

Disruption in the Audit Market: The Future of the Big Four
By Krish Bhaskar and John Flower
Online companions volume
December 2018.docx
Post Publication Comments

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KPMG suspends Carillion audit partner and three others (See January update)

Tesco trial dropped (6 December 2018):

Former bosses cleared of fraud and false accounting.

<https://www.ft.com/content/672fdb88-f949-11e8-af46-2022a0b02a6c>

For us this is more of a failure by the SFO than a misstatement of the profit manipulation. We discussed this in the cases book. The directors who were the subject of this case may not be guilty in that they were not the prime movers of the manipulation of the accounts. However, the accounts were manipulated, as we have shown, and as Tesco, as a corporation, has pleaded guilty. Now the question who is responsible. Here they may very well be a gap in the responsibility process, but for us it should be the Board including the NEDs. Ultimately, we argue, it is they who should accept responsibility and liability for the accounts, annual report and other public market sensitive messages. If this is too broad then the CFO, CEO and Chairman of the audit committee (perhaps), should be held liable for any mistakes/misconduct or those possibly labelled as crimes in the accounts and annual report. That, of course, raises the question of any responsibility of the auditors.

KPMG have probably had worst set of challenges and comments, plus special measures from the FRC, has the largest audit growth, and soars past FTSE 100 as leader taken from the PwC. 8 November 2018.

<https://www.accountancydaily.co/kpmg-grabs-largest-number-ftse-100-audits>

KPMG will stop providing non-audit services to listed companies whose finances they are inspecting after coming under intense pressure over perceived conflicts of interest.

Bill Michael, KPMG's UK chair, said the firm would stop providing non-audit services for FTSE 350 companies "to remove even the perception of a possible conflict", in a memo to partners sent on Thursday. The firm declined to give an end date for the changes.

<https://www.theguardian.com/business/2018/nov/08/kpmg-to-drop-non-audit-services-for-its-ftse-350-clients>

KPMG and Deloitte have backed a suggested ban on UK auditors selling extra services to audit clients. KPMG has made the decision to stop providing any non-audit services for FTSE 350 clients, unless it is essential; Deloitte has followed suit.

<https://www.accountancyage.com/kpmg-deloitte-and-the-audit-dilemma/>

See quotes from the Guardian article at the end.

PwC starts roundtable discussions on future of audit

The company has set up a web page and will produce a white paper with suggestions on how the audit sector can move forward. 27 November 2018.

<https://www.accountancyage.com/2018/11/27/pwc-starts-roundtable-discussions-on-future-of-audit/>

<https://www.accountancydaily.co/pwc-opens-discussions-future-audit>

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And for the website hosted by Gilly Lord, PwC's Head of Audit Strategy and Transformation
<https://www.pwc.co.uk/services/audit-assurance/statutory-audit/insights/confidence-in-the-future-audit-innovation/confidence-in-the-future-gilly-lord-video.html>

BDO to merge with Moore Stephens

But this won't make a rival for the Big Four. As noted in the audit market book such mergers fail to get anywhere near the size of the Big Four. This may change but it would require many more mergers and acquisitions plus some organic growth. We cannot see this happening but we would not rule it out as a possibility.

<https://www.accountancyage.com/2018/11/26/bdo-to-merge-with-moore-stephens/>

In a similar vain Baker Tilly come together with RGL Forensics.

<https://www.accountancyage.com/2018/12/05/baker-tilly-come-together-with-rgl-forensics-to-create-global-accounting-practice/>

Possible issues post publication

FRC has opened an investigation into PwC for its audit work on the Eurasian Natural Resources Corporation (ENRC).

<https://economia.icaew.com/news/december-2018/frc-investigates-pwc-over-enrc-audit>

KPMG to face FRC misconduct hearing over Silentnight

<https://www.accountancydaily.co/kpmg-face-frc-misconduct-hearing-over-silentnight>

Patisserie Valerie faces FRC audit probe (Auditor: Grant Thornton)

<https://www.accountancydaily.co/patisserie-valerie-faces-frc-audit-probe>

Other opinions and developments

Call to 'think small' on audit standards

<https://www.accountancydaily.co/call-think-small-audit-standards>

Woolf: auditors need to go back to basics

<https://www.accountancydaily.co/woolf-auditors-need-go-back-basics>

Software license auditing risks conflict of interest

<https://www.accountancydaily.co/software-license-auditing-risks-conflict-interest>

Deloitte takes over from PwC at Lloyds Bank after 153 years

<https://www.accountancydaily.co/deloitte-takes-over-pwc-lloyds-bank-after-153-years>

ICAEW says tougher FRC sanctions bad for audit competition

'Despite several high-profile corporate collapses and audit failures in recent years, we are sceptical that the number of competitors - as such - available in the market for large corporate and public interest entity (PIE) audits has a direct causal link to auditor performance.'

Then they would say that wouldn't they. Our analysis and evidence disagrees. An increase in largish competitors (such as splitting the Big Four audit divisions) would improve performance and quality.

<https://www.accountancydaily.co/icaew-says-tougher-frc-sanctions-bad-audit-competition>

Continues

Critique of KPMG

Guardian article on KPMG¹

The article argues that KPMG's reputation is down, but revenues and profits up.

Welcome to the pleasant world of KPMG. The firm is in the regulatory equivalent of special measures after the Financial Reporting Council found "an unacceptable deterioration" in audit quality in August but the 635 partners in the UK enjoyed a (very) acceptable improvement in remuneration. They collected £601,000 on average, a 16% rise, in line with the jump in underlying profits to £356m.

Hold on, you might say, isn't this the outfit that gave a clean bill of health to the accounts of Carillion just before the roof fell in? Isn't the FRC also having a hard look at KPMG's audit of Conviviality, the Bargain Booze retailer that imploded at an even faster rate? Didn't KPMG get clobbered recently with fines for its work on the accounts of Ted Baker and Quindell?

Then the article goes on to criticise the size of fines that the FRC can or has levied for misconduct:

The answer to all those questions is yes. The only qualification is that the FRC doesn't do clobbering. The fines in the latter two cases were £3m and £4.5m, which barely moves the financial dial. The record fine dished out by the FRC is £10m for PricewaterhouseCoopers (PwC) for its work on the accounts of BHS and its parent company – and even that was reduced to £6.5m for cooperating with inquiries. At a time of general head-scratching about auditing in the UK, one remedy seems obvious: in a profession where self-policing will always be necessary, fines should hurt.

KPMG suspends Carillion audit partner and three others (See January update)

¹ <https://www.theguardian.com/business/nils-pratley-on-finance/2018/dec/05/kpmg-cannot-fail-to-profit-from-lack-of-competition>