May 2025

PRIVATE EQUITY AND AUDIT: A THREAT OR AN OPPORTUNITY?

About ICAS

- The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We have extensive experience of regulating audit work in the UK as a Recognised Supervisory Body (RSB) under the Companies Act 2006 ("the Act"). We issue licences to firms undertaking audit work, and authorise our members and affiliates to act as Responsible Individuals (RIs). We are also a Recognised Qualifications Body (RQB), training students and awarding the audit qualification.

- ICAS members play a prominent role in the corporate governance, stewardship, reporting, and audit of corporate entities; not just as statutory auditors, but also as directors and senior finance leaders across all commercial sectors, including the investment sector. The students we are training will become the auditors of the future, as well as senior business leaders, in the UK and around the world.

- ICAS' Royal Charter requires that we act in the public interest. Our regulatory functions are designed and exercised to place the public interest first. Our Charter also requires ICAS to represent our members' views and protect their interests. On the rare occasion that these are at odds with the public interest, it is the public interest that must be paramount.

- ICAS is therefore well-placed to comment on the growth of private equity investment in audit firms, and to explore the practical and ethical impacts which may follow. Other forms of external financing may also need to be considered on a similar basis.

- This paper has been prepared with the support of a working group of ICAS members serving on our governance bodies, and was reviewed and approved by our Council on 29 May 2025.

Key points

A. The steady increase in private equity interest in UK audit firms over recent years has brought the longstanding rules governing audit firm ownership into focus.

B. As set out in this paper, private equity investment in audit firms presents both risks and opportunities, with uncertainty over the medium-to-long term impact on the audit profession.

C. With stakeholders expressing varying views, ICAS strongly believes that the number one priority must be ensuring high standards of audit quality and auditor independence, to enable users of financial statements to have confidence in them.

D. Rules are set at a point in time to meet specific environmental conditions at that time. The rules on ownership of audit firms have not been revisited in-depth for a number of years. Given the evolution of society and market conditions in which such firms operate, now would seem an opportune time to reassess whether these rules are still fit for purpose. They cannot be lightly disregarded but must be subject to objective, independent scrutiny to ensure that they still best serve the public interest.

E. The environment in which audit firms and wider business are operating continues to change at pace due to various societal factors: technological advances, including AI; geopolitical uncertainty; and sustainability related matters. Indeed, the audit profession continues to evolve as firms look to deploy greater use of AI tools, with the likelihood of more change in the profession in the next five years than in the last 50. Whilst such a rapidly changing environment needs to be factored into considerations when examining the funding model for audit firms; government, regulators and professional bodies need to be cognisant of the accountancy profession's duty to act in the public interest and the important role that audit plays in the allocation of capital. This has to be the overriding factor when considering what rule changes, if any are required. More broadly ICAS' Shaping the Profession (StP) strategic initiative, is designed to examine, consider and map out an ambitious future for the accountancy profession and evidence its continuing relevance to society.

F. ICAS is therefore advocating for the following, with the challenges faced by many audit firms requiring a level of urgency for action:

- Further review and study of the impact of private equity investment and other external capital providers in audit and other professional service firms, in the UK and abroad. A key focus of this would be recognising the risk that financial considerations can unduly influence behaviours whilst recognising that audit quality can be enhanced with significant investment in platforms and methodologies.
- An open and balanced debate of the ownership requirements amongst key stakeholders, considering not simply the role of private equity, but other models and approaches, including the scope for a more principles-based approach. The restrictions contained in the extant model are there to mitigate the threat that providers of capital will unduly seek to influence behaviour. Therefore, any changes which are proposed will need to be assessed to ensure that they contain appropriate safeguards to mitigate this threat.
- Closer collaboration between auditor licensing bodies to ensure that the ownership requirements are being applied consistently, identifying and understanding the scope for audit firm structures which are compliant in form but not substance.

Current position

1. For many years, UK law has tightly controlled and restricted who is allowed to own and control the professional services firms undertaking statutory audit work.

