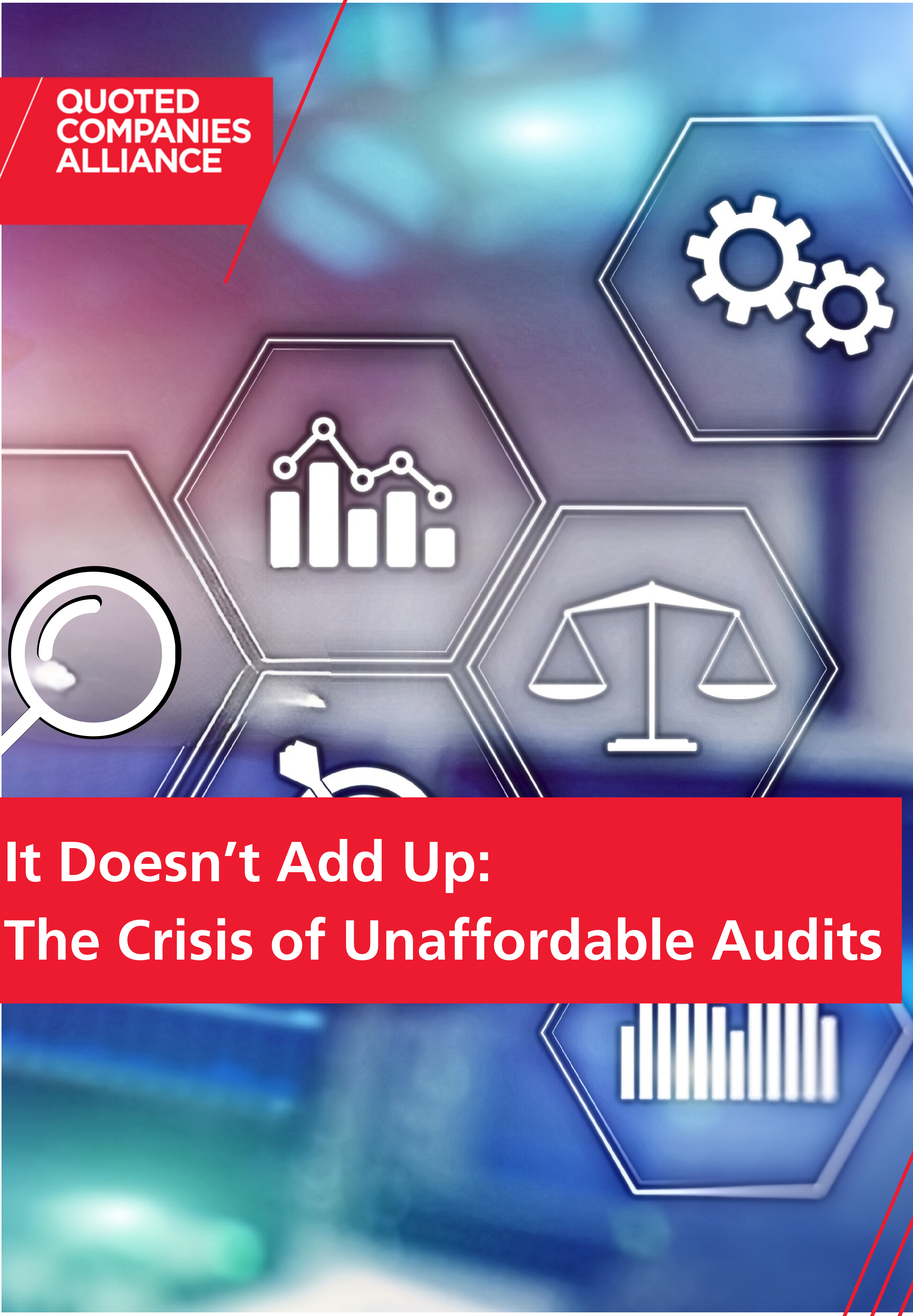
QUOTED COMPANIES ALLIANCE



It Doesn’t Add Up: The Crisis of Unaffordable Audits

Contents

Foreword

In updating the remit of the Financial Reporting Council last November, the Secretary of State for Business, Kemi Badenoch, wrote that in addition to fulfilling its core purpose of enhancing public trust and confidence in corporate governance, financial reporting and audit, the FRC "should contribute to promoting the competitiveness and growth of the UK economy, embedding its growth duty across its work" [1].

Her comments tallied with one of the strategic objectives detailed in the FRC's current three-year plan, to "create a more resilient audit market through greater competition and choice" [2]. These are laudable missions, ones that the Quoted Companies Alliance welcomes. When every public company can access an affordable audit, one that does not force directors to make difficult decisions about how to allocate their limited resources, the FRC can rightly declare it mission accomplished.

For now, that moment is worryingly distant.

Our research finally puts some numbers to one of our members' most common gripes. The cost of audit for a company covered by this research has soared by an astonishing 127% in five years. I know many have experienced bigger jumps. Still, by our calculation that's gone up at five times the rate of inflation and we estimate far, far faster than the costs have increased for FTSE 100 members [3]. Something has got to give.

Quality counts, undoubtedly, and the FRC has made driving up audit quality one of its key focuses for several years now – with notable success. [4]

But that focus comes at a cost if it has inadvertently compromised many companies' ability to invest, recruit, export and, broadly, compete.

