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Chartered Institute of
Management Accountants

Developments in the global accountancy sector

The aim of this report is to highlight the significant factors influencing both the growth of the accountancy sector and also the demand for the skills of the management accountant within the professional practice firms. These factors include developments in corporate reporting such as integrated reporting and the re-emergence of consulting and advisory services which are expected to contribute to growth in this sector and threats of increased competition from emerging markets and concerns over the level of market concentration.

CIMA sector report - May 2011

Key messages

1. Although dominated by the Big Four, the range of accountancy firms operating in this sector is huge, from single office entities servicing the local business market to multinational networks catering for the diverse business needs of the largest international organisations.

2. Global standard setters, local regulators and politicians internationally are imposing immense change on the whole of the accountancy profession through new financial reporting standards and a demand for more effective communication in corporate reports such as integrated reporting. The impact of these changes on those working in accountancy firms is compounded by a questioning of the role of audit.

3. Although there are challenges, most notably in the field of audit service provision, the outlook for accountancy firms is optimistic with projected revenue growth from new markets and activities. Accountancy firms will require comprehensive and relevant information to both drive and sustain this growth ensuring that management accounting skills will be much in demand within their finance functions.

4. In addition, the re-emergence of consulting services also provides significant opportunities for management accountants in the accountancy firms. The clients of the advisory arms of the accountancy firms will have the same need to identify key business drivers and, if they have insufficient in-house resources for this, they will be looking to their business advisors to assist. The management accountant is therefore a key member of the consulting team and their role is likely to increase in significance.

5. Emerging markets present both opportunities and challenges. As these economies develop, the international accountancy firms servicing these markets will increasingly require the skills of the management accountant to both provide critical decision relevant information internally as well as being a key member of consulting team. But at the same time, local competitors will emerge and countries such as Singapore and China have already announced intentions to capture international market share.

6. The global audit market has become concentrated on four major firms – the Big Four. There are significant barriers to entry to this top echelon of the audit market and so this concentration is likely to continue for some time. Although unlikely to break into the top four there are a number of mid-tier accountancy firms that are growing rapidly especially in emerging markets and on a regional basis may challenge the dominance of the Big Four in years to come.

Conclusions

1. Despite the challenges from both the international focus on accounting reform and regulation and the potential threat from new emerging market accounting firms, the sector does appear to be in good shape. The firms have slowly recovered from the economic crisis and expect significant fee generation from consulting and advisory work, while maintaining cost competitiveness in audit. The Big Four are now in hiring mode, and 2011 should be a positive year for the sector.

2. Emerging markets will offer significant opportunities for increased revenues, which should outweigh the potential increase in competition. Indeed in its report Big4.com said that the Big Four firms dominated their space and were unlikely to face any emerging competitors for a long time. While regulation and audit litigation do pose operating and financial risks, it is unlikely that any of these single items will be of sufficient magnitude to generally upset the status quo. The mid-tier firms may disagree.

3. Leading accounting firms will need to ensure they have the strategies to cope with future challenges and exploit the opportunities. This applies to both carrying out their audit function and managing the re-emergence of consulting and advisory services. In terms of the advisory and consulting functions, firms will need sustainable strategies in place to take advantage of the demand for professional advice, in order to help organisations navigate increasing financial innovation and efficiencies, whilst complying with regulation. They must also ensure they are ready to take advantage of continued strong growth and financial deregulation in emerging economies.

4. Corporate reporting plays an essential role in the effective functioning of the market economy. At its best it provides the building blocks of information necessary for effective decision making by investors and other key stakeholders. The task of ensuring that financial reports are clear, comparable and relevant to investors and other stakeholders will clearly remain in the spotlight. Accounting firms will need to ensure that they are part of this debate, both at a global level with politicians and regulators, and at a national level with businesses and other stakeholders.

5. The drive towards more integrated reporting will present challenges and opportunities for the management accountant. Effective integrated reporting requires a comprehensive understanding of the business model and an efficient management accounting information system.

6. On balance the outlook for this sector appears to be positive and as a whole the required skill set is moving away from the traditional financial accounting/audit basis and increasingly into the skill sets of the management accountant.

