THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

Audit and Assurance Faculty

AuditQuality@

Shareholder involvement – Competition and choice

Interim report

What are the concerns relating to auditor competition and choice? Consideration will be given to whether encouragement of competition and choice in the audit market is necessary and if so, what means might be adopted?

AuditQuality@

The *Audit Quality Forum* brings together the audit profession, investors, business and regulators. Their purpose is to work together to generate policy proposals that will further enhance confidence in the independent audit by promoting transparency and accountability.

The Institute of Chartered Accountants in England and Wales, through the Audit and Assurance Faculty, convenes the *Audit Quality Forum*. The Institute initiated its *Audit Quality* programme in 2002 to drive thinking and practice in the field of audit and assurance. Alongside the Institute's *Information for Better Markets* campaign, the Forum is about working in the public interest to promote quality and confidence in corporate reporting.

Further information on the *Audit Quality Forum*, the current work programme and how to get involved is available at **www.icaew.co.uk/auditquality** or contact 020 7920 8493.

Anyone interested in providing feedback on this interim report may send comments to **tony.bromell@icaew.co.uk**.

Laws and regulations referred to in this report are stated as of July 2005.

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Supporting shareholder involvement

Auditors' ultimate responsibility is to report to the shareholders. On a day-to-day basis they deal with the directors and management of the company when carrying out their audit and this relationship needs to be managed effectively so that auditors can perform their audit and provide an independent opinion to the shareholders on the truth and fairness of the financial statements which have been prepared by the board. The Audit and Assurance Faculty's publication, *Audit Quality*, identified client relationships, including the effective management of client portfolios and working with individual clients, as one of the key drivers of audit quality.

The statutory audit is a means of addressing issues that arise from the agency relationship that exists between the shareholders and the board of directors. There are, however, perceived transparency issues for shareholders around the effectiveness of audit as a solution to agency problems, including the nature of shareholder involvement and the availability of choice in the audit market.

The *Audit Quality Forum*, launched in December 2004, identified four initial matters that may improve audit transparency and bring real benefits to shareholders as well as the longer-term issue of competition and choice. The Institute established working parties with representation from key stakeholders to take the matters forward and identify technical and practical issues for discussion at the *Audit Quality Forum* and to report on how these matters may be taken forward to implementation.

This interim report considers potential issues relating to competition and choice in the audit market and what further work is required.

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Executive summary

The *Audit Quality Forum* provides stakeholders with an opportunity to discuss issues around audit transparency and accountability. As a consequence of the Forum meeting in December 2004, a number of issues around shareholder involvement were raised and working parties were set up to consider these various aspects with the objective of making recommendations to address these concerns.

The working party was established to investigate concerns relating to auditor competition and choice and, if felt necessary, consider means of encouraging competition and choice in the audit market. The audit market under consideration is principally that for large listed companies, where the Big 4 audit and accountancy firms hold a substantial part of the audit market. In reaching their interim conclusions the working party looked at identifying stakeholder issues, potential barriers to entry, what relationships there are between competition and audit quality and what evidence and scope there is for action.

The shareholder is unable to make a fully informed judgment on the audit product. This is visible to the shareholder only through the audit report, which is to an extent standard in terms of the ultimate delivery (in no small part due to the implementation of common auditing standards). Accordingly the working party's view is that the maintenance and enhancement of audit quality must remain the overarching policy objective. Competition and choice is necessary to ensure that audit quality is maintained and enhanced, but any proposal for intervention in the audit market to stimulate such competition and choice, needs to take into account what impact, if any, the policy might have on overall audit quality. Absolute maximisation of competition may not be the objective that should be sought, but research is needed.

The working party was careful to differentiate between lack of competition and lack of choice. The working party is not aware of evidence of anti-competitive behaviour in the audit market for large listed companies. Indeed there is clear evidence that there is very considerable competition for business between audit firms. However based on anecdotal evidence, the working party considers the predominant issue to be lack of choice, often as a result of the impact of regulation and legislation which prevents the provider of certain audit or non-audit services from being considered for other types of work. Accordingly this report focuses principally on choice issues but the working party has borne quality in mind in its considerations.