What is harder to measure but no less concerning is the availability of audit. We hear enough anecdotal evidence to conclude that drumming up interest for a competitive tender is significantly harder than it was. In of itself, that trend points to higher cost, but also highlights the opportunity cost: what else could directors be doing to develop their business if they didn't have to hunt around for someone to check their books?

We estimate that the cost of quoted life for a small or mid-sized company – its governance, exchange fees, advisers and enhanced audit - adds at least £500,000 to annual outgoings compared with a similar-sized privately-held entity. Of this, audit accounts for a sizeable chunk. Of course, the upside of being publicly traded is the ready access to capital, visibility to investors and transparency of operation. Yet the volume of departures from London's markets suggests for some the cost-benefit analysis does not currently work.

[1] Financial Times, November 2023, UK ministers set out plans to make regulators better promote growth.
[2] Ibid.
[3] Financial Times, December 2022, FTSE 100 CFOs tell Big Four to cut costs after audit price jump.
[4] FRC, 2024, Views of firms on entry, growth and exit in the markets for smaller PIE and non-PIE audits.

Now we can't expect the FRC to take responsibility for boosting market liquidity, but we can hope it will look closer to understand the drivers of rising audit costs right across the market.

Its Scalebox [5] initiative seeks to help smaller firms understand regulatory standards and grow their capabilities. A recent study it commissioned to explore the barriers to competition in the UK audit market found extensive evidence of smaller audit firms caught between growing demand for their services but severe staffing constraints which limited their ability to meet that demand. The report recommended a "whole system response" involving audit firms, professional bodies and the government to ensure there is enough personnel in the market.

That's fine, but none of these stakeholders face an existential threat. What part of the audit process can be standardised or simplified? Can the profits extracted from this activity be justified?
To be clear, the QCA does not have all the answers. But we know that companies that have actively chosen to be public, that require the imprimatur of a good audit to instil trust and confidence in their shares, should not be priced out of the market.

That's a failure of competition – and it is far from being in the public interest.

James.

James Ashton
Chief Executive
Quoted Companies Alliance

> "The cost of audit for a company covered by this research has soared by an astonishing 127% in five years.

[5] Ibid.

Executive Summary

- The average percentage change in audit fees across all markets between 2017/18 and 2022/23 is 127%.
  - LSE Main Market companies experienced an average increase of 149% in audit fees;
  - AIM companies experienced an average increase of 110% in audit fees; and
  - Aquis companies experienced an average increase of 97% in audit fees.

- Audit costs soared with companies facing a staggering 75% increase in audit fees over five years, jumping from an average of £397,243 in 2017/18 to £694,083 in 2022/23.

- Over the past five years, companies have shouldered, on average, an additional £60,000 annually, accumulating nearly £300,000 in extra audit fees.

- From our sample of 220 companies across the LSE Main Market, AIM and Aquis, 183 companies witnessed an increase in audit costs.

- For companies on the Main Market, this means that companies with a market capitalisation under £500 million, on average, are paying more than half a million, £547,000, or 75%, extra in audit fees.

- Similarly, companies listed on AIM, with a market capitalisation under £500 million, on average, are paying more than £97,000 extra in audit fees, or 75% extra in audit fees.

- As for Aquis companies, with a market capitalisation under £155 million, companies are paying an average of £35,000, or 65%, extra in audit fees.

- Factoring in inflation over a five-year period, companies are paying, on average, an additional £45,000 annually for audit fees, resulting in a total increase above inflation of over £226,000 during the period.

