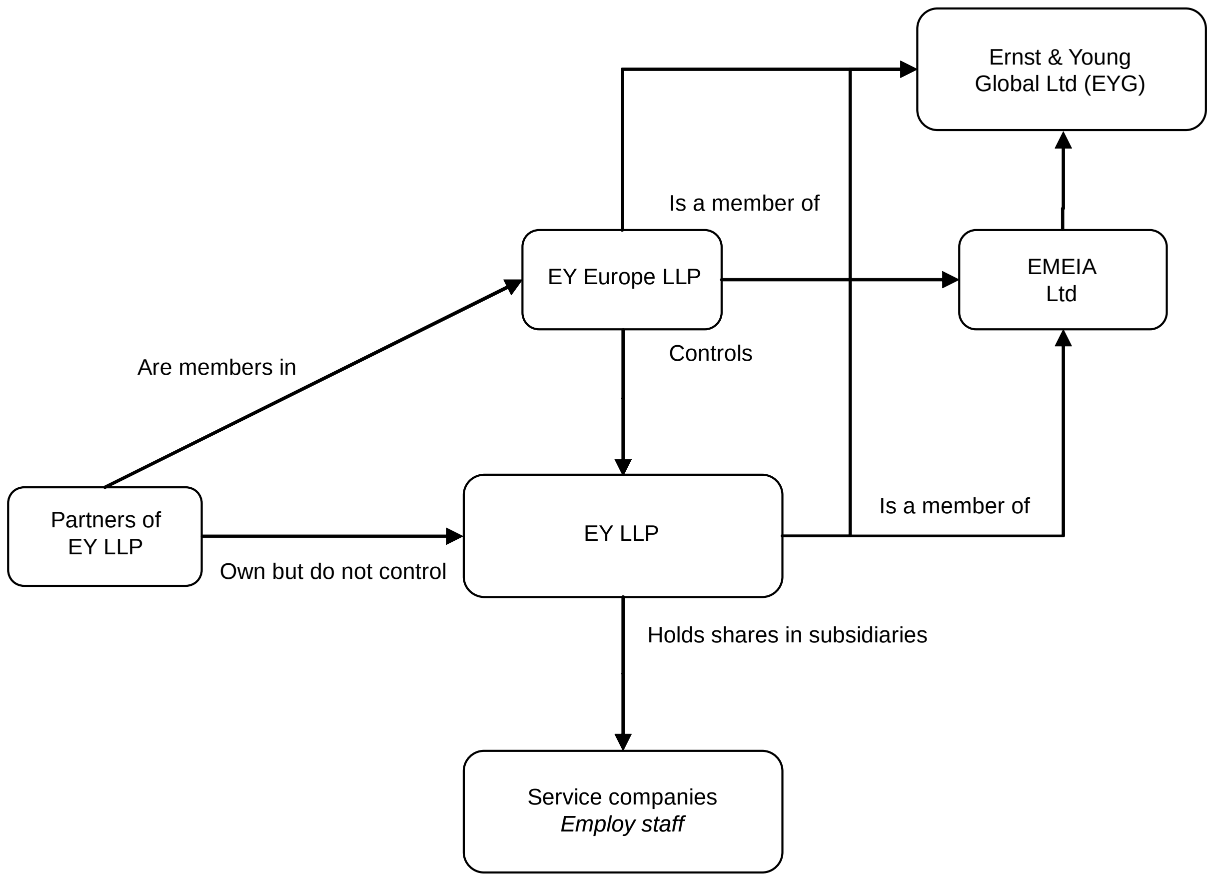
[49] Boys, P 'The origins and evolution of the accounting profession' in Habgood, W (ed), *Chartered Accountants in England and Wales: a guide to historical records*, p34.
[50] www.ey.com/US/en/About-us/Our-history/About-us-Our-history-timeline.
[51] Boys, P 'The origins and evolution of the accounting profession' in Habgood, W (ed), *Chartered Accountants in England and Wales: a guide to historical records,* p34.

have exchanged their voting control of EY UK for a share of the voting rights of EY Europe LLP. As a result, EY UK is effectively operated as part of EY's European network. The structure and governance of EY UK and the EY network more generally is discussed below.

79. EY UK owns a number of subsidiary companies, most of which are dormant. Of the active subsidiaries, most are used for the purposes of employing the staff of EY UK.

FIGURE 5

EY UK Ownership and legal structure



Source: CC analysis of financial statements and 'off the shelf' material.

80. There is a consistent management and governance structure at each of the Global and Area levels of the EY network, including, the European network firms and within the UK. Because of the nature of the EY network and the relationships EY UK has

within it, the UK governance structures should be considered alongside those at the European and Global elements levels of the organization.

81. Whilst a significant amount of control is retained at the European level, the UK firm retains its own Board, appointed by the European Executive, and is responsible inter alia for the commercial, financial and reputational standing of the firm. The Board is led by the Country Managing Partner (CMP), who is appointed (and can be replaced) by the European Managing Partner subject to European Executive approval.

82. The operational management of the UK firm is undertaken by two Sub-Area Managing Partners (SAMPs), who oversee two separate business divisions or 'Sub-Areas', UK & Ireland (UK &I) (where the SAMP is also the CMP) and FSO (Financial Services Office) (discussed in the context of the network below).

Relationship with network

83. Ernst & Young Global Ltd (EYG) is the central governance entity of the Ernst & Young network and coordinates the member firms and cooperation among them (network firm). EYG does not provide services to clients. EY UK is a member of EYG. EY organizes its network through four geographic areas: Americas, Asia-Pacific, Japan and EMEIA (Europe, the Middle East, India and Africa). The European area is overseen by EMEIA Ltd, which essentially acts as a second tier of network firms. EMEIA covers 93 countries, which are then managed as 12 sub areas. In the UK, there are two Sub Areas: UK & Ireland (UK &I) and FSO (Financial Services Office), each overseen by a SAMP.

84. The principal governance and management bodies of the global network are:

(a) The Global Executive led by the Chairman and Chief Executive and with representation from the four Area Managing Partners and the global heads of

functions and service lines. With the Global Advisory Council, it approves nominations for Chairman, Chief Executive Officer and Chief Operating Officer of EYG and ratifies the appointment of Global Managing Partners.

(b) The Global Advisory Council is the main ‘advisory body’ for the network, which is composed of partners from across member firms who are elected for three-year terms. The Global Advisory Council is responsible for advising EYG on policy, strategy and the public interest aspect of decision-making. The Global Advisory Council is required to ratify key decisions of EYG.[52] In September 2011, four Independent Non-Executives (INEs) were also appointed as members of the Advisory Council in line with the UK Audit Firm Governance Code.

