Disruption in the Audit Market: The Future of the Big Four
By Krish Bhaskar and John Flower with Rod Sellers
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Post Publication Comments: Current 2019 Audit Market comments and updates

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Current 2019 Audit Market comments and updates
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See:
https://www.fin-rep.org/wp-content/uploads/2019/11/1b-Current-Audit-Market-July-Oct-2019.pdf

October/September 2019 events

Big Four increase UK market share as audit reform concerns grow
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See for earlier events:

https://www.fin-rep.org/wp-content/uploads/2019/11/1c-Current-Audit-Market-Jan-June-2019.pdf

Case studies

For updates on more than 50 cases see:
Autonomy, Barclays, Patisserie Valerie, Steinhoff, Tesco, Wirecard and others see:
http://www.fin-rep.org/which-book/financial-failures-scandals-from-enron-to-carillion/

For our critique of the CMA (Competition and Markets Authority) Final Report

Please see: http://www.fin-rep.org/which-book/disruption-to-the-audit-market/

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Breaking news November 2019

Reform of the Audit Market – Summary in bullet points

These bullet points are expanded over the next few pages:

- In October 2019, the FRC once gain found audit quality had deteriorated. The Big Seven - Big Four, plus BDO, GT and Mazars – may be next year RSM as well.
- Tensions between audit and consultancy continue especially as reported affecting Deloitte (see next section). This adds fuel to the fire of those seeking a separation of the audit divisions from the consultancy divisions of (may be) not only the Big Four but also the mid-tier challenger firms.
- Joint audits are not in favour and won't occur. This may be a blow for challenger firms but they are in any case in a good place to grow because of the lack of choice and conflicts of interest.
- There is evidence of the mid-tier challenger firms growing. Fast enough?
- Though there is also evidence that the Big Four now have 100% of the FTSE 100 and their domination is growing. Conflicting evidence but may be their dominance will now be challenged. There is simply not enough choice - for auditors.
- Reform of the Audit Market
    - Boris Johnson wants a lower regulation environment. Labour wants a much tighter and tougher version – tougher even than any the of the recent public reviews (CMA, Kingman. Etc.). See end of this report on page 16.
    - Many of the reviews and critiques of the audit market are unhappy about Boris Johnson rowing back from tighter regulations and the dismissal of ARGA. But that now seems to be entrenched but this may change.
    - Future of the forthcoming review: Brydon etc.
    - Doubt about the future of the ARGA – instead a beefed up FRC.
    - Separation of audit and consulting – a real possibility now either voluntarily or with nudges form the FRC and possible 'soft' legislation.
- It seems that the City believes that the splitting the audit function from consulting is now considered vital to restore trust.
- The government is interested in the resilience of top six auditors. They want them to charge higher fees, not be cross-subsidised by consulting, and they want the audit division to have equity capital. And cash reserves to be built up to weather larger fines and the possibility of a collapse. They have to be able to sink or swim on their own.
- Focus on partners pay to make this independent of performance especially sums of money brought in for consulting.
    - FRC may take action and could press for powers to impose a banking-style clampdown on auditors' pay
    - The Big Four could pass the ultimate authority for partners' pay to the NEDs on their board or some external body. PwC can claim that it has thought up this idea first, but it was slightly tenuous. Whilst Deloitte has announced more definitive plans.
- Higher audit fees are being announced in general and some think this may spur competition as auditing divisions as they become more profitable in their own right.
- Cost cutting continues among the audit firms – particularly by KPMG and GT.