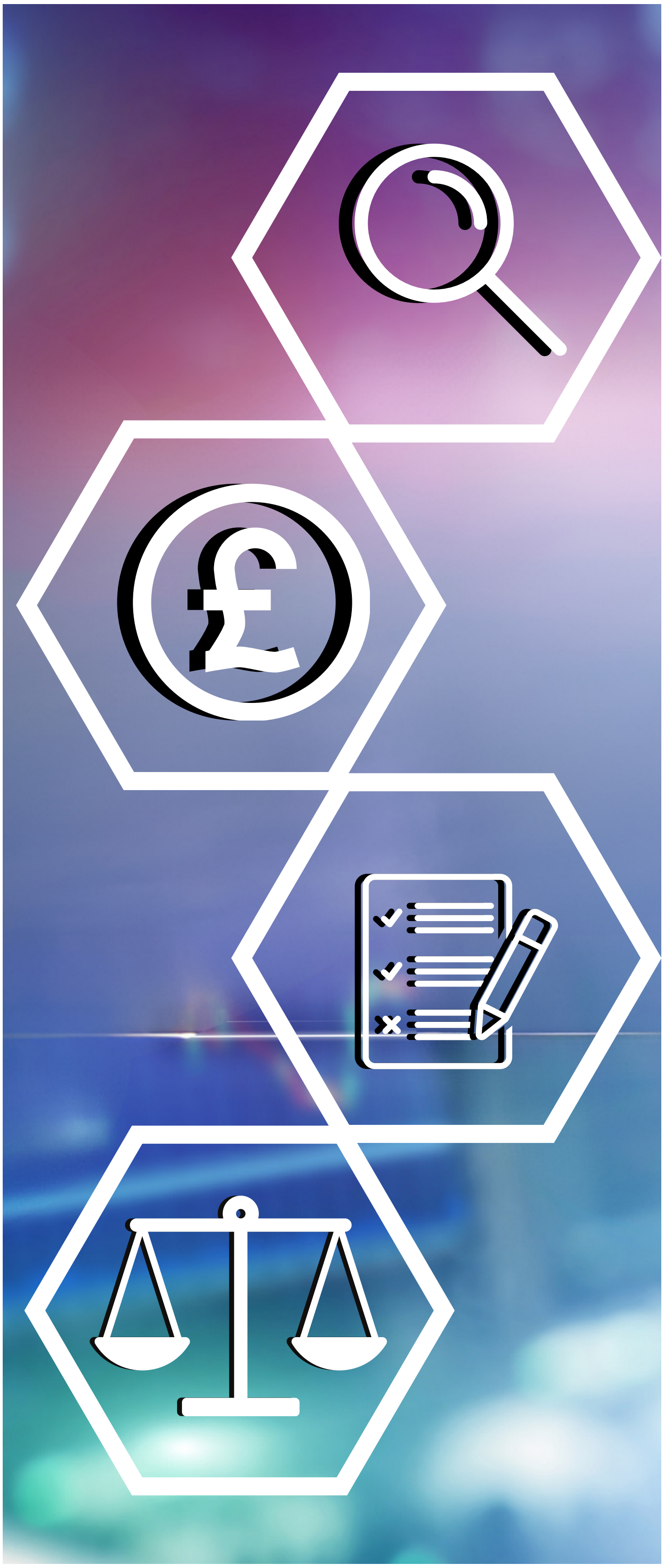
- The QCA believes that several measures can help to improve the current situation, including:
  - Streamlining the audit process to promote efficiency;
  - Enhancing the attractiveness of the industry;
  - Evaluating the liability regime and considering a shift from individual to collective accountability; and
  - Promoting transparency and benchmarking within the industry.

Research - The Cost and Availablity of Auditors

The audit market has been the subject of much attention in recent years. Several high-profile corporate failures, such as BHS in 2016, Carillion in 2018, Patisserie Valerie in 2019, and Thomas Cook also in 2019, have drawn significant attention to the alleged poor auditing standards and practices and resulted in record-high fines.

The result of these failures has seen a considerable amount of attention diverted to these cases and the audit market. They led to Sir Donald Brydon's review into the quality and effectiveness of audit, and the Competition and Market Authority's review into competition in the audit market. We have witnessed a considerable amount of focus on this area from the Government, regulators, media and the wider public.

This research delves into two different aspects of the audit market: cost and availability. The cost of an audit has also received attention in recent years, and there has been much said anecdotally about rising fees. However, any studies that have taken place previously into the changing costs of an audit have typically focussed on the UK's largest companies, such as those in the FTSE 350. For instance, in December 2023, the Financial Reporting Council (FRC) published the report, "Audit market and competition developments: A snapshot" [6]. This report found that between 2021 and 2022, audit fees for FTSE 350 companies had increased by 13% [7]. Similar levels of increases were also witnessed in previous years, with 2019 – 2020 being a slightly smaller increase.



[6] FRC, December 2023, Audit market and competition developments: A snapshot
[7] Ibid.

This study sets out to determine the experience of smaller companies in relation to the costs of audit and the availability of auditors.

In both instances, we find that these companies have experienced significant issues with increasing costs and decreasing availability of auditors.

Whilst this represents a sizeable increase in audit fees, and would suggest substantial year-on-year increases for companies, the FTSE 350 are typically well-resourced, have international reach and have the cash available to deal with these increases.

However, with these increases being seen at the top end of the market, the question remains as to whether the experience of smaller companies – those who are typically less well-resourced and are more cash-constrained – has been the same. When talking about smaller companies, the issue of the availability of auditors also crops up frequently.

This study, therefore, sets out to determine the experience of smaller companies in relation to the costs of audit and the availability of auditors. In both instances, we find that these companies have experienced significant issues with increasing costs and decreasing availability of auditors.

We first tackle the issue of the cost of audit, finding that there have been substantial increases for smaller companies operating across the UK's exchanges, before we consider auditor availability.

The dataset reviewed to assess the changes in cost of audit included a total of 220 companies, picked at random, as follows [8]:

- 100 Main Market companies with a market capitalisation of less than £500 million;
- 100 AIM companies with a market capitalisation of less than £500 million; and
- 20 Aquis companies with a market capitalisation of less than £155 million.

[8] A breakdown of the companies reviewed can be found in the Methodology section.

The Cost of Audit - Results

Across all three markets reviewed, there was a significant increase in the fee paid by companies between the period 2017/18 – 2022/23. Figure 1 shows the average percentage change in audit fees across the three markets, as well as the overall figure, showing that the average increase in audit fees across the five years was 127%.