2. The relevant provisions are currently found in Schedule 10 of the Act, which mandates the involvement of individuals with the audit qualification in audit firms. With limited exceptions, these must be accountants qualified with a relevant UK professional accountancy body. There must be a majority of such individuals on the management board of the firm (if it has one), and they must also hold a majority of the firm's voting rights.

3. In simple terms, therefore, audit firms which are resident and operating in the UK market must be controlled by audit-qualified members of one of the UK's professional accountancy bodies.

4. As the 'competent authority' for audit in the UK, the Financial Reporting Council (FRC) requires these professional accountancy bodies to only issue audit licences to firms which meet the requirements of an eligibility statement which it publishes here.

5. This means that all of the registering bodies in the UK are applying the same rules, with the approach taken by ICAS, ICAEW, and ICAI set out in a shared set of Audit Regulations (available here, with details on eligibility in Regulation 2.03).

6. These ownership restrictions aim to protect the independence of audit firms in forming their opinion on the financial statements by maintaining the quality of audit work, both of which are essential to fostering confidence in the financial reporting of entities requiring an audit.

7. The substance of the current rules is that non-audit qualified investors are prevented from owning a controlling interest in audit firms to protect the interests of external investors and other stakeholders. They may acquire an equity stake in an audit firm, but this will be limited in size and will not allow them to have control over the firm's decision making.

8. Through their training and practical experience, individuals with the audit qualification will understand the technical requirements for performing audit work, and will be aware of the need to follow various ethical standards when undertaking such work. The current ownership model therefore links audit quality with the structure of audit firms.

9. While the risks which the current legislation seeks to avoid are explored in detail below (**Risks and opportunities**), key concerns with private equity investment include (i) the impact and pressure of servicing debt often introduced by a private equity investor on an audit firm, and (ii) the risk of profit being prioritised over the need to undertake a thorough audit in compliance with regulatory requirements (including quality management, performance, and ethics/independence

standards). By requiring majority ownership by audit-qualified professional accountants who are required by rules and regulations to adhere to such standards, quality in audit is less likely to be threatened or called into question.

10 With different levels of regulation applying to professions in the UK, it is not surprising that there are variations in how professional service firms can be owned. However, the restrictions which apply to audit firms are by no means unique, with a requirement for 'ownership by professionals' also applied (to varying extents) to architects, actuaries, and solicitors. It is also worth noting that ownership of audit firms is similarly restricted in other countries in the EU and around the world, for reasons reflecting those in the UK. Therefore, the existing audit firm ownership rules cannot be lightly disregarded but rather must be subject to objective, independent scrutiny to ensure that they still best serve the public interest.

11 In summary, therefore, the current restrictions on who can own audit firms in the UK are:

- Based in law, supported by regulations.
- Relatively longstanding.
- Reflective of restrictions seen in other professions.
- Similar to restrictions applied in other jurisdictions.

Recent developments

12 While more precise definitions may be appropriate depending on the context, private equity generally describes investment partnerships which invest and actively participate in the management of businesses with a view to growing organically and/or by acquisition before ultimately selling them. Private equity firms operate investment funds on behalf of institutional and accredited investors or high net worth individuals, and may acquire private or public companies in their entirety or in part, or invest as part of a consortium. They typically do not hold stakes in companies that remain listed on a stock exchange.

13 While this paper focuses on private equity, a number of the broader principles which are discussed could also apply to other forms of restructuring. This includes seeking a flotation which was the route followed recently by the UK and Irish arm of Baker Tilly.

14 Notwithstanding the restrictions set out above (**Current position**), private equity investment in UK audit firms has been increasing steadily in recent years, reflecting a trend which has been particularly prominent in the USA, where private equity investors have bought stakes in at least five of the top 30 accounting firms. High-profile investments in the UK include the deal announced by Grant Thornton in 2024.