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Deloitte audit and consulting tensions

The current tensions seem to indicate that there is still a conflict between consultancy work and tendering for audits. The FT reported[1]:

> Profits at Deloitte's Switzerland business fell significantly short of its expectations, after an ultimately failed bid to audit Credit Suisse robbed the firm of the hefty advisory fees that it had previously made from the Swiss bank.
> The predicament has energised a small number of Switzerland-based partners who believe the Swiss firm should have greater independence from Deloitte's UK business, according to two people familiar with the matter.
> The Big Four accounting firm has been forced to play down the suggestion of tensions between the UK and Switzerland after a memo from the Swiss unit's chief operating officer about the firm's financial performance was leaked to Inside ParadePlatz, a Swiss blog.
> The memo, which was sent in March but only became public this week, said "performance has markedly slowed over the past 12 months" because of a number of factors including "the loss of revenue at Credit Suisse due to the moratorium imposed upon us during the audit tender".
> …
> The tie-up means the Swiss business is subject to the same strict internal controls around auditor independence as the UK firm, which meant it had to stop consulting work for Credit Suisse for around a year ahead of the audit pitch.
> Deloitte pitched for the contract, which is worth more than CHF55m a year, but lost to PwC in December 2018

This adds fuel to the fire of those seeking a separation of the audit divisions from the consultancy divisions of (may be) not only the Big Four but also the mid-tier challenger firms. Our feeling is that the beefed up FRC, the government and the accounting institutes will nudge the Big Four to implement and harden the operation separation and to ring-fence he audit division so that it has reserve near cash reserves or withstand future problems and have resilience in the face of future issues, failures, litigation and claims arising.

The issue of resilience is a new test that the Boris Johnson/Andrea Leadsom government wants to introduce. Higher audit fees and make sure the audit firms can stand on their own two feet without cross-subsidy from the currently more profitably audit divisions. .

/Continued

[1] Kinder, T., Deloitte audit and consulting tensions, *Financial Times*, 21 November 2019. Available at:
https://www.ft.com/content/896ccf62-0c7b-11ea-bb52-34c8d9dc6d84
Accessed November 2019.

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FRC Audit review 2019 – not good

AQR (Audit Quality Review) inspection reports show that auditors continue to struggle most with challenging management sufficiently, especially in more judgemental areas, such as long-term contracts, goodwill impairment or the valuation of financial instruments. The inherent uncertainty and high potential financial impact of these issues mean the importance of robust, specific and independent challenge is vital[2]. The Developments in Audit publication is also available[3].

The FRC found other shortcomings were identified in more routine audit procedures - notably in relation to revenue recognition. This is typically a key metric considered by users of financial statements. Other shortcomings were:

- year-on-year familiarity with audited entities can lead to the same audit approach being followed even when changes in the business or trading environment demand a different strategy;
- too often, audit teams appear prepared to accept what management tells them rather than questioning its plausibility and drawing on specialists to form their own view; and
- audit teams too regularly accept unrealistic deadlines resulting in inadequate work.

The FRC promised more information including grains on audit work in the future – confirming that ARGA is provably dead, though reference to Kingman recommendations were made in the FRC's report.

The FRC reported that over the past two inspection cycles, the FRC's Audit Quality Review team has referred 17 audits for potential Enforcement action and investigations have been opened in ten of those cases. The FRC has also increased the level of and umber of fines for shoddy audit work. The FRC's wider enforcement activity has seen a near trebling of fines from £15.5m in 2017/2018 to £42.9m in 2018/19. The FRC has also used a far greater use and range of non-financial sanctions, rising from 11 in 2017/18 to 38 in 2018/2019.

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[2] FRC, Report on Developments in Audit, *FRC*, November 2019.
Available at:
Press release: https://www.frc.org.uk/auditors/report-on-developments-in-audit
Report: https://www.frc.org.uk/getattachment/5d176788-3330-4b62-b18e-276c678d3d2c/Developments-in-Audit-Final-Screen.pdf

,[3] FRC, Auditors need to improve their challenge of management urgently, FRC News, 5 November 2019.
Available at:
https://www.frc.org.uk/news/november-2019/auditors-need-to-improve-their-challenge-of-manage
Accessed November 2019.