Figure 1 - Average percentage change in audit fees (2017/18 - 2022/23)

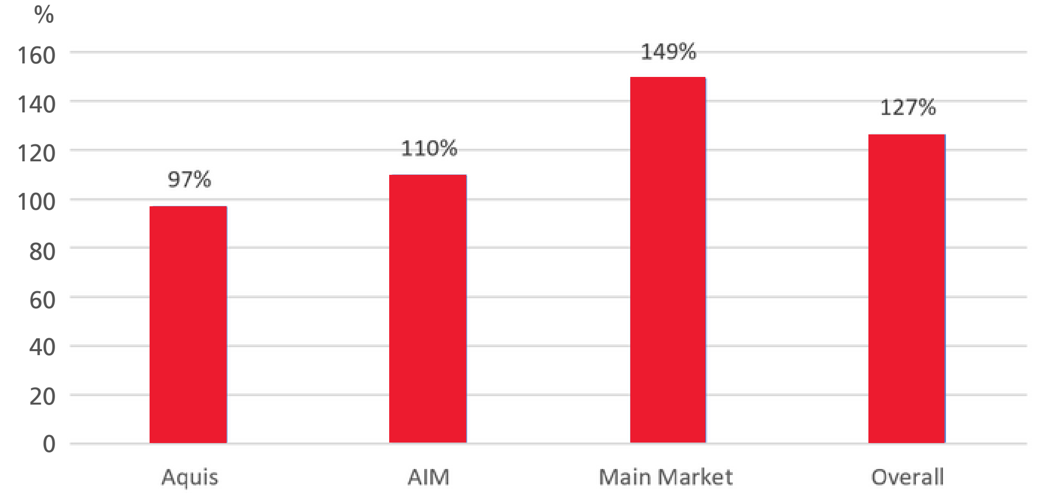
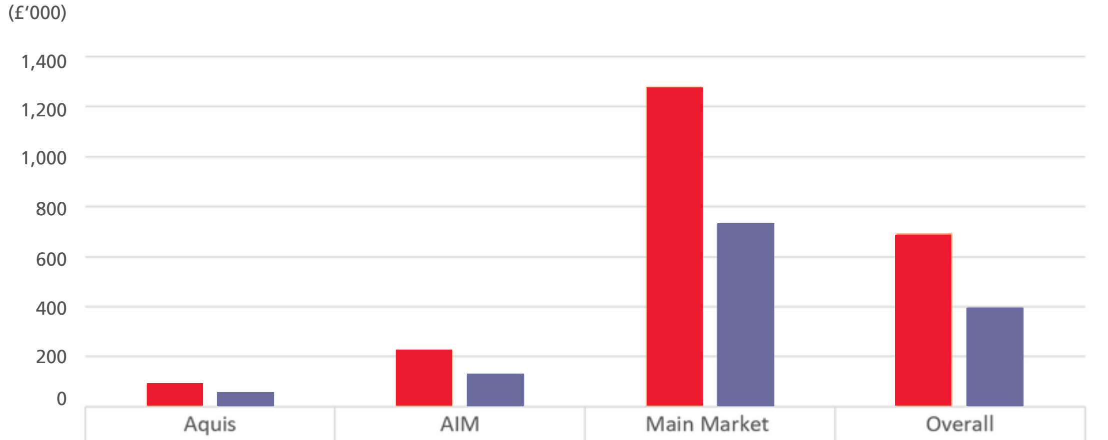
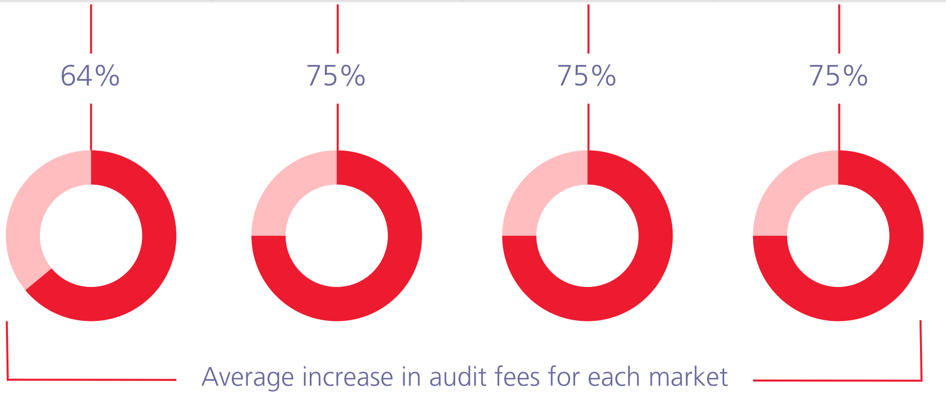


Figure 2 - Average audit fees



	Aquis	AIM	Main Market	Overall
2022/23	£89,900	£228,300	£1,280,700	£694,000
2017/18	£54,900	£130,400	£732,500	£397,200



Average increase in audit fees for each market

Figure 2 demonstrates the average audit fee for the years 2017/18 and 2022/23. It shows an increase for each market, with a total overall increase of 75% for the three markets combined.

It is important to explain why we have provided the two figures. The second figure of 75% represents the percentage change in the total value of audit fees from 2017/18 and 2022/23. Whilst this is important to determine, it can be slightly misleading due to the disparities in the value of fees charged between different companies, with those of a smaller size typically paying much less in value terms than those of a larger size.

For this reason, we believe that the most important figure that reveals the true extent of the change in audit fees is the first figure of 127%, which represents the average percentage change in audit fees.

+127%

This is the average percentage change in audit fees and represents the true extent of the change in audit fees between 2017/18 and 2022/23.

Why Have Audit Fees Risen So Much?

