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Big Four accountancy firms plan for UK break-up

by **Madison Marriage**

The Big Four accountancy firms have drawn up contingency plans for a break-up of their UK businesses, an option politicians and regulators are increasingly pushing to solve conflicts of interest embedded in the industry.

The pressure on the four firms that dominate the sector – KPMG, Deloitte, EY and PwC – to prepare for a forced break-up has increased following high-profile corporate collapses that have called into question the quality of their work as both auditors and consultants for the UK's largest companies.

Executives from all four and the next largest UK audit firms, Grant Thornton and BDO, said they had planned for a potential break-up, in case regulators force them to spin off their audit from their consulting businesses.

A parliamentary report this week urged the competition watchdog to consider breaking up the four, saying they operated as a "cosy club incapable of providing the degree of independent challenge needed". It followed a probe into the collapse of government contractor Carillion in January.

The investigation triggered sharp criticism of KPMG and Deloitte, Carillion's external and internal auditors respectively over the past 19 years, and of EY and PwC, which had various consulting roles.

Remedy for lack of competition

A break-up scenario could involve two options: either forcing each large firm to split into two smaller multidisciplinary firms; or making all of them spin off their consulting work to create audit-only businesses. This second option was backed by Stephen Haddrill, head of the UK accounting watchdog, in February as a potential remedy for the lack of competition in the market.

Bill Michael, chairman of KPMG's UK business, said his firm had been thinking about break-up scenarios "for some time" as the current business model of the Big Four – which generate a growing portion of their revenues from consulting – is "unsustainable".

"We are an oligopoly – that is undeniable," he said. "I can't believe the industry will be the same [in the future]. We have to reduce the level of conflicts and ... demonstrate why they are manageable and why the public and all stakeholders should trust us."

PwC said it had "a documented business continuity plan covering a range of scenarios that could threaten the existence of the firm". EY said: "Working alongside regulators and standard setters, the profession can evolve to best serve business, investors and stakeholder needs."

Audit work might be 'ring-fenced'

BDO, the UK's sixth-largest auditor, has developed contingency plans in case regulators decide to "ring fence" audit work.

It has also planned for regulators deciding that "public interest" entities – listed companies and systemically important institutions – should be audited by audit-only firms. In this scenario, BDO would drop its 232 listed clients.

Other senior executives at the top six firms are deeply concerned that a forced break-up of their businesses would cause significant disruption for the firms and their clients, with one executive saying there would be a "bloodbath". David Sproul, chief executive of Deloitte, told the *Financial Times* in March that creating audit-only firms "would be to the detriment of the capital markets".

Grant Thornton, the UK's fifth-largest accounting firm, said: "We fundamentally do not believe that this is the solution to the existing systemic issues in the audit market."

Accounting executives also argue that a forced break up of audit firms in the UK alone would be ineffective and messy without similar initiatives from international regulators.

'The Big Four are big beasts'

Mr Michael said: "The [Big Four] are big beasts because there are big global companies. There will still be big, complex, hairy companies around the world [even after a break-up]. If you want to split the firms up that has to be done internationally, although maybe the UK could lead the way."

But many academics, politicians and shareholders support calls for a break-up to tackle the dominance of the Big Four, which audited all but nine of the UK's 350 largest listed companies last year, despite the introduction of sweeping reforms aimed at reducing their hold on the market.

Vince Cable, leader of the Liberal Democrats, said the "only way" to improve competition was to break them up. "Unless you do that, three or four companies will continue to completely dominate," he said.

Natasha Landell-Mills, head of stewardship at London-based asset manager Sarasin & Partners, who has previously called for a break-up, said: "In the past, the audit firms argued strongly that mandatory audit firm rotation would lead to weaker audits and potentially chaos. This has not transpired.

"[A break-up] would be difficult for the accountancy firms' business, but that doesn't necessarily mean it would be bad for the public interest."

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