The new chairman of the UK's audit watchdog has called on the government to break up the Big Four accounting firms.

Simon Dingemans, who started at the Financial Reporting Council last month, told the Financial Times an enforced separation of audit and consulting at PwC, Deloitte, EY and KPMG was a “critical” measure to improve the quality of their audits.

“Operational separation of at least the Big Four, if not the bigger six firms, should be a centre piece of reforms driving audit quality improvements,” Mr Dingemans added. He likened his recommendation to the contentious “ringfencing” of UK high-street banks in a regulatory effort to make the financial system safer.

In a forthright interview — his first since taking on the job of transforming the troubled watchdog — the 56-year-old also denounced proposals by the Competition and Markets Authority, the competition watchdog, to introduce mandatory joint auditing in the UK. “Joint audits lead to duplications, confusion of responsibility and extra costs for no obvious added value,” he said.

He added that he was only concerned by the Big Four’s stranglehold of the listed audit market “if they are not robust”; said there needed to be a “stronger second tier” of accounting firms; and insisted that auditors are responsible for spotting fraud in company accounts.

Mr Dingemans, who left a £5m-a-year role as finance chief of GlaxoSmithKline, replaced City grandee Sir Win Bischoff at the helm of the FRC, while former
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Simon Dingemans

HMRC boss Sir Jon Thompson joined as chief executive, ending Stephen Haddrill’s 10-year-tenure. The watchdog’s former management team was forced to step down following a damming report into the regulator’s effectiveness.

The CMA first proposed the break-up of the Big Four in April as part of review of the audit sector and Mr Dingeman’s stance will increase pressure on government to back the competition watchdog’s recommendations with legislation.

Mr Dingemans, who will be paid £150,000 a year as FRC chairman, previously spent 25 years at Goldman Sachs, where he ran its European mergers practice, overseeing £411bn of deals. He became chief financial officer of pharmaceuticals giant GSK in 2011 and chaired the 100 Group, which represents FTSE finance directors, for two years until 2016. His career path has led to some doubts about whether he was the right person to deliver radical reform.

Following his appointment, the House of Commons business select committee said in a report it was “concerned that Mr Dingemans displayed a degree of scepticism about the extent and nature of the change needed”.

However, Mr Dingemans’ supporters said his experience of tightly regulated financial controls and work with investors meant he would be unafraid to make tricky decisions.
Decisiveness will be a key part of the job. The FRC has been the subject of persistent criticism that it is too slow to investigate misconduct, its sanctions too lenient and its board too close to the industry it supervised.

Its people, governance, funding arrangements and culture have all prevented it from properly policing the UK's auditors, critics have claimed. After the collapse of Carillion, Labour MP Rachel Reeves called it the “horse has bolted” regulator.

Last year, Sir John Kingman, the chairman of Legal & General who conducted a review of the FRC, described it a “ramshackle house built on weak foundations”. He recommended that it should be replaced by a new body called the Audit, Reporting and Governance Authority, which would be funded by a compulsory levy and have greater powers to sanction auditors and company directors.

Mr Dingemans said the FRC under the previous management team “was dealing with a fairly unmanageable brief and no powers or money to actually deal with them”.

He insisted that the government’s commitment to act on the findings of the Kingman review would allow him to create a “much bolder regulator with more energy”.
The government has already been criticised for delaying the legislation to replace the FRC. But Mr Dingemans said he is already working to implement the bulk of the 83 Kingman recommendations that do not require government action. These include overhauling its hiring practices and a commitment to publish more detailed grades for audit inspections of large companies.

The role of regulating the Big Four auditors, whose reputations have been damaged by a series of accounting controversies, including Carillion, BHS and Patisserie Valerie, will remain under heavy scrutiny.

As well as the sweeping changes proposed by the CMA review, Donald Brydon, former chairman of the London Stock Exchange, is expected to publish his review into the role and quality of the audit market in January.

“This is a rare opportunity to reform something so wholeheartedly,” Mr Dingemans said. “Now we have to distil all of the reports into a sustainable strategy for improving audit quality.”

Enhancing competition could be another matter. Mr Dingemans dismissed the idea of a “Big Five” audit market. “You’re not going to be able to create another firm of that global scale. The real question is how do you create better quality audits at the Big Four, how do you make those firms more sustainable and at less risk of collapse?”
The answer is partly by forcing financial separation of the largest firms, he said — and not necessarily waiting for government intervention to do so. “If they can see I’m going to have the teeth, then I can do a lot by waving the threat,” he said. “I would like to see the firms driven in to a discussion with us where we say, this is how [a split] is going to work.”

He said he would push accounting firms to separate out audit profits and set up “transfer pricing” deals to contract in specialists. “It would mean we could make sure those audit firms were robust and properly funded, and that they’re charging clients and paying partners appropriately.”

The move will inevitably lead to higher costs for listed companies. “Audit committees recognise fees will go up. Are they happy about it? No. But they acknowledge that it is necessary if you want a more vibrant and sustainable audit market.”

### Auditors’ fraud-busting role

Simon Dingemans is surprisingly unequivocal that an auditor is responsible for detecting fraud. Without hesitation, he responds with a clear “yes” when asked if it is the job of accounting firms to spot fraudulent activity in a company’s accounts.

That question has been at the centre of heated debate in the audit sector since January, when David Dunckley, chief executive of Grant Thornton, told a House of Commons committee that his firm did not look for fraud when carrying out audits.

Mr Dunckley was responding to questions about his firm’s work for Patisserie Valerie, the café chain that fell into administration following the discovery of a £40m accounting fraud. MPs responded angrily to his comments, with Labour MP Peter Kyle asking him: “If an audit company is not picking up on [fraudulent behaviour], what is the point of audit in the first place?”

The debate exacerbated tensions between what a company’s shareholders, employees and pensioners expect from an audit and the reality of an auditor’s legal responsibilities, which has become known as the “expectation gap” in the profession.

The apparent gap has dominated discussions about the need for reform following big corporate failures, including, most recently the collapse of Thomas Cook.

The extent to which auditors should be expected to detect fraud will form a crucial part of the review by Donald Brydon into the audit market. Sir Donald said in February that the issue needed greater clarification: “Is [it an auditor’s] job to be a policeman hunting for fraud? I think probably not. Should it be? Interesting question. There is a whole area to look at around fraud.”