



**Grosvenor**  
Boston

# Accounting & Auditing in the UK

## Content

Industry snapshot  
Key External Drivers  
Products & Services  
Future Demand



# Industry Snapshot

## Key Statistics Snapshot

Revenue  
**£6.3bn**

Annual Growth 09-14  
**1.0%**

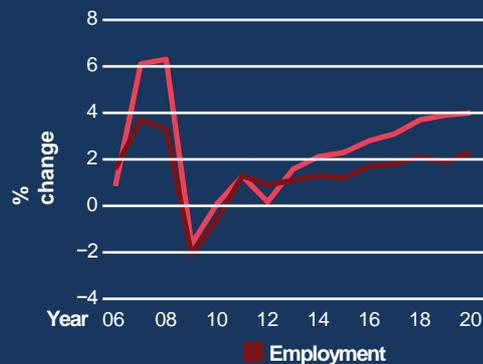
Annual Growth 14-19  
**3.2%**

Profit  
**£1.2bn**

Wages  
**£3.2bn**

Businesses  
**11,425**

### Revenue vs. employment growth



### Business capital expenditure



# Industry Snapshot

The Accounting and Auditing industry comprises two distinct service segments. Accounting services include the preparation of financial accounts and the generation of financial statements. Auditing services mainly involve the process of externally reviewing a company's financial statements in order to guarantee their accuracy. This segment accounts for approximately 60.0% of industry revenue. Industry participants also provide internal auditing services, which are mainly carried out for the benefit of management.

The industry performed reasonably well over the past five years, although economic conditions remained weak during many years of the period. This was primarily due to demand for external audit services being relatively inelastic, as they are compulsory for most large corporations. However, the fall in the number of businesses and a reduction in corporate transactions and business expansion projects constrained demand for these services. Meanwhile demand for internal audit and accounting services were negatively influenced by the fall in the number of business operating in the United Kingdom.

Cost cutting initiatives undertaken by many firms coupled with the availability of accounting software also hampered demand for these types of services. Industry revenue is forecast to grow at a compound annual rate of 1.0% over the five years through 2013-14 to reach £6.3 billion. In 2013-14, revenue is forecast to grow 2.1%. Demand for auditing and accounting services are expected to increase as economic conditions rebound.

Over the coming five years, the Accounting and Auditing industry is forecast to record steady growth as the economy strengthens. According IBISWorld research, industry revenue is expected to grow at a compound annual rate of 3.2% to reach £7.3 billion in 2018-19. Stronger economic conditions will cause the number of businesses operating in the United Kingdom to increase. This coupled with rising capital expenditure budgets and higher volumes of corporate transactions will increase demand for accounting and auditing services. Auditing reforms proposed during the previous period and the introduction of new regulations will also influence industry performance over the next five years.



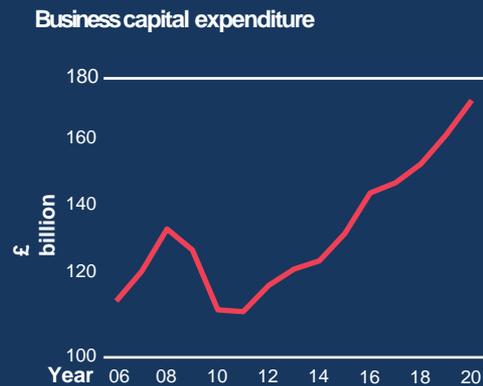
# Key External Drivers

## Business capital expenditure

Strong capital expenditure by businesses reflects growth expectations. Strong growth prospects tend to prompt expansionary activities by businesses, which in turn drives demand for accounting and auditing services due to increased firm structure complexity. Rising capital expenditure budgets also enable businesses to outsource non-core activities, which increases demand. Lower business capital expenditure results from weaker economic conditions, interest rates and credit availability, all adversely affecting growth potential for the Accounting and Auditing industry. Business capital expenditure is expected to increase in 2013-14, presenting an opportunity for industry growth.

