The Building Society Audit Market

A Building Societies Association Report

17 June 2024

Building Societies Association

Executive Summary

It is no secret that there is a lack of competition and choice in the audit market. There have been independent reviews, Government consultations, and regulator projects which confirm this. This report sets out recent findings which show that audit fees have risen significantly above inflationary levels for the building society sector, with a disproportionate burden being carried by smaller building societies, and that auditor competition and choice is lacking for the majority of building societies.

We believe that this is caused by a lack of proportionality in audit regulation and oversight, including the continued application of the Public Interest Entity (PIE) definition to all building societies. External audit for financial services must be robust and we do not want any weakening of audit quality. However, the regulatory environment over the last five years has led to a sharp contraction in competition and choice, with appropriate audit firms bidding for building society audits just 54% of the time compared to 77% of the time previously, and 177% increase in fees for building societies. Action must be taken to address the building society audit market.

The vast majority of building societies should be removed from the scope of PIE audits to best achieve this aim.

Our research found that audit fees have risen in the building society sector in a manner which outpaces their asset size, profit margin and risk of failure. Headline figures include:

- Audit fees for building societies rose by 13.7% on average last year (versus 8.6% increase in the Consumer Price Index (CPI) rate last year[1])
- 2023 audit fees increased by an average of 25% for the smaller half of the building society sector
- Audit fees nearly tripled (up 177%) over the past five years as averaged across all building societies bar Nationwide (compared to 24.8% increase in CPI over the same length of time)
- The cost of audit for the smallest eleven building societies in 2023 was equivalent to 9% of profits, compared to 0.35% for the largest 6 building societies.

Building societies are paying audit fees completely disproportionate to their size compared to private companies - one small building society paid as much for their external audit as the coffee chain Prêt a Manger, despite Prêt's turnover being fifteen times as much. This report looks into this comparison and others in more detail.

PIE audit standards and enforcement has increased regulatory compliance risks for auditors of even small, straightforward building societies, impacting audit firm risk appetite for the sector, and consequently minimising competition and choice. Our research of 27 of the UK's 42 building societies shows that the majority of the UK's building societies have been left with little to no choice when selecting their auditor. By contrast, larger building societies received a broader range of bids that

[1] Inflationary figures based on Bank of England Inflation Calculator, using Consumer Price Inflation (CPI) data from the Office for National Statistics https://www.bankofengland.co.uk/monetary-policy/inflation/inflation-calculator

allowed for better competition. Additionally, feedback from societies indicate that competition for auditors has decreased since 2017. When tying the competition at the most recent tenders with data on the costs of audit, it appears that there is a common thread in the application of the PIE audit regime to all building societies.

The Building Societies Association (BSA) strongly supports robust but proportionate regulation across financial services. However, we do not believe that with all building societies operating on a mutual model for the benefit of their members, and legislatively constricted to supporting savers and home owners, it is fair to subject the vast majority to the same intense accounting and audit regime as publicly traded companies.

The BSA's objective is to champion and support its members: To push for the best outcomes from new and changing regulation and legislation to ensure that building societies can serve their savers, borrowers and communities. The BSA strongly believes that diverse and proportionately regulated markets are strong markets, but the audit market as it stands for building societies does not achieve that. We believe that by making the building society audit regulation more proportionate, namely by carving out the vast majority of building societies from the PIE definition, this will improve competition and choice of auditors and suppress further above inflation increases in the costs of audit.

Contents

Chapter 1 - Research Findings: Audit Fees

This research analysed the cost of audit[2] across all 42 UK building societies as reported in publicly available building society annual report and accounts.[3] Societies have been grouped by asset size for the purposes of evaluating trends outlined in Table A below. While it is important to take a whole sectoral view to evaluate impacts as averaged across all societies, there at times when it is appropriate to also consider the sectoral trend excluding Nationwide, as its size means that divergence from the average can significantly skew results[4]. Cases where this is done are labelled accordingly.