(c) The Global Executive Committees are a number of service line and function committees that bring the four global areas together and cover operational matters.

(d) The Global Practice Group is composed of members of the Global Executive, Area service line and function leaders, and is responsible for ensuring consistency of execution of policy.

85. EYG does not directly incur expenditure. Services to clients are provided through the individual Member Firms. Services to the network are provided through EY Global Services LLP (EYGS LLP) and EY Global Services Ltd (EYGS Ltd) a wholly owned subsidiary of EYGS LLP. Services to the European area are also provided by Ernst & Young (EMEIA) Services Ltd (EYES), which is also owned by EYGS LLP. These companies operate primarily from the UK.

86. In 2011, EYGS Ltd reported expenditure of £565 million with all expenditure recharged to member firms in the financial year. £205 million of this was financed

[52] There are also a number of subcommittees of the EYG Executive.

from payments from EYES. Expenditure incurred by the network is disclosed in its financial statements as:

(a) global technology—£362 million;

(b) industry and business development costs—£87 million; and

(c) other operating costs—£117 million.[53]

87. EYGS Ltd holds £4 million in cash.

88. EYES incurred £635 million of expenditure. All expenditure is recovered from member firms in the EMEIA area. Expenditure incurred by EYES is disclosed as:

(a) charges by EYGS LLP—£183 million;

(b) purchased services—£130 million;

(c) technology—£204 million;

(d) practice and market development—£68 million; and

(e) other costs—£50 million.

89. The figure for purchased services relates to costs incurred by member firms on behalf of the company (largely seconded staff costs). EYES received £360,000 in interest charges from a loan to the subsidiary of a member firm (CE IT Services GmbH). EYES holds £77 million in cash as at 1 July 2011.

90. A review of the financial statements of EYGS LLP found that in 2011 changed from having a revolving credit facility of $450 million with a consortium of four banks to a similar facility with EY Global Finance Inc. (EYGF), a US company, which is owned by member firms. Prior to the switch in facility, EYGS LLP had a bank loan of £168 million outstanding and loans from three unnamed member firms of £51 million.

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[53] Other operating costs includes desktop and software maintenance, infrastructure, knowledge, procurement and transformation. No further information is provided.

91. EYGS LLP has another subsidiary, which provides services to the Asia-Pacific area which was not trading for all of 2011.

UK firm revenues

92. EY's provides services to its clients through four service lines (see Table 2), which are the same in each of the international member firms:

(a) Assurance—[✂] per cent of revenue. This includes accounting and financial reporting, audit, financial accounting advisory, and fraud investigation.

(b) Advisory—[✂] per cent of revenue. This includes risk, performance management and IT risk and assurance.

(c) Tax—[✂] per cent of revenue. This includes direct and indirect tax, and human resource services.

(d) Transaction Advisory services—[✂] per cent of revenue. This includes restructuring, transaction tax advice and valuation and modelling.

93. Table 5 provides detail of the trend in statutory audit revenue. The table indicates that [✂].

TABLE 5 **EY UK revenues from statutory audit**

							£'000
	2005	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
FTSE 250	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: EY 'Other business info'.

Grant Thornton

History

94. The UK member firm of Grant Thornton traces its history to the firm Thornton Baker, which was formed in 1959 through the merger of two firms, Thornton & Thornton

(established 1904) and Baker & Co (established 1868). Between 1959 and 1986, Thornton Baker grew through mergers with 50 other firms.[54]

95. In 1980 a new expanded network, including both Alexander Grant & Co, a US firm (established in 1924 by a former employee of Ernst & Ernst) and Thornton Baker, with 50 international member firms was created and named Grant Thornton International. In 1986 the UK and US member firms renamed themselves to Grant Thornton. A precursor to the Grant Thornton international network, Alexander Grant Tansley Witt, was created in 1969, when Alexander Grant formed alliances with firms from Australia, Canada and the UK. The UK member firm in the network was not related to Thornton Baker.

96. In 2007, Grant Thornton UK (at that point either the fifth- or sixth-largest firm in the UK by revenue) merged with the UK firm of RSM Robson Rhodes (the 12th-largest UK firm) which had been struggling financially. The merger led to the RSM network having to identify a replacement UK member firm (Bentley Jennison).

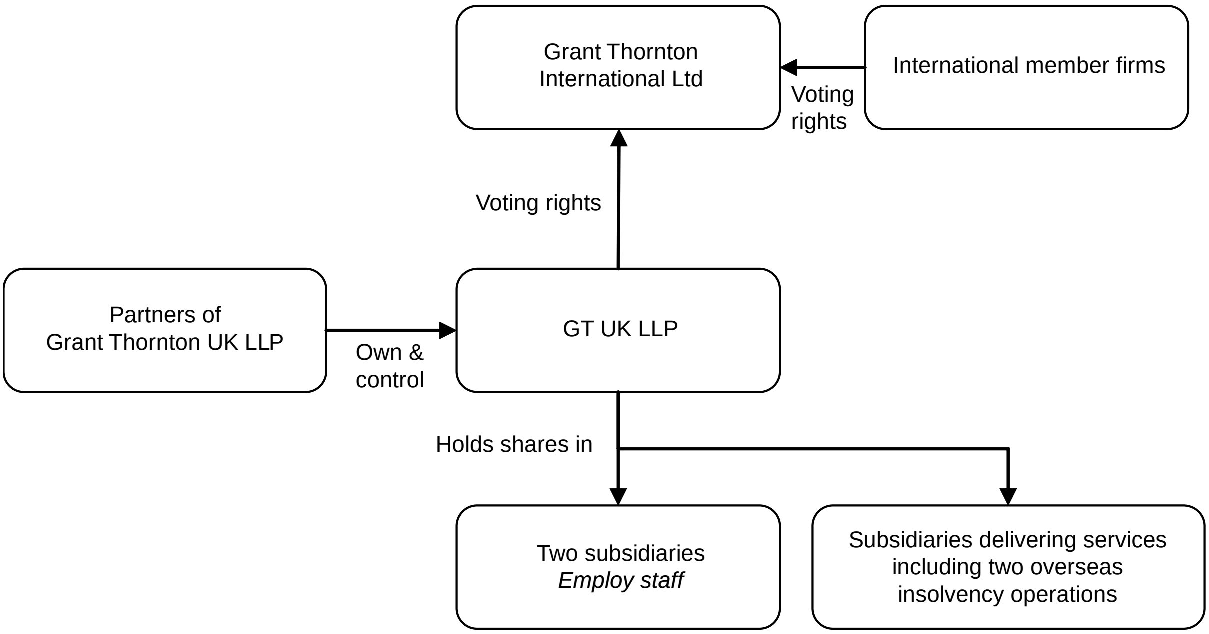
Legal and operational structure

97. Grant Thornton UK LLP is the UK member firm of the Grant Thornton network and is incorporated as a limited liability partnership.

