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Dear FRC colleagues,

Small and medium-sized enterprises (SME) market study

We welcome the opportunity to respond to your consultation *Small and medium-sized enterprises (SME) market study.*

The Quoted Companies Alliance *Corporate Governance Expert Group* and *Accounting, Auditing and Financial Reporting Expert Group* have examined the proposals and advised on this response from the viewpoint of small and mid-sized quoted companies. A list of Expert Group members can be found in Appendix A.

At the QCA, we represent the UK's 1000+ small and mid-sized quoted companies. As this market study focuses on all SMEs, we have limited our response to those quoted or listed companies that would otherwise fall under the SME definition if they were not listed on a public market. Our membership is also made up of advisory firms, including those that provide small and mid-cap company audit services, and we have therefore responded to questions that cover issues affecting both smaller companies and the firms that audit them. In addition, while we welcome the FRC's efforts in focusing on this area, we query why the FRC has limited its market study to private companies, given the current issues in the audit market for smaller public companies.

In 2024, we conducted research into the increasing cost of audit for smaller public companies, covering those across the Main Market, AIM and Aquis with a sub-£500 million market cap. Companies included in that report are outside the definition of an SME, but we believe that the issues highlighted, and solutions proposed, both in that report, and in this response, remain applicable to those public companies that would otherwise be classified as SMEs.

In our response, we provide information on how an increase in audit costs and a lack of auditor availability are placing additional pressures on smaller companies' resources, hampering their ability to grow their business, and reducing the attractiveness of remaining – or becoming – a public company. Some of the drivers of these issues include regulatory complexity, auditors derisking their services, and the current Public Interest Entity (PIE) definition.

In our responses to the questions, we discuss some of these issues in more detail, and provide a number of recommendations we believe could improve the audit market for smaller public companies.

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours sincerely,

James Ashton
Chief Executive

Q1 How well is the UK audit market currently functioning for SMEs?

We do not believe the UK audit market is currently functioning well for smaller public companies due to increases in auditor costs and the availability of audit.

Regarding costs, QCA research found that over a five-year period between 2017/18 to 2022/23, audit costs increased by 75% for sub-£500 million market cap companies across the Main Market, AIM and Aquis[1].

Smaller public companies are already under significant financial pressures and face particular pressures meeting corporate reporting requirements due to their size and the more limited resources they possess compared to their larger counterparts. The net result for companies is a diversion of resources away from business development.

Moreover, increases in the cost of audit can contribute to deterring companies from seeking to join the public markets, or increase the likelihood of companies considering delisting, as it adds to the already significant cost and regulatory burdens of being a public company. As of February 2025, AIM suffered a net loss of 61 companies over the previous 12 months.

Q2 What are the reasons for SMEs obtaining financial audits? What are the primary drivers in instances where an audit may not be mandatory to an SME?

We have no comments as the entities we cover are required to have an audit.

Q3 What, if any, challenges do SMEs experience in relation to audits (e.g. in finding an auditor, engaging with the audit process)?

Linked to the rise in auditor fees for smaller companies discussed in Q1 is a lack of auditor availability. In the same 2024 research, we assessed the number of AIM clients that some of the largest audit firms had in 2017 compared to 2022. Our findings demonstrated that many of the largest firms[2] all had significant decreases in the number of AIM companies they audited in 2022 against the figure for 2017[3].

A decrease in the availability of audit and the subsequent challenges smaller companies face when searching for an auditor have important ramifications, not least:

- Potential delays in financial reporting, leading to concerns among investors about the reliability and openness of a company's financial information.
- An ability to source a reputable auditor can result in doubts about a company's adherence to regulatory standards.
- Additional pressure being placed on companies which may already struggle to find an auditor due to operating in a niche area requiring sector specific knowledge. Often, larger audit firms are best-placed to provide specialist audits compared to smaller firms.

Below, we set out a number of key drivers impacting the increased cost and availability of audit including:

1. **The evolving regulatory landscape**

[1] Quoted Companies Alliance. *It doesn't add up: The crisis of unaffordable audit*. (2024). p.7.
[2] Including PwC, KPMG, Deloitte, EY, and Grant Thornton.
[3] Quoted Companies Alliance*. It doesn't add up: The crisis of unaffordable audit.* (2024). pp. 12-13.

Growing complexity in financial reporting requirements and auditing standards have increased demands on smaller companies and auditors alike to produce the annual report and accounts and for them to be subsequently reviewed. For example, the development of the proposed revisions to ISA (UK) 250, will likely further push costs up for audit firms, and thereby costs for companies, due to the additional amount of documentation an auditor will need in order to comply with the standards.

Moreover, increased complexity in regulatory requirements imposes further pressures on smaller companies when engaging in the audit process. Due to their smaller size, they lack both the in-house expertise and resources as their relatively small finance teams are stretched when meeting the volume of reporting requirements. This creates distance between the information provided by companies and what auditors need, impacting the time auditors need to work with companies, thereby driving up cost. This may also affect the overall quality of financial reporting, reducing the attractiveness for auditors to take on a smaller company audit, thereby exacerbating a lack of availability[4].

2. Risk appetite and auditor selectivity

Auditor derisking is well-documented and relates specifically to the size of a company, with smaller companies being perceived as higher risk and/or challenging to audit. This impacts both fees charged for audit and auditor availability[5].

3. Public Interest Entity (PIE) definition

A further challenge relates to smaller listed companies on the Main Market being subject to the same audit rules and guidelines as larger companies. For example, a smaller Main Market company with a market capitalisation of £30 million is subject to the same regulatory regime as an entity in the FTSE 100 which has a market capitalisation of over £100 billion. This places disproportionate reporting burdens on smaller companies, increasing costs, and hindering their capacity to innovate and grow.