15 While private equity groups will have different plans and motivations when investing in audit firms, some of the common attractions include:

- The prospect of stable and consistent annual revenue streams from regulatory-driven fees and high net profit and return on capital employed.
- A growing demand for specialised accounting and assurance services.
- The scope for consolidation in the market, with an opportunity to combine firms of various sizes, in different locations, into significant national entities which could challenge more established firms (with examples including Apax's purchase of Evelyn Partners, and August Equity's investment in Anderson Anderson and Brown (AAB)). Interestingly, the latter is now the subject of sale speculation.
- The high levels of public trust in the accountancy and audit professions.

16 If audit firms are attractive to some private equity investors, so might private equity investment be attractive to some audit firms. The reasons for this are covered in in detail below (**Risks and opportunities**) but may be summarised as follows:

- A possible solution to succession-planning challenges, offering existing firms' owners a financial exit from the business ("money-out private equity investment").
- Access to the funds required to keep pace with the rapid pace of digitalisation and new technologies ("money-in private equity investment").

- The potential to become part of a more significant market entity.
- For smaller firms, the ability to leverage support and guidance from other professionals.
- The distinction between "money-out" and "money-in" investment is important to recognise. The former will see the investment being received by the selling owners and the latter would see the firm receiving the investment in return for a participating equity interest (which may not be *pari passu* with existing or remaining owners). Naturally, a hybrid of the two approaches is possible.

17 There are contrasting views as to whether consolidation of firms within the audit market is a positive or negative trend. While there are other important factors at play, it is likely that private equity investment is contributing to some extent at least to the decline in the number of licensed audit firms in the UK. The FRC reported in September 2024 that there were 4,038 licensed firms in 2023, compared with 5,127 firms in 2019 (a decline of more than 20% in only four years). The number of Responsible Individuals (RIs) registered by ICAS has also declined, but at a much slower rate. Any acceleration of this trend in audit firm numbers could make it more difficult for some entities to find an auditor (particularly for small and medium-sized entities) or for there to be less competition and therefore a risk of increasing audit costs. Alternatively, some people believe that consolidation could help to build resilience, capability and competition, depending on the size of firms involved.

18 All private equity investment in UK firms must be in accordance with the current ownership restrictions. In some instances, this has caused firms to hive off their audit business into a separate corporate structure, with other workstreams not having the same restrictions. It has also meant private equity investors accepting a lower percentage stake than they might normally desire, in that they are not able to control the audit business.

19 The FRC has taken a keen interest in developments, with its Chief Executive Officer publishing an open letter in September 2024. While stating that the FRC is "*not in principle against a greater participation of external private capital in the UK audit market*", and recognising the potential benefits for the UK audit market, the letter referred to "*important risks that will need to be carefully managed*", and emphasised that the existing ownership requirements must be met "*both in substance and in form*". This message was repeated in an updated letter published by the FRC in March 2025. ICAS understands that the private equity investment will be a key focus of the FRC in 2025 and beyond. Regulators around the globe are also placing similar scrutiny on the ownership of audit firms in their jurisdictions.

20 These developments have taken place in a rapidly changing world. The environment in which audit firms and wider business are operating continues to change at pace due to various societal factors: technological advances, including AI; geopolitical uncertainty; and sustainability related matters. Indeed, the audit profession continues to evolve as firms look to deploy greater use of AI tools , with the likelihood of more change in the profession in the next five years than in the last 50. Such a rapidly changing environment needs to be factored into considerations when examining the funding model for audit firms.

21 Recent developments in this area may therefore be broadly summarised as follows:

- With attractions for investors and owners, recent years have seen a steady growth in the level of private equity investment in UK audit firms (reflecting a trend in other countries).
- It would be reasonable to expect the scale of investment to continue and possibly increase in the future.
- This trend is contributing to market consolidation in the UK and a decline in the number of audit-registered firms.
- As emphasised by the FRC, all such investment must be in accordance with the current ownership restrictions.
- The environment in which audit firms are operating is evolving at pace.

Risks and opportunities

22 A balanced analysis of the ownership requirements for audit firms should identify both risks and opportunities associated with private equity investment and other external funding, guarding against an oversimplified or generalised view of the parties involved, with audit firms having different needs and challenges, and investors also having a range of aims and motivations.