[54] What's in a name, ICAEW.

FIGURE 6

Ownership and structure of Grant Thornton UK



Source: Analysis of Grant Thornton Transparency Report.

98. Grant Thornton reports internally through three managed divisions, which are a combination of geographic locations and service lines:

(a) Regions—36 per cent of revenue;

(b) London—28 per cent of revenue; and

(c) Advisory (national)—36 per cent of revenue.[55]

99. The Regions and London business units are further managed by service line of audit, tax and advisory. Advisory work is managed through three sub-units; Forensic, Reorganisation and Recovery, and Corporate Finance.

100. The firm's governance structures are:

(a) The Partnership Oversight Board (POB) that oversees the National Leadership Board including the setting of the firm's statement of principles, determining

[55] Based on analysis of six-month management accounts to 31 December 2011.

profit-sharing arrangements and the nomination of a candidate for the position of CEO (which is subject to ratification by the firm's partnership). The POB is composed of nine elected partners, three independent non-executive members, with the CEO and two other members of the National Leadership Board acting as non-voting *ex officio* members. The Chair of the POB is selected by the members of the POB.

(b) The National Leadership Board is appointed by the CEO to act as the firm's senior management team, developing and executing the firm's strategy and has responsibility for regulatory compliance and compliance with the firm's statement of principles.

Relationship with network

101. GTUK is a member of GT International Ltd, a company limited by guarantee. As at 30 September 2011, there were 96 member firms with combined revenue of £2.3 billion and 30,000 personnel. GTUK's net revenue in 2011 was £351 million (14.1 per cent of the combined network figure) and employed 3,500 staff and partners (12.5 per cent of the combined network figure). GTUK is the second-largest firm in the network, after the US firm.

102. The two principal governance structures of the network are:

(a) The Board of Governors that appoints the Global CEO and has responsibility for approving strategy and policies determined by the CEO. Members are 'selected from member firms worldwide'.[56]

(b) The Global Leadership Team is appointed by the Global CEO with responsibility for execution of the network's strategy.

[56] Grant Thornton Transparency Report 2011.

UK firm revenues

103. GTUK's revenues in 2011 were generated from the following service lines:

(a) assurance (32 per cent);

(b) tax (24 per cent);

(c) corporate finance (9 per cent);

(d) forensic (5 per cent);

(e) recovery and reorganization (26 per cent); and

(f) other (4 per cent).

104. In the period 2004 to 2011, based on data submitted by GTUK, statutory audit accounted for between 31 and 35 per cent of the firm's revenue. In its 2011 Transparency Report, GTUK stated that 27 per cent of revenue was from statutory audit and 10 per cent was from non-audit services to audit clients.

105. Table 6 summarizes the sources of statutory audit revenue for GTUK.

TABLE 6 **GTUK revenue from statutory audit**

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	-	-	-	-	-	-	-	-
FTSE 250	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: GTUK 'Other business info'.

KPMG

History

106. KPMG's oldest UK predecessor firm, William Peat & Co was established in 1870, by William Barclay Peat. The firm merged with Marwick Mitchell & Co in 1911 and became known as Peat Marwick.[57] The practice then grew organically until the Second World War. After 1945, the firm's expansion in the UK was driven by a series

[57] The relationship between the two firms was actually suspended between 1919 and 1925 before being resumed.

of mergers with regional firms, which led to it developing a position as one of the eight largest firms by the 1980s.[58]

107. The current UK KPMG member firm was formed in 1986 when Peat Marwick merged with KMG Thomson McLintock, the tenth-largest firm in the UK (and UK member firm of the KMG network). Thomson McLintock was established in Glasgow in 1877, and had operated in the UK as a federation of UK partnerships after its London and Glasgow offices formed separate partnerships. This decentralized structure encouraged other regional firms to join, in the knowledge they would retain a degree of autonomy and the firm targeted several regional firms to merge with during the 1960s to ensure a broad coverage of the UK.[59]

108. KMG was a network that developed from the deliberate strategy of Thomson McLintock to create an international network in lieu of establishing its own network of practice offices overseas, which had been necessitated by its existing clients expanding overseas. In 1964, a coordinating (and not practising) firm of McLintock Main Lafrentz International was created, with a US firm, Main Lafrentz. The network grew and in 1979 was renamed KMG (Klynveld Main Goedler) and in 1985 Thomson McLintock adopted the prefix KMG.[60]

109. In 1996 the UK KPMG member firm started to use KPMG Audit Plc to undertake the audit of all of its listed clients, as a way of ring-fencing risk in what KPMG UK perceived to be an increasingly litigious environment.[61] In 2002 the business of the unlimited UK partnership was transferred to a limited liability partnership.

[58] KPMG UK submission to CC, paragraphs 36 & 37, KPMG UK.
[59] Habgood, p29.
[60] KPMG UK submission to CC, paragraph 38, KPMG UK.
[61] KPMG UK submission to CC, paragraph 39, KPMG UK.

110. In 2007, after the implementation of the EU Statutory Audit Directive, which allowed pan-European ownership of audit firms, KPMG Europe LLP (ELLP) was created by the UK and German member firms and has since grown to encompass a number of European and Gulf member firms. However, ELLP does not itself undertake any client services, with member firms providing audit and other services in the relevant country.[62]

Legal and operational structure

111. KPMG LLP (the UK KPMG member firm (KPMG UK)) provides statutory audit in Great Britain, along with its wholly-owned subsidiary, KPMG Audit Plc (see paragraph 112). KPMG's activities in Northern Ireland are undertaken by the KPMG member firm in Ireland. Both the Channel Islands and the Isle of Man are separate KPMG member firms. KPMG UK is a member of KPMG International Cooperative, which is a Swiss 'cooperative', changing status from a Verein in 2003. The governance of KPMG International Cooperative is discussed below.