We believe the reasons behind soaring audit fees broadly fall into four categories:

1. The evolving regulatory landscape;
2. Risk appetite and auditor selectivity;
3. Talent and staffing challenges of audit firms; and
4. Profitability.

The Evolving Regulatory Landscape

One of the key factors attributed to heightened audit fees is the increase in both financial reporting requirements and auditing standards. The growing complexity of these requirements and standards means that both companies and auditors require greater levels of resources in order to produce the accounts and then conduct a thorough examination of a company's accounts, respectively.

In the first instance, this creates significant challenges for companies, requiring them to spend considerably more time and resources on producing their disclosures for their annual report and accounts. We highlighted in a research report last year [9] the impact that this was having on companies who were having to divert resources away from the growth of the company to focus on reporting requirements and compliance.

As a direct consequence of these increased reporting requirements, along with greater levels of auditing standards, auditors have to spend more time reviewing and examining a company's account. On the auditing standards, for example, and whilst not yet implemented, the FRC recently consulted on proposed revisions to ISA (UK) 250 [10]. The proposed changes will likely increase costs for audit firms, due to the additional amount of documentation an auditor will need in order to comply with the standards. This naturally drives up the cost of audit and thus the fee that the auditor's charge to the company.

Moreover, and given the increased complexity of reporting requirements, there can often be a knowledge gap between what is required by regulation and the capacity of companies to meet these requirements. This issue is exacerbated for smaller companies whereby their comparatively smaller finance teams are not only stretched in terms of the volume of requirements but also the skillsets and level of sophistication required of company management. As an example, we note that reporting around issues such as impairment and intangibles can be particularly challenging for companies.

The result of this situation is that there is a potential gap between what is provided by the companies and what is needed by the auditors in order to conduct their work. This then means the auditor spending more time with the company in order to come to a more complete view, driving up the cost of audit further.

Risk Appetite and Auditor Selectivity

An audit firm's risk appetite and selection processes have also resulted in increasing fees. The companies assessed within this study all have a market capitalisation below £500 million, but with an

[9] QCA, January 2023, Annual Report and Accounts: A Never-Ending Story
[10] FRC, October 2023, Proposed Revisions to ISA (UK) 250 Section A and ISA (UK) 250 Section B

average market capitalisation of just over £130 million across the three markets. Due to the smaller nature of these companies, they are often perceived to be a higher level of risk, making the audit more challenging and potentially also proportionally more resource intensive.

It is well-known that certain audit firms have been de-risking in recent years, whereby they decide they no longer want to take on companies that have a high-level of risk or are particularly challenging to audit [11]. This has meant that certain companies have struggled to find an auditor during audit tender processes [12].

A further issue is the increased attention that the audit market has received in recent years in relation to certain failures. This has further contributed to audit firms de-risking and avoiding challenging audits.

Both of these factors contribute to an increase in the level of fees charged by audit firms as they seek to offset the level of risk by charging higher prices.

Talent and Staffing Challenges at Audit Firms

Attracting and retaining talent is an acute problem for the audit industry. These issues have arisen on three fronts: the rise of other industries; liability; and new auditing standards.

The rise of private equity and the technology industry, for instance, has seen levels of interest in the audit industry diminish. These industries typically pay much larger salaries and are more attractive propositions, particularly for newly qualified individuals. In order to be able to compete with these industries, audit firms are having to pay higher salaries, resulting in increased costs.

Closely linked to the rise of other industries is the issue of liability. The extent of individual liability for audit issues are significant and are a barrier to new individuals entering the industry, and current auditors are no longer willing to take on certain audits.

The above two issues are compounded every time there is a new auditing standard added or amended. The new standards subsequently take an auditor more time to review, and there are less people that are able to undertake such work, creating a supply and demand issue which further drives up costs.

Profitability

A final issue is profitability, and audit firms increasing their prices in order to ensure that the audit services they provide are profitable in their own right, rather than using non-audit services to boost profits. This has occurred over time, particularly as the ethical standard has become tighter which has seen the erosion of packaging audit services alongside non-audit services.

[11] FRC, December 2022, Competition in the audit market
[12] Ibid.

The Availability of Auditors

The decreasing availability of auditors has been the subject of much commentary in recent years, and we have heard from companies over their issues with selecting an auditor. This issue has also been recognised by the FRC, who have identified that companies have struggled to find an auditor during audit tender processes [13].

In a similar light, one area that has received quite a bit of attention is around the auditing of Public Interest Entities (PIEs). Currently, there are only 38 firms included on the PIE Auditor Register Firms List [14], and this number is even lower (31) when you remove duplicate firms of the same group [15]. Moreover, 26 of the firms included in the register have five or less Responsible Individuals (RIs), who are required to sign off the audit work conducted.

We also looked at the annual reviews of the top audit firms in the UK and found that the majority of these firms had reduced the number of their PIE clients and the number of RIs at some firms had also reduced. This also tallies with the FRC's annual review of the accountancy profession [16].

Part of the issue here, and the low number of PIE audit firms and RIs, is the PIE Auditor Registration process which came into effect in December 2022. This is an additional approval and registration process that audit firms have to complete in addition to the Recognised Supervisory Body audit registration process for statutory auditors. Generally, this is perceived as being onerous to complete and also presents certain risks for audit firms. The result of this was multiple audit firms pulling out of the PIE audit market, leaving many companies without an auditor.