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The Mid-Tier Challenger firms
It is no longer the Big Six, the Big Four (Deloitte, EY, KPMG, PwC), GT and BDO, Mazars is growing fast and is now recognised by the FRC as the Big Seven. GT with the Patisserie Valerie failure and also resigning as auditor from Sports Direct and a negative. As a precursor to the possibility of joint audits, smaller accounting firms are reporting a wave of audit inquiries from large companies[4]:

> "We have had more invitations to tender for audits in the FTSE 350 market in the last six months than we have in the last 10 years," said David Herbinet, global head of audit at Mazars. RSM won Sports Direct.
> The £180m-revenue firm emerged as a serious challenger to the Big Four this year when it won a high-profile contract to audit the UK business of Goldman Sachs.
> Scott Knight, BDO's head of audit, said he had seen an "unprecedented" rise in demand from large listed companies.
> "The FTSE 350 market is moving more quickly than the pedestrian pace of regulatory reform. We're experiencing an unprecedented level of demand as more companies turn to the UK's largest challenger firms in their search for greater choice that is free from conflicts of interest," he said.
> FTSE 100 insurer Prudential and housebuilder Taylor Wimpey, which are audited by KPMG and Deloitte respectively, have held early-stage conversations with "challenger" firms, including BDO and Mazars, about switching their auditors, said several people close to the discussions.

However, that said, the FTSE 100 is still dominated by auditing firms from the Big Four and only the Big Four.

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[4] Kinder, T., UK audit shake-up spurs flood of inquiries for non-Big Four firms, *Financial Times*, 3 November 2019.
Available at:
https://www.ft.com/content/82ba3ed2-ff21-11e9-b7bc-f3fa4e77dd47
Accessed November 2019.

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Reform of the Audit Market

1) The current Boris Johnson government may opt for a low-cost, **low-regulation** type economy in the post-Brexit period. The low regulation environment seems to include at the very least a lower level of regulation for companies than hitherto planned. That probably means, in addition a rowing back of future planned changes to the governance code.
2) The possible recommendations from the CMA, we think, will be watered down. One recommendation that we think will be dismissed is that of **joint audits**.
3) The Replacement of the FRC by the Kingman recommended ARGA will probably not take place, instead the FRC will grow more teeth.
4) The separation of audit and consulting has already nearly occurred. Just a few additional administrative concerns and Deloitte (of the Big Four) are yet to be in place.

FRC chairman, Simon Dingemans, called for break-up of Big Four accountants. He said that the separation of audit and consulting is 'critical'[5]:

> Operational separation of at least the Big Four, if not the bigger six firms, should be a centre piece of reforms driving audit quality improvements," Mr Dingemans added. He likened his recommendation to the contentious "ringfencing" of UK high-street banks in a regulatory effort to make the financial system safer.

He was against the introduction of mandatory joint auditing in the UK. "Joint audits lead to duplications, confusion of responsibility and extra costs for no obvious added value," he said[6].

As will be seen he likened his recommendation to the contentious "ringfencing" of UK high-street banks in a regulatory effort to make the financial system safer. But as will be seen this was not because of the possible failure of one of the Big Four and the resilience of the audit divisions without the consulting part.

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November [5] Kinder, T., and Jenkins, P., FRC chairman calls for break-up of Big Four accountants, *Financial Times*, 7 November 2019.
Available at:
https://www.ft.com/content/84d1b2c0-0077-11ea-b7bc-f3fa4e77dd47
Accessed November 2019.
[6] Ibid.

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Having been appointed to get tough on auditors, after they failed to spot the demise of Carillion, BHS and Patisserie Valerie, he told the Financial Times: "The real question is how do you make [Big Four audit] firms . . . at less risk of collapse?"[7] The "operational separation" of the audit and non-audit businesses at the Big Four but apparently not to remove conflicts of interests if a firm took consultancy fees from a company it also scrutinised; instead, to "make those firms more sustainable"

What he seems to mean is to stop profitable consultancy work cross-subsidising loss-leading audits. This would imply that the audit divisions would maintain their own funding, a separate board, remuneration policy and set of accounts. Without a subsidised safety net, audit quality must rise he argues. This would force audit fees to be higher audit partner pay to be competitive, talent to be attracted with higher partner numbers and standards to rise.