112. KPMG UK is incorporated as an LLP in the UK. UK partners are members of KPMG LLP, and most UK partners are also members of ELLP. ELLP holds sufficient voting rights to control KPMG UK. When ELLP was created, it was a merger between the UK and German KPMG member firms; whilst KPMG UK remains a separate legal entity, it is controlled by ELLP, which itself is a limited liability partnership.[63,64]

[62] KPMG UK Submission to CC, paragraphs 43 & 44, KPMG UK.
[63] The FRC/AIU describes the UK as being 'owned' by the ELLP; in fact it is controlled by ELLP.
[64] All partners have the same weighting in the ELLP. However, if a resolution that needs an exceptional or extraordinary majority fails, the resolution will be put to audit qualified partners (who must make up 10 per cent of all partners) and if they pass it, it is carried. No decisions in the ELLP are reserved for certain member firms.

113. Since the creation of ELLP, other European (and Gulf) KPMG member firms have joined, so that ELLP now effectively controls the operations of firms present in 18 countries.[65]

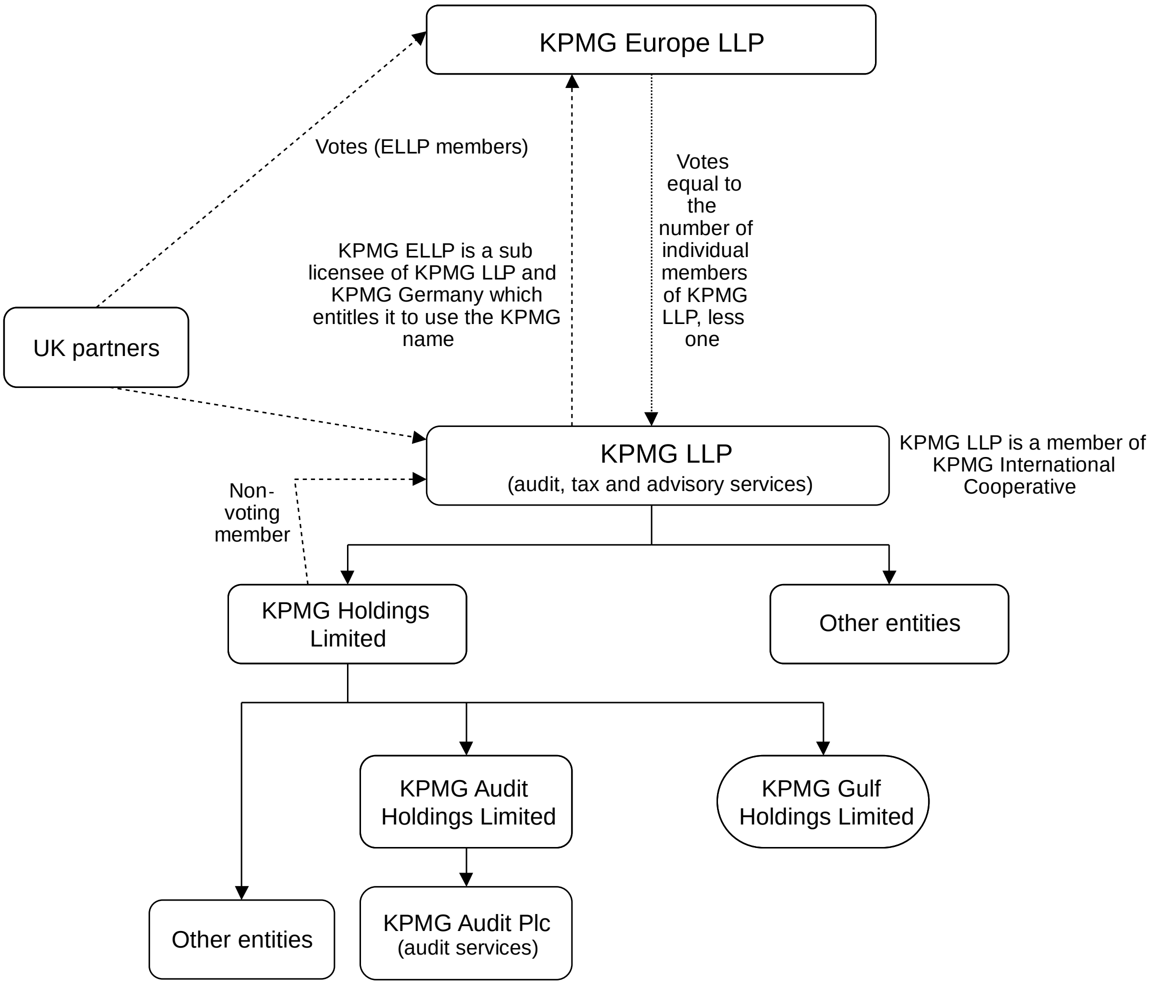
114. KPMG Gulf Holdings Limited holds call options in a number of Gulf operations. KPMG in Saudi Arabia is (deemed to be) controlled, for the purposes of the relevant IFRS, whereas Kuwait and Jordan are subject to significant influence. KPMG Gulf Holdings Limited is an indirect subsidiary of KPMG LLP which is in turn controlled by ELLP.

115. KPMG UK is notable for the use of a separate subsidiary, KPMG Audit plc, for the audit of its Public Interest Entity (PIE) clients, which includes nearly all listed company and financial services audits.

[65] KPMG UK 2011 Transparency report.

FIGURE 7

Ownership and structure of KPMG UK



Source: CC Analysis of financial statements and 'off the shelf' material.

116. ELLP has control of KPMG UK. As noted, ELLP also controls or has interests in member firms operating in 18 countries, with the UK firm being the single largest division of ELLP, accounting for approximately one-third of ELLP's staff and 40 per cent of its revenue. From 2011, a small percentage of profits generated by member firms within ELLP is pooled and distributed to those ELLP partners which have best

exhibited a pan-European mindset within ELLP.[66,67] The net amounts actually transferred from one country to another are, however, minimal.

117. ELLP has a Board which exercises power in all areas except a few relating to organization structure and composition, which must be voted on by the members. Its principal functions are to set strategy and policy and oversee the ELLP Executive Committee. The Board is comprised of two joint Chairmen, ten executive partners, and 15 non-executive partners. All members of the Board are ratified by the ELLP partnership.

118. Six main bodies report to the Board, the most significant of which is the Executive Committee. The Executive Committee is responsible for various matters including the financial performance of ELLP, developing new business areas and recommending policy to the Board.

119. Day-to-day management of KPMG UK and responsibility for compliance with UK regulatory requirements remains the responsibility of a UK executive, known as the 'UK Operating Team'. Although there is a UK 'Board' its primary purpose is for the completion of governance duties such as recommending the approval of the accounts to the voting members.