While there is competition at all levels within the audit market, conflict of interest and regulatory issues in large and/or specialised clients can create severely limited choice. This appears to be the key concern for large clients, particularly those in specialised industries. The problem would undoubtedly be magnified significantly if the Big 4 audit firms were to become a Big 3.

Many potential actions (for example joint audit requirements, international regulatory collaboration) would require significant market intervention. Other measures (for example better communication of shareholders' views) might be achieved more simply. There is little evidence relating to competition behaviour in the audit market and the working party accordingly believes that research is needed in a number of areas to enable conclusions to be drawn as to the appropriateness of any actions. These include:

> Perceptions of investors, brokers/advisors and audit committees of:

– competition and choice in the audit market;

– the need for global networks;

– the different types of audit firms; and

– why they switch auditors.

> Broker/advisor behaviour when advising on issues/capital raising.

> Ambitions of audit firms other than the Big 4, with regard to the large company audit market, including risk/reward and other key influences over those ambitions.

> Indications of any anti-competitive behaviour by the Big 4 firms, updating the OFT work during 2000.

> Experience with joint audit, from both quality and competition perspectives.

Outline terms of reference for such research are given in Appendix 1. We understand that the DTI has agreed to take research forward, along the lines indicated.

Competition and choice: the issue

The issue considered by this working party, competition and choice in the audit market, does not relate only to audit quality.

The maintenance and enhancement of audit quality must remain the overarching policy objective. Competition and choice is necessary to ensure that audit quality is maintained and enhanced. However, in assessing possible intervention in the audit market to stimulate further competition and choice, the impact, if any, of any policy on overall audit quality needs to be taken into account. The absolute maximisation of competition may not be the objective that should be sought, but the working party considers that further research is needed to understand the actual levels of competition and choice and the views of business and end users of audited financial reports.

Some of the relationships between competition and audit quality are considered below (see ‘Relationships between competition and audit quality’). Based on anecdotal evidence, the working party considers the predominant issue to be lack of choice.

While there is competition at all levels within the audit market, conflict of interest and regulatory issues in large and/or specialised clients can create severely limited choice. This appears to be the key concern for large clients, particularly those in specialised industries. The problem would undoubtedly be magnified significantly if the Big 4 audit firms were to become a Big 3.

The working party was tasked with considering means of ‘Encouraging competition in the audit market’.[1]

The focus of the working party has therefore been on identifying stakeholder issues, potential barriers to entry, the interaction between competition and audit quality and what evidence and scope there is for action.

The working party has been mindful of the need to consider international and regulatory constraints, the impact of any proposals on all the stakeholder parties and to ensure a fair balance for those concerned.

[1] ICAEW letter to DTI, 9 December 2004.

Background

The market

The audit market is highly tiered, even considering listed companies alone: the top five companies account for more than one-third of the FT All Share Index (by capitalisation), the top 30 for two-thirds and the top 350 for over 95%.

The working party believes that the principal concern about competition arises at the larger company end of the market. The Big 4 audit firms audit 99% of the FTSE 100 companies between them[2] and 96% of the next tier of FTSE 250 companies, excluding investment trusts.[3] No other firm audits more than two FTSE 250 companies, excluding investment trusts. Even taking into account all active fully listed and AIM companies, the Big 4 audit share is approximately 65%.[4]

This effect is exacerbated by potential conflicts of interest and restrictions in auditor independence rules, which can reduce actual or perceived choice further.

The comments in the rest of this report primarily address the market segments noted above, but there is also a potential future concern right at the other end of the market, where smaller companies are typically audited by small firms of auditors. Between 31 December 2000 and 31 December 2004, the number of firms registered with the Institute of Chartered Accountants in England and Wales to carry out audit work, fell from 7,061 to 5,475.[5] The working party believes the cause of this to be not only the increases in the statutory audit threshold, but the impact of regulation on the cost and complexity of audit. The trend is therefore likely to continue and the impact will be felt most notably outside large urban areas, where registered auditors are more thinly spread geographically.