## FTSE 100

A stronger stock market tends to prompt greater numbers of initial public offerings and mergers and acquisitions. This boosts the quantity and complexity of audit and accounting work, benefiting in particular larger firms in the industry and favourably affecting industry growth. A weak stock market on the other hand reduces the number of initial public offerings and mergers and acquisitions, which negatively influences demand. The FTSE 100 is expected to rise in 2013-14, despite being subject to considerable volatility.



# Key External Drivers

## **IT and telecommunications adoption**

The adoption of information technology and telecommunications is changing the industry as firms, especially small firms, are increasingly using software to prepare financial statements. This provides both opportunities and threats for the industry. Traditional players stand to lose business, as firms are increasingly able to prepare financial statements in-house. However, those players that provide online platforms are likely to benefit from this trend. The provision of audit services will be less threatened by this trend. In 2013-14, IT and telecommunications adoption is expected to increase.

## **Mergers & acquisitions involving UK companies**

Accountants and auditors provide a number of services that facilitate mergers and acquisitions in the United Kingdom. If the value of merger and acquisition activity involving companies in the United Kingdom is high, this is indicative of higher potential demand, in particular for auditing services. Both companies and the agreed deal may require auditing if the value of the agreement is high. In 2013-14, the value of mergers and acquisitions involving UK companies is expected to rise but may still remain well below pre-crisis levels. This may constitute a threat to revenue growth in 2013-14.

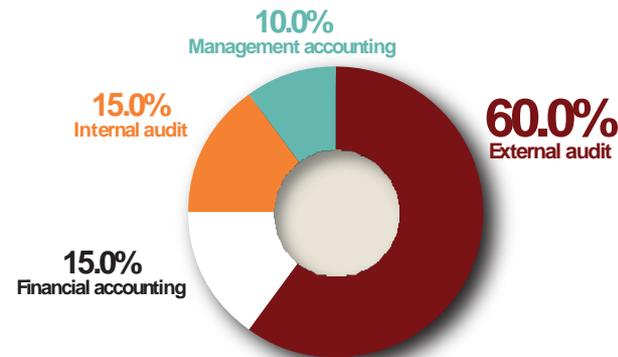


# Products & Services

The Accounting and Auditing industry provides two main groups of services. Accounting services include the preparation of financial statements in order to make them publicly available, or for management purposes. Meanwhile, auditing services are performed in order to check whether the preparation of financial statements has been done accurately and without deception or mistakes.

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Products and services segmentation (2013-14)



**Total £6.3bn**

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# Products & Services

## **External auditing**

The external audit segment is estimated to account for 60.0% of industry revenue and consists of audit and assurance services that are carried out largely for the benefit of the client's external stakeholders (such as investors), lenders, suppliers, employees, customers and regulators. An independent financial audit provides stakeholders with the assurance that an organisation's accounts have been accurately stated. This assists stakeholders in decisions such as whether to invest in, extend credit to, or enter into contracts with the organisation. Publicly listed companies are required by law to publish their accounts and have them independently audited. The Big Four firms perform the majority of public company audits. A study by the Competition Commission found that in 2010, the Big Four firms carried out 99.0% of external audits of the top 100 FTSE companies and 92.0% of FTSE 250 companies. Over the next five years the introduction of competition regulation is likely to significantly reduce the concentration in the external audit services.

Due to statutory requirements for the submission of audited financial accounts by a large proportion of businesses, this auditing service segment proved relatively immune to the financial crisis and economic downturn. Therefore, the share of revenue earned by this segment increased marginally over the past five years.



# Products & Services

## **Internal auditing**

The internal audit segment, accounting for an estimated 15.0% of industry revenue, includes audits that are carried out for the benefit of management. Internal audits tend to be broader than external audits and can relate to performance and management of risk rather than simply the financial accounts. For example, internal audits may assess compliance with internal governance and control processes and external regulations. Internal auditing by independent accounting firms faces competition from in-house auditors, as companies are not required by accounting law to perform internal auditing activities. As a result, the share of revenue generated by this segment declined marginally over the past five years.