120. KPMG UK has a separate subsidiary (KPMG UK Ltd) to provide staff and services to the partnership and those of its subsidiaries which provide services to clients. It is unusual in using a separate entity, KPMG Audit Plc, to undertake its public interest audits, and it is the name of this subsidiary and not After management charges to the

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66 'This year we have also agreed, across ELLP firms, to the greater sharing of economic interests which allows the KPMG Europe LLP leadership to reward positive partner performance regardless of the geography (or geographies) that directly profits from that performance. This is a hugely positive step in our ELLP journey, as it removes potential geographical obstacles to getting the best expertise for our clients.' http://annualreport.kpmg.eu/home/overview/chief-operating-officers-review.

67 An individual partner's profit share will be largely driven by the financial performance of that partner's firm.

Plc for overheads incurred by KPMG LLP and charges for staff from KPMG UK Ltd, the Plc does not normally generate a significant profit, with substantially all profits arising in the LLP.

Relationship with network

121. In aggregate member firms of the KPMG network of independent firms operate in 152 countries. The structure of the KPMG network 'is designed to support consistency of service quality and adherence to agreed values'. KPMG International Cooperative 'establishes, and facilitates the implementation and maintenance of uniform policies and standards of work ... and protects and enhances the use of the KPMG name and brand'.[68] KPMG International Cooperative has 55 member firms and approximately 283 practising sub-licensee firms (together commonly referred to as 'member firms').

122. Member firms of KPMG International are required to have 'the capability to provide certain types of core services and to refer work to other member firms where appropriate'. The basis for calculating contributions to KPMG International by member firms are determined [✂]. KPMG UK contributes [✂]of revenues to KPMG International Cooperative which in 2011 amounted to [✂]

123. The principal governance structures of KPMG International Cooperative are:

(a) The Global Council focuses on high-level governance and acts as a forum for communication between member firms. The Council elects the KPMG International Chairman and approves the appointment of members of the Global Board.

(b) The Global Board has responsibility for approving strategy and policies, protecting the KPMG brand (including admission of member firms), and

[68] KPMG LLP Transparency report 2011.

management of KPMG International. Membership consists of the Chairman and Deputy Chairman and the Chairman of the three geographic regions (Americas, Asia-Pacific and, Europe, the Middle East and Africa) and a number of senior partners from member firms.

(c) The Global Executive Team is led by the Chairman and is supported by the Global Practice Heads, and manages KPMG International. It has responsibility for execution of strategy approved by the Global Board.

124. Each of the three geographic regions also has a Regional Board with its own Chairman and chief operating or executive officer. The Regional Boards assist with implementing policy in their region.

UK firm revenues

125. KPMG's UK revenues are generated through a number of service lines:

(a) audit (27 per cent);

(b) tax (25 per cent);

(c) transactions and restructuring (21 per cent);

(d) risk and compliance (12 per cent); and

(e) performance and technology (15 per cent).[69]

126. Table 7 summarizes the source of KPMG's statutory audit revenue.

TABLE 7 **KPMG statutory audit revenue**

£'000

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
FTSE 250	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: KPMG 'Other business info'.

[69] Analysis of September 2011 Management Accounts.

Mazars

History

127. Mazars was established in Normandy, France in 1940 and remained a largely local firm until the 1980s. It expanded to the UK in 1998 when the British firm of Neville Russell (established 1901) joined its network. Mazars expanded through some local mergers and the creation of new offices in overseas territories. In 2007 Mazars joined the Praxity alliance, which at that point had member firms in 75 countries.

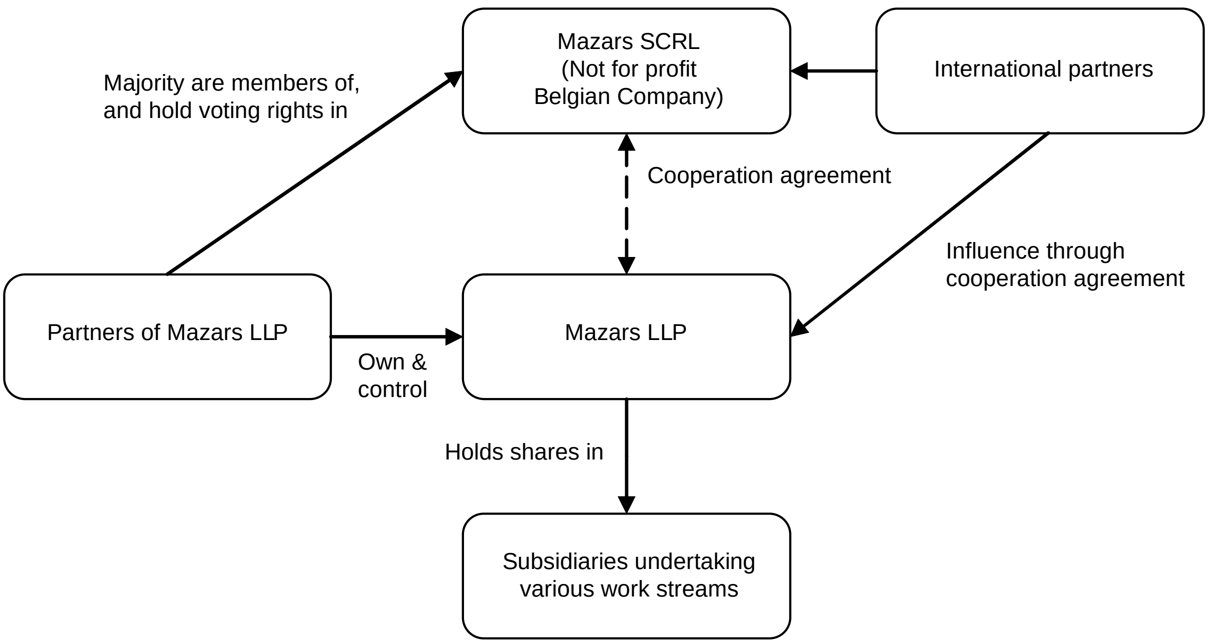
128. In 2007 the UK firm merged with MRI Moores Rowland, a British firm.[70]

Legal and operational structure

129. Figure 7 shows the legal structure of Mazars LLP, and its ownership by its partners. The relationship between the firm and Mazars globally is discussed below.

FIGURE 8

Ownership and structure of Mazars LLP



Source: CC analysis of MFQ and corporate documents.

[70] Moores Rowland was an association of regional partnerships that had roots in a firm established in 1866. In 1999 ten of its offices joined BDO Stoy Hayward with a number of other offices joining other firms.