The grouping of societies is as follows:

Table A: Group Name for Purposes of this Report	Asset Size	Number of Societies
Micro	<£500m	11
Small	<£1,000m	24
Medium	>£1,000m, but <£10,000m	12
Large	>£10,000m	6
	Total Number	**42**

Table B below sets out an analysis of audit costs as averaged across the whole building society market and size based groupings of the building society market:

Table B: Audit Fees	Avg asset size, 2023 (£m)	Avg profit before tax, 2023 (£'000)	Avg audit fees, 2023 (£'000)	Avg audit fees, 2022 (£'000)	Avg increase in audit fee 2022-2023	Avg audit fee as equivalent to asset size, 2023	Avg audit fee as equivalent to profit, 2023	Avg audit fees, 2018 (£'000)	Avg increase in audit fee 2018-2023
Micro Societies	312	1,489	134	104	28.9%	0.0430%	9.03%	59	126%
Small Societies	507	2,374	170	136	24.2%	0.0334%	7.14%	65	162%
Medium Societies	2,757	14,044	387	338	14.4%	0.0140%	2.75%	143	171%
Small and Medium Societies	1,257	6,264	242	204	18.8%	0.0192%	3.86%	91	167%
Large Societies	78,871	621,333	2,186	1,978	10.5%	0.0028%	0.35%	1,062	106%
All Societies	12,345	94,131	520	457	13.7%	0.0042%	0.55%	229	127%
All Societies (excl. Nationwide)	6,014	42,061	401	356	12.5%	0.0067%	0.95%	145	177%

[2] Cost of audit is excluding VAT as quoted in annual report and accounts

[3] Each annual reports for the past five years can be found on each building society's website, on the FCA Mutual Register or the BSA website here - https://www.bsa.org.uk/statistics/sector-info-performance/index-to-members-annual-reports-2015-2022

[4] In 2023, Nationwide declared its asset total was £271.9bn, with the sector as a whole holding £518.5bn assets, meaning Nationwide hold 52.4% of all assets in the building society sector

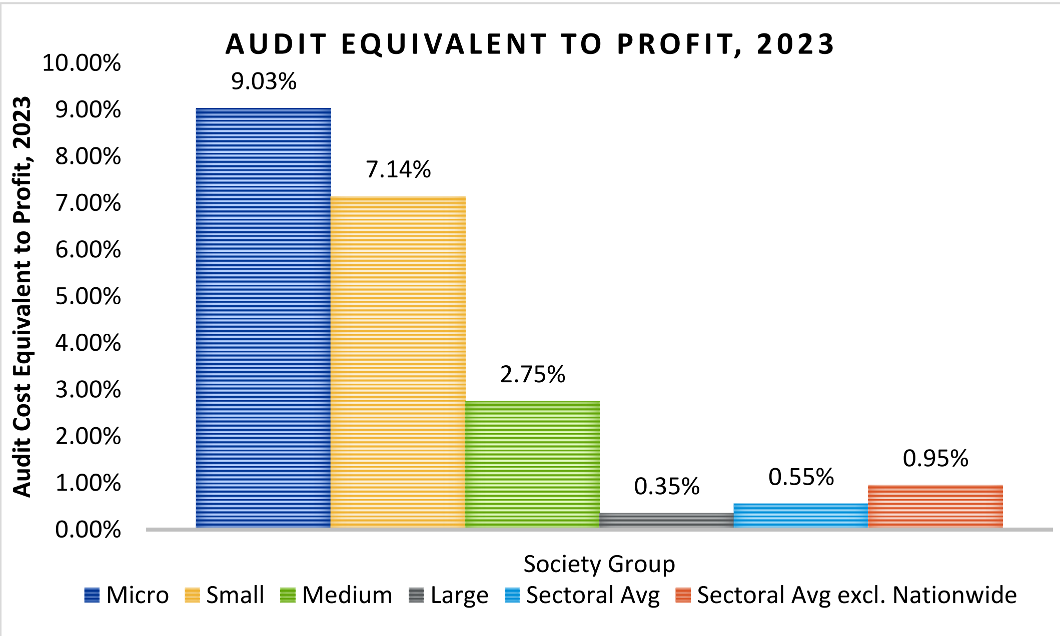
Table C below outlines how building society assets and profits have changed over the past five years:

