

Peterson Institute for International Economics

Should we care about who owns audit firms?

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[00:00:17.27] - Nicolas Véron

Good morning, good afternoon, good evening, and depending on the cultural traditions of where you live, happy New Year. It's not too late in some parts of the world. I'm Nicolas Véron. It's my pleasure to introduce this first session of the financial statement series at the Peterson Institute for International Economics in 2025. And we're delighted to talk about a topic that may sound nerdy, but it's actually very important for many of our stakeholders— auditor ownership and how that matters for the audit business. And we couldn't have better speakers for that than Maria Borisov and Liza McAndrew-Morberg. Maria Borisov got her MBA in finance from the University of Florida at the College of Business Administration. A decade later, in 2017, she got her PhD in accounting at University of North Carolina Chapel Hill. She started her career in business in the early 2000s, initially in Ukraine with Interpipe Corporation, a manufacturing company there. Also worked for the Swedish International Development Agency, for USAID, and importantly for the National Bank of Ukraine in 2004-2005. She then was in the US, worked for the Osprey Financial Group, which is affiliated with the University of North Florida, and for Cushman Wakefield in fields that were always about energy markets and capital markets.

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And after her PhD, became an assistant professor at George Mason University at the Costello College of Business, which she started in May 2017. She's also a research fellow at the Kenan Institute of Private Enterprise and she's teaching accounting, of course. She's also doing research on private equity, which is very germane to our topic today. And she has a lot of policy outreach also for the regulatory community in that area, particularly the US Public Company Accounting Oversight Board, the PCAOB, which has already been represented several times in this series, and which makes my direct segue to Liza. Liza McAndrew-Marburg studied at Santa Clara University in Spanish and accounting. In the '90s and early 2000s, she worked for PwC in San Jose, California, in Helsinki, Finland, then in New Jersey. And in 2007, she joined the Securities and Exchange Commission of the United States in Washington, D.C. as counselor to the director of the Office of International Affairs. So she very much has an international

perspective on accounting and auditing In 2013, she joined the PCAOB, already mentioned, as Director of International Affairs, a position she held until 2022. She now works in various capacities as a policy advisor, including since December '23 in matters of regulatory affairs for the International Financial Reporting Standards Foundation, the IFRS Foundation.

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She doesn't speak in this capacity today. I have to disclose whenever I mention the IFRS Foundation that its chairman is Erkki Liikennan, who is also the chairman of Bruegel, who is my other employer besides the Peterson Institute. But I don't think it creates a big conflict of interest for the purpose of our conversation. So with that, Maria, over to you.

[00:03:52.28] - Maria Nykyforovych Borysoff

Thank you, Nicolas. Let me share my slides with you. Okay, everything works. Is that correct? Okay. Hello everyone, my name is Maria Borisov and I'm here today to talk about the impact of private equity investments on accounting firms. And this is a relatively new phenomenon, but it has already had a significant impact on the accounting industry. So today I'm going to talk about the reasons behind this trend, about the potential benefits and risks, and about the concerns that regulators have expressed so far. But first, what I want to do, I want to put us all on the same timeline, because when we say the trend is recent, what do we mean by that? Well, the first announcement that made headlines was made in October of 2021, when we see here EisnerAmper LLP one of the top 20 companies in the US, agreed to accept private equity investment. A year later, we have another top 25 firm following this trend, and then finally last year we see Grant Thornton made headlines as the biggest accounting firm that received private equity investments. On the next slide, what I'm showing to you is a non-exclusive list of the accounting firms that so far have received private equity investments.

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But specifically what I want to point out is this timeline here. So we see that the trend starts in 2021. There are 2 transactions here, then we have 3 in 2022, and then we have many in 2024, and we expect that trend to continue well into 2025. So the question here becomes why the sudden interest of private equity in accounting. So there are several reasons for that. Well, first, these are the service firms with steady and profitable business model. What do we mean by that? Well, we have an audit side of the business and then we have the tax and advisory side of the business. What's great about it is that it is very well positioned to weather any economic conditions on the markets because during good times you can sell consulting services and you can charge those fees and it makes your performance really great. But then during the

downturns, firms still need audit services. So that audit side is really resilient to the downturns. And even if the consulting side of your business suffers, the audit side is still helping you to weather the storm. There is also potential for increased growth because the market is highly fragmented.

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If you look at the press releases during those announcing private equity deals, you will almost always see something along the lines of the There is potential to consolidate. The markets are fragmented, and you will see that usually what happens after getting that private equity capital, an accounting firm goes on a buying spree and they start acquiring smaller CPA firms. There is also great potential for cost cutting and streamlining because this is what private equity funds are good at, right? So we have AI, we have machine learning, we have all of these efficiencies that may be implemented. So companies are really going after that. And at the same time, we have to keep in mind most of the funds that so far have invested into accounting firms, they already have experience in investments in professional service industries. So we have seen them already being invested into wealth management, insurance, legal firms, and healthcare. And I want to highlight healthcare industry in here because even though it seems like there is nothing in common between accounting firms and healthcare, there is this ethical component that is really strong in both industries. Doctors have to care about their patients while thinking about the business side of things.

