KINGLAND | PUBLIC ACCOUNTING

Weighing the ROI
of Enterprise Independence and Risk Management Systems

Introduction

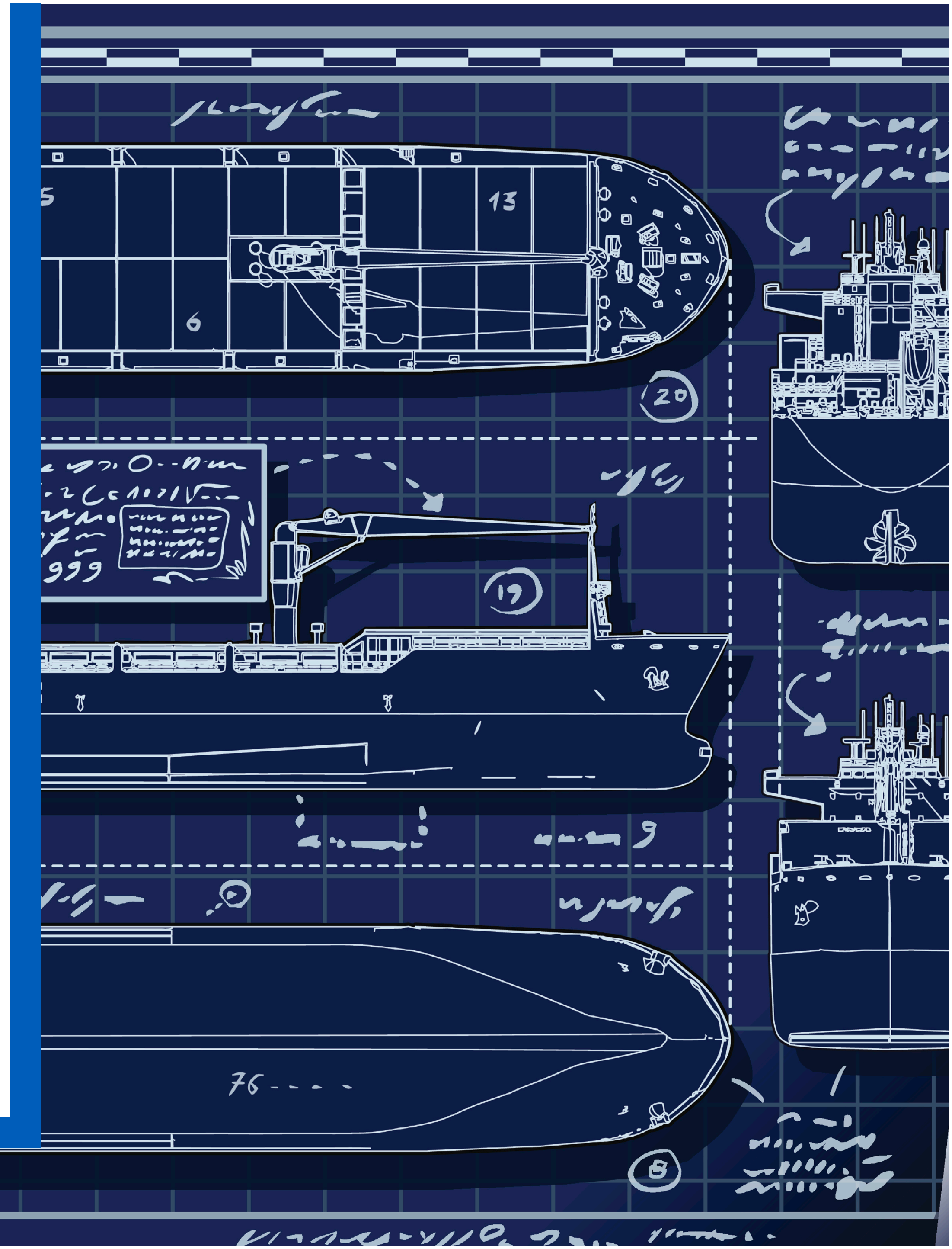
For public accounting firms, an enterprise independence and risk system has moved from a "nice to have" to a "need". United States, European Union, and United Kingdom regulatory environments, increased private equity investment, M&A activity, and deepening reliance on technology to drive efficiency all apply pressure on firms to make this decision.

What do we mean by an independence and risk management system? Independence and risk management encapsulates conflict checking, independence checking, business relationship checking, and client acceptance within a firm.

Quantifying the return on investment (ROI) for an enterprise independence and risk system is difficult. Similar to investing in a cybersecurity system or investing in the general wellness of your employees, the realized return is obscured through multiple abstracting layers. Tracing results back to give credit to the initial investment is not a black and white exercise, but key areas weighed on a balance of positive or negative return lead us to a clear answer.