## **Management Accounting**

Management accounting involves the preparation of financial statements and information for internal use by management, estimated to account for 10.0% of industry revenue. In this segment, accounting firms face competition from in-house accounting departments, particularly in large companies.

However, the opportunity still exists for accounting firms to provide advice and tools to assist in-house accountants. Small- and medium-size businesses are a key market for financial and management accounting services, particularly those that wish to remain lean and focused on their core business by outsourcing non-core functions like accounting and the preparation of financial statements. This segment's share of revenue is expected to have declined over the past five years, as businesses slashed costs. Advancements in technology and the greater availability of accounting software also negatively influenced demand for these services.

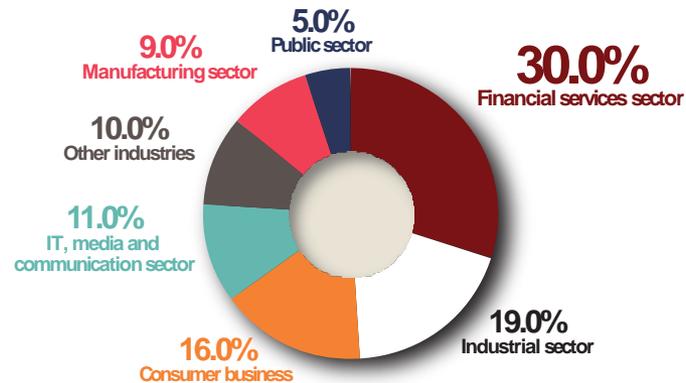


# Products & Services

## Major Markets

The market for accounting and auditing services is diverse, spanning across all sectors of the economy. While auditing is not compulsory for all businesses, the preparation of financial statements through accounting services is required for businesses across all sectors with publicly listed firms being obliged to publish their accounts. As a result, corporate clients from different sectors are users of industry services.

Major market segmentation (2013-14)



Total £6.3bn



# Products & Services

## **Financial services**

Clients from the financial services sector account for about 30.0% of industry revenue and constitute the largest market for the Accounting and Auditing industry. Owing to Britain's position as a financial hub, along with the complexity of operations and regulatory requirements for banks, insurance companies and investment management service providers, this market segment has proven strong during the past five years and yields a stable share of industry revenue. Banking and insurance companies often require more complex audits, consequently auditors, on average, earn higher revenue from this sector.

## **Industrial sector**

The industrial sector accounts for an estimated 19.0% of industry revenue. Businesses involved in raw materials, equipment and components make up a relatively high proportion of listed companies, which are required to produce regular, audited financial accounts. As a result, this market segment's share of revenue is expected have remained relatively stable over the past five years.

## **Consumer business**

The third-largest market for industry operators is consumer businesses. Companies that are involved in retail, travel and leisure comprise 16.0% of total revenue. The share of revenue generated from client businesses are expected to have declined over the past five years. This is mainly due to the difficulties faced by these types of businesses. Several consumer businesses have entered administration, as they have been unable to continue as a going concern.



# Products & Services

## **IT, media and communication**

The IT, media and communication sector represents another prominent market segment for industry players, with many businesses in the sector outsourcing their accounting functions in order to focus on their core business areas. IT companies in particular are strong outsourcers of non-core activities as their employees are often equipped with a strong technical rather than a business background. This segment has grown during the past five years to account for 11.0% of industry revenue and is expected to increase its share in the future.

## **Public sector**

The public sector consists of government departments and health-care institutions and is currently estimated to account for 5.0% of industry revenue. Public-sector entities have decreased their outsourcing process of financial and accounting functions during the past five years following tighter budgets and austerity measures taken in response to the most recent economic downturn.