23 What follows is a general summary of some of the main opportunities and risks which have been identified in ICAS' review. Further work and study is recommended to understand these in greater detail, with the benefit of feedback from auditors and investors.

Opportunity 1 – succession planning

24 For several years, succession planning has been a growing problem for accountancy firms of varying sizes impacted by challenges over the attractiveness of the audit profession, and the availability of audit-qualified accountants who are willing and able to become owners. Employees who might previously have invested in a firm may find it more difficult to do so when they are dealing with other financial pressures, including student debts and the challenges of entering the housing market.

25 This has caused some firm owners to explore other avenues to help them navigate an appropriate exit strategy from the business. A private-equity backed consolidation strategy could provide an opportunity for multiple audit practices to survive the retirement of their senior principals, which may benefit clients.

26 Investment into a firm may make it easier to retain higher-performers by offering more competitive salaries, as well as other development opportunities within a larger entity.

Opportunity 2 – capital investment

27 Like many professional services firms, auditors are faced with the ongoing rapid pace of digitalisation and new technologies, with significant investments seemingly required at regular intervals. This is likely to require considerable expenditure, which may not be available through the firm's current financial model.

28 While a range of funding options should be explored by firms, private equity may provide an opportunity for capital investment to get the firm to where it wants to be in the short-to-medium term, calming anxieties about being left behind and not being able to meet client demands. Debt funding may be an alternative option, but will depend on economic conditions and the terms that can be negotiated.

Opportunity 3 – growth with economies of scale

29 Thriving practices may wish to expand their operations, believing that their business model may prosper on a larger scale. Private equity could provide the funds needed to purchase other firms, which could then be merged with the purchaser's firm (with different models available).

30 Some stakeholders have raised concerns about the lack of choice of auditors, particularly in relation to the FTSE 350 audit market. The prospect of private equity-back consolidators might therefore be viewed as a means of creating greater choice in this market, although whether private equity-backed firms would want to compete here remains to be seen (having regard to the increased risks involved).

31 For smaller firms, working more closely with a larger firm (on whatever basis) could provide benefits through 'economies of scale' – e.g. an opportunity to share core functions, including IT and HR. It might also provide access to technical assistance and support.

Opportunity 4 – successful partnership

32 A successful working partnership with private equity investors may introduce new ideas, experience, and skills to an audit firm. Under-pressure principals may appreciate management support, and creative input on financial challenges. This could lead to better run and more innovative audit firms.

33 While concerns correctly focus on audit quality, investors are attracted in part to audit firms because of their trusted reputation, creating a shared desire (in an ideal scenario) to maintain or increase quality standards. This may be supported by a more performance-focused approach to management, including KPIs and other metrics.

34 Although private equity investment often targets a short-term turnaround, there are indications that the strategy for audit firms may be different, with investors attracted to stable and consistent annual revenue streams over the longer term. This could mitigate against fears of disruption and insecurity in the market.

Risk 1 – audit quality

35 Some stakeholders fear that audit quality will inevitably be compromised to a greater or lesser extent if a firm's owners are too focused on profitability and servicing high leverage as there is undoubtedly a risk that financial considerations can unduly influence behaviours.

36 Audit work is detailed and process-driven, often requiring significant amounts of time and resource. Investors may be tempted to increase the profitability of an audit by reducing the amount of work involved, or by eliminating some of the regulatory or quality management measures.

37 Alternatively, investors may wish to increase profit margins by taking on more audit clients, without increasing the number of qualified staff engaged on the audits (or actively decreasing employee numbers through restructuring). This could lead to over-worked employees who are more likely to make mistakes and/or leave the firm (and possibly the audit profession). It is, however, possible that an enhanced system of quality management could provide the means to increase efficiency, and potentially effectiveness, without unduly increasing the risks involved.

Risk 2 – ethical challenges

38 One of the core elements of the audit profession is the independence of auditors from their clients. This should increase confidence that an audit provides a fair and impartial view of an entity's financial reports.