130. Mazars UK is a Limited Liability Partnership, owned by its partners. Approximately two-thirds of its partners are also members of Mazars SCRL, a Belgian not-for-profit company (these partners are referred to as International Partners in this document). The voting power of International Partners is weighted for matters relating to Mazars LLP, so that each partner has twice the number of votes of a non-International Partner.

131. Non-International Partners receive a fixed share of Mazars UK's profits plus an additional performance-related amount. Partners who are members of Mazars SCRL are allocated profit sharing 'points' which are reviewed every three years. Capital contributions of International Partners range from [✂] depending on profit points, whilst non-International Partners must contribute either £[✂] or £[✂] depending on their allocated profit share.

132. Mazars structures its business around two Country Business Units (CBUs): Public Interest Entities (PIE) (44 per cent of firm net revenue), and Owner Manager Businesses (OMB) (56 per cent of firm net revenue).[71]

133. The firm's offices are managed as either PIE (London, Luton and Jersey) or OMB (all other offices). The CBUs are then managed by Operational Business Units (OBU), which for the OMB CBU is done on a geographic basis.

134. The OBUs for the PIE CBU are based on service lines:

(a) Audit—47 per cent of PIE revenue;

(b) Tax—21 per cent of PIE revenue;

(c) Actuarial—3 per cent of PIE revenue;

(d) Advisory—20 per cent of PIE revenue;

[71] CC analysis of Mazars August 2011 Management Accounts.

(e) Internal Control—9 per cent of PIE revenue; and

(f) Outsourcing.[72]

135. Audit and Assurance are overseen by the Audit and Assurance Group, which reports to the National Executive. The CBUs are supported by the Country Support Unit. Not all PIE clients are audited by the PIE CBU and vice versa; however, the PIE CBU has ultimate responsibility for all PIE clients.

136. The principal governance arrangements of the firm are as follows:

(a) The National Senior Partner is elected by the UK partners. The Senior Partner nominates an executive team, which is then ratified by the UK partnership.

(b) The Executive and the Senior Partner are responsible for setting and delivering the firm's strategy. The Executive is also responsible for setting a management structure that is consistent with Mazars globally.

(c) The Governance Council is elected by the partners and oversees the work of the executive on behalf of the partnership as a whole. The Council also is responsible for the arrangements of the partnership including membership and remuneration.

Relationship with network

137. Mazars differs from the typical network model, describing itself as a 'partnership of partners' and as an 'integrated partnership'. As noted above, two-thirds of partners are International Partners, owning a share in Mazars SCRL and control approximately [✂]per cent of voting rights in the UK firm. It is the intention of the firm that this will increase to [✂] per cent in the future, to ensure consistency with firms internationally.

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[72] Analysis of Mazars August 2011 Management Accounts. Outsourcing is not reported as a separate line. Service lines are not separately analysed for the whole firm.

138. The international governance structures of Mazars SCRL are:

(a) The Group Executive Board is led by the global President (Chair) and Chief Executive of Mazars and is composed of members nominated by the President and ratified by the members of SCRL. The Executive Board is responsible for key strategic decisions. The Chair is elected by the members every three years.

(b) The Group Governance Council is elected by the members of Mazars SCRL to administer the admission of new partners and oversee the work of the Executive Board and global business units (individual territories). It meets every four months.

(c) Global Business Units manage 'country business units' from an international perspective, with management of local issues undertaken by the Country Business Unit.

(d) The Global Strategic Committee has responsibility for '*proposing and supporting the Group's strategic developments around the world'.*[73]

(e) The Global Executive Committee includes members of the Group Executive Board and representatives of the Global Business Units and Support Units and is responsible for global coordination and day-to-day operational management of Mazars globally and meets monthly.

139. The UK firm's structure was introduced in 2009 as part of an international standardization of management structures in member firms. Internationally, Mazars monitors its performance through four Business units, being PIE, OMB, Tax and Law. In the UK, Tax is included within PIE or OMB and there is no legal practice.

140. There are 'integrated' firms in 69 countries and non-integrated in 15 countries. Non-'Integrated' firms are joint-ventures and correspondent firms which include members of the Praxity alliance.

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[73] www.mazars.com/Home/About-us/Key-facts-organisation/Management-of-the-Group/Global-Strategic-Committee.

Revenue

141. In the period 2004 to 2011, between 34 and 39 per cent of Mazars UK's revenue was derived from statutory audit.[74] The firm's income is generated by the following service lines:

(a) Audit and assurance (41 per cent);

(b) Accounting and financial (7 per cent); and

(c) Specialized services[75] (52 per cent).[76]

142. Table 8 summarizes the source of statutory audit revenue for Mazars UK.

TABLE 8 **Mazars UK revenue from statutory audit**

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	-	-	-	-	-	-	-	-
FTSE 250	[✂]	[✂]	-	-	-	-	-	-
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: Mazars 'Other business info'.

PKF

History

143. PKF, UK, formerly known as Pannell Kerr Forster, was established in 1869 by WH Pannell. The firm merged with two other firms in 1945 and merged again in 1963 and 1978.[77] In 1969, the firm created a network with firms in Australia, Canada and the USA. The four founding firms adopted the name, Pannell Kerr Forster in 1980 (from the British and US member firm Harris, Kerr and Forster). The network's name was shortened to PKF in 2000.