This was summarised by the FT's Matthew Vincent as[8]:

> However, it turns out that Mr Dingemans is actually seeking the opposite outcome to bank ringfencing — and demonstrating quite the opposite of regulatory capture. While bank ringfencing aims to make the separated entity safer than its parent company, his proposed auditor separation is intended to make audit practices less safe — and less financially cushioned by their parent firms.
>
> Under the current system, accountancy groups have the ability to share profits from consultancy with their audit divisions — enabling more profitable consultancy work to cross-subsidise loss-leading audits. It is this subsidised safety net that has really damaged audit quality, Mr Dingemans argues, because it has allowed: fees to fall; audit partner pay to be cut; talent to be lost to more lucrative non-audit work; consultants to do audit work, further blurring roles; and reputational risk to have no direct financial impact. At one firm, all this has resulted in audit partner numbers being halved.
>
> Under an operationally separate system, audit practices would have to stand on their own feet financially — maintaining their own funding, a separate board, remuneration policy and set of accounts. Without a subsidised safety net, audit quality must rise, Mr Dingemans believes, because it would force: fees to be higher; audit partner pay to be competitive; talent to be attracted; consultants to be hired under transfer-pricing deals; and reputational risk to be consequential. Audit partner numbers, and standards, would rise in the industry as a whole.

[7] Vincent, M., Audit watchdog captures the mood with Big Four break-up plan, *Financial Times,* 7 November 2019.
Available at:
https://www.ft.com/content/892548de-016a-11ea-b7bc-f3fa4e77dd47
Accessed November 2019.
[8] Ibid.

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Splitting the auditors is vital to restore trust

The FT Editorial Board pinioned below[9]:

> The thrust of the remedies is threefold: to reduce the potential conflict of interest between audit and advisory divisions; to encourage greater competition from challenger firms; and to improve the quality of audit in general. Under the current system, accountancy firms are able to share the profits from their consultancy activities with the audit division, a practice that in effect allows the more profitable consulting work to cross-subsidise less lucrative audits.
>
> The CMA proposal for the Big Four to split their auditing and advisory arms into separate operations is therefore welcome. The move stops short of a structural split into freestanding firms which would be disruptive, complicated and time-consuming given the global nature of the business.
>
> The industry has countered that a split would lead to higher audit fees and could deter people from joining the profession. There is little evidence to support the latter, while the prospect of higher fees should not be a deterrent. Higher fees would lead to a better funded audit industry and should, ultimately, improve quality. Deloitte, Britains' second-largest accountant, has proposed giving a final say over its auditors' pay to its non-executives to fend off an enforced split. Measuring the result of auditors' work, however, is difficult and the record of non-executives challenging executives is patchy.
>
> Enhancing competition is another area for reform. Proposals under consideration by ministers include requiring large companies to appoint two auditors, one from outside the Big Four. Doubling auditor involvement would increase costs but would provide an extra challenge. A cap on the Big Four's share of audit work also merits debate.
>
> Improving the quality, however, requires more than structural change. Much rests on a government-ordered review by Donald Brydon, a former London Stock Exchange chair, expected in January. The system will remain weak unless audit reconnects with its original purpose: to protect creditors, employees and shareholders against the abuse of limited liability.

[9] FT The Editorial Board, Splitting the auditors is vital to restore trust, *Financial Times*, 19 November 2019. Available at:
https://www.ft.com/content/d7ed1804-0ad7-11ea-b2d6-9bf4d1957a67
Accessed November 2019.

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> The FT has previously proposed rethinking fair value accounting rules. These should also be made subservient to the law which requires auditors to vouchsafe that the figures present a "true and fair" picture. The collapse of Thomas Cook, which kept paying a dividend despite increasing losses, is a case in point. Good audits are the bedrock of strong markets. At the very least, the government should act swiftly to put new measures into law.

