
I. OVERVIEW

I find it rather difficult to characterize the purpose of this book and its intended audience. Certainly, the book was not written with academic readers in mind. This is clear from the title with the dubious and pejorative reference to the Big 4 firms as “the global accounting monopoly.” Moreover, early in the book (pp. 9 and 10) the authors distance themselves from the academic literature in auditing, which is described as “narrow and a-historical” and typically “reverential” and “non-confrontational” toward the Big 4 firms. Moreover, (many) accounting academics are themselves tarred with the term “idiot savants” (p.10). I suspect then, that the book is intended for a general audience that has an interest in business topics and who might also be attracted to (virtual) bookstore offerings with titles like *The Coming Global Catastrophe* or *How to Make a Hundred Million without Really Trying*. Such readers would know next to nothing about auditing—or accounting for that matter—but might recognize “the Big 4” from news articles about fraud and corporate malfeasance with which the names of these firms are periodically associated.

Since readers of The Accounting Review are by-and-large academics, what can we learn from this book? My short answer is—not too much. When reading it, I felt that I was listening to the voice of someone who had worked a short time for a Big 4 firm, had very bad experiences there, and was bent on obtaining a bit of revenge. For example, the daily routine of a junior auditor is described as “dull and repetitive” (p. 113) and the function of auditing is supposedly “low status” and “deprecated” inside the firms. Further, it is claimed that, “[m]ost graduates view a stint in auditing as a stepping stone to something else. Anything else.” Personal experiences vary, but—by contrast—I view the four years I spent on the audit staff in the Chicago office of Ernst & Ernst (albeit, in an earlier era) as interesting, fun, and crucial to my personal development. I am sure many others have had similar positive, more recent experiences in one of the Big 4 firms.

Probably the strongest features of the book are the broad histories of the individual firms and some of the key players in those histories, as well as the history of the profession as a whole. The authors recognize the crucial importance of the changes that occurred during the 1970s following the U.S. Department of Justice’s decision that anti-trust legislation applied to the sale of professional services—not just to trade in goods. The resulting transition of public accounting from a somewhat amorphous “professional” orientation to an economics-based “business” orientation is well known. The authors do a reasonable job of describing the ensuing cultural changes within firms; the rise, fall, and rebirth of management advisory services; as well as a particularly interesting discussion of the less well-known controversies surrounding taxation consulting. The pervasive weakness of the book is the authors’ analysis of these controversies, which comes across as sensationalistic and amateurish. Given their disdain for the academic literature, this is not surprising.

Before considering some of these issues in more detail, I should comment on the history of the Italian Medici Bank that is discussed at length in the book as analogous to the history of the Big 4. While I found this to be of some initial interest—particularly the idea that the Medici family pioneered the franchise model of partnerships to limit their legal liability—by page 190 the analogy is stretched beyond breaking and the discussion is more annoying than helpful.

II. THE SUPPOSED CULTURE OF THE BIG 4

In Chapters 7 and 8, the authors provide their “take” on how the Big 4 firms operate. The reader can guess that this will not be approbation when the organizational structure is initially compared to that of the Mafia, where the “earnings flow from the
most junior thug upward” (p. 83). This is meant as a description of a firm’s staff leverage—the ratio of more junior staff to partners. The fact that large public accounting firms have traditionally had pyramidal organizations with a broad base of junior staff is certainly true, although technology and outsourcing may well be shrinking the base. Rather than provide a reasoned analysis of the costs and benefits—either to the firm partners or the staff members themselves—of maintaining a mix of staff with various levels of experience, the authors recount instances where staff with inadequate skills contributed to audit failure, client complaints about seeing too many junior staff rather than the partner who sold the job, and several personal anecdotes in which former Big 4 staff complain about constant evaluation and review of their work. The tone of these chapters—and, in fact, the book as a whole—is well conveyed by quotations from some staff member’s resignation letter that “went viral” and complained that “her job … involved filling out useless workpapers that didn’t benefit anybody” and that “auditing was for people who truly don’t have any other options” (p. 107).

