Initial submission from Jeremy Schwartz, PhD, Loyola University Maryland

Audit Market Investigation

To Whom it May Concern:

In response to the Competition Commission's invitation to submit evidence for their investigation into the market for the supply of statutory audit services to large companies I have attached a study, coauthored with Lawrance Evans, Jr. PhD, on the U.S. experience after the collapse of one of the top-tier audit firms, Arthur Andersen. The study entitled "Was It Market Power or Sarbanes-Oxley? An Analysis Using the Workhorse Audit Fee Model and Panel Data Techniques" examines whether the upward trend in audit fees in the early 2000s can be attributed to increased concentration of the U.S. audit market or the Sarbanes-Oxley legislation passed in the wake of the accounting scandals of the early 2000s. We find the following:

1. Market concentration, as measured by the Herfindahl – Hirschman Index (HHI), only has a significant positive impact on the largest firms ($250 million in assets). A one percent increase in the HHI for these firms increases their audit fees by 0.25%.

2. Firms with specific industrial expertise produce audits at lower cost and pass along those savings to their clients. An expert, defined by auditing more than 10% of clients in an industry, reduce audit fees by 27% compared to non-experts.

3. Using a simulation of our statistical model, a world where Arthur Andersen continued to operate in the U.S. market would not have substantially reduced fees in comparison to their current levels. While, the top-tier audit firms would exert less market power on very large firms, there would also be fewer auditors with expertise to produce audits at a lower cost.