

APPENDIX B – THE AUDIT FIRMS

1 There are approximately 15,000 entities, including about 1,200 international companies, that file financial statements with the SEC.¹ The financial statements included in those filings are audited by a variety of international, national, regional and local audit firms. The differences among the firms in terms of structure and service offerings, client demographics and size of practice usually result in their being stratified into two groups, the eight largest firms and all other firms. Additional information about audit firms is included in Chapter 5 of this report (comparative mix of revenue data) and Appendix D.

2 Substantially all U.S. registrants are audited by member firms of the SEC Practice Section (SECPS). Not all members of the SECPS audit public companies. According to recent AICPA data, the SECPS membership profile by number of SEC clients is as follows:

<u>Number of SEC clients</u>	<u>Number of member firms</u>
0	478
1	352
2 – 4	298
5 – 10	104
11-15	19
16-20	9
21-30	11
Over 30	<u>14</u>
Total	<u>1,285</u>

Thus, 65% of the SECPS member firms have only one or no SEC clients; almost 90% have four or less. In addition, approximately 50 U.S. firms that are not SECPS members audit the financial statements of U.S. registrants. Some of those firms are not eligible for SECPS membership because of past violations of the membership requirements.² Most foreign registrants are audited by foreign firms that are not members of the SECPS.³

¹ SEC staff estimates as of March 2000.

² SEC Practice Section, *Annual Report – Year Ended June 30, 1997*.

³ See Chapter 7 for a description of recent changes to SECPS membership requirements for member firms with foreign associated firms that perform audits of foreign registrants. Each SECPS member firm is required to seek the adoption of the changes by any firm outside the United States that is a member of, correspondent with or similarly associated with an international firm or international association of firms with which the SECPS member is associated.

EIGHT LARGEST FIRMS

The Big 5 Firms

3 The five largest audit firms are (in alphabetical order) Arthur Andersen LLP, Deloitte & Touche LLP, Ernst & Young LLP, KPMG LLP and PricewaterhouseCoopers LLP. They are commonly referred to as the “Big 5 firms.” Since their founding over 100 years ago, these firms have become highly regarded as established leaders in the accounting and auditing profession. In 1999, these firms collectively audited approximately 76% of U.S. public registrants⁴ and had U.S. revenues of approximately \$26 billion, of which approximately \$9.5 billion was for accounting and auditing services.⁵

International Presence

4 The Big 5 firms are international accounting, auditing and consulting firms whose U.S. practices are organized as limited liability partnerships. The average size of a Big 5 firm in the United States is approximately 90 offices, 2,000 partners and 24,000 professionals.⁶ Globally, these firms average approximately 100,000 professionals serving clients across 130 countries.⁷

5 The global organization of the Big 5 firms varies. Their structure may range from an affiliation of firms joined by international marketing and cost-sharing agreements without central management to a single integrated firm that is managed internationally. Globalization efforts have focused primarily on common branding and marketing, consistent service delivery, common infrastructure and access to additional capital resources. The majority of the Big 5 firms have established their international presence through international affiliations. Historically, the affiliate structure has presented obstacles in delivering seamless global service to clients and achieving uniform management policies because of the level of autonomy that may remain with the individual affiliates.

6 Increasingly, there is market pressure to be organized as an integrated global firm that can act as one entity, deliver uniform worldwide services and implement consistent business policies. Recently, some of the firms have moved toward complete globalization by combining member firms in certain regional areas, which has strengthened the delivery of global services to clients and assisted in creating and implementing uniform accounting and auditing standards worldwide.

⁴ Data provided by SECPS staff.

⁵ Compiled from information in “Annual Survey of National Accounting Firms – 2000,” *Public Accounting Report*, March 31, 2000.

⁶ Compiled from 1999 firm annual reports submitted to the SECPS.

⁷ Compiled from data on firm websites as of February 2000.

Service Offerings and Structure of Practice

7 The Big 5 firms offer a wide array of services, encompassing:

- Assurance services, including traditional audit, information systems security, internal audit outsourcing and risk assurance services
- Tax services, including corporate and individual planning and compliance and global strategic tax planning
- Consulting services, including strategic change management, process improvement, systems design and implementation, and human resources

8 The increased demand for and competitive pressures to expand these service offerings, differentiate them and identify new markets have led the Big 5 firms to:

- Adopt the term “assurance” services as an umbrella for audit activities and other services historically provided by the audit staff, such as assistance in mergers and acquisitions, as well as newly developed services that are audit related, such as internal audit outsourcing and risk assurance
- Assign the delivery of specialized assurance services, such as transaction-based services (e.g., due diligence and financing advice), to teams of experts in those fields
- Develop new service offerings to address emerging market needs, such as e-business
- Expand the breadth of consulting services to compete with traditional consulting firms
- Expand tax services to include legal services

The expansion of these services has contributed significantly to the Big 5 firms’ annual double-digit revenue growth over the past decade. Three of the Big 5 firms have announced that they have split off, or intend to split off, some or all of their consulting practices from their audit and tax practices, as discussed in Chapter 5.

