Big Four foisting 'high risk' clients onto smaller competitors

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The Financial Reporting Council has found that the Big Four's auditing function has collectively improved for two consecutive years. However, the improvements have been linked by some to the quartet dumping 'risky' clients onto smaller competitors who are ill-equipped for them – which in turn sees their audit quality rate drop.

The auditing work of the professional services world's Big Four has been on the receiving end of a stinging criticism in recent years. PwC, Deloitte, KPMG and EY have been at the centre of a number of major book-keeping scandals, as well as the focus of a series of inquests, and the recipients of a number of record fines over the last three years. High-profile cases have included Thomas Cook, Silentnight, Autonomy and Carillion, among others – leading to public pressure for the accounting sector's ombudsman to take action.

The Financial Reporting Council (FRC) has come under pressure in its own right, as it was perceived as failing to bring the industry to heel. Hefty fines still pale in comparison to the profit margins of the Big Four in particular – and on more than one occasion, the watchdog has been branded "toothless" as a result.

On the back of this, to challenge the declining quality of major audits in the UK, the FRC has recently been pushing for a series of structural reforms to the industry. Proposed changes to UK professional services include shared audit proposals, in order to break up the alleged oligopoly of the Big Four in the sector – something the firms vehemently oppose.

In order to avoid such perceivably drastic measures, the Big Four has sought to collectively demonstrate that it is improving. As such, the defenders of the quartet are now pointing to the fact the firms have shown a second consecutive year of improvement, with the FRC's latest annual audit scores finding that 75% of audits checked by the firms were up to standard. That figure stood at 71% in 2021, and 67% the year before.

Most significantly PwC and Deloitte boosted their scores to more than 80%, while KPMG reportedly saw "significant" improvement from its previous score of 59% – having been described as unacceptable for the past three years. EY was the only Big Four firm whose score worsened, with audits needing improvement rising from 20% to 35% – though this still leaves the firm with a majority of acceptable work.

Taking these figures at face value might paint a Big Four that is finally working hard to self-regulate, and boost its standards. However, that might not tell the whole story. Critics have pointed out that the foursome's general improvement seems to largely be due to the firms dropping 'risky clients'. This leaves them for challenger firms to pick up – unwittingly 'winning' large contracts that were formerly the preserve of the Big Four, only to discover their limited resources mean they struggle to tackle such clients adequately.

The impacts this is having further down the audit sector food chain can be seen by the cases of BDO and Mazars. Two of the closest rivals to the Big Four have seen their auditing remain 'unacceptable' by the FRC's reckoning, with half of the eight audits checked failing to meet standards at Mazars, and 42% of BDO's audits needing improvements – something those campaigning for wider market reforms allege is the result of them picking up the 'more challenging' audits dropped by the Big Four.

Risks of de-risking

Sarah Rapson, the FRC's Executive Director for Supervision, told Reuters, "The story with BDO and Mazars is that they're both growing too fast. They have ingested too many audits into their portfolios without having the right capability capacity to be able to do them."

Chris Biggs, **Founder of Theta Global Advisors, meanwhile said of the news, "***On the surface it's great to see consistent improvement over the course of the last two years amongst the Big Four, it becomes less encouraging if this is as a result of difficult audits simply being passed on to smaller firms. This responsibility should be shared across the industry, and there also should be measures and controls in place to ensure quality audits when challenger firms do take on difficult audits."*

Biggs boasts over ten years' experience with a Big Four firm, having been a Director at PwC. He argued that the FRC's findings should not distract from the need to bring in shared audits between the Big Four and smaller companies – one way which has been increasingly touted as a way to diversify the sector and improve its competitiveness.

He added, "Possible increased costs and time delays for firms outside of the Big Four performing particularly complex and demanding audits are in some ways to be expected because of shared audits. However, these risks can be managed and mitigated with appropriate structures to facilitate a growth period as these smaller firms gain more experience and resources when working on such projects… There have been three independent reviews so far and major failings are still happening with the Big Four's current monopoly. The legislative reform this year has certainly re-energised the push, but we need to now see more follow through if the issues are to be solved effectively and for the long-term."