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And at the same time, accountants and auditors, they provide audit as a service that they sell. But at the same time, this is a public good that also involves this huge ethical component in it. So even though the trend of private equity investments in accounting is recent, private equity has been around for decades now, and we know what effects that investment may have on the target firm. So what does research document about the effects of private equity funds on their portfolio companies? You can see here that We have both the positive and the negative impacts. Among the positive impacts, there is improved operational performance, increased productivity, and increased investments in technology and innovation. All of that sounds great if we apply that to accounting. Among the negative impacts, research has documented job losses, reduced employee earnings, benefits, and job security. And again, specifically in healthcare setting, because private equity was very active and is very active in that industry now, we see increased mortality rates in nursing homes and increased complications in hospitals. What predictions based on these findings from the research can we possibly make as it relates to accounting? Well, we can expect improved audit quality if these private equity stakes go towards investments in technology, in acquisitions, and in talent.

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We all know that there is currently a shortage accountants on the job market. So having that capital and really investing into technology and the people is paramount for many accounting companies. There is also a strong incentive for a private equity firm to maintain and enhance the reputation, so, of their portfolio company because eventually they have to sell it. So usually when we hear private equity funds addressing concerns from the regulators, they will say we have no interest in deteriorating quality of audits because we have to sell our portfolio company eventually. Why would we have worsened audit quality? Well, first off, there is a short-term investment horizon. By the nature of private equity, usually they hold their portfolio companies on average for 3 to 5 years, and that is a short time to actually acquire a company and make enough of the improvement to increase that exit price that the private equity fund is after. So that can lead to the workforce reductions and cost-cutting measures that may potentially have a negative impact on the audit quality. And then there are independence concerns. What are those about? So the SEC, a year, approximately a year after the first deal was announced, issued a statement, and they said that the complex transactions that investors that are not traditional accounting firms are pursuing may lead to an elevated risk to an auditor's independence.

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And then subsequently, in May of 2024, the chief accountant of the SEC called out private equity firms specifically and said that depending on how the investments are structured, they could lead the firm's professionals to question the firm's commitment to both independence and high-quality audits. So here I would like to specifically highlight the part where he mentions the structure of the investment. Why is that piece important? That piece is important because accounting firms historically are owned by partners who hold a CPA certification, which is a Chartered Public Accountant, and that is a regulatory requirement. When the company decides to accept a private equity investment, it has to undergo a legal change in its structure. And that change is, that new structure that we create is referred to as an alternative practice structure. Let me explain what that entails. So we have an accounting firm here and we have a private equity firm that approaches the accounting firm and they decide that they will work together and the accounting firm accepts the investment from the private equity firm. What happens afterwards is that the accounting firm splits into 2 parts. The first part is the LLP, limited partnership, where the attest services go.

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So this is the home for the audit services now. And now the second part is the LLC, limited liability company, where the tax and advisory services go. And private equity firm actually invests into the LLC portion of the business only. This is a structure that is being pursued so far by all of the transactions that I have seen. And this can be kind of like an aha moment for many because they look at the structure and they say, well, it seems like the advisory part of the business that private equity is involved in is completely insulated from the audit side of the business. So what are the concerns that are being expressed based on? So when we looked closer into the details that were disclosed about these transactions and we just observed the behavior of the firms post-investment, this is what we find. There are some potential links that include personnel, both the top management and the lower-level employees. There is the management service agreement usually between the audit part of the business and the advisory part, where the audit company pays an annual fee for various services. There are shared customer accounts, customer compensation structures that are tied to performance of the customer accounts.

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And also, if you go to the website of all of these companies, what you will see that there is one common brand and most likely a shared office. So as a client, if you go there, you will never guess unless you really look into the small font and additional disclosures that there are multiple legal entities behind this one brand that sells you audit and advisory services. So I'm going to stop here because Liza is going to explain more about the concerns that I kept talking about. And before I do that, I'm going to finish my presentation here. When you look at this structure, does it alleviate your concerns? And then at some point of this presentation, I will give you an answer from a UK financial regulator about that. So Liza, on to you.

[00:15:54.16] - Nicolas Véron

That's quite a cliffhanger. Thank you so much.

[00:15:58.03] - Liza McAndrew Moberg

Well, I'm, I'm going to try, Maria, not to, not to be too much of the spoiler because I'm also going to talk a little bit about the UK regulator in my remarks. Nicola, thank you very much for inviting me back, and thanks to the Peterson Institute for having me here today. So the comments that I want to bring is very much from my regulatory background. I spent, you know, about 14 years as a CPA at a large firm and about the same amount of time as a regulator, very much in the disclosure and audited financial statement world. And I'm drawing very much from 2 different documents that were recently published in December, the International Forum of Independent

Audit Regulators. So the group of the PCAOBs of the world, put out a statement specifically on this topic on private equity. It was a brief statement, but it listed out some of their main considerations. And then the other one is the UK Financial Reporting Council, FRC, in September also put out an open letter. They sent a letter to their regulated entities, but also posted it on their website, which is very much their practice, where they set out their concerns.