Resilience of top six auditors

Apparently, the department for business (BEIS) asked about the capital strength and insurance provisions of the Big Six (PwC, Deloitte, EY, KPMG, GT and BDO). This was something of a surprise given the inactivity of BEIS and Boris Johnson's government. The survey was prompted by concerns over vulnerability at the larger audit firm[10]:

> In a question that recalls the implosion in 2002 of Arthur Andersen, the department for business, which is led by Andrea Leadsom, also asked the firms to share their "contingency planning" for the risk of failure at any large audit firm, which would disrupt the provision of audit services and the overall stability of the UK financial system.
> The vulnerability of large audit firms to the risk of big regulatory fines or litigation has been put under scrutiny after a number of flawed audits contributed to the collapse of businesses that have left creditors and investors out of pocket.
> Legal and regulatory claims against audit firms have been growing in size and frequency. KPMG's US business was ordered to pay $50m by the Securities and Exchange Commission for "ethical failures" in June, while last year, PwC's US arm paid $335m in damages for negligence in its audit of Colonial Bank in Alabama. In the UK, Grant Thornton lost a £21m negligence lawsuit brought by its former client Assetco, while PwC was fined a record £10m — reduced to £6.5m after a settlement — for misconduct in its audits of BHS.
> Unlike banks and insurers, audit firms are not required to hold minimum levels of capital. Each of the six largest firms operates as a limited liability partnership. The firms are required to hold professional indemnity insurance with a minimum cover of £1.5m, but scandals in the sector have resulted in soaring insurance bills.

This has led to new forms of possible controls of the audit market.

[10] Kinder, T', UK tests resilience of top six auditors, *Financial Times,* 12 November 2019.
Available at:
https://www.ft.com/content/2928b35a-0550-11ea-a984-fbbacad9e7dd
Accessed November 2019.

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Focus on partners pay

The one remedy which has not been suggested before it to break the link between monetary performance and partner pay. If someone else decides then this may shift the focus to such factors as audit quality.

FRC may take action

The FRC, the audit watchdog, has been reported that it could press for powers to impose a banking-style clampdown on auditors' pay after the string of scandals such as BHS, Carillion and Patisserie Valerie. The Sunday Times reported[11]:

> The Financial Reporting Council (FRC) is considering asking the government for powers to set remuneration standards for auditors if the big accountants' audit practices are separated from their advisory practices under proposed reforms.
> The FRC could implement a "clawback" clause for audit partners in an attempt to improve the quality of audits and steer the focus away from generating revenue.
> A clawback clause would mean that partners would be forced to return a chunk of their bonuses if audits fell below the required quality.
> The radical plan follows the collapse of BHS, which was audited by PwC; Carillion, which was audited by KPMG; and Patisserie Valerie, audited by Grant Thornton. EY has also come under fire over its auditing of Thomas Cook.

Deloitte jumps first?

PwC can claim that it has thought up this idea first, but it was slightly tenuous. Whilst Deloitte has announced more definitive plans. It is reported that Deloitte has given a final say over the pay and bonuses of its auditors to its NEDs (non-executive directors) in a first for the accounting sector, as the Big Four firms seek to fend off demands they should be broken up. That said tit looks as if pressure is mounting for the operational separation to be made in some sort of official move[12].

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[11] Dunkley, E., Financial Reporting Council plots pay crackdown on auditing bosses, *The Sunday Times*, 17 November 2019.
Available at:
https://www.thetimes.co.uk/article/financial-reporting-council-plots-pay-crackdown-on-auditing-bosses-zprjgm75c
Accessed November 2019.

[12] Kinder, T., and Binham, C., Deloitte hands control over UK auditor pay to non-execs, *Financial Times*, 18 November 2019.
Available at:
https://www.ft.com/content/e5c6ad54-07c7-11ea-a984-fbbacad9e7dd
Accessed November 2019.