Relationships between competition and audit quality

Audit is a regulated environment, in order to maintain audit quality. As noted above, the aim should be to ensure that competition and choice serve to maintain and enhance quality – they are not objectives in themselves. Anecdotal evidence suggests that, in the large company audit market at least, the main problem is seen to be one of choice. Accordingly this report focuses elsewhere on that issue but the working party has borne quality in mind in its considerations. There are a number of potential links between quality and price, and between price and competition. These include:

> Auditor power – if there is too much competition in the market, there is a potential reduction in the power of the auditor to impose the 'right' reporting and accounting on the client. This relationship is not absolute as one of the biggest drivers of quality is reputation, where competition is not an issue assuming there is at least some choice.

> Relative size of the audit firm – if the audit firm or partner is dominated by a relatively large client then the commercial desire to retain that client could impair audit quality. Conversely if the client is relatively small in the portfolio of the audit firm or partner, audit quality could suffer through neglect.

[2] *Accountancy*, September 2004 FTSE 100 Survey, adjusted for recent changes in FTSE composition.
[3] *Financial Director,* January 2004, FTSE 350 Audit Fees Survey, from data supplied by ICC Information.
[4] 'FAME' database, June 2005.
[5] 'Audit Regulation: Report to the DTI' from ICAEW, ICAI and ICAS.

> Costs and pricing – auditing and ethical standards require the proper amount of work to be undertaken to give the audit opinion, regardless of the fee charged. However, there will inevitably be pressures as a result of competition driving the audit fee down. There has been academic research in the US, and in the past in the UK, indicating evidence of corner cutting as a result of fee (and therefore cost) pressures. This was at lower staff levels however, so the potential impact of that on ultimate quality of the audit is unclear. In the UK, research in the 1990s indicated that, at that time, reduction in fee levels was the main reason for switching auditors: overcapacity in the market and the relatively fixed-cost structure of the audit firms drove fee cutting. It is unclear whether this resulted in cost cutting as margins tend to be lower in the early years of an audit.

> Need for competition – it is generally accepted that competition encourages efficiency and, *ceteris paribus*, a more efficient audit allows better outputs and/or a lower priced audit.

> Product differentiation – there is an argument that more competition encourages more innovation by auditors and improved quality. In practice, because the apparent output of an audit (the audit report) is very standardised, there has been little scope for genuine product differentiation and audit became commoditised. There are no quality ratings available in the UK and therefore price was the key area in which to compete. Anecdotal evidence suggests that the increased communication between auditors and audit committees in recent years has resulted in at least a partial change in perception in this area.

It follows that there is a need to ensure that audit fees are not cut below the level at which there is a threat to a high quality audit: there is a key role for the audit committee here. Anecdotal evidence is that audit fee pressure has subsided over the last year or so.

Absolute maximisation of competition as a policy goal in its own right may not be the objective that should be sought. However, a key point (as elsewhere in this topic) is that there is little evidence in this area. The working party believes that research needs to be undertaken before it would be appropriate to make quality-related recommendations.

There have been suggestions by some that joint audit might improve audit quality and break down resistance to appointing non-Big 4 firms, thus being a boost to competition and choice. Possible downsides include: cost; a magnification of conflicts in, e.g. banks, where specialised audit teams are necessary, and a possibility that the effect will be that all the joint audits will be distributed around the Big 4. Clearly there has been little appetite in the UK for joint audit in recent years, so it would have to be legislated, which would be a significant market intervention. Again, the working party believes that further research is needed in this area.