Table C: Assets and Profits	2023 – Assets (£Xm)	2018 – Assets (£Xm)	% Asset Increase 2018-2023	2023 – Statutory Profit Before Tax (£X,000)	2018 – Statutory Profit Before Tax (£X,000)	% Profit Increase 2018-2023
All building societies	518490	406502	27.5%	3953499	1830407	116%
All building societies (excl. Nationwide)	246590	177404	39%	1724499	853407	102%

Audit Fee Relationship to Profit and Asset Size

As shown in Table B on page 5, on average, the larger a building society is, the more the audit costs. However, the smallest 11 societies are paying ten times more than the sectoral average for the cost of their audit as equivalent to their asset size, at 0.043% compared to 0.0042%. There is also evidence to show that, on average, the larger a society is, the more profit it makes. However, the research has shown that smaller societies are also disproportionately paying a higher cost for their audit as equivalent to their profit compared to larger societies. In 2023, the cost of audit as equivalent to statutory profit before tax averaged:

- 0.55% for the whole sector;
- 0.95% for the whole sector if excluding Nationwide;
- 0.35% for building societies with asset sizes more than £10,000 million, capturing the largest 6 of the UK's 42 building societies;
- 7% for building societies with asset sizes of less than £1,000 million, capturing the smaller 22 of the UK's 42 building societies; and
- 9% for building societies with sizes of less than £500 million, capturing the smallest 11 of the UK's 42 building societies;

