

Big Four takeovers raise concerns

By JEFF BUCKSTEIN

KPMG's recent acquisition of American hedge fund consultant Rothstein Kass and Zanett Commercial Solutions Inc., a business and technology consulting company, has continued the trend toward Big Four accounting firms offering more services — and raising concerns about compromising audit independence.

"The Big Four have historically expanded their operations into consulting and advisory services. If one firm does it the others do it to maintain some sort of competitive parity," said Mark O'Connor, chief executive officer and co-founder of Monadnock Research of Gloucester, Mass., which provides research on management and IT consulting industries.

Other notable transactions over the past couple of years include PwC combining with global consulting firm Booz & Company earlier this year, and Deloitte acquiring global strategy consulting firm Monitor Company Group in 2013.

"If you have a firm that is trying to get on the good side of its auditor, what better way to do it than to say 'we'll expand our revenues with you as a firm' ... [But] it's a business model that's built on conflict," said O'Connor.

He cited the fate of the now defunct audit giant Arthur Andersen's relationship with Enron Corporation as the result of a worst-case scenario.

Enron's collapse in late 2001 was a major catalyst to the enactment of key legislation, most notably *The Sarbanes-Oxley Act* of 2002, which contains explicit prohibitions against a number of non-audit services being provided to audit clients. They include the design and implementation of financial information systems, bookkeeping or similar services related to the accounting records or financial statements, internal audit outsourcing, appraisal or valuation services, actuarial services, and legal services unrelated to the audit, among others.

The particular focus of concern at the time of Enron was on IT technology consulting, systems implementation strategies, internal audit outsourcing and other types of strategic accounting such as setting up off-balance-sheet vehicles. That focus has changed as Big Four firms try to compete with large strategy firms, said Francine McKenna, a freelance business journalist and certified public accountant based in Chicago, and author of an online blog about auditors.

Jane Kinney, Canadian managing partner for quality and risk with Deloitte Canada in Toronto, said the underlying conditions that led to *Sarbanes-Oxley* are being closely watched for in today's environment.

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more than 10 years now. The percentage of work that would be done in our consulting practice for audit clients is extremely small," she said.

Moreover, sometimes even non-audit work that is allowed still won't get done because clients don't want their auditors to do it. "Board [members] and executives don't look to their auditors for strategy services. So the concerns around providing large-scale consulting services to audit clients are not really based on what's actually happening. We're not being hired to do that work for audit clients," Kinney said.

McKenna said the Rothstein Kass acquisition is an interesting move for KPMG because Rothstein Kass has earned success, along with a good reputation, sticking to a niche involving broker dealers and hedge funds. This could help KPMG expand in those areas, she noted.

But she questioned whether this merger will allow the former Rothstein Kass personnel to continue to operate within KPMG on such a concentrated basis.



McKenna

"The problem with the four large firms is that no one who has specific expertise is really very special, because they're just too big. KPMG has found a good firm that has a very strong focus in a niche. But the bigger issue is 'will they really see a longer term benefit from them?' Because when you fold a firm like that into [a much larger company], you sort of dilute that focus that's made them successful," McKenna said.

KPMG was asked to comment about the Rothstein Kass acquisition, including potential independence concerns, but a spokesperson only mentioned that

the firm "performs the necessary due diligence to execute each transaction and adheres to all independence requirements."

Kinney said that when Deloitte acquired Monitor in 2013, it added strength to continue what it had already been doing, and she dismissed fears about audit independence being compromised by a prospective spillover of prohibited services to audit clients. "It's very clear what the prohibited services are. That's the law. But outside of those prohibited services it is possible to provide non-audit services to audit clients," she noted.

However, in order to do even that, barriers exist. Activity needs to be pre-approved by members of boards or the audit committees. And in practice, clients can be much stricter than the law, with their own internal policies being much more restrictive about what services are provided and by whom, Kinney said.

In fact, "a number of our clients would prohibit all non-audit services from Deloitte when we're the auditors, and that's pretty normal in the marketplace. So the marketplace has gotten ahead of the actual law from our standpoint. [For example] in some cases clients would prohibit the auditors from providing any tax service. That's not [legally] prohibited, but the clients would say 'we want to use another firm rather than our auditors,'" she said.

Deloitte also has internal safeguards in place to ensure independence is maintained, including a policy stating what its members can and cannot do, with all employees and partners being required to sign off on having read and understood those requirements. There is also mandatory training, Kinney explained.

"Auditor independence is — and should continue to be — a central topic for the profession to concentrate on. Advisory, or what some might call consulting, is a huge piece of that," said Anne-Marie Hubert, advisory services managing partner at EY Canada in Montreal.

"As professional service providers, we are continually evaluating ourselves to ensure we're providing not just what our clients need today, but the services they'll need tomorrow, too. By providing advisory services with appropriate oversight and consideration of independence threats, we can help our clients to succeed, and empower our

people to develop and continue to meet expectations."

Although independence rules in the U.S. and Canada are detailed and complex, the substance between the two countries is pretty much the same, said Kinney, who noted that auditors in Canada are guided by both Canadian Securities Administrators standards as well as the profession's independence standards.

The Canadian Public Accountability Board (CPAB), which has jurisdiction over Canadian audit firms, was asked to comment about perceived audit independence threats. "This is an area CPAB will be watching over the next 12 months, and will be able to comment [about] at that time," said Adrienne Jackson, the oversight board's director of communications in Toronto.

O'Connor was critical of the regulators' role south of the border when it comes to monitoring audit independence.

"Having regional regulations that address this are key. But I'm not sure they're going to be sufficient without enforcement and from everything I've seen in the

United States, enforcement of regulations has been insufficient," said O'Connor.

He alleged, for instance, that while there appears to be much corporate shareholder litigation activity, the U.S. Public Company Accounting Oversight Board (PCAOB), which oversees the audits of public companies, rarely examines the conduct of auditors publicly.

A PCAOB spokesperson told *The Bottom Line* that the PCAOB inspects for and enforces the independence rules of the board and the Securities and Exchange Commission, and that part of this inspection process involves closely monitoring the activities of Big Four accounting firms, including their recent acquisitions over the past couple of years.

"We take seriously all allegations of serious audit misconduct — including potential independence violations. Where there is evidence of significant risk to investors, we do not hesitate to investigate fully and, where appropriate, take disciplinary action. However we are unable to discuss ongoing investigations," said the spokesperson, who noted that pending disciplinary proceedings must remain non-public under *Sarbanes-Oxley* unless the auditor consents to a public proceeding, which none have done.

The PCAOB has asked the U.S. Congress to change that law and make disciplinary proceedings public, the spokesperson added.

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