[00:17:02.13]

And I think there's one little paragraph that I'll kind of paraphrase really quickly here for you that kind of sums it all up. The ownership structure is a matter for firms. The regulators aren't in the business of regulating how the firms are structured unless, other than meeting basic parameters like Maria just set out, majority ownership of CPAs is a very common one across, around the world. But in, and in principle, they're not against private equity investment. However, in their role of defending the public interest in supporting growth, They're primarily concerned with the outcomes and behaviors of the firms to deliver high-quality audits, having a culture where they act in the public interest, and ensuring the health of the audit market, that it's resilient and it provides choice. And I think that in a nutshell just captures really how all of the regulators are looking at this. So if I look at why they put this letter out and why IFRS put out its statement, it's very much for the reasons that Maria demonstrated. This is an increasing trend. It's growing rapidly. And, and so the, the regulators want to basically in their, in their role of monitoring overall quality, get out ahead of what are the considerations and what are the potential risks to this developing trend.

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Now, one thing that's interesting is at this time, the activity that's happened so far has had limited impact, I think, on the public interest entity audits. So most audit regulators are only auditing the public interest entity audits, which typically is listed companies, maybe some financial institutions, jurisdiction to jurisdiction, it varies. But a lot of this activity actually is of firms who have limited public company audit activity. But the regulators are spotting this trend, and especially with Grant Thornton is a great example of where this trend is very much moving forward. And so they're trying to get ahead of of, of some of their considerations. I think that they're, the, the considerations they have touch on 2 very long-term things that they've been talking about for a long time, the regulators, quality, fundamentally quality. And when you, when it's, when they're looking at quality, they're talking primarily about the culture of the firms and whether the governance structures are built in a way that maintains quality and prioritizes quality and specifically the public interest focus of a mandatory audit over the short-term profits. And then the second thing that I think they're looking at is competitiveness.

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There's been a longstanding conversation about the lack of choice in audit. And certainly there are barriers to entry for smaller audit firms being able to provide an audit of a publicly listed company. And so there are potentials for this, for this trend to actually improve. the choice consideration. And then on the other hand, there's also the opportunity that it doesn't work out so well. I think, and we can go into more detail on some of these individual aspects of culture and governance and quality that they're thinking about, but I think at the end of the day, to sum it all up, regulators don't yet have data that would support what the actual impact on quality will be. For that matter, it's not really clear what data you could use at all to measure audit quality. in this scenario or in any other. And so regulators are, are finding themselves in a position where they know they need to be on top of this. They know they need to be thinking about the risks as any good regulator would, but it's not super clear exactly what that concern should be. With that, Nicolas, I hope I didn't exceed my 5 minutes and back to you.

[00:20:38.16] - Nicolas Véron

That was fantastic. Thank you so much. I have lots of follow-up questions already. I encourage people who are joining us on Zoom to use the Q&A tool. I know we have great specialist talent in the audience, but maybe let me start and we'll come back to the British cliffhanger, Maria. But, but just why is this happening now? Why? What triggered— you described a very recent phenomenon. I remember discussions a long time ago, like 20-plus years ago, when people were talking about that as a possibility, but it didn't materialize. And now suddenly Suddenly, we have this cascade of deals. What triggered it?

[00:21:18.13] - Maria Nykyforovych Borysoff

So it is true that there were attempts to actually consolidate that market in professional financial services. Several firms pursued it. It was not very successful back then, 20 years ago. Based on my research into this, well, first, it's really— it was really hard at that time to consolidate everything together. When you have multiple firms and they have different cultures and different work styles and workflows. At that time, technology was not as good as it is today to kind of bring everyone on the same page. So that failed. And I feel like today there is also, there is huge gap between the Big 4 companies, audit companies, and everyone else there. And that gap actually, and Liza mentioned that, creates this opportunity for smaller companies to consolidate and actually gain market share and become more competitive. So now it makes sense, given all of the productivity tools that exist now in AI specifically, that is a big talk in this industry, to make a real difference in terms of creating bigger firms that are competitors to the Big 4s and that are able to provide audits to the listed companies.

[00:22:48.24] - Nicolas Véron

Do you think it's plausible that we get, you know, a Big 5 or Big 6 thanks to that consolidation, or does that remain a pipe dream given the structure and the incentives in the market?

[00:23:02.29] - Maria Nykyforovych Borysoff

I don't— Liza, do you have any thoughts about that?

[00:23:06.02] - Liza McAndrew Moberg

Yeah, it's possible, and it depends on how you measure, right? So there, there are ways that you measure the size of a firm and whether it's its overall revenues, whether it's its headcount, whether it's the market cap of the listed companies that it, that it audits. There are a lot of different ways to measure, but is there absolutely the possibility that some of these firms, you know, as I, when I talked about the barrier to entry, There's not a big barrier to entry to become a CPA firm, right? I mean, I'm a CPA. I could become my own firm and audit, offer tax services to all of my neighbors. It's that step up where you can actually serve a multinational client. That's where you really have the big barriers to entry. And even below that, even on a domestic front, a huge challenge for audit firms who want to audit a public company is meeting all of the details of the regulatory requirements. And some would say that that has become increasingly difficult in recent years. So in many ways, the private equity investment helps with a lot of those issues. So the PCAOB recently issued a report that said they've observed that where there's more standardization of some of the processes and procedures, you actually get fewer deficiencies.