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Deloitte jumps first?/Continued

The FT went on to report[13]:

> The second-largest UK accounting firm's decision is aimed at preventing the perception of conflicts of interest between its audit and consulting divisions and avoiding a forced split.
> The firm's independent non-executive directors, which include former chairman of Barclays bank Gerry Grimstone, will review the policies and performance metrics by which Deloitte's auditors are paid and monitor individual remuneration. Deloitte partners earned an average of £882,000 in 2019 — their biggest payout in a decade.
> Auditors at Deloitte and its main rivals PwC, KPMG and EY are paid from total profits, which include fees made by consultants. This has led to concerns that they could be less motivated to challenge companies over their accounts if this jeopardised more lucrative advisory fees.
> The Big Four have strongly denied that their auditors are conflicted by a shared profit pool but agreed the perception of a conflict had fuelled calls from politicians and regulators for a break up. Deloitte's move to hand oversight of pay to its independent non-executives is an attempt to reduce the risk of a conflict.
> None of its rivals have yet made such a move, although PwC UK said in September (2019) it was considering a similar change[14].

The FT's Lex commented[15]:

> For companies under siege over corporate governance, the first line of defence is to call on the non-executive directors. So it is with Deloitte, one of the Big Four under attack for perceived conflict of interest between its consultancy and audit divisions. Facing calls for a break up, the second-biggest UK accountancy firm says partner remuneration will need to be cleared by its non-executive directors. They will focus on audit quality rather than, say, business generated.

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[13] Ibid. Repeated: Kinder, T., and Binham, C., Deloitte hands control over UK auditor pay to non-execs, *Financial Times*, 18 November 2019.
Available at:
https://www.ft.com/content/e5c6ad54-07c7-11ea-a984-fbbacad9e7dd
Accessed November 2019.

[14] Kinder, T., PwC UK considers giving external body oversight of auditors' pay, *Financial Times*, 27 September 2019.
Available at:
https://www.ft.com/content/d0c2c5f0-e07b-11e9-9743-db5a370481bc
Accessed September 2019.

[15] Lex, Deloitte's defence: NED shred, *Financial Times*, 18 November 2019.
Available at:
https://www.ft.com/content/ce780f54-bd2c-465c-b57a-6f85a154c4e9
Accessed November 2019.

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Higher audit fees will spur competition

EY chair says higher audit fees will spur competition[16], Steve Varley claims smaller firms should be encouraged by rising charges:

> A significant increase in UK audit fees should encourage smaller firms to challenge the dominance of the Big Four, the UK chairman of EY has claimed.
>
> Steve Varley, who has been chairman of EY UK since 2011, made the prediction as the Big Four auditor said that charging companies more for vetting their books had helped lift annual profits.
>
> Over the summer, EY warned its largest listed British clients, which include Vodafone, Burberry and Aston Martin Lagonda, that they would have to pay more for audits because of "unprecedented market forces". The UK accounting industry faces the largest overhaul in decades amid intense scrutiny from politicians and regulators.
>
> A double-digit percentage increase in audit fees contributed to a 2 per cent growth in EY UK's audit revenues to £453m in the 12 months to June 30. Profits from the audit business rose by £10m to £68m in 2019."
>
> The reaction from clients has been positive overall, as boards know it will deliver higher quality audits," Mr Varley said of the jump in fees. "None of them want to get an invitation to appear before a select committee inquiry."
>
> The rise in audit fees being charged by EY has been mirrored by Deloitte, PwC and KPMG, who together make up the Big Four accountants. Mr Varley said EY was conducting "various scenario planning", including for a forced split of its audit and advisory functions, which is being considered by the British government.

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[16] Kinder, T., EY chair says higher audit fees will spur competition, Financial Times, 19 November 2019. Available at:
https://www.ft.com/content/7b4ae322-0a11-11ea-bb52-34c8d9dc6d84
Accessed November 2019.

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Breaking news November 2019/Continued

Cost cutting continues among the audit firms

KPMG will axe a tenth of its UK partners by Christmas following a review of individual performance, the latest in a series of measures to overhaul the Big Four firm[17]. The one-off cull of partners comes as the firm scales back its costs and restructures its operating model as it tries to recover from a reputational crisis and prepare for regulatory changes to the audit sector. This follows review into individuals' performance.

GT has suffered a bad year and has changed its year end from June to December. As the FT reported[18]:

> Profit per partner fell to £323,000 from about £343,000 last year, it said last week. That is close to half the amount enjoyed by close rivals at BDO. Partner pay at Big Four firm KPMG was £601,000. PwC's profit per partner topped £765,000.