Potential barriers to entry and constraints

The working party believes that potential barriers to entry fall into a number of areas which can broadly be analysed into:

> market choice or demand-pull from investors, audit committees and institutions making a conscious decision to choose a Big 4 firm whether as a result of the 'deep pocket syndrome', lack of information about shareholders' views, a perceived need for a large global network, perceived quality differences caused by the next tier audit firms not being present in the FTSE100, familiarity, specialisation or network coverage issues;

> restrictions on ability of smaller firms to handle the very largest audits through size or network coverage;

> disincentives to move into the large audit market as a result of cost, risk or reward issues; and

> restrictions on the audit market and the ability to operate within it, through regulation or specialisation.

These are considered in more detail in 'Potential barriers to entry' below.

The recommendations

Having considered what stakeholders regard as the key concerns, potential barriers to entry, what relationships there are between competition and audit quality and what evidence and scope there is for action, the working party believes that research is needed in a number of areas. Many potential actions (for example joint audit requirements, international anti-trust collaboration) would require significant market intervention. Other measures (for example better communication of shareholders' views) might be achieved more simply. There is little evidence relating to competition behaviour in the audit market and the working party believes that research is needed in a number of areas to enable conclusions to be drawn as to the appropriateness of any actions.

To this end, the working party makes the following interim recommendation:

Specific measures

Research should be commissioned into a number of areas covering such matters as:

> Perceptions of investors, brokers/advisors and audit committees of:

  – competition and choice in the audit market;

  – the need for global networks; and

  – different types of audit firms.

> Switching of auditors and reasons therefore.

> Broker/advisor behaviour when advising on issues/capital raising.

> Ambitions of audit firms other than the Big 4, with regard to the large company audit market, including risk/reward and other key influences over those ambitions.

> Indications of any anti-competitive behaviour by the Big 4 firms, updating the OFT work during 2000.

> Experience with joint audit, from both quality and competition perspectives.

Outline terms of reference for such research are given in Appendix 1. We understand that the DTI has agreed to take research forward, along the lines indicated.

The benefits and impact of competition and choice are set out below.

Benefits and impact

A balance between regulation and free market competition is important. The audit market cannot and does not operate totally on a caveat emptor basis as the audit product is visible to the shareholder only through the audit report, which is to an extent standard in terms of the ultimate delivery (in no small part due to the implementation of common auditing standards): the shareholder is unable to make a fully informed judgment. High standards in terms of the quality of those who undertake audits are vital. So are the standards in terms of their performance and behaviour.

However, it is generally accepted that in a broadly capitalist economy, a free market economy will, with correction mechanisms to deal with quality issues, generate the greatest international wealth and lead to the most efficient economic operation. An intrinsic part of the operation of such a market is that there are many buyers and sellers. Competition in the audit market promotes efficiency and ensures that audit firms need to safeguard their reputations.

Businesses need choice and flexibility not only in the providers of audit services but also the other services offered by accountancy firms. Competition will ensure that prices are not excessive and that the audit product develops efficiently.

It is important that audit is an activity worth undertaking and that the auditor retains the ability to influence the client in the production of the report being audited, rather than the client influencing the auditor. As previously stated the maximisation of competition is not necessarily the appropriate primary objective in this market but reduction of competition beyond that currently offered would result in significant problems. While there may be a need for regulation to support the objective of high quality audits, it should be implemented in such a way as to minimise anti-competitive effects.

Potential barriers to entry – initial view

Choice and demand

There is a perception that audit committees, investors and financial institutions appear, or have appeared, to choose or demand Big 4 auditors for the largest listed companies. This could be for a number of reasons, for example: the 'deep pockets' issue; a lack of information about shareholders' views, a perception that smaller audit firms produce lower quality caused by their not being present in the FTSE100 audit market; network issues (see below); or merely being comfortable with well-known brands. The Office of Fair Trading (OFT), in the 2001 report on its investigation into the accountancy profession, observed: 'Even large national companies often prefer to use a Big Five firm because they believe their investors feel more comfortable if their accounts are signed by a firm with a strong reputation...'.[6]

Anecdotal evidence suggests that more large clients are approaching the larger audit firms outside the Big 4 for non-audit work but the trend is less noticeable for audit work.