In this paper we weigh the ROI of an independence and risk system across 5 criteria:

1. **Regulatory Fines and Oversight**
2. **Client Satisfaction and Reputation**
3. **Process Efficiency**
4. **Growth of Business**
5. **Readiness for Future M&A**



Summary

Regulatory Fines and Oversight

Regulatory bodies such as the Public Company Accounting Oversight Board (PCAOB) impose significant fines for violations related to independence and conflicts of interest. By investing in a system that helps avoid these violations, a firm can significantly reduce the risk of such fines. Additionally, regulators consider the investment by the firm as a key part of a system of quality control, establishing the right tone from the firm even when a single individual is found to be non-compliant.

Client Satisfaction and Reputation

By effectively ensuring independence and avoiding conflicts of interest, a firm enhances its reputation in the market. The result is increased client satisfaction, as clients can trust that their interests are being prioritized.

Process Efficiency

An enterprise independence and risk system streamlines the overarching process of accepting new clients or rejecting clients due to identified risk. The result is significant time savings by enabling partners and practitioners to focus on their client-billable responsibilities rather than administrative tasks.

Growth of Business

With improved process efficiency and enhanced reputation, a firm is well-positioned to attract new clients and retain existing ones. The result is business growth, providing a significant return on the investment in the system.

Readiness for Future M&A

As a firm grows and considers merging with or acquiring other firms, having a robust independence and risk system in place will expedite the due diligence process and be considered as an aspect of valuation. The firm is more attractive to potential partners and private equity firms, providing another avenue for ROI.

Let’s dig into each in more detail.

Regulatory Fines and Oversight

The PCAOB has increased focus this past year on failures to maintain quality control and failures to maintain independence. Not only will the number of conflicts decrease in having an enterprise system, but inspectors are more likely to hand down harsher punishments to firms that are operating without a system.

Between 2020 and 2023, the PCAOB's part 1A audit inspection deficiency rate grew from 29% to 52%. These findings come as a result of the PCAOB committing more resources to reviewing audits. Additionally, the regulatory community is being less forgiving in its enforcement when it comes to systems of quality management. A fine today for the same violation 3 years ago will be substantially higher, and smaller firms have begun getting hit with higher fines.

Putting this into perspective, as of April 2024, the PCOAB has already issued $31.75 million in fines. This is already 60% more than 2023, and nearly 30 times the fines issued in 2021 ($1.1 million). If they are to continue at this pace, the PCAOB will end 2024 with nearly $100 million in fines.
All of this data tells us that the PCAOB is making good on their **2022-2026 strategic plan**. The goals of this plan are as follows:

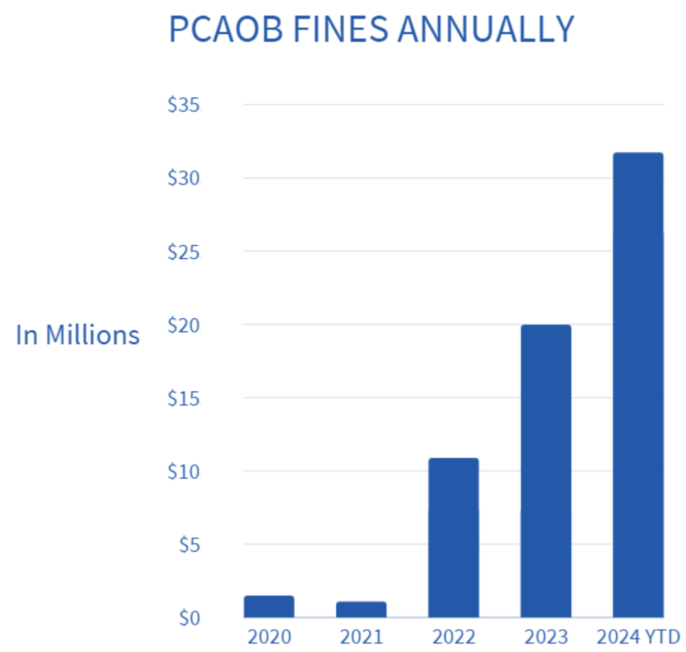
- Goal 1: Modernize Standards
- Goal 2: Enhance Inspections
- Goal 3: Strengthen Enforcement
- Goal 4: Improve Organizational Effectiveness