About CIMA

CIMA, the Chartered Institute of Management Accountants, founded in 1919, is the world's leading and largest professional body of management accountants, with 183,000 members and students operating in 168 countries, working at the heart of business. CIMA members and students work in industry, commerce and not-for-profit organisations. CIMA works closely with employers and sponsors leading-edge research, constantly updating its qualification, professional experience requirements and continuing professional development to ensure it remains the employers' choice when recruiting financially trained business leaders.

According to independent research conducted by the University of Bath School of Management, CIMA's syllabus and examination structure are the most relevant to the needs of business of all the accountancy bodies it assessed. For more information about CIMA, please visit **www.cimaglobal.com** Follow us on Twitter at **www.twitter.com/CIMA_News**

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The global accountancy sector

The global accountancy sector comprises traditional financial accounting, tax and audit functions as well as other important services such as business advisory, business consulting and management accounting. The range of accountancy firms providing services in this sector is huge – from single office firms servicing the local business market to global networks catering for the needs of multinational organisations.

The sector is dominated by the Big Four accountancy firms Deloitte (Deloitte Touche Tohmatsu Ltd), Ernst & Young (Ernst & Young Global Ltd), KPMG (KPMG International Cooperative) and PwC (PricewaterhouseCoopers International Ltd), with combined revenue in fiscal year 2010 of £95 billion. Globally the Big Four employ more than 600,000 staff, with a total of 34,000 partners and 460,000 other professionals.

Mid-tier firms say they provide a credible alternative to the Big Four and have invested significantly in the development of their international networks. In 2010, Grant Thornton International acquired firms in nine emerging markets and had significant mergers in the US, Canada and Australia. In 2010, BDO International Ltd experienced a 32% increase in fee income in Asia Pacific with a substantial expansion of BDO China.

And, in terms of career potential, big may not always be best. According to a recent survey by recruiter Marks Sattin, only 40% of accountants with less than three years' experience said it was important to work for a big firm. With the tendency towards increased audit thresholds, accountancy firms are reviewing their business models by making a transition into business and strategic advice.

Relevant global developments

The regulatory background

Every financial crisis or corporate scandal leads to revelations of accounting failures and a call for a new wave of regulation. The financial crisis and banking failures of 2007-2009 are no exception. When politicians launched a hunt for people to blame in the wake of the worst market failure since the Wall Street crash, it did not take long to cast their searchlight on the accountancy profession.

It is only under conditions of severe stress that the fundamental unsoundness of some financial practices are revealed. As Warren Buffett famously said in the wake of the technology crash of 2000, 'you only find out who is swimming naked when the tide goes out.' From mark to market accounting that allowed banks to pay bonuses against innovative financial instruments that turned out to be worthless through to the Repo 105 device that took $50bn off Lehman Brothers' balance sheet, the role of accountancy and accountants has been called into question.

Case study – Lehman Brothers' use of Repo 105 transactions

Lehman Brothers, the failed investment bank, stands accused of misleading investors, regulators and other users of their financial statements due to its use of Repo 105 transactions to temporarily improve its leverage position at financial reporting period ends.

But what are Repo 105 transactions? In simple terms, assets are sold typically just before a reporting period end for 5% less than their current balance sheet value with an agreement to buy them back shortly after the period end for the amount borrowed plus interest. The difference between the cash received and the asset values is known as the 'haircut'. The cash received is used to either pay down debt or improve the net debt position specifically to make period end figures look better.

As Lehman did not technically have sufficient cash at the period end to repurchase the assets, due to the 5% haircut, then US GAAP regards it as having lost control of the assets and requires the assets to be removed from the balance sheet and replaced with the cash. This was the case even though the bank's own staff regarded Repo 105 as little more than an accounting gimmick.

The accountancy profession must now deal with a set of radical reforms proposed by politicians and regulators that could change the ground rules for accountancy firms just as much of the world is showing the early signs of moving from economic crisis to economic growth again. At the heart of the changes is a desire to achieve greater harmonisation of the rules on how financial instruments should be valued and how those should be reflected in the accounts of companies that hold them. Many find it hard to believe that the accounting treatment can be so fundamentally different from one accounting regime to the next, for example the Lehman Brothers' Repo 105 device was permissible under US rules, but not under international rules.