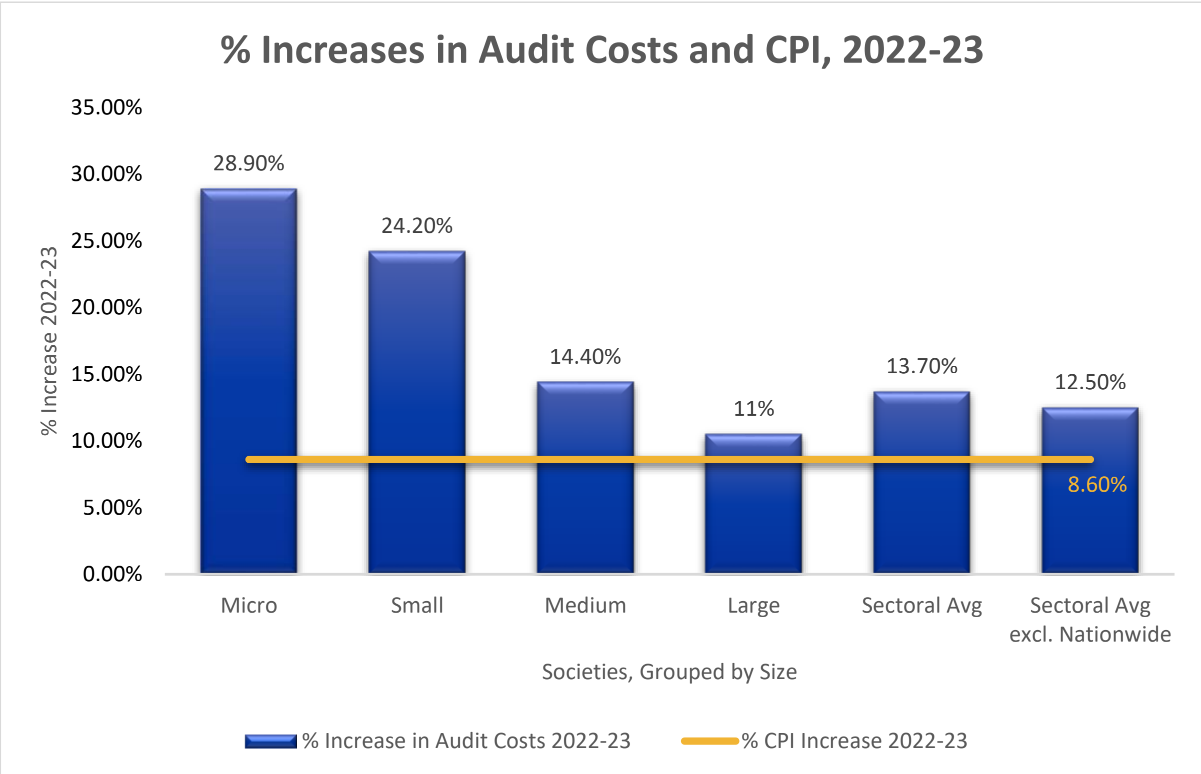


Although there is a natural a range within the data sets, this research found that there were four building societies whose 2023 audit was equivalent to more than 15% of their statutory profit before tax. Although smaller building societies are able to absorb this disproportionately large costs of audit, it is stark to see such a wide difference in the data sets, prompting questions if this is fair. It is clear that the PIE audit regulatory framework is not allowing for the cost of external audits to scale proportionately to building society size.

Audit Fee Price Changes

This research also analysed the difference in the cost of audit from last year. The rate of inflation during this same period was 8.6%. As outlined on page 5 in Table B, the cost of audit between 2022 and 2023 rose on average by:

- 13.7% for the whole sector;
- 12.5% for the whole sector if excluding Nationwide;
- 10.5% for building societies with asset sizes more than £10,000 million, capturing the largest 6 of the UK's 42 building societies;
- 24.2% for building societies with asset sizes of less than £1,000 million, capturing the smaller 22 of the UK's 42 building societies; and
- 28.9% for building societies with sizes of less than £500 million, capturing the smallest 11 of the UK's 42 building societies.