For example, Jeffreys Henry (now Gravita) was one of the audit firms that decided not to complete the PIE auditor registration in December 2022. This meant that they had to resign from over fifteen companies on the Main Market. This already followed UHY Hacker Young withdrawing from PIE audits which resulted in around ten companies losing their auditor.

> The decreasing availability of auditors has been the subject of much commentary in recent years, and we have heard from companies over their issues with selecting an auditor.

[13] FRC, December 2022, Competition in the audit market
[14] FRC, PIE Auditor Register Firms List, accessed January 2023
[15] Several audit firms are listed more than once where they also operate in Ireland or Northern Ireland, for instance.
[16] FRC, August 2023, Key Facts and Trends in the Accountancy Profession

Furthermore, and while the PIE auditor registration does not extend to other entities of public interest (OEPIs), which the FRC defines to include some AIM companies that exceed SME thresholds, many audit firms are cautious of taking on work for OEPIs. The reason for this is that auditing an OEPI brings the audit firm into the scope of the FRC's Audit Quality Review (AQR) process. This means some firms choose not to audit OEPIs either, which results in some of the larger AIM companies finding themselves restricted to a limited pool of firms to choose from.

Whilst the PIE and OEPI issue is typically about larger companies, with this study focussed primarily on smaller companies, there are many small companies affected by this and it speaks to wider issues with the availability of audit firms.

The PIE Auditor Registration process is perceived as being onerous to complete and also presents certain risks for audit firms. The result of this was multiple audit firms pulling out of the PIE audit market, leaving many companies without an auditor.

In order to address this from the smaller company perspective, we assessed the number of AIM clients that some of the largest audit firms had in 2017 and compared it to 2022. Many of the largest firms, including PwC, KPMG, Deloitte, EY, and Grant Thornton, all had fairly sizeable decreases in the number of AIM companies audited in 2022 than they did in 2017. Only three of the firms included in the research – BDO, PKF Littlejohn and Crowe – had a notable increase in the number of AIM clients [17]. Figure 3 demonstrates this.

Figure 3 - Number of AIM clients [18]

Table 1 - Number of AIM clients

UK Firm Name	Number of AIM clients 2017	Number of AIM clients 2022	Change in number
PwC	84	56	-28
KPMG	88	17	-71
Deloitte	49	23	-26
EY	32	18	-14
GT	113	49	-64
BDO	125	165	40
RSM	51	55	4
Mazars	15	17	2
Crowe	38	61	23
Shipleys	5	4	-1
PKF Littlejohn	18	76	58
Haysmacintyre	13	17	4

A similar pattern emerges when looking at the number of clients audit firms have outside of the FTSE 350 and listed on regulated markets. The Big 4, excluding Deloitte, all decreased their share of the market, whilst many of the smaller firms increased their share of the market.

[17] Other audit firms had increased the number of AIM company clients, but the numbers were negligible.
[18] FRC, August 2023, Key Facts and Trends in the Accountancy Profession (2018 and 2023 editions)

Figure 4 - Number of other clients listed on regulated markets (outside FTSE 350) [19]

Table 2 - Number of other clients listed on regulated markets (outside FTSE 350)

UK Firm Name	Number of listed clients 2017	Number of listed clients 2022	Change in number
PwC	109	71	-38
KPMG	125	39	-86
Deloitte	89	120	31
EY	96	61	-35
GT	47	7	-40
BDO	52	118	66
RSM	11	14	3
Mazars	1	17	16
Crowe	8	26	18
Shipleys	2	7	5
PKF Littlejohn	1	11	10
Haysmacintyre	3	0	-3

This trend suggests not only a shift in client portfolios but also a strategic re-evaluation by the larger audit firms, potentially to maintain audit quality and compliance standards. This, in turn, has implications for market concentration and competition within the industry. It is not necessarily a bad thing that smaller, challenger firms are increasing their share of the market. However, it is essential that both quality and competition remain.During our research on this paper, we held several conversations with companies whose audit fees have risen, but they suggested that there had been no corresponding increase in quality and, in some cases, a decline in quality.

This serves as a reminder to the FRC that more efforts are needed to further improve quality and competition levels and address audit costs for companies operating in this space.

[19] Ibid.

The Impact on Companies

As shown in the earlier sections of this report, the increase in audit fees is substantial and the decrease in auditor availability is notable. The impact of this on companies is sizeable.

Cost Implications

Small and mid-cap companies can often face financial strain; their smaller size, more limited resources, and the difficulties they encounter when seeking to raise capital mean that many of them often struggle with the financial burdens of being a publicly traded business. The substantial increase in audit fees further exacerbates these issues. Companies are forced to divert crucial resources away from investment into the business, such as towards research and development (R&D), hindering their growth and innovation.

Furthermore, the increase in the cost of audit can also be seen as a deterrent to companies seeking an admission to the public markets. The cost of audit poses a significant obstacle and can discourage smaller companies from navigating the complexities of the public markets. In addition, and in the same way that the costs of audit are prohibitive, audit-related issues, flagged by advisors or investors, further compound this challenge, dissuading companies from even considering a public listing.