The G20 group of the leading emerging and developed countries agreed in September 2009 that the US and other major economies should work towards a single set of global accounting standards by June 2011. Many of the world's major economies have already or will soon adopt the principles of International Financial Reporting Standards (IFRS). However the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have admitted they will not meet the G20's deadline. Given the volume of issues that the two bodies are seeking to cover, this is not surprising but nevertheless the delay is likely to cause more uncertainty between now and the end of 2011.

In response to calls for a broader more understandable form of reporting the International Integrated Report Committee (IIRC) established. The IIRC promotes what it calls an 'Integrated Report' in which organisations provide a concise, clear, comprehensive and comparable integrated reporting framework structured around the organisation's strategic objectives, its governance and business model and integrating both material financial and non-financial information. To be able to produce an effective integrated report requires a comprehensive understanding of the business model and an efficient management accounting information system to provide the source data and narrative content.

The business environment

According to recent 'The 2010 Big Four Firms Performance Analysis' by online community www.Big4.com, the forecast for 2011 is fairly optimistic:

- Advisory services have been the fastest growing sector as the firms have extended their services into risk management and business consulting. Advisory has grown from 22% of total revenues in 2004 to 29% in 2010.
- Emerging markets, particularly in Asia, are growing at strong rates (revenue from the Asia Pacific region increased by 9% from 2009 to 2010).
- The increase in global economic confidence will keep their Advisory and Tax service lines strong.
- Increased M&A and IPO activity will spur additional business for the firms.
- All the firms have strengthened their bottom lines, with cost control and aggressive top-line growth being their priority.
- Additional hiring in 2011 and beyond point to increased confidence within the firms.
- A better revenue base for the firms, combined with positive market conditions, point to a much better 2011.
- Projected revenue growth for 2011, across all firms, will likely be in the 4% to 7% range.

While consulting and advisory work is expected to grow significantly, audit revenues are likely to remain static. This provides a challenge to the large global accountancy firms, with an average of 47% of revenues generated by audit. There is pressure to maintain cost effectiveness without compromising quality.

The re-emergence of consulting and advisory services

One of the lessons from the financial crisis is that organisations need to think differently to create long-term sustainable businesses. Organisations need to be clear on how they generate value, how their organisations actually work and what the risks are. They also need to understand the role of incentives in driving the right, or wrong, behaviours – as well as how good governance can make a difference. And underpinning this is the need to restore public trust in business competence and ethical standards.

This has provided huge opportunities in particular for the Big Four firms to re-develop their consulting practices that, with the exception of Deloitte, were sold off to Capgemini, Atos and IBM shortly after the financial scandals of 2000. The Big Four have an extensive focus on building up their consulting capabilities and there is a clear market gap for services such as finance effectiveness, supply chain optimisation, offshoring and outsourcing support, systems integration, governance and analytics.

The Big Four are optimistic in their outlook for 2011 and beyond; revenue is expected to grow at a steady rate, mainly due to strong performance from advisory services. Other growth will come from key emerging markets with a likely focus on the healthcare, technology, infrastructure, energy, natural resource and communication sectors. This growth is likely to be achieved through a combination of acquisition (such as the recent buyout of outsourcing specialists EquaTerra by KPMG) and by organic growth leading to a significant increase in recruitment. On 25 February 2011, the Lex column in the Financial Times highlighted the significant growth plans - 'KPMG, whose advisory fees comprise an industry leading 32% of revenues, expects to double its global consulting business within four years. In the UK, Ernst & Young wants to double advisory revenues within three.'

The value of good management information is immense. It supports good governance by enabling evidence based decision making. Good management information is imperative for sustainable business and to ensure that business from emerging economies achieve their aspirations. The tools and techniques used by the management accountant in business, such as activity-based costing help organisations to achieve cost leadership – a key priority in both the private and public sectors.

In other words, the management accountant in a consulting team is a key contributor to shaping the business and creating value and will have a larger role to play in this sector. As Charles Tilley, CIMA Chief Executive, says 'the way I like to view the management accountant is as the navigator – planning the route and providing the information and key performance indicators – to influence the desired behaviours.'