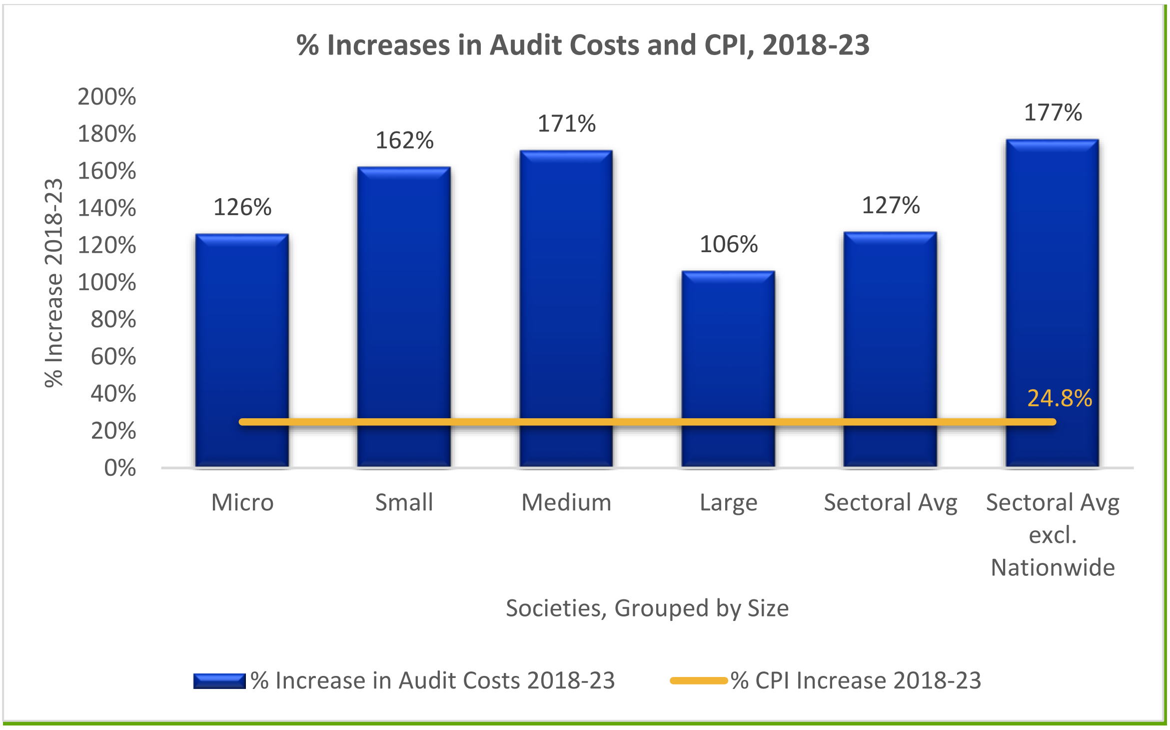


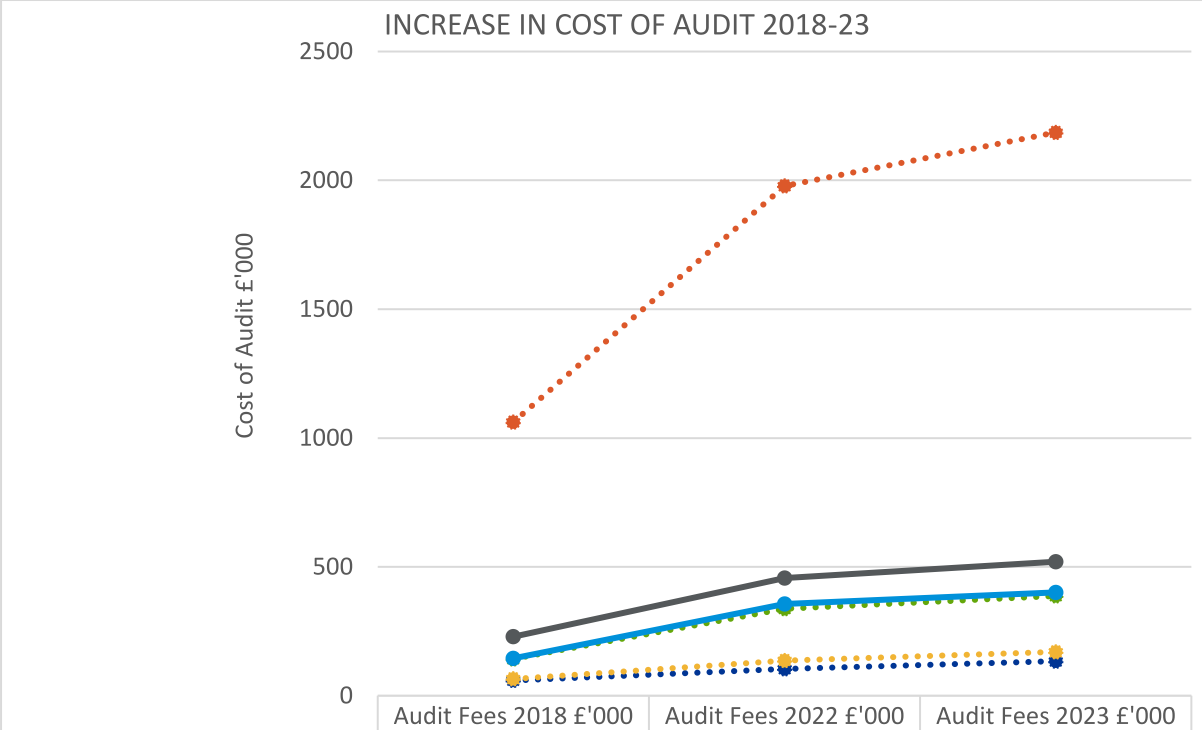
Although there will have been inflationary pressures impacting the most recent changes, it is notable that increases have fallen most heavily on smaller societies, far outstripping the rate of inflation. While the above figures are averaged, there were 7 building societies whose audit cost increased by more than 30%, with one building society seeing an increase of 133% in one year.

It would be remiss to not also raise instances where cost increases were minimal, negligible or negative. Three societies had a small annual increase of less than 5% from the previous year. Four societies saw a reduction in their fees. However, two of these firms only declare their audit fee to the nearest £100k and both had a reduction by £100k. It is possible that this decrease is less than £100k due to this rounding, and so this decrease must be caveated accordingly. The two other societies referenced saw decreases of 12.4% and 9.6%. It is noteworthy this only happened directly following a retender process and selection of a new external auditor. Another society saw a similar decrease in cost in 2022 following a retender process for a new auditor, with the new auditor costing 9% less than the previous auditor. There is insufficient evidence to state there is strong correlation between retendering delivering smaller audit costs, but it is noteworthy that public data had indicated this happening at least three times in this small sector.