The working party believes that research is needed to understand the reality and causes of such perceptions and what impact they have on the switching of auditors.

Audit methodology

It may be that the need for a large global network is perceived, in some instances, to be greater than it actually is.

To improve audit quality and enhance accountability, the proposed EU 8th Company Law Directive requires group auditors to take sole responsibility for an audit. This may discourage smaller firms without a global presence from taking on global audits.

Audit practice and audit firm organisation tends to result in group audits including, inter-alia, individual local audits of group divisions or subsidiaries with the results being assembled at the centre. Depending on how the group is organised, it may actually be possible to do more, or even all of the work leading to the group audit opinion, at the centre, though this can be affected by the legal structure.

International networks

A recent survey indicated that the smallest of the Big 4 networks has a worldwide income of $12.2bn and the largest of the next tier networks $2.7bn.[7] Where the audit work requires a widespread international presence, the scope of the smaller networks therefore results in a greater need to use other audit firms in some locations. This could be perceived to be less optimal by clients than using member firms of a single international organisation throughout, although there are arguments that use of different firms increases intra-auditor diligence. Though the comment was not universally agreed with, the OFT Report stated: 'Multi-national clients often want their audit or other accountancy work to be done consistently round the world by a firm with global reach. Although the second tier firms have tried to set up their own international networks, their coverage is only partial...'.[8]

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[6] 'Competition in Professions', March 2001, Office of Fair Trading.
[7] *Accountancy*, June 2004, International Accountancy Networks Survey.
[8] 'Competition in Professions', March 2001, Office of Fair Trading.

The size discrepancy also means that there is a perception that only the Big 4 are known well in all major economies, adding to the demand-pull referred to above, for firms with an international capital base.

Reputation and branding

Larger audit firms trade on their brand names, as well as the qualifications of their partners and staff. They are therefore better known in the market, and by users of accounts. This potentially encourages perception of quality differences, again resulting in the demand-pull noted above. It can also have an effect on recruitment, with graduates focusing on the better-known brands rather than on other firms and being a Chartered Accountant per se.

The working party on *Identifying the Audit Partner* has produced proposals for indicating the name of the individual audit partner who signs the audit report. It is unlikely that this would impact on competition, though in theory it could result in individuals becoming more mobile.

International influences on potential actions

There are periodic calls in some circles for competition to be enhanced through breaking up the largest audit firms. There are however a number of practical problems with this suggestion which render it, in the working party's view, unrealistic. Not least of these are the international linkages noted above: the larger firms are influenced by what happens to them internationally: for example Andersen was brought down in the UK by actions pertaining to it in the US. As a result of this and the points noted above, any action to enhance competition by splitting up existing firms would in some cases need to be co-ordinated internationally to be practicable and have an impact. A further factor is that even the largest audit firms are themselves partnerships based on the decision made by partners to work together. There could therefore be no certainty that after the break up of one or more of the existing large audit firms, the partners involved would choose to join (and remain with) the entity to which those driving the break up and establishment of new entities might hope.

Complexity

Some industries and the regulatory environment around them have become so complex that only certain auditors will seek or are able in practice to take them on (e.g. banks). It is not cost-effective for other audit firms to seek to break into the market unless they can take on several such clients.

Regulation

Large elements of regulation are counter choice, e.g. new audit independence rules which make provision of other services to audit clients less attractive; and restrictions on ownership of audit firms (derived from Company and EU law), which make it difficult for businesses in other industries to enter the market.

While regulation is inevitable in the audit market (see 'Benefits and impact', above), it is important that when setting or re-assessing correction mechanisms, regulators consider their effect on competition.

Some views have been expressed that the trend towards international harmonisation of standards has a potential anti-competitive effect. As international standards are not specifically designed with the UK framework in mind, they impose procedures that add to cost and complexity without necessarily improving the benefit of the output at a national level. The potential benefits of uniform standards through rationalisation of international operations are of more use to some firms than others.