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So private equity coming in and taking a bunch of firms who have talented people, they're good accountants, but all, all of the small nuts and bolts and all of the management of, say, billing for example, which takes up a ton of partner and manager time in the typical accounting firm. If you get efficiencies in all of those processes, is it possible that you actually get quality going up and the ability to compete?

[00:24:46.06] - Nicolas Véron

Liza mentioned international expansion because that's one of the biggest barriers to entry, right? Auditing the accounts of a multinational business requires a huge network. Do you see that in the deals you have observed? Are we already at the stage when some of those firms that

have private equity investors use the private equity money to expand abroad, or is that just something to watch for the future?

[00:25:12.21] - Maria Nykyforovych Borysoff

So I think what we have seen in public, because we also have to keep in mind private equity has the word private in it for a reason. Many details of these conversations and negotiations and even the done transactions are not made public. So I'm speaking to the one that was public. There was a conversation of Grant Thornton US investing into Grant Thornton in the UK. And what we have seen in the press at least was that the UK firm decided against it. So they said that they will be pursuing different opportunities. But that is an example of companies wanting to be able to have that selling point to their clients that we have offices on all of the continents and we can really serve you well.

[00:26:12.05] - Liza McAndrew Moberg

Nikola, maybe one other thought here is that as it is, all of the accounting firms anyway really are structured as individual partnerships, right? And they operate through a network agreement to collaborate with others. But there is a substantive difference between the very largest of the accounting firms, the Big 4, the Big 6, that the integration of that central function and how much of a central quality monitoring function there is differs dramatically when you go from there to, say, some of the smaller international networks that we've heard of. So, so there's, I think in the private equity space, it's very much possible that the number of entities that are available to be a part of those looser networks actually increases.

[00:27:01.05] - Nicolas Véron

There is an opposite concern, right? Because, and Heinz-Würgeler is mentioning that possibility in the Q&A. If you, if you get a Big Four to buy one of those firms, that can be an exit strategy for the private equity firm. So maybe Maria, Can you give us a sense of that? A, do you think that given, you know, competition policy and everything, it is plausible that some of these private equity invested firms will end up being swallowed by one of the Big Four? And B, more generally, can be— if that's not the only possibility, what are the other exit strategies? How can those private equity firms make a profit by exiting their investment?

[00:27:41.03] - Maria Nykyforovych Borysoff

So actually, that is a great question and everyone wants to know, including myself. What is good about us actually changing the date, right, from the original date to this date, is that we

now have one exit that was just announced last week. So Citrin Cooperman, the accounting firm that accepted the private equity investment from Yeah. Oh, you have that?

[00:28:07.10]

Yes.

[00:28:07.25]

Great. You came prepared.

[00:28:10.02] - Nicolas Véron

I feel prepared. For our audience, an explanation is necessary. We originally planned this for the 9th of January, but then it was declared a day of mourning for the death of former President Carter in the US, and therefore we had to reschedule.

[00:28:26.10] - Liza McAndrew Moberg

Yes.

[00:28:26.21] - Maria Nykyforovych Borysoff

So now, instead of speculating, at least we have one observation of an actual exit. So Citron Cooperman accepted the private equity investment from New Mountain Capital in 2022. And last week it was announced that New Mountain, which is a private equity firm, is selling their stake to Blackstone. So here what we see is a sale from a private equity firm to a bigger private equity firm. And that is a plausible strategy because So, New Mountain came in. Well, first, now we have a documented time horizon. So, it was 3 years that New Mountain kept Citron Cooperman in its portfolio. The implication of that is, what can you meaningfully do to drive that exit multiple? And when I say exit multiple, that is the increase in price of the portfolio company between the investment date and the exit date. from that investment. So selling to even a bigger private equity firm makes sense because now that private equity firm, I think this is the logic, believes that with more capital and more advice, because it is possible to drive that business and grow that business even further. Because what we know about private equity firms they specialize usually in 3 things.

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They do financial management, they do operational management, and they change the governance of the companies. So here it is actually like an ideal setting where all of those come together, and if used in a good way, this will propel the real growth of that accounting firm going forward. Now, in terms of selling to a Big 4, I cannot speak to that. I can tell you that I try to talk to people from Big 4s and everyone starts that conversation by saying that you cannot cite me, you cannot say anything, this is off record. I know that some of the firms actually had conversations about private equity investments. I know that these negotiations in some cases are ongoing and in some cases they broke down. So currently it seems like the most viable strategy is selling from a smaller private equity firm to a bigger one.

[00:31:00.20] - Nicolas Véron

Blackstone. Well, when I mention Blackstone, of course, I think of the late Pete Peterson, who was one of its co-founders and gave his name also to our institute. Blackstone obviously has an exit strategy of their own, right? So if it's not selling to a Big Four, what could it be? Is it plausible that these entities— and you explained the structure— could in the end go public? What, what, what is the— what are the alternatives?

[00:31:29.17] - Maria Nykyforovych Borysoff

So that is a complicated question, which I do not have an answer to, because there is still this implication of the requirement that the attest services have to be owned by the CPAs, as we already discussed.

[00:31:44.08] - Nicolas Véron

Just sorry for interrupting, but that requirement is basically the same in the US and in other jurisdictions, or are there big variations about that?