144. Not all member firms adopt the PKF brand name.

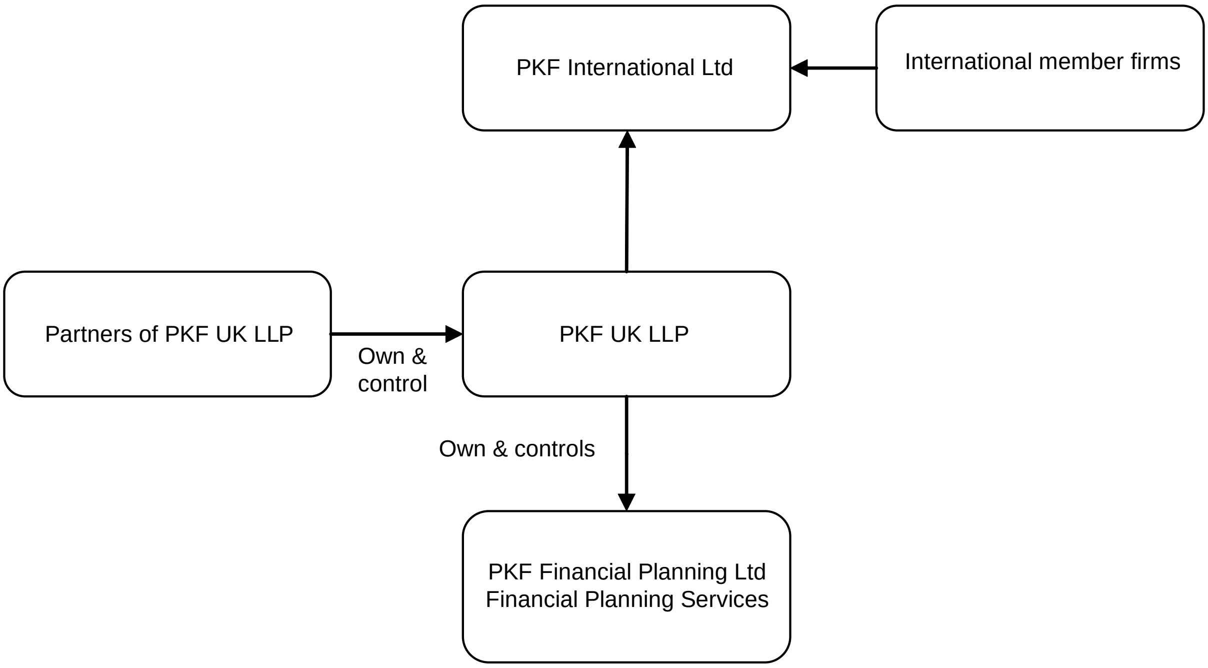
[74] 'Other business info' submitted by Mazars.
[75] Includes Transaction Services, Risk Management and Internal Control, Organization and IT Services and Actuarial Services.
[76] Analysis of Mazars LLP 2011 Transparency report.
[77] The companies PKF merged with were Crewdson, Youwett & Howard, and Lewis Hardy & Co in 1945; Fitzpatrick, Graham & Co in 1963; Keens, Shay, Keens & Co in 1978. It also subsequently merged with Rowley, Pemberton, Roberts & Co in 1980 and Ball Baker Leake in 1985.

Legal and operational structure

145. PKF UK LLP is the UK member firm of the PKF network and is incorporated as a limited liability partnership. PKF UK LLP is a member of PKF International Ltd, the network body for PKF.

FIGURE 9

PKF organizational structure



Source: PKF Transparency Report.

146. The governance framework for PKF UK is as follows:

(a) The Board is chaired by the Senior Partner, who is elected every three years and three other partners who are elected, and the Managing partner and two other members of the management team.

(b) The Managing Partner is responsible for the firm's strategic direction and management including financial performance and the quality of professional services. The Managing Partner is appointed by the Nomination Committee, established by the Board.

147. Whilst the firm offers a number of service lines as outlined in paragraph 151, the firm is managed for certain services by Regional Managing Partners on a geographic basis and by Heads of certain specialized services on a national silo basis.

Relationship with network

148. Membership of the PKF network is through membership of PKF International Ltd, a company limited by guarantee.

149. The network has member firms and both exclusive and non-exclusive correspondent firms. The UK firm is a member firm.

150. Governance of the network is overseen by the International Board. The Board has a created a number of committees including the International Professional Standards Committee which sets the minimum professional standards to be met by member firms and promotes audit materials and capabilities. A number of other committees are responsible for other service lines.

UK firm revenues

151. PKF UK generates its revenues through a number of service lines:

(a) audit and assurance (42 per cent);

(b) taxation (21 per cent);

(c) corporate finance and forensic (9 per cent);

(d) corporate recovery and insolvency (11 per cent); and

(e) management consulting (18 per cent).[78]

152. Statutory audit comprises the majority of the audit and assurance practice, and is the source of 32 per cent of the firm's revenue.

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[78] PKF UK Transparency report 2011.

TABLE 9 **PKF statutory audit revenue**

£'000

	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	-	-	-	-	-	-	-	-
FTSE 250	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	-	-	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: PKF 'Other business info'

PwC

History

153. PwC UK was formed in 1998 on the merger of the two UK firms of Price Waterhouse and Coopers & Lybrand which formed part of the merger of their respective networks. The merger of the two networks was approved by the EC.[79]

154. Both Price Waterhouse and Coopers & Lybrand's oldest founding firms were established in the 19th century. Coopers & Lybrand's predecessor UK firm, Cooper Brothers & Co had been established in 1854. In 1946, in part due to the need to replace overseas offices which had been forced to close during World War II, Coopers decided to create an international network, allowing it to be represented globally by indigenous firms in addition to the overseas offices it had established itself. This led to a period of increased international activity.[80,81]

155. Coopers & Lybrand was formed in 1957, through an alliance of three firms. One of each of the three firms had been founded in the UK, USA or Canada respectively. All three firms had established overseas offices and the alliance was seen to be mutually beneficial, particularly to the US firm due to the increase in the level of investment by US firms in the UK. The name Coopers & Lybrand was used in

[79] Case No IV/M.1016—Price Waterhouse/Coopers & Lybrand.
[80] For example, in 1948 a relationship with a large US firm, Scovell, Washington & Co was established.
[81] Overview of firm history based on Boys, P 'The origins and evolution of the accounting profession' in Habgood, W (ed), *Chartered Accountants in England and Wales: a guide to historical records and Annex 4 of PwC response to CC Issues Statement.*

international practice whilst the founding firms retained their own names in their domestic territories. It was not until 1973 that all member firms adopted the Coopers & Lybrand name.

156. Price Waterhouse was established in the UK in 1849. Unlike other networks, the Price Waterhouse network developed through organic international expansion driven by the UK firm, establishing new autonomous partnerships in each territory it wished to expand into, though, did also enter into agency arrangements with local firms to carry out work under its name and shared overseas offices with other British firms.

157. The merger of Price Waterhouse and Coopers & Lybrand in the UK created the largest firm in the audit market, with 50 per cent of the FTSE 100 and 37 per cent of the FTSE 250 being clients of the combined firm in 1998. Between 1998 and 2010 the firm lost market share with respect of the number of clients, ending the period with 38 FTSE100 audit clients and 26 per cent of the FTSE 250 Network.

Legal and operational structure

158. PwC UK is incorporated as an LLP and is a member of PwC International Ltd, a company limited by guarantee, which is the network body of the PwC network. The PwC UK partners, who own the UK firm, have the ability to elect members to the Global Board of the network body. Details of the arrangements with the network are discussed below. The legal structure of PwC is shown below in Figure 10.