We understand this issue of international harmonisation is to be considered by a separate working party being established by the *Audit Quality Forum* to consider the purpose of audits, and related matters.

Pricing

The potential impact of competition on pricing and (indirectly) quality, is considered under ‘Relationships between competition and audit quality’ above. In theory, low pricing which does not properly reflect risk makes it unattractive for new entrants, or existing suppliers with little presence in the market. There might therefore be an incentive for those already in the market to keep prices down.

However, if audit is the least profitable area of work, then the interaction of this with the auditor independence rules (see ‘Regulation’ above) could mean that audit firms with the most audit clients are potentially disadvantaged in terms of other work. In addition, where there is a genuine lack of choice, the perception has been put forward that costs increase.

Current actual pricing behaviour is uncertain. The OFT Report in 2001 stated: ‘... it is doubtful that the Big Five have been engaging in predatory pricing. A more likely explanation is that they were competing fiercely on price against each other and the second-tier firms were caught in the crossfire...we cannot conclude that any restriction on competition arising from...abusive or parallel behaviour arises...’.[9] The working party believes there may be merit in a research study to update this conclusion.

Appetite for large audits

It is unclear to what extent audit firms other than the Big 4, wish to have a presence in the large client audit market and if so at which level. It may be that audit fees do not sufficiently reflect risk to give a suitable risk/reward balance to attract such firms further up the market.

Because of the complexity (see above), there needs to be a critical mass of clients for the work to be viable. In addition, the significant costs of tendering mean that if there is a resistance to appointing these firms (see ‘Choice and demand’ above), there is little point in their tendering for larger audit appointments.

The ambitions and drivers of the audit firms outside of the Big 4, which could participate in this market, are not fully understood and the working party believes research is needed in this area.

[9] ‘Competition in Professions’, March 2001, Office of Fair Trading.

Auditor liability

The Government has proposed auditor liability reform, based on permitting proportional liability by contract. Oversight and monitoring of auditors by the Institute and the Financial Reporting Council's Audit Inspection Unit would continue and a criminal offence of knowingly or recklessly signing a false audit opinion would be introduced. This is not considered in detail in this report as it has been addressed in the discussions surrounding a move to reform auditor liability. The key competition aspect in respect of liability is that unlimited liability increases risk and insurance costs (where that cover is obtainable). A number of stakeholders in the market believe that this therefore acts as a deterrent to move into audits which are large relative to the size of the audit firm. Reform based on proportional liability would not be anti-competitive and would help to mitigate the potential effects of this barrier to entry.

Next steps

The working party recommends that research be commissioned, via appropriate parties, in the areas referred to in the 'Recommendations' section above.

Appendix 1

Outline terms of reference for proposed research

The outline focuses on the UK market. In principle similar work could be carried out in other jurisdictions. In particular, work investigating the effectiveness of joint audits would have to be carried out in other jurisdictions, possibly France, South Africa and/or Denmark.

Overall research objectives

> To identify the causes of concentration in the market for audit services in listed/quoted/publicly traded companies in the UK.

> To consider the implications of the concentration for competition, choice, audit quality and the continuing provision of audit services to the UK capital market.

> To obtain views on what, if any, action could be taken to reduce the concentration, including the possibility of requiring joint audits.

Research which could be carried out to meet the overall objectives

Detailed objective one: to identify the extent of concentration in the UK market and to obtain an overview of other key markets. To investigate how concentration has changed over time in the UK and to identify switching patterns.

This information should be obtainable from publicly available sources. The increase in market concentration over a period, possibly from before the PwC merger, should be identified focussing on: Big 4 dominance in the market generally and particularly in industry sectors; and changes in the market share of non-Big 4 firms. Concentration could be analysed across audit firms by company size, fee level and level of non-audit service provision, and re-alignments split between those caused by audit firm merger/takeover and voluntary re-alignments.