As KPMG is finding making an accurate assessment of who should get culled is far from straightforward[19].

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[17] Kinder, T., KPMG to cull a tenth of its UK partners as part of overhaul, *Financial Times*, 3 November 2019. Available at:
https://www.ft.com/content/4c4ed8e0-fcd7-11e9-a354-36acbbb0d9b6
Accessed November 2019.

[18] Burgess, K., Times are particularly tough for auditors at Grant Thornton, *Financial Times*, 3 November 2019. Available at:
https://www.ft.com/content/e1a72f26-fc07-11e9-98fd-4d6c20050229
Accessed November 2019.

[19] Hill, A., How do you decide who gets the chop in a professional services firm?, *Financial Times*, 3 November 2019.
Available at:
https://www.ft.com/content/dff40c38-0140-11ea-be59-e49b2a136b8d
Accessed November 2019.

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Top-ranked mid-tier firms will be the beneficiaries of a seismic shift

Audit failures have caused the choice for the Big Four has become less clear cut than it was. Accusations of auditor negligence followed the collapse of several companies. These have damaged confidence in the profession's Big Four. Pending regulations may cap the number of FTSE 350 companies an accountancy firm can audit, or have a similar effect.

> Some companies are preparing to jump ship ahead of their peers. It makes sense to get in early. Top-ranked mid-tier firms are the obvious beneficiaries of this seismic shift. But their capacity is finite.
>
> Scale begets scale. Having belatedly received their invitation to sit at the top table, smaller firms may lack the international reach and depth of service to handle the books of colossi. Yet smaller audit groups are more than capable of making the same mis-steps as their bigger peers. Grant Thornton's audits of failed cakemaker Patisserie Valerie demonstrated that. While they can staff up to handle expected higher workloads, that puts a huge burden on training. BDO this year hired 390 trainees, including a record number of school leavers.
>
> The Competition and Markets Authority, acknowledging the barriers to entry for challenger firms, is pushing joint audits as a way to square the circle. This is both an interim solution and an imperfect one. Co-auditors will tussle for fees more eagerly than blame. But that is the cost of structural change in big industries. It takes time to wash through. Client companies just have to suck it up — and hope that today's accounting minnow will grow into a big fish[20].

/Continued

[20] Lex, Top-ranked mid-tier firms will be the beneficiaries of a seismic shift, *Financial Times*, 3 November 2019.
Available at:
https://www.ft.com/content/4308c902-3d35-4dba-9aa9-50938f9e6797
Accessed November 2019.

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The Guardian's report (salient features)[21]:

> "We aim to take on the excesses of the shareholder model and lay some of the foundations of a stakeholder economy," he said. "Today's business model of shareholder domination is increasingly proving to be incompatible with not just the fair and respectful treatment of workers but also with the responsibilities associated with any organisation operating within a democracy."
>
> He said a Labour government would establish a series of powerful commissions to oversee corporate behaviour. An overarching business commission would contain within it three separate watchdogs – a companies commission, a finance commission, and an enforcement commission.
>
> Answering questions afterwards, McDonnell confirmed he would like banks to be included in the new system, in what could be the biggest shake-up of financial regulation since 1997 when Gordon Brown made the Bank of England independent. "My own view is that I would like to see banking within it," he said.
>
> McDonnell outlined a series of perceived faults with the way shareholder capitalism worked, including short-termism, excessive executive pay, the lack of bargaining power for workers and the "cartel" behaviour of the big four accounting firms.
>
> He said Labour would force the big four – Ernst and Young, Deloitte, KPMG and PwC – to separate their audit and non-audit businesses. This would be aimed at avoiding the conflicts of interest he claimed could arise when the firms were selling consultancy services to the same company whose accounts they were meant to be casting a sceptical eye over.
>
> McDonnell also said a Labour government would establish a "statutory auditor" to carry out its own checks on companies. "Its purpose will be to conduct real-time audits of banks, building societies, credit unions, insurers and major investment firms. The auditor will not be dependent on fees from client companies and as a result could become independent and robust," he said.
>
> He said Labour would rewrite the Companies Act to ensure firms were responsible to employees and customers as well as their shareholders, and insist that one-third of board members were staff.

