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Big accounting firms preparing for day of rec

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In Britain accountancy firms are in the gun following a series of high profile corporate failures.

OPINION: The big firms dominating the accounting industry know the days of their current business model are numbered. But it will take a catalyst before they change.

Our competition watchdog should be looking into this. In Britain, there is a growing appetite to break up the big four accounting firms, Deloitte, EY, KPMG and PWC, precipitated by a series of high profile corporate collapses.

These corporates had been audited by one of the big four which did not pick up the growing problems in these businesses, the very purpose of the audits.

CHRIS MCKEEN/STUFF

Shamubeel Eaqub: "Their business in consulting is conflicted but profitable and growing."

A changing revenue model is the big issue for the big four. Their traditional business of accounting and auditing is risky and in decline, and their business in consulting is conflicted but profitable and growing.

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The big four advise businesses and government on many things, including public policy, tax reform, strategy, risk and mergers and acquisitions.

Consulting is growing and highly profitable, while auditing is not. Firms that offer both auditing and consulting services are inherently conflicted.

They need to maintain good relationship with businesses they are auditing to secure future lucrative consulting roles.

They have policies in place to manage this conflict. For example, they will not consult for a firm they are currently auditing. But the conflict never truly disappears.

Firms routinely take a musical chair approach. One firm will spend some years on audit, then do consulting for that firm. Sometimes a partner from the firm will join the board of the company when they retire from the big four.

The conflicts and relationships are over a long period of time and with significant implications for individuals concerned. Being overly challenging in an audit is akin to fouling your own nest.

A British parliamentary report described the big four as a "cosy club incapable of providing the degree of independent challenge needed".

For a bunch of accountants, the accountability is not high enough. When building firm Carillion failed in Britain, there was sharp criticism of KPMG and Deloitte, the external and internal auditors.

But unless they are held accountable for their work, and made to pay a commensurate fine, their behaviour will not change.

Following the global financial crisis, the leading banks showed this to be true. Many were fined apparently large sums of money, but they were so small compared to their overall profits that they barely noticed.

Worse, they were emboldened to lobby even harder to reverse tighter rules and regulations on the industry. In the US they have succeeded in reversing these rules.

When there are big profits on the line, there is plenty of incentive for businesses to keep doing what they are. Even if the outcome is not good for all concerned.

For the big four, the situation is a little different. They audit because of their history, not because they really want to any more.

But if their competitors dropped or carved off their audit roles, so would they. They have been engaged in a rather tortuously long game of chicken.

The British authorities identified two options to break up the conflicts in the audit/consulting industry.

One would be to split up the big firms into many multi-disciplinary firms, a bunch of mini-big fours if you will, to create more competition.

The risk is that over time these smaller firms will coalesce into future big four.

The second option is better, where the audit role is separated off. This would make audit stand on its own feet and make their only job to challenge the businesses to ensure they are fit and looking after their shareholders' interests.

Any move would take time. But the British experience this year and the recommendations mark very clearly the beginning of the end for the big four in their current form. Auditing must be independent.

In New Zealand, we should look at rules to make this happen over time. In the meantime, the Government can lead by example and use audit-only firms.

Such a change would be bad for the big four, but good for the public interest.

- Sunday Star Times