Availability Implications

In a similar vein, small and mid-cap companies are increasingly burdened with legislative and regulatory requirements that means the businesses key individuals are focused on achieving compliance rather than using their skills to drive the growth of the business. Encountering issues during the auditor tender process in relation to the finding of an auditor, only further increases the burdens companies face.

The inability to secure an auditor can have serious knock-on effects for companies, and may lead to delays in financial reporting, raising concerns amongst investors about the transparency and reliability of a company's financial information. Moreover, the absence of a reputable auditor can cast doubt on the company's adherence to regulatory standards, potentially triggering increased scepticism within the market. This, in turn, may result in diminished investor trust, hindering the company's ability to attract capital and establish a positive market image.

Contractions in the number of auditors willing and able to take on an audit of a particular companies can be particularly pronounced for companies who require auditors with specific sector knowledge, or specialisms, with it being likely that the larger firms possess these skillsets. Smaller audit firms and the individual auditors within these firms may not possess the necessary understanding of the company in order to conduct a comprehensive audit.

These two factors have undoubtedly played their part in the current de-equitisation crisis that is depleting the number of companies on our public markets. Just last year, the Main Market lost 73 companies and AIM lost 78 companies, and there were only 14 and 9 IPOs on each market respectively [20].

[20] LSE website, News and Prices, Reports, Main Market Factsheet and AIM Factsheet (as at December 2023)

Throughout our research, we spoke to several companies on the challenges they faced in relation to the cost of audit, the availability of auditors, and the quality of their experience. We provide a few short case studies below to highlight their experiences.

Case study 1

Market:	AIM
Sector:	Consumer products and services
Market Capitalisation:	>£250 million

The company experienced a tenfold increase in their audit fee from 2017 to 2022. During that time, the business grew from two operating divisions to eight but doubted the hike was warranted.

In addition, the company has not been happy with the quality of the work done by its auditor, pointing out concerns over the length of time taken to conduct the audit and a lack of understanding of the company's products and services. The heightened scrutiny, additional checks, reviews, and inquiries did not necessarily translate into an improvement in quality.

During its tendering process, several audit firms explained they were already at capacity and unwilling to take on more clients. Some also said they were unwilling to take on a company of their size due to the perceived risks it may entail.

Case study 2

Market:	Main Market (LSE)
Sector:	Healthcare
Market Capitalisation:	<£200 million

The company faced the possible suspension of trading in its shares due to a slow audit and staff shortages at its audit firm. This caused the company to miss deadlines that it needed to make in order to meet certain requirements and obligations. The company said the issue was the result of the breakdown in communication and transparency by the audit firm.

Case study 3

Market:	AIM
Sector:	Technology
Market Capitalisation:	<£200 million

The company experienced significant issues in relation to adhering to its regulatory requirements and obligations due to delays in the time taken to conduct its audit. The audit firm proposed an additional fee to expedite the audit process, resulting in additional costs for the company.

Proposals

Achieving a high-quality, cost-effective, and competitive audit market requires a collaborative effort involving audit firms, companies, and regulators. The escalating costs of audits over the past five years, as highlighted by our research into small and mid-caps, warrants a comprehensive reassessment of the audit process. It is more than likely that fees will continue to rise due to the volume and complexity of accounting and auditing standards increasing, and a continuation in the increase of fees to such an extent is simply unsustainable and will result in further disinterest in the UK's public markets.

Similarly, the decline in auditors for small and mid-cap companies has created a challenging environment for these companies who, due to their size constraints, already encounter issues with navigating life as a public company.

This outcome is a consequence of market reactions to regulatory actions that, over the years, have introduced new standards and requirements incrementally, without holistic consideration of existing obligations for companies and their auditors and how they manage these new obligations.

Regulators should pivot towards assessing how new rules aim to improve and streamline the auditing process rather than burdening it with excessive red tape, which makes it increasingly challenging for companies to operate effectively and efficiently. It is crucial to strike a balance that promotes the integrity of audits while fostering an environment where companies, especially in the small and mid-cap space, can thrive and comply with regulatory frameworks without undue impediments.

With this in mind, we propose a series of recommendations that we believe can help re-shape the audit market, encourage affordable audits and improve the choice for companies in selecting an auditor. Companies of different sizes, sectors, and complexities have unique and distinct pressures that can influence the amount of funds they can allocate towards their audit, and also need an auditor to match their individual circumstances.

Achieving a high-quality, cost-effective, and competitive audit market requires a collaborative effort involving audit firms, companies, and regulators.

It is more than likely that fees will continue to rise and will result in further disinterest in the UK's public markets.

The decline in auditors for small and mid-cap companies has created a challenging environment for these companies who already encounter issues with navigating life as a public company.

Companies of different sizes, sectors, and complexities have unique and distinct pressures that can influence the amount of funds they can allocate towards their audit.

Recommendations

1

Streamline Audits

The cost of an audit has grown to such an extent that consideration should be given to streamlining auditing, and what is required within an audit. The focus should be on improving the efficiency and timeliness of audits, without compromising the integrity of an audit.

Therefore, we recommend a review which:

- Simplifies requirements and standards to enhance efficiency; and
- Identifies and assesses requirements and standards that are not absolutely necessary and removes them.

