



The American Antitrust Institute

BIG 4 AUDIT FIRMS: BACK IN THE SPOTLIGHT

by **Bernard Ascher**

April 14, 2011

The Big 4 audit firms are back in the news, but the scene has shifted to London and Brussels, where inquiries are questioning the role of the audit industry during the financial crisis of 2008. On March 31, the UK House of Lords released an extremely critical report, charging the audit firms with “complacency” and “dereliction of duty” in not detecting financial problems of the banking industry and not sounding an alarm. The report calls for an investigation by the UK Office of Fair Trading of the highly concentrated audit industry. In Brussels, the European Commission is in the midst of an in-depth investigation of the audit industry based on a Green Paper issued last October.

The Big 4 accounting firms - PricewaterhouseCoopers, Deloitte, Ernst & Young, and KPMG - audit the financial statements of nearly all of the world’s large public companies (those with annual sales of over \$250 million). Arguably, they are the only audit firms capable of doing so, because of the reach of their global networks and their vast resources (collective earnings over \$100 million last year and 600,000 employees worldwide).

The UK and EU investigations bring to the surface a number of issues facing the industry and its regulators. In addition to the dominance of the industry by the Big 4, these include the lack of communication between auditors and regulators; the need for improving the quality of audits to make them more transparent and meaningful; determining the proper role for auditors in a potential financial crisis; whether bank loans contain restrictive covenants, making loans contingent upon the borrowers’ use of a Big 4 audit firm; and the basic fear that loss of another firm like Arthur Andersen (after the Enron scandal in 2002) would severely disrupt financial reporting in the business world.

The European Commission’s investigation of the audit industry could result in European-wide rule changes. At a conference in February, Internal Market Commission Michel Barnier indicated that new measures are needed to bring greater choice into the audit market which is “hyper-

concentrated.” Several possibilities have been suggested, including limits on the market share of the large accounting firms and joint auditing, where work would be shared between a Big 4 firm and a non-Big 4 firm. Other suggested options are restrictions on the extent to which firms could combine audit and non-audit roles; a regular rotation of audit firms; and regular competitive tendering for audit work. Barnier is seeking to propose a directive this November. He concluded his presentation at the conference by stating, "The status quo is not an option for the auditing world. It's not about changing for the sake of change, but to reply to very real needs which we can no longer ignore."

Meanwhile, in the United States, where audit industry issues were not addressed in financial reform legislation and were barely mentioned in the report of the Financial Crisis Inquiry Commission, a subcommittee of the Senate Banking Committee held a hearing on April 7 regarding the role to be played by the accounting profession in preventing another financial crisis. During the hearing, James Doty, newly appointed chairman of the Public Company Accounting Oversight Board (PCAOB), indicated that several pending investigations of audit firms may lead to disciplinary actions against the firms and individuals. The Sarbanes-Oxley law, which created PCAOB, requires that these proceedings be kept confidential. Otherwise, the only high-profile action pending is the New York State case against Ernst & Young for its audit role in the bankruptcy of Lehman Brothers.

The American Antitrust Institute (AAI) is concerned about concentration in the audit industry and has expressed its concerns in several papers posted on its website (<http://www.antitrustinstitute.org>). Those postings include:

Ascher, Bernard, “The Audit Industry: World’s Weakest Oligopoly?,” AAI Working Paper #08-03, August 2008, available at [AAI Working Paper 08-03: The Audit Industry: World's Weakest Oligopoly?](#)

Ascher, Bernard and Foer, Albert A. , “Financial Reform and the Big 4 Audit Firms,” AAI Working Paper No. 10-01, January 2010, available at [AAI Working Paper 10-01_010720101109.pdf](#)

AAI Provides Public Comments to EU on the Audit Industry, December 2010, available at [Green Paper Comments from AAI.pdf](#)

Ascher, Bernard and Foer, Albert A. , “Audit Firms: Too Few to Fail,” March 10, 2011,
available at [Audit firms commentary.pdf](#)

Corporate Crime Reporter on AAI's Commentary on Audit Industry, March 14, 2011,
available at [ccr audit firms.pdf](#)