The increase in audit fees is even more concerning when analysing the difference in the cost of audit in 2023 as compared to 2018. The rate of inflation over this same period of time was 24.8%. As outlined in Table B on page 5, the cost of audit over the last five years rose on average by:

- 127% for the whole sector;
- 177% for the whole sector if excluding Nationwide;
- 106% for building societies with asset sizes more than £10,000 million, capturing the largest 6 of the UK's 42 building societies;
- 189% for building societies with asset sizes more than £10,000 million but excluding Nationwide, capturing 5 of the UK's 42 building societies;
- 162% for building societies with asset sizes of less than £1,000 million, capturing the smaller 22 of the UK's 42 building societies;
- 171% for building societies with asset sizes between £1,000 million and £10,000 million, capturing the 12 of the UK's 42 building societies





	Audit Fees 2018 £'000	Audit Fees 2022 £'000	Audit Fees 2023 £'000
Micro	59	104	134
Small	65	136	170
Medium	143	338	387
Sectoral Avg	229	457	520
Sectoral Avg excl. Nationwide	145	356	401
Large	1062	1978	2186

As outlined on page 6 in Table C, these increases are beyond increases in the asset size of the whole sector and profits both including Nationwide (27.5% increase in assets and 116% increases in profit) and excluding Nationwide (39% increase in assets and 102% increase in profit). Within the data set, evidence has shown that there are 13 building societies who have seen their audit fees more than triple over five years, with three of those seeing fees quadruple and one society seeing a nearly six fold increase in their audit fees over this same time period.

The building society sector has had stable growth and while there has been some additional regulation placed on it, the PRA has been taking action to make prudential regulation be applied more proportionately on small domestic deposit takers. While the audit profession has been going through changes which have had an impact on the risk appetite of audit firm and cost of audit due to growth regulation, we question how the impact has been allowed to fall so heavily on building societies, particularly smaller building societies.

Comparison with Other Sectors

It is not just the building society audit market which has seen a lack of competition and choice alongside increased fees. . However, upon researching further, the majority of the building society audit market has seen changes disproportionate to its size, complexity and impact in comparison with other sectors.

In March 2024, the Quoted Companies Alliance ("QCA") published a report which stated that the cost of annual external audit for companies on the London Stock Exchange Main Market with a capitalisation under £500m has risen by 75% in the past five years.[5] When looking at the raw changes to the cost of audit to UK building societies, costs have increased by 177% in five years if excluding Nationwide, more than twice the rate of the increase for listed companies. The QCA says that the real increase for listed companies could be as high as 127%, due to the effects of lessening choice of audits, enhanced reporting requirements and a shrinking profession,[6] and the real increase for building societies could very likely be much higher than that too if the effects of less competition and choice are taken into account. These public companies and building societies are subject to the same standard in accounting and audit – yet building societies have seen even higher increases in the cost of audit.

There have been pressures on the entire audit market which have affected auditor competition, choice and costs. However, it is important to see if the distinction between PIEs and non-PIEs has any effect on the changing costs of audit. While all building societies are PIEs regardless of their size, no credit union falls within scope of the PIE regime. Credit unions have also seen significant rises in their audit fees in relative terms, far exceeding inflation rates. This report compares the cost of audit of the two smallest building societies, Penrith and Earl Shilton (assets total £306m) and the two of the largest credit unions, No1 Copper Pot Credit Union and Glasgow Credit Union (assets total £352m), as firms broadly comparable in size and financial product offerings.[7] An analysis of their publicly available information on audit was as follows:

- These two credit unions faced significant rises over five years in their audit fees, with an average increase of 111.5%, similar to these two building societies who saw an average increase of 137.2%
- The cost of audit for these building societies has increased by £95k in the past five years with these credit unions seeing an increase of £29k
- The building societies paid more than three times as much for their 2023 audit as the credit unions did (£185k and £55k respectively);
- The building societies' external audit fees rose by 26.7% last year, whereas these credit unions' audit fees increased by 19.6%; and,
- The cost of audit for these building societies is equivalent to 15.1% of their profit, compared to the credit unions where their audit fees are equivalent to 0.9% of their profit.

