Economic Model of the Firm

Brian Hunt, Chief Executive Officer of the Canadian Public Accountability Board, moderated the session with the following panelists: Paul George, Executive Director, Conduct, Financial Reporting Council; Fod Barnes, Senior Adviser, Oxera; and Nicolas Veron, Visiting Fellow, Peterson Institute for International Economics and Senior Fellow, Bruegel, Brussels. The presentations focused on how the economic model of the audit firm is evolving and whether these changes may have a negative impact on audit quality. At the outset, one panelist stated that under the current structure, approximately forty percent of revenues of the global networks come from audit fees, however in many countries this number is shrinking due to the growth of advisory and legal services. Recent acquisitions of consulting firms among the major global auditing networks include EY (acquired 9 firms); KPMG (acquired 10 firms); Deloitte (acquired 17 firms); and PwC (acquired 7 firms). Another panelist stated that there is no usable financial or structural information in the public domain on global networks except revenues sliced by geography and business lines. This contrasts with other industries like banking, broker dealers, and other financial sectors, which have a great deal of public disclosure enabling public discussion and evaluation. Audit regulators are limited in their abilities to evaluate the economic model of the firm because of the lack of transparency.

The panel discussed three areas where a negative impact on audit quality potentially could occur:

1) Governance and tone at the top. While CEOs of the global networks were traditionally promoted from the audit practices, many of the current CEOs have emerged from the consulting practices. Leadership interests could influence the direction of the firm and alter its priorities.

2) Impact on the talent pool of audit professionals. The most talented students and young employees may be drawn away from audit by the arguably more varied, exciting work performed by the firm’s consulting practices.

3) Consulting subsidized audit. There may be a growing trend of more profitable consulting practices subsidizing the firms’ audit practices. This raises questions about whether the firms will eventually split, and whether any of the Big Four audit firms might exit the audit field.

The panelists and IFIAR Members agreed that the economic model of the firm needs further study. Of particular interest may be how to increase competition. It was noted that the big firms can easily increase concentration by acquisition of smaller firms, but there appear to be insurmountable hurdles for the next tier firms to grow.