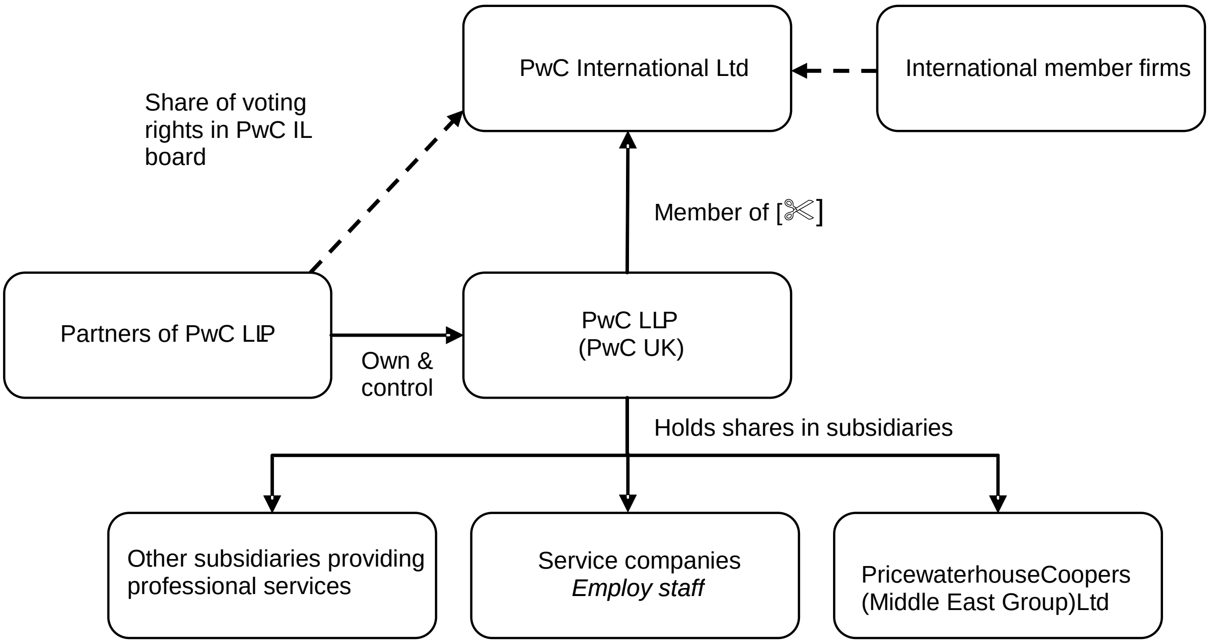
159. As with the other firms, PwC LLP has a number of subsidiaries, which exist for a variety of purposes, such as the employment of staff.

160. In addition to PwC LLP, there is also a UK law firm, PwC Legal, which is part of the PwC network and is a separate, independently owned legal entity to PwC LLP. Due

to the nature of its relationship to PwC LLP it is consolidated into PwC UK's financial statements under IAS 27, but there is no sharing of profits between the two entities and their respective members.[82]

FIGURE 10

PwC ownership and legal structure



Source: CC Analysis of financial statements and 'off the shelf' material.

161. PwC LLP is managed through three service lines and a number of market segments, though it is the service lines that form the primary division of the firm. The service lines are:

(a) Assurance—[✂] per cent of revenue; 6,600 partners and staff.

(b) Advisory—[✂] per cent of revenue; 4,100 partners and staff.

(c) Tax—[✂] per cent of revenue; 3,000 partners and staff.[83]

162. The assurance practice which provides (among other things) statutory audit serives, is divided into:

(a) Core Assurance.

[82] PwC LLP Annual Report, Note 23 to the financial statements.
[83] Figures do not sum to 100 due to rounding and a small 'year end adjustment' not allocated to a specific LoS.

(b) Risk Assurance Services (RAS).

(c) Actuarial and Insurance Management Services (AIMS).

(d) Capital markets, Accounting Advisory and Structuring (CMAS).

163. Approximately [✂] of RAS's workload relates to statutory audit. Core Assurance and RAS's work for large firms are managed through ten units, six of which are regional, with an additional four in London, focusing on:

(a) Banking and Capital Markets.

(b) Insurance and Investment Management.

(c) London Top Tier.

(d) London Mid Tier.

164. In addition to the service lines, there are overarching management structures for oversight of the business by markets and regions.

165. There are in addition, three main bodies that respectively, govern, supervise and exercise oversight of the firm as a whole:

(a) Executive Board—chaired by the Senior Partner, including the Lines of Service leaders and is responsible for the strategy, direction and management of the firm.

(b) Supervisory Board—independent of the Executive Board, and elected by the partners to oversee and protect the interests of the partners.

(c) Public Interest Body—discharges the requirements of the Audit Firm Governance Code and includes non-executive members.

Relationship with network

166. The PwC network covers over 150 countries and employs some 169,000 staff as of 2011. There is no profit-sharing across the network. Governance of the network is through four bodies:

(a) The Network Leadership Team (NLT) sets strategy and standards that all member firms have to apply. The NLT is formed of the Senior Partners from the US, UK and China member firms and the Chairman of the PwC network and a fifth member appointed by the Global Board.

(b) The Strategy Council, which is made up of leaders of the largest PwC member firms is responsible for agreeing any proposed change in strategy and direction for the network.

(c) The Network Executive Team is appointed by the NLT, which it reports into, has responsibility for consistency across key service lines and functional areas sic as Risk and Quality, Human Capital, Operations, Communications and branding.

(d) The Global Board provides oversight of the Network Leadership Team and approves network standards. Members are elected by partners from all member firms every four years.

167. All member firms must agree to abide by network standards. Member firms are responsible for implementing appropriate quality control arrangements and these are subject to periodic review by the network.

168. The UK firm has a permanent seat on the NLT and therefore is certain to have its views represented when the network determines its strategy. UK partners elect the firm's Senior Partner and also have opportunity to vote to elect members of the Global Board; currently two of the 18 members are PwC partners.

UK firm revenues

169. PwC generates its revenues through three service lines:

(a) Assurance ([✂] per cent).

(b) Advisory ([✂] per cent).

(c) Tax ([✂] per cent).

170. Table 10 provides a summary of the source of PwC's statutory audit revenue.

TABLE 10 **PwC statutory audit revenue**

								£'000
	2004	*2005*	*2006*	*2007*	*2008*	*2009*	*2010*	*2011*
FTSE 100	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
FTSE 250	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Other	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]
Total	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]	[✂]

Source: PwC 'Other Business Info'.