Much of the discussion of Big 4 culture concerns firm partners. While some of the caricatures of partner types—Lifers, Technicians, Super Partners, etc.—are amusing to read (p. 86), I am not sure they convey anything useful. In fact, acknowledging the existence of these various types is seemingly inconsistent with other claims that the selection of Big 4 firm partners involves a “curious mixture of personal attributes” (p. 85) that results in partners who share strong similarities. Obviously, the selection of a fellow partner in a partnership organization will be a highly personal process during which the incumbents consider the incremental net benefits of this person to the firm. I suspect that this process is essentially the same in a Big 4 firm as it would be in a non-Big 4 firm or a firm of architects, lawyers, or consultants, and that similar amusing tales could be told about the partner selection process in these firms—maybe even about the promotion of accounting academics!

III. AUDITING AND PROBLEMS OF INDEPENDENCE

Chapters 9 through 12 are (to me) the core of the book, in the sense that they touch on serious issues that have been of interest to academic researchers for many years. These chapters cover the nature of auditing, conflicts arising from the auditing—consulting nexus, tax advisory work, and the problems of the Big 4 firms in penetrating the China market. Unfortunately, as with most of this book, the discussion is largely shallow and sensationalistic. Consider this characterization of the “seven deadly sins of traditional auditing” (p. 149) as “Lapdog. Slacker. Innovation killer. Nitpicker. Red-tape tangler. Under-deliverer. Hollow ritualist.” These sound more like quotes from a Donald Trump Twitter rant than even a semi-serious analysis for a general audience! The discussion in these chapters is largely built around the many cases of “audit failures” (McKesson & Robbins, Colonial Bank, Westec Corp., Enron, Lehman Bros., etc.) that are well known and more carefully examined in places such as the casebook by Knapp (2013).

One of the more glaring weaknesses in the authors’ discussion of the audit service is their apparent inability to comprehend (or perhaps accept) that an audit opinion is in the nature of a statistical confidence interval that true financial information falls within some bound (materiality) of reported financial information with a high probability (reasonable assurance). They denigrate this idea with comments like “the accounting profession had so defined auditing that it was a job at which no one could ever fail” (p. 130). Of course, an audit firm can indeed fail at this job if it incurs a rate of audit failure that is unreasonably high—particularly when compared to its peers (Arthur Andersen & Co. in the 1990s?). Conversely, the authors also never acknowledge that some rate of audit failure (i.e., providing an unqualified opinion on materially misstated financial statements) is expected and built into the system—as must be the case in the absence of perfect (and prohibitively expensive) audits! This normal or expected rate of audit failure is particularly galling to the authors when auditors fail to detect management fraud. They (correctly) point out that most frauds that come to light are not detected by auditors, but by other parties including whistleblowers, financial analysts, regulators, and others. But rather than provide insights as to why this might be the case—such as the fact that Type I errors (falsely accusing a client of fraud) are easily committed and would be very costly to an auditor—they again lay the blame on the Big 4’s “leveraged professional services model that involves sending out junior and less experienced staff to do the work” (p. 135) and other features of normal auditing, such as the use of sampling.

The authors’ discussion of the joint performance of auditing and management advisory services for the same client is also superficial. There is no recognition of the difficult-to-evaluate trade-off between economies of scope and possible threats to independence. Also, there is no recognition of the fact that the performance of virtually all management advisory services for audit clients was effectively banned in the U.S. by the Sarbanes-Oxley Act of 2002 (annoyingly referred to as Sarbox) and in virtually all other countries through the post-2002 ethical requirements of the International Federation of Accountants. Instead, the authors decry the “commercialization” of public accounting, the poor performance of junior staff “who are inculcated to appease clients and neglect wider social interests” (p. 143), and the (unexplained) weak incentives of the Big 4 firms to maintain the value of their brands, since the rejection of one Big 4 firm by a company’s audit committee would lead to the hiring of “another Big 4 firm with a similarly dismal record of performance” (p. 146).
IV. THE SUPPOSED BIG 4 AUDITING MONOPOLY

