THE WALL STREET JOURNAL.

Private Equity Has Closer Ties to Companies' Auditors Than Ever Before

As private-equity investors acquire more stakes in midsize accounting firms, concerns from regulators and accountants grow over potential conflicts of interest

By Mark Maurer
Oct.30, 2024 6:00 am ET

Private equity is becoming a lifeline for accounting firms that are looking for more money to pay for technology and talent, but the resulting ownership shake-ups are pushing unlikely partners closer together, raising concerns from both accountants and regulators.

Several midsize audit and consulting firms in the U.S. are selling stakes, both large and small, to outside investors. Grant Thornton in May became the largest firm of its kind to sell its U.S. unit to a group led by New Mountain Capital, followed by an agreement last week to merge nonaudit services in the U.S. and Ireland. Armanino, a San Ramon, Calif.-based accounting firm, sold a stake to Further Global Capital Management this month.

By the end of 2025, more than half of the largest 30 U.S. accounting firms will have either sold an ownership stake or part of their business to private-equity investors, up from zero in 2020, said Allan Koltin, chief executive at advisory firm Koltin Consulting Group.

An auditor's objectivity, both real and perceived, is critical to the business of accounting firms, which typically also have consulting and tax operations. Whether that independence can be preserved or not under new buyers is coming into question, especially as private-equity managers take a hands-on approach with their new acquisitions.

Audit and consulting firm Grant Thornton in May sold its U.S. unit to a group led by New Mountain Capital
PHOTO: PATRICK BOLGER/BLOOMBERG NEWS

Accounting firm Cherry Bekaert's leadership team discusses organizational matters, often involving the audit business, weekly with Parthenon Capital Partners, the private-equity firm that took a stake in the Raleigh, N.C.-based firm's nonaudit side of the business in 2022.

Sometimes the conversation is about Cherry Bekaert's acquisitions of other firms, some of which have an audit business, said Michelle Thompson, CEO of its nonaudit arm. Cherry Bekaert also updates Parthenon on its financial results or risk management.

"We work very closely with the audit team," said Andrew Dodson, managing partner at Parthenon Capital. "Making sure that we have the right controls over audit quality is something that we take super seriously and have a lot of visibility into," he said, referring to compliance with an agreement between the audit and nonaudit sides. He added that Parthenon has no influence over individual audits.

While the relationships between the private-equity investors and the audit side may be a normal course of business, many accountants and regulators are watching the intricate dynamics. The American Institute of CPAs, an advocacy group and auditing standard setter, is exploring ways to strengthen requirements on undue influence over audit firms.

Paul Munter, the Securities and Exchange Commission's chief accountant, has urged at conferences and in public statements in recent years that accounting firms exercise caution in receiving investments from private equity due to any possible conflicts. “Firm leaders need to be sensitive to the message such arrangements could send and stand ready to correct any such misimpressions,” Munter said in May. The SEC’s audit watchdog, the Public Company Accounting Oversight Board, is looking at the private-equity issue carefully, a spokeswoman said.

There are some guardrails in place already. Audit firms with new investors are setting up structures to separate audit and nonaudit practices to comply with rules prohibiting the impairment of the auditors’ objectivity and independence. For instance, the private-equity firm doesn’t have direct ownership in the audit business, or governance rights, because that could subject auditors to pressure on financial metrics.

Further, rules generally prohibit accounting firms from auditing their private-equity investors directly or funds that the private-equity firm manages. But the rules are less specific when it comes to portfolio companies that the private-equity owner backs.

Baker Tilly in June sold a stake to Hellman & Friedman and Valeas Capital Partners. PHOTO: ALEXANDER POHL/ZUMA PRESS

If there is even a perception that such investments are influencing auditor independence, the financial statements produced by those auditors may lose credibility, said Jenelle Conaway, assistant accounting professor at Wake Forest University.

“The intensity with which private equity is getting involved is different from anything we’ve experienced before,” Conaway said. “There’s the potential for the strong influence on the nonaudit side to spill over to the audit side through these big firm-level decisions.”

Accounting firms as investments

Many private-equity funds view accounting firms as low-risk investments that could net a sizable return based in part on recurring revenue streams. They say they’re investing heavily and not on a cost-cutting mission, an approach with which private equity is commonly associated.

“To get the kind of return they want to get in five years, you have to turbocharge the growth engine,” Koltin said. That growth has largely come from acquisitions, backed by private-equity’s capital.

U.S. revenue at EisnerAmper, Citrin Cooperman and Cherry Bekaert, all of which sold stakes to private equity in 2021 and 2022, collectively rose 50% as of August 2024 compared with the same 12-month period a year earlier, according to Inside Public Accounting, a practice-management resources provider.

The faster-growing consulting revenue often helps propel the acquisitions for private-equity firms. “There are lots of reasons PE firms are looking at accounting firms, but I don’t think the audit practice is a key driver of the investment thesis,” said Matthew Bosher, partner at law firm Hunton Andrews Kurth.

Many accounting firms have been rethinking their ownership structures as they’re strained by partner retirements and funding extensive technology investments while spending to attract and retain workers during an accountant shortage. In addition to private equity, firms have opted for an employee stock ownership plan, sale to a public company or a merger of equals.

Certified public accountants need to represent the primary ownership of any audit business, ranging from 50% to fully owned depending on the state, according to CPA licensing laws in the U.S.

Private-equity firms are using an alternative practice structure that audit firms began to adopt in the 1990s to comply with rules over outside investment. Under this structure, there is an administrative services agreement between the audit and nonaudit units in which the latter provides personnel and administrative services for a fee. Private-equity funds invest in the nonaudit arm of the firm and as a result have oversight over the budget and spending on technology and talent.

The advisory business generally approves and decides the budget for the overall firm, with input from and approval by the audit business, said Steven Berger, partner at law firm Vedder Price.

Still, accounting firms under new ownership have to exercise a lot of judgment in applying the existing rules to their own situation since those rules largely don't account for the complexity of the new investments.

Baker Tilly, which in June sold a stake to Hellman & Friedman and Valeas Capital Partners, hasn't audited portfolio companies of those investors in part because there's ample market share it could capture elsewhere, said Jere Shawver, CEO of Baker Tilly's U.S. audit arm.

"Both the audit firm and the private-equity firm address independence questions at the outset of every deal and there is no one answer," Vedder Price's Berger said. Audit firms have expanded their compliance staff and internal policies to ensure their independence won't be impaired, he said.

Some factors that firms look at include how much of a stake a private-equity firm owns in the overall accounting firm; the specific fund invested in a portfolio company and whether or not it is the same as the one invested in the audit firm; whether the fund controls the portfolio company or not; and, checking for overlap in directors named by the private-equity firm for the advisory business and those in a portfolio company.

"I would put it in the category of: They're our cousins and we hang out with them, so we don't think it's a good idea to audit our cousins," Shawver said. Baker Tilly aims to increase its current U.S. revenue of $1.81 billion by up to three times by 2030, he added.