CIMA-trained Deloitte consultants improve win rates and retention

The market for financial consultancy services has proved resilient over the past year, bucking recessionary trends. However, strong demand within a people-led sector brings its own pressures. Consultancies must be able to find, deploy – and retain – suitably qualified individuals if they are to maintain credibility among their client base and perform to the high standards demanded by clients.

Justin Watson, private sector lead for operations finance at Deloitte, says CIMA qualified individuals have a strong understanding of finance issues and financial modelling, which means they can provide the crucial analytical skills required to understand opportunities in finance and assess the cost base of client companies. That analysis, in turn, helps Deloitte transform businesses by reducing costs and enhancing profitability.

Over the past 18 months, for instance, Deloitte consultants have worked with a FMCG company, with large teams of consultants working across the global business. 'At the core of that has been a finance team from our practice, who have been modelling the cost base of the business and facilitating all our transformation teams to understand where the best value is to transform performance and financial value of the business.' The work is estimated to have added $1bn to the client's bottom line over the 18 month period.

Consultancies use win-rates as a key measure of how well they are performing. The CIMA qualification gives a measure of reassurance to prospective clients, says Watson. 'If we are in a sales situation, people introduce themselves as being CIMA qualified and that helps establish credibility, especially when we are meeting CFOs and controllers,' he says.

Offering support for CIMA training at Deloitte has also helped him retain key individuals. 'Attrition is a major issue. If you look across the industry as a whole, you would say on average it is somewhere around 15-20% a year in consulting. No one who has been on our CIMA programme has left us in the last two years.'

Evidence that there is a growing demand for skills other than audit in the accountancy firms was provided by the International Federation of Accountants (IFAC) in their fourth global leadership survey[1] of 94 bodies in 73 member countries. 78% of the survey respondents ranked the demand for public practice (non-audit services) as very high or high.

The re-emergence of business advisory and consulting provides significant opportunities within the advisory services departments of the accounting firms for management accountants, from trainee to experienced recruits. Just as finance functions within companies need to embed good management information and practices so do management accountants working for the accounting firms both within their own organisations and also for their advisory clients.

The impact of emerging economies

The balance of economic power is increasingly tilting towards the East and particularly towards China. This presents a challenge and an opportunity. As China increasingly moves towards market economics it will need the skills to ensure it can keep pace with financial innovation and stay ahead of changes to regulations. At the same time the need for reform of the banking and wider financial system in China will also require the expertise that accountants can bring.

The Chinese Ministry of Finance (MoF) plans to develop between five and ten large domestic public accounting firms within the next decade to take on the Big Four in China. The move is being seen as a sign that the Beijing government is determined to avoid the market concentration that exists in most developed countries. Although foreign firms are prohibited from opening fully owned firms in China, the Big Four are all affiliated to local companies.

Further evidence of China's desire to integrate more closely with the western accounting industry was its decision in 2006 to introduce an entirely new regime of Chinese accounting standards based explicitly on IFRS. Although this move predated the financial crisis and subsequent regulatory backlash, it had the benefit of putting China in a good position to participate in the debate over the need for a single accounting standard.

As a report published by the Institute of Chartered Accountants of Scotland said, it marked a watershed moment not only for China but also in the development of accounting standards more widely.[2] 'China's implementation effort demonstrates just how much can be achieved by emerging markets and transitional economies if the right leadership and resources are committed' it said. China, with the successful establishment of the Chinese Accounting Standards for Business Enterprises and its convergence with IFRS, is among the leading jurisdictions making efforts to move towards a single set of high quality, globally accepted standards.

In 2010, Singapore announced its intention to transform its accountancy sector into a leading global accountancy hub for the Asia-Pacific region by 2020. The Asia-Pacific accountancy services market is today the fastest growing region for the global accountancy networks, and is forecasted to reach $38.3 billion by 2013. Singapore's vision is by no means limited to being a regional hub for shared service centres for financial accounting and audit purposes, it extends to being a comprehensive accounting service provider including being an educational centre for training and continuing professional development. Opportunities for experienced accountants will arise as this initiative gathers momentum.