This brings us to the notion that the Big 4 firms have monopoly power in the market for audit services for (presumably) large corporations. This is explicit in the book’s title and implicit in the previous quote. Moreover, the quote implies a degree of (at least tacit) collusion, since the Big 4 presumably just play “musical chairs” with clients. While the authors do not claim collusion among the Big 4, they do decry a supposed lack of competition. For example, they say:

Accountancy is notably less competitive than other professions, such as law and engineering. Competition is especially weak in the market for audit services. (p. 4)

The authors’ source for this information is unknown. I suspect that the claim comes from conflating the fact that individual auditors are licensed professionals who have exclusive rights to perform assurance services, that there is a mandatory audit requirement for listed companies, and that large listed companies (in most countries—except perhaps China) utilize the Big 4 firms. As Nick Dopuch and I pointed out many years ago in our essay on the nature of competition in the auditing profession, competition in the audit services market for corporate audits is competition among public accounting firms not individual auditors, and the fact that auditors are licensed professionals, and the existence of a mandatory audit requirements are not relevant (Dopuch and Simunic 1980). Moreover, one cannot infer the state of competition in a market simply from the structure of the industry. Indeed, economic theorists in industrial organization have shown that even a duopoly of two suppliers can lead to a competitive market price, and well-functioning markets with two major suppliers are common, for example in the Canadian airline industry. While formal tests of price competition in auditing are few and the evidence dated (e.g., Simunic 1980), no one (to my knowledge) has demonstrated that the Big 4 firms collude or that audit pricing is not competitive. Indeed, probably the best way to describe the economic interactions of the Big 4 would be as spatial competition among non-colluding oligopolists. As such, the Big 4 firms have incentives to structure their operations to be “close” to clients in characteristics space (to be cost efficient), and to engage in intense price and non-price rivalry. With free entry into specific client locations by any of the Big 4 (e.g., specialized client industries), any economic rents earned would be quasi-rents, sufficient to earn a normal return on location-specific investments (see Chan, Ferguson, Simunic, and Stokes 2004). Finally, as an aside, if the Big 4 firms were merely playing “musical chairs” with clients, they would be indifferent to proposals for mandatory audit firm rotation—which is certainly not the case!

V. THE SUPPOSED PERILOUS FUTURE OF THE BIG 4

Unlike the authors of this book, I do not pretend to know what the future holds for public accounting, for audit services, or for the Big 4 firms. Like everyone, I can see that advances in technology are changing—sometimes for better and sometimes for worse—the world we live in. But in many ways “the more things change, the more they remain the same.” On that note, I recall taking an undergraduate auditing course at DePaul University in Chicago in the 1960s. Our professor opined that the IBM 409 accounting machine would make accountants obsolete. Well, punch-card-based information systems using the IBM 409 are long, long gone but—as far as I can tell—accountants are still around.

Like many authors who write books about business these days, Gow and Kells are fond of the term “disruption,” and the jargon that goes with it—the gig economy, Big Data, audit bots, etc. They opine that auditing may become a sub-branch of information technology (IT), performed by computer programs run by IT people, largely because “the repetitive work of auditing is well suited to robots” (p. 204). This returns to one of the major themes that underlie this book—the mechanical, mindless, boring, and essentially useless nature of audit work—and reinforces my belief (which could be wrong) that at least one of the authors had a bad experience working for a Big 4 firm. But I have taught an undergraduate auditing course, on and off, for the past 40 years—with considerable success. Rather than focusing on the mundane aspects of detail audit tasks, I discuss with my students the interesting and complex issues that arise when a for-profit business sells a service of unobservable quality to a client that seeks to influence the decisions of investors, creditors, and others, and in which the auditor’s effort is also essentially unobservable. This motivates a discussion of interesting topics such as ethics, regulation, legal liability, and auditor judgment. Also, I note that while tests of the existence assertion concerning transactions and account balances might well be performed by technology (an audit bot), the really important audit issues involve completeness, rights and obligations, valuation, and disclosure—for which audit skill, experience, and judgment are critical. Moreover, I acquaint my students with important findings from the extensive academic research literature in auditing—a literature that Gow and Kells should have mastered before they undertook writing this book.

REFERENCES


DAN A. SIMUNIC

Professor of Accounting

*Simon Fraser University and The University of British Columbia*