Competition and choice in the audit market

Key messages

- Large global accounting networks have emerged in response to the demands of multinational companies which require their auditors to have a similar global reach and consistent auditing expertise around the world. Over many years, those networks have invested substantially in developing the necessary tools and skills to meet the market’s demands for high quality audits across the world.

- Multinational companies are sophisticated buyers that typically have access to at least four well-resourced, experienced and respected suppliers and regularly exert significant purchasing power in choosing and negotiating with their auditors.

- The large networks compete intensively on industry expertise, innovation, quality and cost, all of which are regularly reviewed by audit committees or their equivalent.

- We support reforms which would allow other market participants to grow and develop, such as changing rules governing firms’ access to capital, reform of regulation around auditor liability, and bans on restrictive ‘Big Four Clauses’.

- Measures designed to artificially constrain existing large global networks are inappropriate and will likely limit a company’s choice of auditor, reduce competition and restrict continuous quality improvement.
What is the challenge?
There are at least four large accounting networks around the world competing to provide audit services to the largest most complex organisations. Some question whether this provides enough competition.

Others comment on the extent of concentration in particular specialised market segments or industry sectors; that the market could not withstand the collapse of another large accounting network; and that the four largest networks, the so-called Big Four, each use their market power to dictate terms to existing or prospective clients.

It is also suggested that investment by the largest networks in new methodologies, technology and people throughout the world to improve service and meet market needs, has created a gap between the largest networks and other smaller networks and firms which is hard to bridge in the short term.

Certain measures have been suggested to encourage smaller networks and firms to grow over a period of time, broaden their global reach, and acquire the appropriate skills and expertise to better compete in the audit market for large complex organisations.

Proposed market interventions include mandatory firm rotation, so-called 'audit-only' restrictions on the largest audit networks and joint audits.

Why is this important?
Audits of public companies provide investors and other users of financial statements with confidence in a company's reported financial information. In so doing, they serve the public interest by facilitating the efficient and effective operation of the capital markets. Competition in respect of quality helps make sure that the public interest is continuously well-served and price competition ensures that audit services are provided cost effectively. Artificial market interventions such as mandatory firm rotation or 'audit-only' restrictions on the largest audit networks, particularly where there is already intense competition, may lead to significant adverse consequences - lower quality, less innovation and reduced efficiency resulting in higher prices.

Where are we now?
Large, multinational companies have specific and ever-changing needs that reflect their complexity, geographic reach, industry and growth strategies. Those companies, and their shareholders, demand quality and value from their auditors.

As in all competitive markets, companies, or those charged with governance, exercise their buying power by choosing the provider that can best serve their needs and the needs of their stakeholders. But the audit market has specific characteristics that make it different to most:

- These purchasers of audit services are among the largest and most sophisticated buyers of services in the world.
- The internal process through which large companies select and reappoint their auditor involves more scrutiny and a higher level of corporate governance than for any other business service, with an annual shareholder vote often required to confirm the appointment.
- The audit firm’s service, quality and value proposition are under regular review by the company, its audit committee and the audit firm’s regulator. There is significant formal and informal information available with which to assess the performance of audit firms, and in many territories there is public, transparent disclosure of audit fees.
- There is an ever present threat of tender which gives the company real bargaining power. In fact, purchasers have regular opportunities to exert their buyer power both inside and outside of the tender process - for example, in many territories the auditor appointment is reviewed annually.
Over many years, the largest audit firms have responded to the demands of this market by developing their global networks and investing around the world in new and existing markets, tools, methodologies, industry expertise and talented people to meet those needs.

For example, the PwC Network: has invested hundreds of millions of dollars in the development and roll-out of a new proprietary global audit software tool that will help further improve quality on even our most complex multinational clients; trains over 60,000 audit professionals annually at a significant cost; and maintains global systems to provide controls over audit quality and compliance with many independence requirements - both those imposed externally and those required by PwC internal policy.

The investment required and the need for auditors to be large and sophisticated to participate in this market has inevitably affected potential entrants. In particular, the structure and form of the larger global accounting networks, which allows the movement of staff and expertise between territories to address company requirements, is not easily matched by the smaller networks.

However, there is strong competition amongst the largest global accounting networks on many factors including quality, innovation, industry and technical expertise, geographic reach and price to name a few. They actively target each other’s clients and constantly strive to improve their own services.

As far as market concentration is concerned, in certain geographic or industry segments the specialist expertise that has built up in particular audit firms has had the effect of reducing the number of firms that actually perform audits in those segments at any particular time. However, that does not constrain companies from asking other firms to serve them, other firms from choosing to make investments in specialised expertise, or those other firms accepting the engagements and making use of expertise from elsewhere in their network.

What does PwC believe?

Competition among audit service providers is good for everyone. PwC believes:

- The market today demonstrates characteristics and outcomes that reflect a fiercely competitive market, for example, pricing pressure and the insistence on continuously delivering a quality high-value audit are both significant in the current market.
- Integrated multidisciplinary firms are critical for the performance of quality audits, especially of large multinational companies. As companies and accounting principles become more complex and global, the need for many different kinds of expertise in the audit process becomes increasingly important to deliver quality audits and value to shareholders - audit firms that do not have these skills cannot deliver the service required.
- For large corporate buyers, the presence of at least four suppliers provides ample competition. Smaller 'large companies' may also be well served by firms outside of the Big Four, further increasing choice.
- We recognise concerns over the impact of another audit firm collapse, but suggest that significant changes in regulation, in independent oversight by both regulators and those charged with governance since Arthur Andersen’s disappearance, and the heightened organisational and behavioural discipline of modern audit firms and networks reduce the likelihood of another large audit firm collapse.
- With the shifting of economic power, for example toward China and India, new large audit networks may well emerge. We urge regulators to continue discussion about what reforms would encourage and foster these entrants whilst maintaining or enhancing audit quality.
Point of view

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PwC welcomes competition from existing and new firms, but not via artificial market interventions that would: firstly, undermine the competitive process by limiting choice and reducing quality; and secondly, put undue restrictions on the very scale required by audit networks to invest in audit quality and effectively serve the capital markets.

PwC supports measures that encourage further natural competition:

- Changing the rules governing who owns audit firms to increase firms’ access to capital and reform of the regulations around liability, so new firms and existing non-Big Four firms can grow and compete more easily
- Banning restrictive measures required by some lenders, sometimes known as ‘Big Four Clauses,’ which deny companies the opportunity to consider smaller audit firms
- Mutual recognition of auditor qualifications across geographic borders, for example a single ‘European passport’ for auditors which would be beneficial to the audit of large complex groups, facilitating the mobilisation to appropriate places of people with the necessary expertise and specialised knowledge, and potentially allowing more firms to compete across borders

- Development and strengthening of independent national regulatory oversight of competition in audit markets around the world. We believe national competition authorities are best placed to investigate and address any genuine future concerns about competition in the audit market rather than disproportionate international audit regulation.

Allowing other smaller firms to compete without unfairly restricting the largest audit networks will have a more positive effect on the market than imposing artificial constraints on the largest audit networks, which are likely to have a negative impact on audit quality.

In summary

Large accounting networks are necessary to perform quality audits of the financial statements of multinational companies. There is already sufficient choice available of, and intense competition among, large networks which encourages high quality audits, efficient services and competitive pricing.

Purchasers of audit services for large companies recognise this and choose to appoint auditors who they believe will offer them the best service. In response to these competitive pressures, the largest audit networks have made, and continue to make, significant investments to maintain or improve audit quality. We support measures that would allow smaller audit firms and their networks to make similar investments necessary to compete in the large audit market. This will provide greater choice for companies and increased competition.