2

Enhance the Attractiveness of the Audit Industry

The current liability regime for auditors is creating issues in terms of attracting and retaining talent within the audit industry. In particular, newly qualified individuals are put off by the liability regime that reprimands individuals rather than the audit firm as a whole. Assessing how the liability regime impedes new entrants into the audit profession would be a welcome step.

In addition to an assessment of the liability regime, thought should be given to shifting the signing off of an audit from the individual partner to the audit firm. This approach would promote collective accountability and reduce dependence on individual auditors.

3

Promote Fee Transparency and Benchmarking

The FRC should encourage the development of industry benchmarks for audit fees, as well as encouraging auditors to provide a breakdown of the fees they charge to companies.

4

Encourage Constructive Communication and Engagement

A constructive engagement and formal feedback loop is essential both for the quality of the audit and the timeliness of it. Auditors should ensure that they have the necessary measures in place to facilitate such processes with their clients.

5

Amend the AQR Process

The FRC's Audit Quality Review (AQR) process could be improved by increasing engagement with a company's audit committee. The FRC's review teams currently meet with the audit committee/audit committee chair prior to the start of the inspection. However, we believe additional engagement with the company's audit committee/audit committee chair would be beneficial. For instance, this could include the FRC sharing a draft of the outcomes of its review, and allowing for the company to respond, prior to the publication of the final review report.

6

Introduce Market Opening Measures

The FRC should seek to introduce a series of market opening measures, aimed at ensuring that companies have a sufficient choice of audit firm and that there are appropriate levels of competition between the firms. This should look at the underlying causes of audit firms' decisions to audit certain companies, and focus on measures that facilitate firm entry and expansion and prevent exit.

Methodology and Caveats

In highlighting the changes in the cost of audit, this research covered a total of 220 companies, across the Main Market (100), AIM (100), and Aquis (20), over a five-year period. The research captured the total fee paid by the company to its auditors for audit-related services only for each company's most recent financial year (2022/23) and the fee paid five years previous (2017/18).

As not all companies report to the same year-end, we used each company's most recent annual report and the report produced five years earlier.

The companies were picked at random, but from a filtered list of companies in order to ensure that we collected the data for commercial companies only and those that had been listed for at least five years. As such, the filtered list removed the majority of the following types of companies from our research:

- Investment companies (equity investment instruments and non-equity investment instruments);
- Real Estate Investment Trusts (REITs);
- Companies listed on the Professional Securities Market;
- Companies listed on the admission to trading only segment;
- Special purpose acquisition companies; and
- Companies with a listing date before 2016.

Following this, we selected, at random, a range of companies from each market, leaving us with:

- 100 Main Market companies with a market capitalisation between £3.3m to £498m;
- 100 AIM companies with a market capitalisation between £5m and £440m; and
- 20 Aquis companies with a market capitalisation between £0.34m and £154m.

Each company's annual report was reviewed for 2017/18 and 2022/23 to find the fee paid to their auditor for audit services only. Due to the sample size, we did not review the individual circumstances of each company to determine why their audit fee may have changed by the amount it did. However, several anomalies where there was a particularly large increase were considered and potentially removed to ensure the reliability of the data collected.

Below, we provide a brief breakdown of some of the key figures:

183 of the 220 companies experienced an increase in audit fee

- 90/100 on the Main Market;
- 79/100 on AIM; and
- 14/20 on Aquis.

The average percentage change across all three markets was 127%

- 149% on the Main Market;
- 110% on AIM; and
- 97% on Aquis.

The overall change in audit fee across the three markets was 75%

- 75% on the Main Market;
- 75% on AIM and
- 64% on Aquis.

The average audit fee in 2017/18 across all three markets was £397,243

- £732,508 on the Main Market;
- £130,445 on AIM; and
- £54,903 on Aquis.

The average audit fee in 2022/23 across all markets was £694,083

- £1,280,347 on the Main Market;
- £228,347 on AIM; and
- £89,919 on Aquis.

The market capitalisation range of the companies reviewed across all three markets was £0.34 million to £498 million.

- £3.3m to £498m on the Main Market;
- £5m to £440m on AIM;
- £0.34m to £154m on Aquis.

About the QCA

The Quoted Companies Alliance champions the UK's community of 1000+ small and mid-sized publicly traded businesses and the firms that advise them.

We believe the public markets can be the best place for companies to source the funds to grow, operate transparently and distribute wealth, fairly.

The QCA seeks to inform policy in dialogue with regulators and government, showcase the latest thinking on leadership, investment, technology and governance through our events and research, and to provide a forum to share good practice among members, who are quoted on the Main Market, AIM and the Aquis Stock Exchange.

For more information, please visit www.theqca.com and

Become a member of the QCA today

- Enjoy access to our busy events programme featuring fund managers, regulators, senior politicians, corporate peers and the media
- Influence our campaigns and policy work that presses to improve public market regulation and reward through our seven Expert Groups
- Stay informed with our boardroom good practice guides, training workshops, sector surveys and in-depth research
- Take advantage of exclusive member discounts on partner-run courses, professional services and technology tools
- Tap unparalleled business development and thought leadership opportunities

To find out more visit www.theqca.com/membership-plans

The Quoted Companies Alliance champions the UK's community of 1000+ small and mid-sized publicly traded businesses and the firms that advise them. It is a company limited by guarantee registered in England under number 4025281.