Audit market concentration

The subject of audit market concentration continues to be hotly debated. We believe that there are several factors driving audit market concentration: complexity of accounting standards, the requirements for auditors with global reach, the reputational risk of choosing an auditor outside of the Big Four and the significant infrastructure investment required by a global audit firm.

In September 2010, CIMA was pleased to give evidence to the House of Lords' enquiry into Audit Market Concentration[3] in which we concluded that the audit market remains competitive. However, any further reduction in the number of market participants would significantly impair competition by presenting further conflict of interest challenges.

1 2010 Fourth Annual Global Leadership Survey, IFAC. March 2011

2 Chinese Accounting Reform: Towards a principles based global regime. Institute of Chartered Accountants of Scotland. June 2010

3 Auditors: market concentration and their role, October 2010 http://community.cimaglobal.com/files/cima-community/HoL%20Auditor%20report%20September%202010.pdf

It is the purpose of good management information to equip boards to manage in an effective, entrepreneurial and prudent manner so as to deliver long-term success. We believe that the role of audit should be extended to cover whether the information provided to boards is sufficient for the board to determine the business model and adequately assess associated risks.

Each of the globally represented firms has invested significantly in their global governance structures, audit methodologies and a global approach to learning and development. Ernst & Young is now organised in global and regional units, and KPMG Europe LLP is now formed of 16 national firms (including a range of CIS countries and Saudi Arabia) and 30,000 people. Although, each of the Big Four firms is developing a global approach, the Big Four are largely still networks of individual member firms, where associated risks need to be managed.

Each of the Big Four firms have developed audit hubs in India, where non-judgmental audit work can be undertaken, using the consistent global audit methodologies developed by the firms. This not only manages the cost base but also taps into an unrivalled source of talent. Indeed, a number of firms have extended their off-shoring model to tax and consultancy.

How management accountants contribute to success in the accountancy sector

Whether as part of the internal finance team within an accountancy firm or as part of its advisory team providing consulting services to clients, the management accountant has a vital role contributing to sustainable success.

Successful organisations have a clear strategy for achieving their vision which they must then implement effectively. The foundation for a successful strategy is a thorough understanding of the organisation's operational capabilities as well as its external business environment, risks and opportunities. Progress must be mapped against a set of strategic objectives and measured with key performance indicators. The management accountant's skill set encompasses each of these areas and utilising their services helps to drive business excellence.

Every business needs timely decision-relevant information and the management accountant is well placed to supply this. This information often comes from outside of the finance function and the management accountant's understanding of the importance of business partnering skills clearly assists here too. Advice on the latest business intelligence tools for planning, budgeting and decision making allows the decision maker to form their assessment based on the relevant information rather than an incomplete picture.

Most organisations say that their people are their greatest asset. But only the most successful actually adopt strategies and policies that recognise this and seek to motivate and incentivise their staff to achieve the organisation's strategic objectives. The management accountant is ideally placed to advise on incentive and performance measurement issues whilst at the same time fully understanding the strategic imperatives.

Cost leadership is another area of business to which the management accountant can contribute significantly. Operational excellence is a prerequisite of long-term business sustainability and results from reduced costs, more efficient use of scarce resources and improved quality control – all domains of the management accountant.

Competitive advantage is often only maintained by continually supplying a wider range of products to more demanding customers in a greater number of geographical markets to tighter delivery schedules. Supply chain management is key for achieving sustainable business success in this environment. The management accountant can assist the process through improved supply chain planning, inventory management, streamlining of the procurement function and asset utilisation.

Awareness of risk management as a discipline is at an all time high. Financial expertise is an essential component of any risk strategy, and by applying the core disciplines of management accountancy, the necessary rigour can be applied that is essential to organisational success in this unpredictable and faster-moving world.

CIMA sector reports

This report is one of a series of six reports all of which examine current issues and trends. Other titles in the series are:

- The global manufacturing sector
- The global banking sector: current issues
- Global outsourcing and offshoring (forthcoming)
- The energy sector (forthcoming)
- The technology sector (forthcoming)

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