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[5] The QCA found that audit fees across all markets during the most recent five year period was 127%, with the London Stock Exchange Main Market companies seeing an average increase of 149%, with AIM companies seeing an average increase of 110%. https://www.icaew.com/insights/viewpoints-on-the-news/2024/mar-2024/audit-fees-rise-by-75-since-2017#:~:text=The%20QCA%20found%20that%20the,of%20110%25%20in%20audit%20fees.

[6] https://www.theqca.com/press-releases/the-crisis-of-unaffordable-audits/

[7] Asset sizes as reported in 2023 annual report and accounts are total assets as follows: Penrith £138m, Earl Shilton £168m, No1 Copper Pot £161m and Glasgow Credit Union £191m

These building societies and credit unions offer similar financial products, such as saving and mortgage products, they are both dual regulated by the PRA and the FCA, their deposits are within scope of the FSCS, and managers are within scope of the Senior Managers and Certification Regime. These two building societies and two credit unions are audited by four different audit firms which are all registered for the purposes of carrying out the statutory audits of PIEs, although the credit unions have contracted their auditor role to smaller audit firms than those seen in the building society audit market. In addition, it is stark that the key distinction between these firms that could lead to such inflated audit costs is that for the purposes of statutory audit, credit unions are not designated as PIEs whereas building societies are. This is not to say that credit unions are protected from the recognised issues in the non-PIE audit market, where it is noted that as credit unions have been growing, and the cost of audit services have been increasing at a disproportionate rate. The needs of credit unions and their members are better served by the existing non-PIE audit regime than smaller building societies are served by the existing PIE audit regime. Reflecting on the background of the regulation of building societies along with the purpose of the PIE audit, we conclude that the PIE status of most building societies is disproportionate to the risk posed by the building societies, while increasing the risk for auditors, consequently reducing auditor appetite and pushing up audit costs for smaller building societies.

While banks are also within the scope of PIE, it is more difficult to draw a direct comparison of the cost of audit for building societies and banks due to the typically more risky and complex nature of banks, in comparison to monoline mortgage lenders. Therefore, it is helpful to perhaps compare the experience of building societies to other large private companies who are not currently PIEs but would have fallen within scope of the 2022 Government proposals to extend the scope of PIE to private companies with a turnover of more than £750 million a year as well as having over 750 employees.[8] Building societies are not typically measured on the basis of turnover, rather asset size, to indicate their size. For the purposes of making this comparison, the "turnover" of a building society is made up of income the society makes, such as interest, fees, commission, financial instruments or other operating income, as indicated in the income statement in each building society's annual report and accounts.

Although the risks and significance to the UK economy of private companies is different to that of a financial institution like a building society, the cost of audit is disproportionately lower for the largest private companies compared to building societies. For example, both Suffolk Building Society and Prêt A Manger Ltd[9], the chain coffee shop, paid the same amount for their external audit in 2023. However Prêt's turnover is over fifteen times as much as Suffolk's, their profit is thirteen times as much as Suffolk's, they employ fifty times as many people, and have fifty-five times as many units on the UK's high streets. Another example comes in the shape of the Progressive Building Society and Moy Park Ltd[10], both being entities based in Northern Ireland. Both pay approximately the same amount to their auditors, while Moy Park's turnover is twenty-one times as much as Progressive's, their profit is one and a half times as much, Moy Park's audit cost increased by just 86% in five years compared to Progressive's increase of 173% in five years, and they employ thirty-five times as many people. These are just two examples from across the audit market that are demonstrating the disproportionate scope, regulation and oversight of auditing standards for most building societies.

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[8] 'Restoring Trust in Audit and Corporate Governance: Government Response' May 2022
https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms

[9] Registered at Companies House, company number 01854213

[10] Registered at Companies House, company number NI004842

While the BSA recognise and support the need for a strong and robust audit regime for firms operating in financial services, **we believe the vast majority of building societies should be removed from the scope of PIE**, on the basis that the benefits of a PIE audit for the majority of building societies is outweighed by the significant impact it has on competition, choice and cost. The BSA believes these funds could be better spent supporting savers and residential mortgage holders as part of a diverse mutuals sector.