The Next Three Largest Firms

9 The next three largest firms are (in alphabetical order) BDO Seidman, LLP, Grant Thornton LLP and McGladrey & Pullen, LLP. In 1999, these firms collectively audited approximately 6% of U.S. registrants. The average size of these firms is 47 U.S. offices, 330 partners and 2,200 professionals.⁸ Globally, they average 483 offices across 86 countries.⁹

⁸ Compiled from 1999 firm annual reports submitted to the SECPS.

⁹ Compiled from data on firm websites as of August 2000.

10 BDO Seidman, LLP and Grant Thornton LLP are international accounting and consulting firms organized in the United States as limited liability partnerships. Their global reach is achieved through various international affiliations. In addition, BDO Seidman has formed the BDO Seidman Alliance, which is an alliance of more than 30 independent U.S. firms.

11 McGladrey & Pullen, LLP (McGladrey) is a national accounting firm that is represented internationally through its affiliation with RSM International. McGladrey provides audit and accounting services and certain income tax services to its clients. McGladrey is related to RSM McGladrey, Inc., which offers clients nonattest professional services. McGladrey and RSM McGladrey, Inc. are separate legal entities. McGladrey is wholly owned by its partners, and RSM McGladrey, Inc. is an indirect wholly owned subsidiary of H&R Block, Inc. In August 1999, H&R Block, Inc. acquired the non-attest assets and business of McGladrey and consolidated them with those of other smaller accounting firms in a “roll-up” transaction.

12 Like the Big 5 firms, these firms provide accounting, tax and consulting services, but the services are directed primarily to middle market, entrepreneurial clients. Competitive pressures for firm growth and capital needs and regulators’ concerns for auditor independence have led these firms to focus on many of the same growth strategies as the Big 5 firms.

OTHER FIRMS

13 There are approximately 45,000 local and regional accounting firms in the United States, generally organized as partnerships or sole proprietorships,¹⁰ of which approximately 800 audit SEC registrants and are members of the SECPS.¹¹ Collectively, these SECPS members audit approximately 17% of U.S. registrants.¹² Over 7,200 of the smaller firms¹³ are members of the AICPA’s Partnering for CPA Practice Success, which was founded in 1977 to serve as an advocate for smaller firms within the AICPA and to improve the quality of their services and operations. The smaller firms play a significant role in contributing to the leadership of the profession. They participate extensively in AICPA boards, committees and initiatives such as the CPA Vision Project and CPA Web Trust.¹⁴

International Presence

14 The smaller firms generally have not had a significant international presence as their practices have been focused regionally or locally. However, that is changing as these

¹⁰ Data provided by AICPA staff.

¹¹ See paragraph 2.

¹² SECPS 1997 Annual Report.

¹³ AICPA website, August 2000.

¹⁴ The purpose of the CPA Vision Project is to define a comprehensive and integrated vision of the profession’s future. CPA Web Trust is an example of expanding assurance services beyond their traditional boundaries.

firms increasingly form networks of independently owned firms within the United States and internationally. These domestic and international associations seek to leverage the firms' collective knowledge, obtain client referrals, establish strategic alliances, expand their geographic reach and increase their service offerings. There are now more than 130 associations of accounting firms, including 30 international associations, that together include approximately 1,000 U.S. regional and local firms.¹⁵

15 Generally, association membership requires annual dues to fund the activities of the association and may require correspondent fees for certain referrals and labor sharing. There is no profit sharing or common name among the association members, and common branding is limited generally to references by a firm to its membership in the association on its letterhead or website.

Practice and Structure

16 Alternative structures for small firms have emerged as a result of corporate purchases of their non-attest businesses and roll-up transactions in which the purchasing entity (frequently referred to as a "consolidator") acquires the non-attest assets and employees of small firms. Because state laws generally require that CPAs own at least a majority of audit firms, the audit practices of these firms are retained in partnerships controlled by their former partners. In these structures, several audit firms may be affiliated with, but not owned by, the consolidator, or the firms may be merged into a single audit firm. As a result of these transactions, an operational link is formed between the audit partnership and the new corporate entity performing the non-attest services. Various business arrangements, such as cost sharing and employee leasing, may occur between the two entities.

17 Many industry leaders believe that consolidation in one form or another is the business model of the future for small firms because it provides for expanded services, improved name recognition, higher staff retention and expanded capital resources. Some view consolidators and associations as a means of leveling the playing field between the small firms and the large firms in the middle market arena.

¹⁵ David Albrecht, professor of accounting, Bowling Green State University, Bowling Green, Ohio, as quoted in Richard Glickman, "International Associations," *Journal of Accountancy* (January 2000).