[00:31:52.26] - Maria Nykyforovych Borysoff

So I think Liza can speak to that because she mentioned that that requirement is pretty much all over the world. Liza, can you speak to that?

[00:31:58.29] - Liza McAndrew Moberg

Yeah, it's, it's a gen— it varies slightly from jurisdiction to jurisdiction, but for the most part, yeah, you— an accounting firm that's registered to do public company audits at least does need to be owned by practitioners. There are different approaches. I think the minority of the approaches would be more stringent than that or have maybe more criteria in order to become,

whereas what I think it's quite typical, the model that we have in the US where you do have to be a partnership or a group of practitioners, you are able to register as long as you are, you know, you hold your licenses to be a practitioner and any exit of you from that registration would be based on if there's an enforcement action. So it's not like there's kind of a criteria that you need to meet first to prove your quality in order to get in. it's more you by default can get in if you meet basic criteria and you can get kicked out if you don't behave well.

[00:32:57.02] - Nicolas Véron

That's right. Thanks for that. Back to you, Maria.

[00:33:00.18] - Maria Nykyforovych Borysoff

Yeah, so I think it's hard to say whether there is a need for separation again, right, that the advisory part of the business goes public, for example, and then the attest part of the business stays private. Again, that is This has its own implications because like I said, if you go to websites of any of those companies, they do not position themselves as different legal entities. They position themselves as one single brand, one company that actually can cater to multiple needs of clients, right? That is the point. We can give you test services, but we also have all of these other services that we can provide you with. So the going public strategy is a big question mark at the moment.

[00:33:49.06] - Liza McAndrew Moberg

Yeah, Nicolas, if I can build on that a little bit more. I mean, again, let's look to the UK for just a second. The UK has just finished its transitional stage for an initiative they started in 2020, which was for operational separation of the Big 4 firms. And they didn't endeavor to separate them legally. They said your attest function and your advisory function should operationally be separate in order to ensure that the attest side has the right governance and the right decision-making around it, that it is a standalone viable practice, but it still has the ability and makes good decisions for audit quality, not for maximizing profit on the advisory side, but still has access to all of the experts that are on the advisory side, because the firms made their case for, we actually do draw on that expertise and that real live market experience to make our audits better. And so I think that when we look at the private equity, how they actually would separate the attest function from advisory function and some of these quality questions that we have around it, also the profitability questions, right, around it. I think the UK experiment is going to give us a lot of analogous considerations to look at.

[00:35:04.04] - Nicolas Véron

Is this a moment to get back to Maria's teaser about the UK, right? What is it that you had in mind when you mentioned it at the end of your presentation?

[00:35:14.10] - Maria Nykyforovych Borysoff

Yes. So let me let me share this slide with you. In the US, usually when you show this and you explain the changes in the structure, people would usually say, well, this should be enough. We obviously see that there are 2 independent legal entities. And then in the UK, this is what the quote from the Financial Times that was published in September of 2024. So they say that the regulators would judge the control of the P as PE investor, right, over the accounting firm would be judged by reference to economic substance. So going back to the comments by Liza, and not just the legal form. So I think it is important to understand the viewpoints of different regulators here in the US, for example, and there in the UK, because currently here, private equity funds would use the alternative practice structure as an argument to the complete independence of the attest services from the advisory. And then in the UK, the regulators are already saying, well, the legal separation may actually be not the only thing that we care about.

[00:36:39.29] - Nicolas Véron

All right. Still talking about the structure thing. We have Mark Pankin in the audience. Sorry about that. Who mentioned a CPA firm called CBIZ, which is a publicly traded firm, actually a firm, actually CBIZ, which owns CBIZ CPAs and with an alternative practice structure and a governing board at the CPA firms that is independent from the parent company, CBIZ Inc. I don't know if you know that case. I didn't know it, so maybe that's too nerdy, but any comment about that one?

[00:37:15.28] - Maria Nykyforovych Borysoff

No, I'm not familiar with this example.

[00:37:17.26] - Nicolas Véron

So that would be interesting to explore, maybe if Maren Pankin wants to give us more insight. I guess it's a US company.

[00:37:28.01] - Liza McAndrew Moberg

Yeah, and that, I guess, focusing on that, that part about the governing board is independent from the public company. I mean, I think that's really the regulatory focus is, is it truly independent? Does that, and, and not questioning CBIZ whatsoever, but the, the, the view that

the regulators would take in any of these structures is, is how can we make sure that it truly is independent? And they are not just in, in, from an investment point of view, but also judgments and decisions, choices of investment. How do we promote, who do we promote within the firm? What access to, to staff? I think Maria's model gave a, a nice indication that many times that the staff actually do not sit within the LLP. They sit over in, in the other structure, and there's a service arrangement. Well, how do I get to decide which of those staff I use and how they get, you know, for an individual audit? There's a lot of focus by regulators on what choices go around making sure you have the right complement of staff below the partner level to service that audit. Well, what access do I have to those staff who are not really mine within the LLP?

