

Financially speaking

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Auditing - much ado about something

There are stirrings in the normally unemotional world of auditing: there is the prospect of EU regulation for the largest international audit firms.

Is this a long-overdue attempt to break up a cosy cabal of four very large firms, or an ill-founded assault on an area of Anglo-Saxon excellence, spurred on by Gallic envy?

There are four main lines of criticism of the status quo: firstly there is too little choice, with only four firms dominating the audit market for the largest listed companies throughout the world.

The second is linked to this and it is that any cataclysmic claim against any of the Big 4 firms will reduce the choice even further.

The third criticism is that the auditing profession performed dismally in the financial crisis: it has been described by Michel Barnier, a European Commissioner, as the dog that did not bark. We all looked on askance in 2008 as revered financial institutions demonstrated feet of the softest clay. Instead of being cautiously and sturdily constructed on the sure foundations of rock, they appeared as shaking edifices, with all the solidity and permanence of canvas on thin sticks of timber. Many saw this as, in part, an audit failure.

The final criticism is that the Big 4

have been very adept at selling other services to their clients: these have covered obvious areas such as taxation and less obvious ones such as management consultancy. There is, at the very least, the perception of a possible loss of independence. Yet independence is at the very heart of being an auditor. This perception is reinforced when one learns that various audit relationships within the listed company market have endured for more than a century.

Criticism is easy: the production of workable alternatives is more difficult. There is an extremely large gap between the resources and skills of the Big 4 and the following pack of a further five or more national firms. These firms are far smaller, and they are still developing their international networks and internal disciplines. Michel Barnier is wrestling with this reality.

The proposals that are being discussed include the following:

- there should be restrictions on the provision of non-audit services to audit clients;
- Joint audits, undertaken by two firms, rather than one, would help to free up the market and should be encouraged;
- Clauses in banking and other agreements, requiring the audit to be undertaken by a Big 4 firm, should be banned;

■ There should be mandatory rotation of auditors of public-interest entities every 6 years;

It is difficult to know if these proposals will be introduced. The current intense competition between the Big 4 has an unexpected side-effect: it results in the following pack finding it very difficult to move up the auditing food chain. Will there be intervention in the existing free market in order to assist the national firms to do this?

We at Scrutton Bland have an extensive audit practice; it is our perception that it is the resources and expertise of the Big 4 which make them such formidable opponents in their own markets. It is to be hoped that any market intervention does not dilute this. Large international groups are complex entities to audit and they require a vast array of skills in many different countries. This is the Big 4 offering.

At the end of the day all of this does matter: we are all affected by business failures. Equitable Life, Enron, Northern Rock, Lehman Brothers and RBS all suggest that we have some way to go in developing a truly robust financial reporting system. Auditors have a central role to play in that.

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