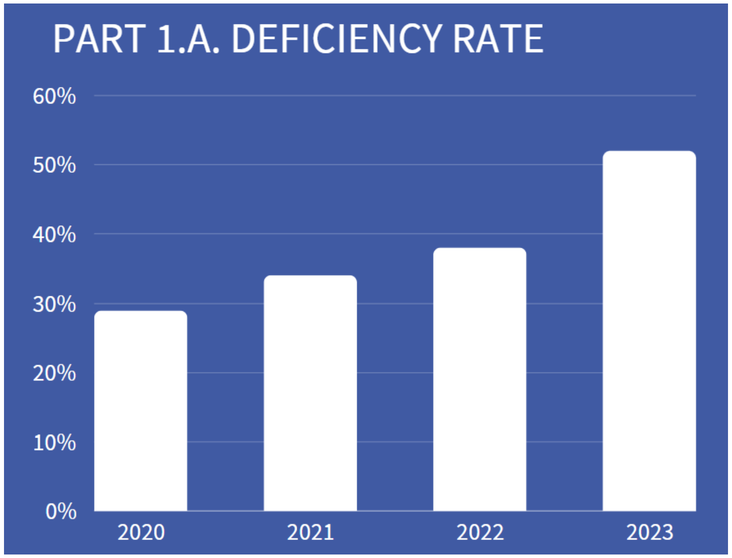
Focusing on Goal 2, the PCAOB is enhancing the inspection of each firms' quality control system. This general term does not refer to one specific technology system, but the collection of systems working in concert to facilitate the firm's work. Historically, time tested enterprise software will be more effective to a firm's overall quality control system compared to a home-grown system. Enterprise software systems are built by software technology professionals, are updated and maintained over time, and depending on the vendor will be recognizable by regulators - providing certain comforts of common capabilities.

Focusing on Goal 3, two of the objectives for this goal are to "rigorously enforce PCAOB and other applicable standards, laws, and rules", and to "impose more significant penalties". The recent history of enforcement has clearly shown this trend, and the industry should expect the trend to continue for the foreseeable future.

Between these two goals, US firms and global firms doing business in the US will benefit from investing in high quality systems that bolster their system of quality control. Firms that invest in technology can expect to avoid regulatory fines and/or see them reduced versus organizations that choose not to invest.

> *"...as of April 2024, the PCAOB has already issued $31.75 million in fines"*





Client Satisfaction and Reputation

An enterprise system enables firms to provide a consistent and streamlined experience. By effectively ensuring independence and avoiding conflicts of interest, a firm enhances its reputation in the market. The result is increased client satisfaction, as clients can trust that their interests are being prioritized.

Kingland has worked with new firms struggling with a tough data process problem - separate service lines asking the same client for the same information so that each service line can complete its independence checks. If client data is siloed by service, requesting the same data multiple times from clients can be unavoidable. Duplicate independence checking understandably upsets the firm's client as it takes more of the client's time, and the situation causes the client to question the firm's regulatory compliance ecosystem.

For example, if a firm has 10,000 clients, and provides 13,000 discrete service engagements to those clients, 23% of the engagements (3,000 / 13,000) overlap with another client's engagement. An enterprise system that enables teams in different service lines to see that independence checks have already been completed would prevent up to 23% of unnecessary independence checks from taking place. The firm improves their client's experience, their reputation, and saves time in the process.

For a multi-disciplinary public accounting firm, the reputational benefits of consistency as well as the cost avoidance of duplication work provide a positive ROI.

> *An enterprise system that enables teams in different service lines to see that independence checks have already been completed would* ***prevent up to 23% of unnecessary independence checks*** *from taking place.*

Growth of Business

The acceleration of processes through an enterprise independence and risk system enables firms to clear new business faster than their competition.

In situations where a company submits requests to multiple accounting firms for the same service, the firm that responds ahead of the pack has an advantage. This situation is especially true for time sensitive services related to M&A, bankruptcy, and related services. The first firm to respond with a high quality proposal proves that they are able to operate efficiently and confidently, implying that the services to follow will also be efficient.

Enterprise technology can increase speed as they leverage cloud services, smart workflows, and other technology. Quoting CPA Practice Advisor - according to the 2024 US Accounting Industry Report, "Firms are being rewarded for their shift to the cloud, as well, with 71% of cloud-based practices reporting improved profitability in 2023, compared to only 55% of respondents overall"[1]. Technology makes meaningful differences to a firm's bottom line.

By expediting independence and risk management processes, a firm has more chances to earn business because of the fact that they are able to take more chances at earning the business. Proposal submission dates are no longer missed because of lengthy manual processes.

The growth of a firm is determined by the strategy of what business to pursue, not limited by process.

Depending on the size of the proposal, a win (versus loss) of only 1 or a handful of proposals due to speed pays for enterprise software in a given year.

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[1]*https://www.cpapracticeadvisor.com/2024/02/08/accounting-firms-that-embrace-cloud-tech-see-higher-growth-says-survey/101379/*

Process Efficiency

An enterprise system will save up to 95% of people hours that are typically spent conducting conflict checks without a system.

