Dear Mr Gadhia

Audit Market Investigation
KPMG Response to the Competition Commission’s Working Paper “Bundling of audit and non-audit services”

Thank you for affording us the opportunity to comment on the Competition Commission’s (CC’s) Working Paper “Bundling of audit and non-audit services” (the “Working Paper”), published on 18 October 2012.

Overall, we agree with the CC’s conclusion that there is no evidence to support the view that the bundling of non-audit services with the statutory audit acts as a barrier to entry, as we have also set out in our Main Submission in response to the CC’s Issues Statement (”Main Submission”). In this response we set out some brief comments on the CC’s evidence and analysis in the Working Paper.

The CC concludes that “regulations in Ethical Standard 4 create a restriction on non-audit services acting as a barrier to entry and that the regulatory climate has resulted in increased scrutiny on auditors providing non-audit services”.

We agree that ethical standards and the corporate governance guidelines overlaid by independent regulatory inspections limit the scope for bundling, as we set out in our Main Submission.

The CC’s case study evidence showed that companies had policies in place in relation to the provision of non-audit services by their statutory audit firm. This accords with our own

---

1 Paragraph 52 of the Working Paper.
2 Paragraph 29 of our Main Submission.
4 Paragraphs 29, footnote 42 and paragraph 319 of our Main Submission.
experience – as we have set out in previous submissions⁶ and as the CC has recognised⁷, Audit Committees (ACs) and AC Chairs (ACCs) discharge their duty to shareholders diligently and effectively, and that includes scrutiny of the level and type of non-audit services provided by the audit firm. We also agree with the CC’s conclusion from its case studies that in some cases companies find it to be more efficient for the audit firm to provide certain non-audit services⁸, as we have set out in our Main Submission⁹.

The CC has found a small number of examples of audit firms offering non-audit services in tender proposals¹⁰. We would note that in our experience, information in relation to non-audit services is almost invariably included in proposals upon the request of companies. As we have set out in our Main Submission, to the extent that audit firms sell audit-related or other non-audit services to their audit clients, this does not amount to bundling, and there are good efficiency reasons for this joint provision¹¹. We agree with the CC that discounts on non-audit services are likely to be discounts on scale rates rather than discounts on market rates. These discounts will reflect competitive pressure in the supply of the relevant non-audit service and will therefore not be related to whether or not the company is an audit client. As a result this evidence does not provide any support to the hypothesis that audit firms bundle services.

We agree with the CC’s conclusion that its survey (the “CC’s survey”) shows that non-audit services are not a significant influence in the decision to select an audit firm or as a reason to switch audit firm¹². Rather, as we have set out in our response to the CC’s working paper “Survey results”, the CC’s survey shows that the factors that FDs and ACCs look for when considering whether to appoint or reappoint an auditor are largely similar and for both groups the most important factors are: the experience and knowledge of the engagement partner; a good working relationship with the audit team; the reputation of the audit firm; the experience and knowledge of the engagement team; and, sector-specific experience or expertise¹³.

Finally, we had some specific comments in relation to the CC’s quantitative analysis, namely:

- The CC finds that a relatively large proportion of audit clients use their audit firm for at least some non-audit services¹⁴. As the CC recognises, this is not evidence of bundling. The fact that within any accounting period there are some audit- and non-audit services provided by

---

⁶ Section 3.2 of our response to the CC’s working paper “Framework for the CC’s assessment and revised theories of harm”, paragraph 1.8 of our response to the CC’s working paper “Nature and strength of competition in the supply of FTSE350 audits”.
⁷ Paragraphs 74 – 76 and 88 of the CC’s working paper “Nature and strength of competition in the supply of FTSE350 audits”.
⁹ Section 9.2.2 of our Main Submission.
¹¹ Paragraph 332 of our Main Submission.
¹³ Table 11 and paragraph 35 of the Working Paper.
the same firm to the same client does not show that these services are in any way conditional on each other. Non-audit services will be negotiated separately, usually at a different time to the (re)appointment as audit firm. Furthermore there is no evidence that the largest four audit firms provide these services to their audit clients more often than the mid-tier.\footnote{The CC’s survey found no evidence that FTSE350 companies (a higher proportion of which are audited by the largest four audit firms) were more likely to use their audit firm for non-audit services than non-FTSE350 companies.}

- The general downward trend in the provision of non-audit services to audit clients identified by the CC\footnote{Paragraph 22 of the Working Paper.} accords with our own experience.

- The CC finds no strong evidence that there is a correlation between audit engagement profitability and the degree of non-audit services provided to audit clients. We agree with the CC’s conclusion that this analysis provides no evidence in support for a bundling theory of harm.

- We will comment further on the methodology for calculating engagement profitability in the context of our response to the CC’s working papers on profitability.

We trust that these comments and observations are useful in informing your consideration of the Working Paper. Do not hesitate to contact me if you have any queries or wish to pursue any of these points further.

Yours sincerely

David L Gardner
Director of Public Policy