[00:38:34.08] - Nicolas Véron

And thanks for correcting me. It's pronounced CBIZ and not CBIZ. I apologize for my mispronunciation. But back to this question again, staying a minute more about the structure. So there is this requirement, and Liza, you mentioned in most jurisdictions that the audit firm, the assurance function as it's called in the jargon, should be, as opposed to consulting and tax advice, they should be owned by certified accountants, whatever the name of the license is in the different jurisdictions. Could that evolve over time, or is that in your view something that won't change in any circumstance? And maybe a question to Maria, because you mentioned the legal profession, and in my mind, the legal profession also had something along those lines, right? Lawyers have to be members of the bar or something equivalent. How does it work in legal? Is there a kind of equivalent regulations that, you know, individual certified lawyers should be owners of the relevant structure? Is there anything to learn from that or other examples? And, and do you see in the future, for the same reasons, you know, AI investment, blah, blah, blah, international expansion, Would it be a possibility that the policy of requiring individual ownership could change also for the assurance piece?

[00:40:06.13]

Maybe Maria first.

[00:40:08.26] - Maria Nykyforovych Borysoff

So I will actually pivot to the healthcare industry because I already mentioned there are ethical considerations in that industry as well as actually a requirement that MDs, doctors, own medical practices. And the nice connection to the setting that we are looking at in accounting is that, that management service agreement that we observe between the attest side and the advisory side is actually happening in healthcare as well. So there is a medical practice that is owned by MDs, and then there is a legally independent entity that private equity invests into. And they also have

the management service agreement. And because this has been going on for a while and for a longer time than in accounting, what is being observed, and actually there are lots of concerns about that, is that medical practices are being stripped of assets and then all of those assets are being transferred to this legal entity that is owned by the private equity side. And then under that management service agreement, the medical practice pays to this legal entity the fees for all of the— for the use of the facilities, for example, for the use of the equipment, for the billing services that that site provides, and everything else that you can imagine is involved in running the business.

[00:41:46.29]

So in a The big question becomes, how high is that fee? What determines that fee? And if that incentive is strong enough, do we start to shift into this gray area where the ethical concerns start to overlap with the business concerns? And that impacts the decision-making. And I think that is the concern in the accounting structure as well. Will the incentives be structured in a way that will shift us into that gray area where keeping a client happy potentially impacts the decision-making on the audit side of the business?

[00:42:37.22] - Nicolas Véron

Trade-off which has always been present in auditing, right? I mean, make the client happy versus integrity of the audit. Process in a way that was internalized by the practicing auditors until now. Now there's this kind of division of labor between the greedy investor and the practicing auditor with integrity. And the question is, how can they— how can they manage it? But the conflict itself is not entirely new. Can you give us a little bit of a sense of how you view that conflict or that tension maybe playing out and And in a way, you know, there was this slide from Maria on pluses and minuses. It will help with investment. It will create, you know, challenges. And we see those horrible stories of PE-invested healthcare firms when— where people start to die. How concerned are you? How do you see that playing out?

[00:43:35.17] - Maria Nykyforovych Borysoff

So I think as a researcher, I want to present a balanced view. And that's why I list both the good sides and the bad sides of this. Liza was very correct when she said currently regulators don't have data to go off of, right? We observe these deals, but then again, because they're private, we don't have enough of publicly observable processes and changes that these companies are undergoing. So currently we can speculate, Again, based on the prior research findings and what private equity has been doing in other companies. And yes, there are concerns, but are there good things to this? Yes, there are. And we actually try to measure in my research that we

presented to the PCAOB, we try to measure the indirect perception, market perception of private equity investments in accounting firms. And the way we did it, we looked at the market reactions of the stocks of the companies that have auditors that receive a private equity investment. And you know what? The markets reacted positively. It was not a negative reaction. It looks like the market actually thinks that this is good. And I think this is because initial reaction can be all of that capital, if used for good things, for implementing technological change, for hiring good people, will actually increase the competitiveness.

[00:45:20.12]

It can increase the audit quality. Again, the reputational concerns, right? If you need to sell this company 3 years later, then maybe you will be investing in actually that company doing a really good job. Because this is how you acquire new clients. Are there downsides? Possible downsides, I'm going to emphasize that. Yes, there are. But I'm trying to kind of just list all of these points of view and maybe Liza can contribute to this.

[00:45:59.05] - Nicolas Véron

Liza, you're You're, you're doubly qualified here because not only are you a former regulator, but you're a former regulator. So you, you can be more free to talk than a current regulator.

[00:46:12.22] - Liza McAndrew Moberg

Indeed. I, so, Nicolas, I just, I, I, I very much affirm, as you were saying, that this conflict of interest has always been there. I mean, there's a conversation that happens often about enforcement action, right? What's that motivation with the firm? Is it, is it enforcement? penalty, actually the cost of doing business. And so you can, you know, have lower operating costs and get more audits done and keep more clients happy and have the volume of your revenues higher. And yeah, maybe you get an enforcement action here and there, but we can pay for that and we can manage the PR aspect of it versus no, we truly— and going to the title and the description of this, we are a profession. We're not an industry. We hold ourselves to high account, you know, to high standards. of ethics, and we would never look at our job that way. The reality is the tension has always been there. And if the ultimate motivation were return to stockholders and a board of directors with fiduciary responsibility to the shareholders, that may exacerbate that tension a bit. It might change the angle on it. But you're right, that wouldn't be a wholly new conflict for the accounting profession.