Q4 What, if any, challenges do audit firms experience in relation to audits for SMEs?

Auditors are experiencing acute challenges in terms of attracting talent and staffing due to competition from other industries, and the extent of individual liability for any audit issues.

In addition, the development of new auditing standards are also a contributing factor to diminishing the attractiveness of auditing as a career.

A further issue relates to profitability as audit firms increasingly rely on audit services to boost their profits instead of through the provision of non-audit services. This has developed over time, particularly as the ethical standard has become more restricted, limiting the extent to which audit firms can package audit services with non-audit services.

Q5 What, if anything, would you like to see change in relation to SME audits? (For example, any regulatory /policy changes and/or any specific actions taken by the FRC, Government, firms, companies or others).

Below, we provide a number of recommendations for improving smaller company audit:

[4] Quoted Companies Alliance. *It doesn't add up: The crisis of unaffordable audit.* (2024). p.8
[5] Ibid. pp.8-9.

1. **Simplify and streamline audits**

This could be done by reviewing requirements and standards with a view to their simplification and removing any that are shown to be unnecessary. Specifically, we believe that there is scope to review the international standards of auditing (ISAs) as adopted in the UK. This could include reforming guidelines and rules around ISAs to make them less prescriptive or by creating more opportunities for the application of ISAs to be more proportionate to business size.

2. **Reconsidering the PIE definition**

To address this issue, we believe there must be a change to the regulatory landscape based on the principle of proportionality. In practice, this means adopting a different approach to the current PIE definition, one based on company size or market capitalisation and not the exchange it is listed on. This will reduce the challenges smaller listed companies face in terms of reporting burdens and cost, alongside the availability of auditors appropriate to the companies' size. This would result in a more proportionate approach to audit which supports growth and broader resilience in the audit market by focusing on companies of systemic and genuine public interest.

3. **Promote Fee Transparency and Benchmarking**

The FRC should look to develop industry benchmarks for audit fees, in addition to encouraging auditors to disclose a breakdown of the fees they charge companies.

4. **Review the Ethical Standard for auditors**

The FRC could review the ethical standard for auditors with a view to considering how auditors could be given greater scope to assist companies with their financial reporting. This may lead to an improvement in quality and reporting standards without questioning the company's independence.

5. **Introduce Market Opening measures**

Ensuring that smaller companies have a sufficient choice of audit firm and that there is adequate competition should be a priority for the FRC. We believe that the FRC could implement a series of market opening measures that foster firm entry and expansion and avert market exit. For example, the FRC should look to build upon and grow the work of its "Scalebox" initiative.

Q6 What, if any, forthcoming developments might the FRC want to consider as part of this market study?

The FRC may want to consider examining the auditing process and standards of other countries for smaller companies. In many countries, smaller companies are held to more proportionate auditing standards and this benefits both the company and the auditor and may resolve the challenges they face. For example, based on recommendations made by the Nordic Accountant Federation, the IAASB's auditing standard for Less Complex Entities presents a proportionate standard for auditors which is tailored to the needs of smaller, less complex company audits. We believe the FRC, as part of this market study, should consider the IAASB's standard as offering a more proportionate approach for smaller company audits.

Appendix A

The Quoted Companies Alliance *Corporate Governance Expert Group*

Laura Nuttall (Chair)	**One Advisory**
David Hicks (Deputy Chair)	**Simmons & Simmons LLP**
Anthony Appleton	BDO LLP
Aisling Arthur	Travers Smith LLP
John Britton	Computershare
Nigel Brown	Gateley PLC
Amanda Cantwell	Practical Law
Louis Cooper	Risk & Control Services
Lee Cooper	Link Group
Tim Copnell	KPMG
Edward Craft	Wedlake Bell LLP
David Fuller	CLS Holdings PLC
Nigel Gordon	Fladgate LLP
Ian Greenwood	Korn Ferry
Kate Higgins	Mishcon De Reya
Tara Hogg	LexisNexis
Eleanor Kelly	LexisNexis
Kam Lally	Wedlake Bell LLP
Paul Norris	MM & K Limited
Will Pomroy	Hermes Investment Management Limited
Jack Shepherd	CMS
Julie Stanbrook	Slaughter and May LLP
Nic Stratford	Mercer
Peter Swabey	Chartered Governance Institute
Séverine Béquin	Young & Co's Brewery Plc
Camelia Thomas	Practical Law Company Limited
Melanie Wadsworth	Faegre Baker Daniels LLP
Karen Waldron	Link Group
Sarah Wild	Practical Law Company Limited
Shaun Zulafqar	Shakespeare Martineau LLP

The Quoted Companies Alliance *Accounting, Auditing and Financial Reporting Expert Group*

Rochelle Duffy (Chair)	**PKF Littlejohn LLP**
Tom Stock (Deputy Chair)	**HaysMac LLP**
Edward Beale	Western Selection PLC

Matthew Brazier	Invesco Asset Management Limited
Joseph Brewer	Gravita
Simon Cooper	KPMG LLP
Anna Hicks	Saffery Champness LLP
Mark Hodgkins	Ensilica
Clive Lovett	Kinovo PLC
Sandra McGowan	BDO LLP
Jennifer Ilsley	Grant Thornton UK LLP
James Nayler	Mazars LLP
Matthew Stallabrass	Crowe UK LLP
Ziqi Zheng	UHY Hacker Young