The collapse of building and services business Carillion has again shone a spotlight on the audit market and whether or not it is fit for purpose. With a combined revenue of $134bn in 2017, according to Statista, is the dominance of the Big Four having a negative effect? Until now, there has been consensus that the answer to market choice is not to break but to build. But when even the Financial Reporting Council (FRC) breaks that consensus, we need to look at why. Is it time to consider breaking up the Big Four, or separating audit from non-audit firms? As politicians and regulators mull over such questions, we asked a range of experts to weigh up the pros and cons.

The numbers on Big Four revenues may have little relevance to the daily lives of many Business & Management readers. But they underline the enormous size and power of these four firms. Clearly their size is one reason they are able to offer the wide range of services they do. They are able to draw on deep reserves of expertise and technology, as well as huge global networks of talent.

But at the top end of the audit market, the largest businesses (officially described as public interest entities – PIEs) have little choice but to use one of the Big Four to conduct their audit. That limited choice has long been a source of frustration for some, although the firms highlight a review by the Competition and Markets Authority and new limits on the length of tenure and non-audit services.

Since everyone agrees that there isn’t enough competition or choice, and that the market structure must change, the question is surely not, “why do the Big Four have so many PIEs?” but, “what is putting other large firms off?” It is removing such barriers to entry that the FRC would be better focused on addressing.

But there is no shortage of critics who cite the risk of cartel behaviour. Research from The Maturity Institute published in autumn 2017 called the Big Four a “cartel-like group.” Nor do these firms always deliver an immaculate service. It is inevitable that there will be errors and questionable performance by auditors.

But even if all the criticisms are unjustified, the power of the Big Four might have negative effects on other firms by hogging market share, vacuuming up talent within the audit industry and through the disproportionate influence they have on the nature of regulation.

Michael Izza’s blog on this subject is available at tinyurl.com/BAM-Izza
AUDIT QUALITY

"The size of the Big Four is hugely damaging for the economy and society. In the old days there was pride in professionalism, there was a separation between audit and consultancy. Now, the ethics of the Big Four are purely commercial. That brings a certain culture and it compromises their independence, their ethics and their integrity."

"When you have a huge commercial bank as a client, the chances are that some of their clients will also be your clients. So you are inviting the possibility of huge conflicts of interest. Government is a client of the Big Four, but they are also advising corporates on how to minimise taxes. So they are selling services to government and minimising revenues to government. How is that sustainable?"

"The fact they are advising to government and the fact that they hire ex-ministers after they leave government gives the Big Four huge influence. They are so big and powerful that they can capture the regulatory process. I think auditing needs to be taken out of the private sector. We have examples of public auditing that works, like the National Audit Office."

"If you were to separate audit from other activities and you required audit firms not to be profit-maximising, to be totally separate and not afraid of challenging the client and being sceptical, that would be a worthwhile approach to a new regulatory environment to be reformed."

"Some of the smaller [accountancy/ audit] firms are upset about the dominance of the Big Four. They are upset about the huge increase in regulation that they face and the costs associated with that. They are upset that their voice is not heard in the regulatory environment."

"All of this is extremely dangerous, in terms of the integrity of the profession and the future of the profession."

"The external lens on quality are the FRC inspection results, ongoing FRC investigations and things like company failures. From EY’s perspective, our quality has been steadily improving in recent years. If you look at these two lenses and try to link the size of the firm to audit quality, it doesn’t add up. The size of the firm allows us to have the specialist services we need to do a high-quality audit."

"Having gone through lots of tenders, I can tell you competition is incredibly fierce due to the amount of innovation firms are choosing at present. We are investing in technology to support our methodologies. You are also starting to see techniques using big data to get better insight and test things we haven’t tested before, such as culture."

"There is a point to be made about choice at the top end. That partly driven by regulation: rotation means you put the incumbent out of it and firms are often conflicted because of other work they have done in the year before the appointment. Sometimes companies want a particular firm to do their tax work and not be their auditor."

"More firms at the top end of the audit market would increase choice, but it would not necessarily allow audit firms to invest in innovation as we are today. We do audits for smaller firms too. We use the same audit methodology for a small or a large business. We might have some simplified approaches to methodology if the company isn’t listed, but it’s the same work and the same technology, including use of robotics and other innovations."

"We share across the profession with ICAEW and the FRC; so it is a collaborative environment. When you’re having a regulatory inspection it doesn’t feel like you have a lot of lobbying power. I can’t see evidence we are abusing our powers. It feels like we’re quite a heavily regulated profession."

"Trust and competition in the audit market has once again become a hot topic in the UK. The idea that the size of an audit firm is a proxy for quality is clearly not a valid concept."

"Mid-tier firms certainly have the capability to audit the larger, FTSE businesses. It’s an attractive move for those bold enough to make it, not simply as a result of increasing public scrutiny of larger audits but because of the ability to make every client feel number one, which is crucial during times where change is constant and profound."

"At BDO we continue to be invited to pitch for an increasing number of larger audits, but mid- and smaller-tier firms shouldn’t just be there to make up numbers. Where there is a fair fight - as with our recent success with FTSE 250 firm Mitie - we can go toe-to-toe."

"With lack of trust in big firms set to remain under the media’s microscope, audit committees are becoming even more sophisticated in their procurement models and a rise in conflict work is having a positive impact for our business. We audit more listed clients than EY and have the fastest growth rate over the last few years compared with our larger competitors."

"While new reforms and regulations are a step in the right direction, real change to open up the market won’t come overnight. Responsibility also lies with individual participants, with audit committee members, CFOs, CEOs and investors, to think about what market structure UK Plc needs and ensure that they are opening their doors to firms beyond the Big Four."

"Deloitte signs 15,000 audits in the UK each year and our 4,000 audit professionals are dedicated to delivering the high quality work that underpins trust and confidence in the capital markets. But we recognise that there is an expectation gap between what an audit does and what people think it should do. This gap is significant and it needs auditors, investors, regulators, standard setters and the wider public to work together to better understand the causes of this gap and find solutions to close it. We are supportive of such a debate."

"We do not believe there is a case for breaking up one or more of the firms. The quality of our audit is improved by being able to access specialist resources that sit outside of our audit business – for example within our tax analytics or tax. By bringing a broad range of skills and expertise to audit engagements we are better able to service the needs of investors, audit committees, regulators and the markets as a whole. A break-up would be to detriment of capital markets."

"Real change to open up the market won’t come overnight. Responsibility also lies with audit committees, CFOs, CEOs and investors."

"There is a market at the top end for audit, when there are so few firms? The options on who you can appoint to carry out an audit are very limited, so at the top end I would say there are real questions about whether there is a market for that."

"The Big Four dominate the thinking of the profession with regard to audit and the regulatory environment around audit. They so dominate the market with regard to lobbying on tax and other regulatory issues that the voices of other firms and interests tend to be ignored. That’s very dangerous."

"Research suggests that large businesses are often not the most innovative businesses – in some ways they are too big to be innovative. To some extent that’s true in the audit market. The Big Four retraction to what they know to maintain their market share and their earnings."

"I believe that the power of the Big Four is bad for the business environment. Audit is fundamental to the concept of capitalism as we know it. If the confidence of investors and markets is critical to make modern capitalism work, then the quality of financial reporting we have today is not good enough. There is a need for change.

"Does that mean we need to have a rule for large companies that means there is a separation of audit from all other services? Ultimately, I think it does. The idea that there is a market in audit is breaking down. It is a regulatory function that is too important to capitalism to be left to the market. I know that sounds strange, but the referee can’t be paid by the players."

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