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Feel the Churn: Big 4 Get Squeezed on Audit Engagements

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Tammy Whitehouse | September 1, 2015

Whether it is a natural cyclical shift or a fallout from regulatory pressure on the audit profession, Big 4 firms are losing corporate audit engagements to smaller firms.

Data from Audit Analytics over the past few years shows Big 4 firms as a group have lost more clients than they've signed on, while second-tier national firms and regional firms are gaining more clients than they are losing. In the first half of 2015 alone, Deloitte is the only Big 4 firm to win more clients than it lost, but by only one. The firm picked up six clients from other Big 4 firms and four from national firms, but lost nine clients overall: two to other Big 4 firms, five to national firms, and two to regional or local firms.

KPMG signed nine new clients in the first half of 2015, but lost 15, mostly to national and regional firms, for a net loss of six engagements. PwC added two clients but lost 12, four to other Big 4 firms and the rest to national or regional firms. EY took the biggest hit in the first half, winning five new engagements but losing 22 for a net loss of 17 audit jobs.

Among the national firms, BDO and Grant Thornton won a combined 22 engagements away from Big 4 firms,

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although they also lost eight jobs to the Big 4. BDO ended the half up nine clients, and Grant Thornton was up a net two new engagements. The churn in 2014 was similar. Big 4 firms lost a total of 64 engagements while national firms picked up a net 55 public company clients. KPMG won a net 15 engagements in 2014, but Deloitte lost eight net jobs, while PwC lost 28 and EY lost 43 on a net basis.

Drawing conclusions on why the shift is occurring is not easy, but audit experts at non-Big 4 firms point to several factors, including regulatory pressure, fee pressure, and a changing economy. Big 4 firms did not respond to requests to discuss the data.

Deiso

"It's never the result of one thing," says Phyllis Deiso, a partner and national SEC practice leader at McGladrey. "We're a regulated industry and we're very reactive to our regulators and their comments. Audit procedures never decrease, only increase."

As costs rise—both the direct cost of the audit and the indirect internal costs to comply with audit requests—some companies are at their breaking point, looking for alternatives, Deiso says. "I don't think I've ever been involved in a proposal situation or talked with an audit committee where fees and cost were not some component of the dialogue," she says.

Pete Bible, a partner at audit firm EisnerAmper, which has a net gain of five engagements over the past 18 months, says fees are clearly an issue.

Bible

"Some believe that the inspection process has led to over-auditing by the large firms, especially in the area of internal control over financial reporting," he says. "The national office phenomena—where a company's financial statements will disappear into a black hole and come back with all kinds of changes that are not negotiable—is always a concern when we meet with companies."

"When the economy is weak, the larger firms have capacity, so they reduce prices to get into the middle market. When the market comes back, clients start to realize they are underserved from a client service perspective. What we're seeing is a continuation of that trend."

Trent Gazzaway, National Managing Partner, Grant Thornton

Bible and others do say the shift by some companies away from Big 4 firms is sometimes by the company's choice, but also sometimes by the audit firm's choice as well. "The gate swings both ways," he says.

Inspection Reports

Amid a string of harsh audit inspection results from the Public Company Accounting Oversight Board, the Big 4 firms may be looking to shed riskier clients. "We've been told by prospective clients that the risk profile of the client doesn't continue to meet the risk parameters of the audit firm," Deiso says.

Trent Gazzaway

GAINS & LOSSES

Audit Analytics analyzes gains and losses for large accelerated filers, accelerated filers, and smaller reporting companies in 2015.

Gazzaway, national managing partner at Grant Thornton, says (not surprisingly) that companies find firms just below the Big 4 provide better client service and more attention from the engagement partner and managers.

"It has a lot to do with the leverage model," he says. "When the economy is weak, the larger firms have capacity, so they reduce prices to get into the middle market. When the market comes back, clients start to realize they are underserved from a client service perspective. What we're seeing is a continuation of that trend."