[00:47:20.20] - Nicolas Véron

Fascinated by this semantic insistence on being a profession, not an industry. I mean, looked at from outside, it looks also a little bit like an industry. What do you think of the semantics in your practice, Liza?

[00:47:34.21] - Liza McAndrew Moberg

I, being still a CPA, I do very much view myself as a professional. And, you know, I've worked as a regulator for so long because I really am interested in the public policy and the public interest aspect of that work. But, you know, some of these firms are huge. You can't say that to a person, every single person in the practice necessarily always has the same mindset. And I would also highlight that, you know, we have changing trends in the workforce, right? And as the workforce ages and as more people who right now are partners who kind of grew up in that we're a profession, not an industry mindset, is the culture of the incoming profession, which as Maria rightly points out, we have a shortage of CPAs. That's a real concern. What is that culture that is fostered amongst them? Is it as a profession or a professional in an industry?

[00:48:34.09] - Nicolas Véron

So, Marina, you mentioned in your presentation, it's also in Reinhilde Wögler's question. I mean, if I can put it that way, the staff is increasingly made of robots, right? So, I mean, IA is having profound impact on the business of accounting firms and auditing. Does that mean it's mechanically going to be more of an industry and less of a profession, or are things more complicated?

[00:49:04.02] - Maria Nykyforovych Borysoff

From what I've heard from the partners in accounting firms, because I attended the presentation that was specifically about that, what are the changes that accounting firms are undergoing when they implement AI. And everyone agreed that it's not that AI is going to replace people. It's the people with AI skills, CPAs with AI skills, are going to replace CPAs without the AI skills. So I think this is an important thing to keep in mind when we think about that. So there will still be competition on the job market for really good people with high competency levels.

[00:49:52.03] - Nicolas Véron

They can be— they can still think of themselves as professionals, as with the kind of mindset that Liza referred to, right?

[00:49:59.21] - Maria Nykyforovych Borysoff

So it's not just the computer who will be doing this. There will be people involved.

[00:50:06.03] - Liza McAndrew Moberg

Yeah, one of the— again, the PCA recently put out a spotlight report that it was specifically on culture. And one of their observations was, I mentioned before, more standardization actually brings down deficiencies. But on the other side, they also observe that more kind of offshoring of the work or using specialized service centers for some of the procedures might impair younger professionals developing those core foundational skills that when they— over the years, as you have more exposure to sticky situations, And you, you, you have to practice professional skepticism, but you have to cut your teeth on something that's a little bit easier before you have the really complicated, you know, my client is trying to change their earnings for the period. So, so I think that's an interesting point on as there's more investment in AI, how is, how is it that we actually develop these professionals who do have, you know, they're auditors with skepticism with AI skills versus I used AI and now I might be done.

[00:51:09.20] - Nicolas Véron

If you're an auditor and you've never actually done an inventory, can you really understand how an inventory can be manipulated, right? So, Liza, I actually, both of you mentioned audit quality, but Liza, this question is for you because I know that the PCAOB has been trying for years to develop audit quality measurement metrics, assessment in the most, you know, kind of precise and specific and if possible quantitative way. My impression of our debate is that the fact that the ownership structure becomes a bit more capitalistic one way or another means that regulators will be increasingly important. Right. So essentially, we will need more input from regulators to make sure the integrity of the audit process is there, maybe than was the case in the past. Not to say it's an entire shift of responsibility from the auditors to the regulators, because that would not be workable. But, but it seems to me that there is a little bit of that rebalancing. Am I wrong? And also, can you tell us more about what the PCAOB managed to achieve in terms of audit quality measurement?

[00:52:28.06] - Liza McAndrew Moberg

Yeah, so a little contentious at the moment. So the PCAOB recently finalized a requirement that requires certain metrics to be made disclosed about the firm overall, as well as individual audit engagements. And, you know, previously they had an initiative on audit quality indicators to try to come up with audit quality indicators. Now they're metrics. I think you observe amongst the regulators that they are trying to differentiate a little bit audit quality indicators versus metrics because of this inability to really clearly say these factors are the ones that change audit quality,

right? So, right, the PCAOB finalized that standard. It's with the SEC now to approve it, and the SEC, I understand, recently extended its comment period, which means it will continue into the next commission to decide whether to approve that standard. But I would say, Nicolas, more generally, not specific to the SEC rulemaking, I mean, I think at the end of the day, if the regulators are finding deficiencies in the audit, that means something needs to be improved. And really it was, it's less about the audit quality indicators than what they call root cause analysis. Why are these problems happening and what needs to happen to fix it?

[00:53:42.05]

And again, you know, the motivation always should have been there with or without private equity, but it's, this will be an interesting case study that private equity has a motivation in a short timeframe to identify what are those problems so that we have a better reputation, which means better profitability. quality for their ultimate exit strategy. So I think, long way to say, Nicolas, I think it's that root cause analysis, what's really behind the problems and how do you fix that, much more so than specifically audit quality indicators.

[00:54:10.19] - Nicolas Véron

So audit quality indicators idea is still live, or is there any— I'm sorry, I'm displaying my ignorance here because I've not been watching that field enough in the last few years. So any developments on that front? Because it's It sounds like a good idea.