Detailed objective two: to investigate the influences on company directors/shareholders in choosing their auditors; to explore their attitudes and beliefs about market concentration and future prospects; to identify any evidence of anti-competitive behaviour by the Big 4 from the companies' perspective; and to identify changes, if any, they would like to see introduced to reduce the concentration.

Companies make a choice every year whether to retain or change their auditor. Influences on the choice may arise from within a company or from external influences. Preliminary investigation would be needed to identify the questions to be asked. These could include: signalling value of Big 4 name; audit quality; quality of personal relationships between the auditor and auditee; impact of audit partner change; capability/influence of the audit committee; influence of regulators; ownership or management change within the company; changes in the financing structure of the company, such as coming to the market or raising finance by other means; audit price; capacity of the firm to meet the company's needs for audit and non-audit services; the increasing complexity of technical and regulatory demands; global reach; alumni behaviour; switching costs; Big 4 marketing behaviour etc.

It is important that all key stakeholders in the market be surveyed. CFOs and audit committee chairs across a range of companies selected from the data collected in detailed objective one could be surveyed to identify the most important influences on auditor choice. The choice of sample could be, for example, all the FTSE 250 and a sample of the rest. Companies which have switched auditors could be surveyed to identify the reasons for change and the influences on the choice of replacement. Industry sectors where the concentration is tight could be separately surveyed and the constraints on choice and cost identified.

The methods used to survey could be questionnaires, postal, electronic or telephone, for a sample of the larger groups, with follow up interviews or focus groups to explore the key emerging issues further. Where the groups are small, such as some industry sectors, interviews or focus groups may suffice.

Attitudes to, and knowledge of, joint audit and solutions to the concentration problems would be better explored in interviews/focus groups.

Detailed objective three: to investigate the attitudes of investors (institutional and private), analysts, regulators, lenders, investment banks and any other influential stakeholders, such as representatives of industry groups (CBI, 100 group, ABI etc) to auditor choice and market concentration; to identify any evidence of anti-competitive behaviour by the Big 4 from the stakeholder perspective; and to identify changes, if any, they would like to see introduced to reduce the concentration.

An ideal methodology for this part of the study would be to parallel, where appropriate, the questions and methodology adopted to investigate influences on auditor choice within companies, so that differences in views between the different interest groups could be identified. Decisions would be needed as to which groups should be surveyed by questionnaire and which by interview or focus group. Additional questions specific to these groups could also be asked. As in detailed objective two, attitudes to, and knowledge of, joint audit and solutions to the concentration problems would be better explored in interviews/focus groups. It will be necessary for the research to identify any differences in this group and in particular between the responses of actual investors (i.e. fund managers and private investors) and the other groups surveyed.

Detailed objective four: to investigate the views of the audit firms about the reasons for the audit market concentration and future prospects; to identify what they perceive as the barriers to entry to the listed company audit market; to identify any evidence of anti-competitive behaviour by the Big 4 from the other firms' perspective; and to identify changes, if any, they would like to see introduced to reduce the concentration.

As with detailed objective three, wherever possible, the same questions and methodologies should be used. Given the small number of firms in this market, interviews or focus groups may be preferable to surveys. Specifically the views of Big 4 and the firms immediately below them need to be obtained.

Detailed objective five: to investigate whether the market values a Big 4 auditor more than a non-Big 4 auditor.

Two studies could be considered in this area. First, to investigate whether there is any evidence that a Big 4 auditor reduces a company's cost of capital or adds a premium to the share price. Second, to investigate whether a Big 4 auditor can charge a higher fee.

Both these questions could be asked as part of the research mentioned in the other objectives, but the results would not cover the whole of the market, or be statistically valid. Another possibility would be to commission the development of economic models, investigating the relationships between, share price, switching, fees and Big 4 incumbency.

Appendix 2

Working party

We are grateful to the following people for their input to this interim report issued to the *Audit Quality Forum*. Their input does not necessarily reflect the views of the organisations they work for or are attached to.

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