[21] Stewart, H., Labour would rewrite rules of UK economy, says John McDonnell, The Guardian, 19 November 2019.
Available at:
https://www.theguardian.com/politics/2019/nov/19/labour-rewrite-rules-economy-john-mcdonnell
Accessed November 2019.

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> Larger companies would also be given the option to create a German-style two-tier board structure, with a separate supervisory board having oversight over executives.
>
> McDonnell confirmed that Labour would force large companies to establish an "inclusive ownership fund", in which they would be obliged to set aside up to 10% of their shares for employees, who would then be entitled to receive dividends worth up to £500.

The Times focussed on slightly different issues[22]:

> In a trenchant attack on "corporate greed and short-termism" the shadow chancellor said that Labour would end the
> "unfettered pursuit of profit" and make companies act in the interests of their employees and customers.
>
> He also vowed to break-up the "cartel" of the big four accountancy firms by forcing them to separate out their auditing functions from other commercial work.
>
> "We aim to take on the excesses of the shareholder model and lay some of the foundations of a stakeholder economy," he said. "Today's business model is increasingly proving to be incompatible with not just the fair and respectful treatment of workers but also with the responsibilities associated with any organisation operating within a democracy."
>
> Rewrite the Companies Act to make businesses responsible to employees and customers as well as their shareholders, and insist that one third of board members were staff.
>
> Mr McDonnell also said that Labour would go ahead with a plan for an excessive pay levy by charging companies a 2.5 per cent levy on earnings above £330,000 and 5 per cent on those above £500,000.
>
> Although a number of the policies outlined by Mr McDonnell were included in Labour's 2017 manifesto others went further. He said that Labour would undertake a "much-needed overhaul" of the government's entire system of business regulation and establish a new business commission that would integrate the accounting, auditing,

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[22] Wright, O., Labour would impose 5% 'excessive' pay levy, says John McDonnell, *The Times*, 20 November 2019.
Available at:
https://www.thetimes.co.uk/article/election-2019-mcdonnell-targets-corporate-greed-by-taxing-bosses-pay-dqv8t3pwk
Accessed November 2019.

> insolvency, and financial sector regulators. An independent ombudsman would adjudicate on disputes between regulators and stakeholders.

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The FT reported[23]:

> A Labour government would install workers and consumers on the boards of all UK listed companies as part of what the shadow chancellor called an attempt to "rewrite the rules of our economy".
>
> John McDonnell set out plans on Tuesday to shake up corporate governance, reform the audit market and rewrite company law to tackle what he called the current overriding "predatory business model".
>
> Mr McDonnell said companies would be allowed to have either a single board or a new German-style two-tier structure with a supervisory board overseeing the executives. In either set-up, companies would be expected to have workers, consumers and shareholders represented.
>
> Meanwhile, Mr McDonnell confirmed that Labour was proceeding with its controversial plan to seize 10 per cent of the shares of all companies with more than 250 staff in the UK — albeit over 10 years — and hand them to staff through "inclusive ownership funds".
>
> The funds would receive the dividends for those shares but distribute to employees only up to a cap of £500 per worker. Any surplus would be passed to the government as an effective tax.
>
> However, the plan has been refined so that it would no longer apply to the international profits of UK-based companies in order to prevent a "transfer of wealth from the global south to the UK". The calculation would be based on profits generated in the UK, as illustrated by companies' domestic corporation tax payments.
>
> There would be an overarching "business commission" to oversee a shake-up of Britain's regulatory system; the Big Four accountancy firms would be forced to separate their audit and non-audit businesses; and a new statutory auditor would regulate financial services companies.

[23] Pickard, J., McDonnell takes aim at 'predatory business model', Financial Times, 20 November 2019. Available at:
https://www.ft.com/content/21ce7dc4-0adc-11ea-b2d6-9bf4d1957a67
Accessed November 2019.