[00:54:27.12] - Liza McAndrew Moberg

Yeah. So what I've observed in general is the narrative shifted over the past, I would say, you know, 5 to 8 years from talking a lot about measures of audit quality into being more robust in the conversation around culture. So the UKFRC did a thematic review in 2018. We keep talking about the UKFRC. They do really exciting things. They put out a thematic review, and there's a report on their website in 2018 around audit firm culture. And at the time they did that, that amongst the regulatory community, it was, well, yeah, you're right, but we don't really know how to talk about it. It's not really in our standard. Like governance is in our standard, independence is in our standard, ethical behavior, but culture and how you look at culture, how you measure it, how you would write an inspection finding on it was a little bit more loose. And I think the UK really went all in in this narrative around it that now you see the PCAOB put out report at the end of last year, a spotlight on audit firm culture. I think that's where you're going to see the conversation much more than efforts at discrete measures of audit quality.

[00:55:35.02] - Nicolas Véron

Very interesting. We talked about the US, we talked about the UK. Any other jurisdiction in the world that, you know, sticks its neck in this debate? Or at this point, is it just, you know, a kind of London and New York, New York and London story? I'm I'm just curious about what you hear from elsewhere in the world. Maybe Maria.

[00:56:01.11] - Maria Nykyforovych Borysoff

I have read the document, but that document was provided to me by Liza from Japan, correct, Liza?

[00:56:10.02] - Liza McAndrew Moberg

IFRS is headquartered in Japan, yeah.

[00:56:12.10] - Maria Nykyforovych Borysoff

Yes, so I will let you answer that question.

[00:56:15.15] - Nicolas Véron

It's an international organization, right? So IFRS Secretariat, which happens to be in Tokyo, but it could be in, you know, on Easter Island as well, right?

[00:56:25.21] - Liza McAndrew Moberg

Yeah, that's right. And it's a consensus organization made of— its board is members of the regulators from around the world and they operate by consensus. So yes, it's very much an international organization. But Nicola, was your question more specifically trends on private equity investment around the world?

[00:56:41.08] - Nicolas Véron

That's our theme today. Is that an issue that at this point, just because private equity frankly is more developed in the US and the UK, is it an issue that only shows up in those jurisdictions? And Maria, you've rightly emphasized that this is a recent emerging issue. Or do we see also some trends developing in other jurisdictions already, or do you expect that to show up? Liza?

[00:57:12.03] - Liza McAndrew Moberg

Oh, thanks.

[00:57:12.26]

Sorry.

[00:57:13.24]

So yeah, I haven't heard about it pervasively in the rest of the world. So it, I think it very much follows where you have active private, private equity investment. They're investing in those markets. So, while it was an IFRS statement, I think that there are themes that you see in the statement that you've heard from some of the other larger regulators around the world, and a lot less concern or statements being made in, say, Asia, Africa, Latin America.

[00:57:42.00] - Nicolas Véron

It's also probably the case, but I may be mistaken about it, that the PCAOB and the FRC are simply the 2 largest audit regulators in the world, right?

[00:57:50.12] - Liza McAndrew Moberg

Yeah, they are, with CPAB in Canada also being a, also a very, you know, forward-thinking and very active on the culture debate as well.

[00:57:58.29] - Nicolas Véron

That's right. Okay, so we're going towards this space, but I'd like to go back to the incentives of the private equity investors themselves. Maria, you talk with those guys, as you, I mentioned, you have been doing research on private equity for a long time, not just in the context of accounting. How do you see their— I mean, what do you observe in their motivation? Of course, their motivation is to make money, but in terms of their understanding of the industry— sorry, of the professional— of the profession's, you know, practices, idiosyncrasies, can you give us a little bit of color of what you see from that side of the landscape?

[00:58:47.22] - Maria Nykyforovych Borysoff

I think the main trend that we see is that the private equity investor comes in and acquires a stake in the accounting firm. And then you will see that all of these companies start pursuing a so-called roll-up strategy. And in private equity, what we mean by a roll-up strategy is you start buying other practices that are within the same industry as you are. And there can be different approaches there because sometimes companies start buying other companies in close proximity. So this is just gaining market share in the local market that they are located in. And then other companies actually start investing into CPA firms elsewhere. So you are covering the

wider geography, and that connects us to that question that companies want to be able to service their clients all over the country. We know United States is a big country and we have multiple states and regulations and all of these things. So the main trend, I would say, given the short time horizon there, is currently the industry is undergoing the consolidation. So we are buying smaller players and we are creating these bigger companies with higher competencies and higher levels of investments into the workforce and the technologies that help to deliver the product.

[01:00:28.17] - Nicolas Véron

I think we're at an hour. So I would have tons more questions as usual, but one hour goes very fast. Thank you so much. This was extraordinary. Extraordinarily informative on an emerging trend. Not all emerging trends are about Bitcoin and central bank digital currencies in finance. So we're very attuned to trying to find them in other areas at the Peterson Institute. Very, very thought-provoking conversation. Thanks so much to Liza McAndrew Moberg and Maria Borisov for their insights today. Thank you.

[01:01:04.29] - Maria Nykyforovych Borysoff

Thank you.