Arnie Hanish

In the following tables, we disaggregate the auditor changes by the size of the companies gained or lost, as represented by the companies' filing status. The first table shows auditor changes for Large Accelerated Filers, i.e., those with a worldwide public float of more than $700 million.

Large Accelerated Filers: Q2 2015 Client Wins and Losses

Firm	Wins	Losses	Net
Deloitte & Touche	6	1	5
Grant Thornton	4	3	1
BDO USA	2	1	1
KPMG	3	3	0
PwC	1	5	-4
E&Y		5	-5
Total	**16**	**18**	**-2**

Deloitte led the Big Four accounting firms, with a net gain of five Large Accelerated Filers in the second quarter of 2015.

The next table presents wins and losses for Accelerated Filers, which are companies with public float between $75 million and $700 million.

Accelerated Filers: Q2 Top 5 Net Gains and Losses

Firm	Wins	Losses	Net
Hein & Assoc.	3		3
Moss Adams	2		2
McGladrey	2		2
Crowe Horwath	2		2
Deloitte & Touche	2	1	1
KPMG		2	-2
PwC	1	3	-2
E&Y			-2
7 others tied		1	-1

Hanish, chairman of the audit committee at public company Omeros and retired as chief accounting officer at Eli Lilly, says cost is definitely a factor when considering hiring an audit firm—but not the only factor. Inspection results are interesting as well, but not conclusive.

"When you're thinking about changing an audit team or firm, you also need to look at the service level and the degree of expertise that firm brings to the table," he says. "It's not all about fees, or the results of studies, or inspection reports. Those are important data points, but it's not all about that."

Hein & Associates had another good quarter. The regional firm recently placed in the Audit Analytics 2014 ranking of the Top 50 Auditors Ranked by Total SEC Registrants.

Finally, the last table presents the top five gains and losses for Smaller Reporting Companies.

Smaller Reporting Companies: Q2 2015
Top 5 Net Gains and Losses

Firm	Wins	Losses	Net
MaloneBailey	37	1	36
Gillespie & Assoc.	8	2	6
Marcum/Marcum Bernstein & Pinchuk	13	7	6
BDO USA	5		5
RBSM	4		4
M&K CPAs		5	-5
Anderson Bradshaw		6	-6
De Joya Griffith	1	8	-7
Harris & Gillespie CPAs		10	-10
Terry L Johnson CPA	1	21	-20

Source: Audit Analytics.

Carcello

Joe Carcello, executive director of the corporate governance center at the University of Tennessee, says it's not clear from the available data whether companies are migrating away from the Big 4 over cost, quality, service, or any other reason.

It is interesting, Carcello says, that Deloitte, which has posted the least-unfavorable inspection results the past few years, is also experiencing the least client loss. EY, on the other hand, has suffered the most unfavorable inspection outcomes among the Big 4, and seen the biggest loss in clients. In the middle, however, the data with PwC and KPMG do not correlate as neatly.

"It's a big unknown," Carcello says. "It would be wonderful if firms that at least appear to be doing higher-quality work were being rewarded in the marketplace, but we don't know whether this switching or change in behavior is happening because of quality or fees. It's hard to make any strong inferences."

Ramamoorti

Sri Ramamoorti, an associate professor at Kennesaw State University and a director in its corporate governance center, says many national firms employ former Big 4 audit partners, especially after the demise of Arthur Andersen—so the tier below Big 4 is a more viable alternative than it has been historically. "When Andersen was around, there was a lock on the Big 5," he says. "Smaller firms couldn't get in. That assumption needs to be vigorously challenged in today's world."

Pinnell

And vigorously challenged it is, says Wayne Pinnell, managing partner at regional audit firm Haskell & White. "Our fee structure is generally more friendly, and it is coupled with more attention from senior members of the team," he says. "Coming out of the recession, everyone has gotten a little busier, so the Big 4 have increased their fees. Companies are trying to fight back and are looking for alternatives."