## **Other segments**

These include businesses in the manufacturing sector and other corporations not classified in any of the above market segments. The share of industry revenue of these segments is estimated to have declined marginally over the past five years. Although demand for auditing services remained less affected, demand for accounting services declined as many firms brought accounting functions back in-house during tough economic times.



# Future Demand

## **Growing Demand**

Demand for external auditing services will rise over the next five years. Demand is expected to increase, especially in the medium term, when more businesses undertake expansion projects that were previously delayed. The number of corporate transactions is expected to increase mildly from the start of the period before increasing more strongly in the medium term when economic conditions are more stable and investor sentiment is less volatile. These factors will augur well for industry participants as they generally require more complex and time-consuming audit services, which result in higher fees earned. The number of businesses operating in the United Kingdom is also expected to increase over the coming five years and increase demand for external audit, because they are compulsory by law.

Demand for internal auditing is expected to increase weakly in the short term before gaining momentum during the latter part of the period. Although the number of businesses is expected to increase and expand the client base, demand for internal audit services will be subdued in the short term, as they are discretionary and businesses will remain extremely cautious about their spending.

A rise in the number of businesses will increase demand for the preparation of financial and management accounts. Businesses are also expected to begin to outsource these activities in the medium term when conditions improve considerably, which will also augur well for the industry. Meanwhile, changes to accounting standards, which will be phased out over the coming five years, are also likely to stimulate demand, as many businesses will seek outside help when preparing financial accounts. However, further developments in technology will constrain demand growth to some extent, as it will make it easier for firms to prepare their own financial statements.



# Future Demand

The CC's proposals, which require Britain's biggest corporations to review their auditors every 10 years under the diluted reforms announced in October 2013, will influence industry performance and structure over the coming five years. However, the exact consequences of these proposals could vary considerably, as they continue to be open to public consultation.

Meanwhile, the audit reforms proposed by the EC will also affect the industry over the outlook period. In April 2013, EU lawmakers only endorsed watered-down plans of the aggressive auditing reforms proposed by the EC in 2011. This includes reducing the compulsory rotation of auditors from every six to 12 years to every 25 years. It also rejected the commission's proposal for a crackdown on auditors doing additional work, which had raised the prospects of a break up of one or more of the Big Four accounting firms.

Audit reforms are not the only feature of the industry that is currently under consideration. Analysis of the causes of the financial crisis has triggered changes in various areas of finance, including both accounting and auditing.

The changes introduced by the Financial Reporting Council include switching from the UK Generally Accepted Accounting Principles (GAAP) to the Financial Reporting Standard (FRS), which will increase the uniformity of financial reporting. The changes seek to address problems arising from greater globalisation of businesses and the financial complexity that this brings, such as hedging. The proposed shift is expected to apply to all financial periods beginning on or after 1 January 2015, but will be optional for companies beforehand. The change is likely to be positive for the industry, as it should increase demand for outsourced accountancy services.

One of the other key themes in the post-financial crisis discussion has been the potential broadening of the role of the auditor to expand it further beyond judging an organisation's accounts and making sure disclosures are fairly presented. A recommendation in the House of Lord's 2011 report was that auditors should provide a narrative on areas such as business model and risk management. The goal would be to provide greater transparency in company accounts. A move in this direction is likely to allow auditors to generate higher revenue per client by adding more value in each audit.



# Future Demand

Despite the bleak economic conditions over the past five years, the major players have all moved to increase staff numbers. A focus on expertise in a strong human resource base was considered key in delivering superior services to the industry's clients. However, smaller players shed staff in order to improve cost efficiencies. Nevertheless, employment numbers were positively influenced due to some employees that had been made redundant starting their own businesses. As a result, industry employment is estimated to increase at a compound annual rate of 0.8% over the five years to reach 74,263 in 2013-14.

The total number of enterprises operating in the industry is expected to remain relatively unchanged. The industry witnessed merger and consolidation activity, and some smaller firms exited the industry as they were unable to compete.





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