A mid-tier firm will process between 50,000 and 150,000 conflict and independence checks per year, depending on their policies and size. A large firm / global network will process many times this amount. Each firm will have a varying average duration to complete conflict and independence checks based on their policy. However, the efficiency gained as a percentage of time is even across firms as processes shift to collect information automatically instead of manually.

The process efficiency gains a firm will experience are not contained to independence and conflict checking. Within an independence and risk management system, automatic processing extends efficiency gains to the breadth of the client acceptance process. Sanction checks, anti-money laundering checks, beneficial owner and affiliate checks, and services authorization all become more streamlined in enterprise system processing.

Manual processes rely on substantial broad communication that will take small amounts of time from a broad population of people. Kingland has found that manual processes can be cut from a matter of weeks to a matter of days or hours by leveraging data in automation.

In the example of the mid-tier firm, let's use 50,000 checks are sent as a negative affirmation to 1,000 people every time a check needs to be completed. In other words, a conflict will not be identified if nobody responds to confirm a conflict exists. Even if each recipient only spends an average of 30 seconds on each check, whether that be to respond or to delete the email, the firm is still spending over 400,000 people hours on conflict checks alone every year. While some firms may limit the number of people that the email is sent (reducing the people hours), many firms will have far more than 50,000 checks each year.

Enterprise systems leverage data to make asking the majority of the firm about the conflict unnecessary. In the example of a mid-tier firm with 1,000 people asked in a negative request system, only a small fraction of the population will need to provide input on the conflict check. Hours instead can be shifted to other work, including billable work. Regardless of the hourly rate applied, it becomes clear that the efficiency gained through an enterprise system in the reduction of people hours is a positive return for a firm.

On this criteria alone, most firms will automatically have a positive ROI.

> *"Kingland has found that manual processes can be cut from a matter of weeks to a matter of **days or hours** by leveraging data in automation."*

Readiness for Future M&A

Many public accounting firms are pursuing enterprise systems across their organization to ensure future merger and acquisition (M&A) activity can occur smoothly and maximize valuations. Firms that have enterprise systems are able to integrate more easily, and these firms are increasingly being targeted by private equity (PE) firms for investment.

Kingland's own market research has shown that firms are seeking out enterprise systems earlier than they would otherwise be required to by regulators. The earlier spend on technology is driven by interest M&A growth opportunities and because the enterprise system makes a firm more attractive to PE firms.

Daniel Hood, Editor-in-Chief of Accounting Today, credits PE money as the first reason behind 2023's double digit growth in the industry. **The publication's Top 100 Firms report for 2024** highlights Cherry Bekaert, Citrin Cooperman, and Eisner Advisory as all leaning into this strategy, with Cherry Bekaert leading the pack in PE partnered M&A growth with 99.66% revenue growth in 2023[2]. Further down in the report, Aprio is highlighted for merging 8 smaller firms in a matter of 6 months in 2023.

What is it exactly about enterprise systems that make firms so attractive for this kind of investment and activity? **Protection, integration.**

Protection

When a PE firm invests in a public accounting firm or a public accounting firm rolls up other smaller public accounting firms, a significant investment is being made. The investor wants to ensure that their investment is protected. Does the firm take risk management seriously or are they flying blind to regulatory and reputational risks? An enterprise system provides comfort that the public accounting firm has the right risk management processes and tools in place to protect the investment and streamline the growth of that investment.

Integration

When two firms merge, they bring together their different books of business. Increased risk for independence and conflict violations exist as the two clients come together, and each acquired client and relationship needs to be checked against the client list and business relationships of the acquiring firm. If both firms are operating with home grown or manual systems, their data is almost guaranteed to not speak the same language. The process of merging will be highly manual and expensive as each client is checked under a newly created manual process that works between the two firms. By having an enterprise system, firms can move with speed to integrate additional firms, having confidence that the data and processes will protect them.

The return on investment is significant:

Valuation: Organizations with enterprise risk management software are able to provide assurance to investors that their risks are understood, causing higher valuations. A small increase in a valuation pays for a system many times over.

Integration Ease: Organizations with proper enterprise software is able to roll up firms quickly, safely, and at a lower cost. The reduced cost of an integration and the avoidance of a compliance miss typically pays for a system quickly.

EisnerAmper **increased its technology budget by 66%** in 2023 after inking a private equity deal[3]

[2]https://finance.yahoo.com/news/cherry-bekaert-ranked-first-fastest-140000086.html
[3]https://www.journalofaccountancy.com/issues/2023/feb/private-equity-eyes-accounting-firms-large-and-small.html

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