39 There are fears that increased private equity investment in audit firms could make it more likely that auditors will find themselves reviewing the financial records of entities with direct or indirect connections to the firm's investors (with such risks being less likely and more easily identifiable under traditional ownership models). This is a significant concern given the sometimes-complex structures of private equity investment.

40 The worst-case scenario is that auditors find themselves under pressure (explicit or implied) to change their audit conclusions, or not be as transparent as they may have been in their opinion on the basis of a financial interest in the client from one of the firm's investors.

Risk 3 –market impact

41 As outlined above, private equity can lead to consolidation in the audit market, with firms of various sizes being purchased to form part of a larger audit entity.

42 While this could be viewed positively, for the reasons outlined above, there are also negative conclusions which might be reached.

43 A smaller number of audit firms means more limited choice for entities looking for an auditor, particularly outside of the major urban areas. It also means less diversity of approach, moving closer to a 'one size fits all' basis.

44 A concentration of audits amongst a smaller population might increase the risk of regulatory failures. For example, if the audits of 10 previously licensed firms are now subject to one firm's procedures, and those procedures are deficient, then the quality of more audits will be impacted. Also, if this one firm decides that audit is no longer a profitable workstream, and surrenders its licence – which could be a greater risk with more focus on profitability – that would effectively mean 10 firms have exited the market.

45 From a client perspective, the impact of private equity on audit fees is likely to be a key concern. The emphasis on profit has been noted on several occasions above, with the risk that fees may rise more sharply than before in order to increase profit.

46 Another client-based risk is the possibility that larger audit firms may choose to disengage from some of their smaller / less-profitable clients, who might then struggle to find a replacement firm, for the reasons noted above. Firms might also choose to step away from clients who do not tie in with their new risk profile (including smaller Public Interest Entities).

47 ICAS has concerns that some private equity investors are insisting that acquired audit firms switch their audit registration to the same professional body, due to the perception that having all associated firms dealing with the same regulator will make life easier (even though the professional bodies are all operating very similar processes). If this trend continues then there may be fewer professional bodies involved with audit, creating a lack of diversity, and increasing the 'single point of failure' risk for the FRC.

Risk 4 – culture

48 There may be tensions between the motivations of a private equity investor and the duties and responsibilities of auditors to their stakeholders. There could be a negative impact on the culture of the firm which affects the level of professionalism in making audit judgments. Difficult ethical decisions might face undue influence as a result of commercial pressures. There is also a risk that a private equity-backed firm might not be viewed as attractive as the traditional partnership structure when recruiting new talent.

49 Concerns have been raised over the tendency of private equity investors to adopt a shorter-term perspective, with the assumption that they may look to sell their stake in a firm after a short period of time, making as much profit as possible. This could mean that some of the longer-term positive aspects of audit firm culture – e.g. developing trust, long-term succession planning through development of staff etc – are deprioritised.

50 Under the traditional ownership model, employees in a firm can identify who owns and controls the firm. In an ideal scenario, they can expect the owners to provide an example of the culture expected in the firm (i.e. demonstrating the tone from the top). If ownership becomes more complicated, disparate, and vaguer, the opportunity to establish commonly-held positive behaviours may be jeopardised.

Risk 5 – what happens next

51 As this is an area of rapid change, there is uncertainty over what happens next, with concerns over the longer-term impact of private equity investment, and the possibility that damage to the system may not become apparent until it is too late for it to be fixed.

52 As noted above, private equity investment may offer senior partners a route out of the business. If this involves a significant pay-off, and they subsequently retire, that money has effectively left the audit profession and offers no further benefit beyond enriching the retiring partners.

53 Depending on the structure and scale of an investment, an audit firm could find itself saddled with considerable debt incurred as a result of corporate restructuring. Servicing this debt might introduce levels of financial pressure which were previously absent, and could increase risks in relation to audit quality and ethical challenges, as noted above. In addition, high levels of debt could expose the audit to the risk of failure in its own right.

