INTERNATIONAL FORUM OF INDEPENDENT AUDIT REGULATORS

18F Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku,
Tokyo 100-0004 Japan
Tel: +81-3-4510-3495
Fax: +81-3-4510-3499
Email: secretariat@ifiar.org Web: www.ifiar.org

December 16, 2024
Tokyo, Japan

International Forum of Independent Audit Regulators (IFIAR) statement on private equity investment in audit firms

IFIAR Members have observed a growing international trend for audit firms to accept private equity investment into their business models. Many of these firms conduct the audits of public interest entities, where the public has a strong interest in the quality of these firms' audit work and their compliance with independence requirements.

The key attributes of an audit firm conducting audits are commitments to audit quality; independence; integrity and a culture of professional ethical behaviour. These attributes apply, regardless of the firm's source of capital. A firm that is considering accepting private equity or entering any other non-traditional ownership structure must ensure that potential investors into the firm guarantee that these key attributes are not harmed by excessive commercial incentives and that the complexities of maintaining auditor independence are understood.

Some IFIAR Members recognise that there may be potential benefits to audit quality from firms having access to additional capital through private equity investment. These may include, among others:

- More funds available for investment in technology, systems of quality management, talent or other initiatives that may have a positive impact on audit quality
- Increased competition and auditor choice in an environment where larger, better capitalized firms can attain scale to compete in audit markets

Some IFIAR Members also note the potential risks to audit quality and independence from private equity investment. These may include, among others:

- Increased focus on short-term returns on investment resulting in a greater focus on the profitability of audits and a reduction in audit quality.
- Changes to the incentive structures within firms – potentially prioritizing profit over audit quality – leading to a deterioration in the culture of challenge, professional skepticism and independence required by audit firms.
- Increased volume of and complexity in identifying threats to independence and conflicts of interest as private equity investors often have many investments in other entities. The ability of an audit firm to monitor these threats may present significant challenges.
- Limited understanding by private equity investors (or new firm directors nominated by such investors) of audit firms' public interest responsibilities.
- Attrition from audit firms and subsequent lack of experienced talent in the area of audit, as a result of reduced incentives for younger professionals to stay at the firms to

18F Otemachi Financial City Grand Cube,
1-9-2 Otemachi, Chiyoda-ku,
Tokyo 100-0004 Japan
Tel: +81-3-4510-3495
Fax: +81-3-4510-3499
Email: secretariat@ifiar.org Web: www.ifiar.org

conduct audits. This could be a particular issue if a new legal ownership structure does not provide the opportunity for employees to share in the future profits of the firm.
- New investors considering the audits of public interest entities as less profitable and attractive, causing a reduction in market capacity for this work.

Audit firm ownership requirements vary across jurisdictions, as do audit regulators' mandates for oversight of transactions involving private equity. IFIAR Members are alert to the possibility that the economic substance of a transaction may conflict with its legal compliance with local regulations.

IFIAR and its Members will engage with the audit firm leaders to understand developments in this area and the steps that they are taking to safeguard audit quality and independence against risks. Given potential benefits and risks underlying this issue, IFIAR will continue to monitor developments in private equity investments in audit firms and will support its Members in considering the risks and impacts of such investments in their respective jurisdictions.