54 When private equity investors look to sell their stake in an audit firm, it seems unlikely that the purchasers will be the firm's employees (particularly where there has been consolidation of several audit firms). Given the level of money involved, it seems more likely that investments will pass between various private equity houses, leading to a cycle of short-term investments and disposals which could disrupt staff and audit quality.

55 If this comes to pass, it will represent a significant change to the audit firm market, presenting risks to audit quality, trust, and reputations which have been facilitated through relative stability in ownership over the longer-term. The attractiveness of audit as a career for younger professionals may further be diminished if the chance of ownership disappears.

56 The impact on future regulation of the audit profession would also need to be considered. At present, there is a clear and obvious connection between regulators and the individuals who own and control audit firms. If private equity investment becomes more widespread, regulators may need to reconsider, and possibly expand, the scope and scale of their operations.

Summary

57 An open and balanced approach to the question of private equity investment in audit firms is likely to identify both risks and opportunities:

Opportunities

- Succession planning
- Capital investment which may enhance audit quality
- Growth with economies of scale
- Successful partnerships between firms and investors

Risks

- Audit quality
- Ethical challenges
- Market impact (fees, limited choice etc)
- Culture
- What happens next

What's next

58 ICAS encourages all stakeholders to engage in an open and balanced debate of the ownership requirements for audit firms, with the benefit of more research and data, as well as input from auditors and investors. This should take account of what is happening in other professions and other jurisdictions.

59 If conclusions are drawn that the risks involved with increasing the scale of investment allowed by private equity are too great, consideration should be given to what other options are available to deal with the challenges faced by firms which are undoubtedly leading to market flight, for example:

- Changes to the ownership requirements which might otherwise allow more flexibility – e.g. reducing the emphasis on the audit qualification, but retaining a requirement for the involvement of professional accountants or other regulated professionals.
- A less prescriptive, more principles-based approach to ownership requirements whilst retaining appropriate safeguards.

60 The professional bodies should be ready to engage with audit firms to discuss the challenges they face (e.g. succession, funding etc) and the full range of options which may be available (depending on a firm's business model, strategy, needs, and risk appetite).

61 Audit firms are reminded of their responsibility to carefully evaluate the risks and benefits offered by private equity investment. As advised by the FRC, particular care is required to ensure that all legal and regulatory requirements are met in both substance and form. Firms must be satisfied that such investment will not negatively impact audit quality or lead to ethical challenges which cannot be managed.

62 As part of an appropriate due diligence process, firms should seek to understand clearly the motivations, intentions, and values of private equity investors, including their business strategy, exit plans, and any potential implications for the future of the firm.

63 Potential investors in audit firms need to be aware of the tightly regulated markets these firms operate in, particularly firms auditing Public Interest Entities. The scope for increasing efficiency while lowering costs in audit workstreams may be more limited than in some alternative investment opportunities. All investments are going to be subject to close ongoing regulatory scrutiny.

64 Audit firms need to comply with stringent audit, quality management, ethics and independence standards and other applicable standards. Compliance with such standards/regulations is a pre-requisite requirement for the licence for such firms to operate.

65 Where private equity investment is agreed, firms should ensure that appropriate controls and safeguards are considered and written into the contract to manage the risks involved.

66 We expect the professional bodies and the FRC to continue to work together to ensure that all audit firms are subject to the same eligibility requirements (in substance and in form) and that the risk of 'regulatory arbitrage' is minimised.

67 In summary:

Rules are set at a point in time to meet specific environmental conditions at that time. The rules on ownership of audit firms have not been revisited in-depth for a number of years. Given the evolution of society and market conditions in which such firms operate, now would seem an opportune time to reassess whether these rules are still fit for purpose. They cannot be lightly disregarded but must be subject to objective, independent scrutiny to ensure that they still best serve the public interest. Such a review of the ownership rules must be undertaken by a wider group of stakeholders than just the firms themselves. Those who ultimately rely on the work of auditors e.g. investors and financial institutions must have a say as do the businesses who contract for their services.

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