Chapter 2 - Research Findings: Competition in Audit

This chapter analyses the state of competition and choice in the external audit market for building societies. Information on the 2023 external auditor is publicly available, but information on the competitiveness of each individual tender for an auditor is commercially sensitive and accordingly not publicly available. All 42 building societies were contacted and asked to complete a survey of their experiences in their most recent tender for external audit. The below results have removed identifying information, including current auditors, when they last tendered, how many auditors would have been acceptable at tender, and how many auditors actually bid for each tender.

Concentration of Auditors

Taken from the 2023 annual report and accounts of each building society, the following is a breakdown of how external auditors are concentrated across the building society external audit market, listed alphabetically:

Table D: Audit Firm Concentration in 2023	Number of audits	Size of audits	% of number of audits	% of audit fees receives as a proportionate of the sector
BDO	9	7 small audits 2 medium audits	21.4%	11%
Deloitte	7	1 small audit 4 medium audits 2 large audits	16.7%	17%
EY	3	1 medium audit 2 large audits	7.1%	43%
KPMG	1	1 medium audit	2.3%	3%
Mazars	12	10 small audits 2 medium audits	28.6%	9%
PwC	10	6 small audits 2 medium audits 2 large audits	23.8%	18%

As seen from the above Table D, there were only six audit firms which were engaged in the building society audit market in 2023. They are not equally spread in either number of audits across the market or in their share of the market as a proportion of the whole building society external audit market. For example, EY audits just 3 building societies, yet it receives 43% of all audit fees due to auditing larger building societies, while Mazars audits 12 building societies and receives 9% of the all audit fees due to auditing smaller building societies.

Audit Firm Appetite and Competition at Tender

27 building societies completed a survey and produced information on their most recent tender process to select an external auditor. Societies were asked two questions:

- Prior to the receipt of tenders for audit by audit firms, how many different audit firms would have been acceptable to be considered for the role of external auditor? and
- How many audit firms tendered for the role of external auditor?

The breakdown of respondents is as follows:

- 8 of the smallest 11 building societies responded (micro societies)
- 18 of the small 24 building societies responded (small societies)
- 6 of the medium 12 building societies responded (medium societies)
- 3 of the largest 6 building societies responded (large societies)

The data on acceptable audit firms and audit firms which did bid at the most recent tender is outlined in Table E. To remove identifying information, the below does not individually indicate the success rate of individual audit tenders, rather groups building societies of similar size with each other:

Table E: Audit Firm Competition by Society Size	How many auditors would have been acceptable to be considered for external auditor?	At most recent tender, how many bids were submitted?	Rate of acceptable : bid
Micro Societies (assets <£500m)	Two deemed acceptable – 2 responses Three deemed acceptable – 2 responses Four deemed acceptable – 2 responses Five deemed acceptable - 1 responses Eight deemed acceptable – 1 responses	One bid – 1 responses Two bids – 4 responses Three bids – 3 responses	31 acceptable : 18 bids 58% of acceptable auditors bid
Small Societies (assets <£1,000m)	One deemed acceptable – 1 responses Two deemed acceptable – 4 responses Three deemed acceptable – 3 responses Four deemed acceptable- 5 responses Five deemed acceptable – 2 responses Six deemed acceptable- 2 responses Eight deemed acceptable – 1 responses	One bid – 3 responses Two bids – 9 responses Three bids – 6 responses	68 acceptable : 39 bids 57% of acceptable auditors bid
Medium Societies (assets £1,000m - £10,000m)	Three deemed acceptable – 2 responses Four deemed acceptable – 3 responses Five deemed acceptable - 1 responses	One bid – 1 responses Two bids – 3 responses Three bids - 2 responses	23 acceptable : 13 bids 56% of acceptable auditors bid
Large Societies (assets >£10,000m)	Four deemed acceptable – 3 responses	Four bids – 3 responses	12 acceptable : 12 bids 100% of acceptable auditors bid

The above indicates that 12 of the 27 respondent societies received just two bids at their most recent audit tender, a concerning fact considering that the majority of societies had at least four audit firms which had the expertise and skill to carry out the audit. This concern deepens when seeing that four societies which responded to this survey had only one bid for the most recent tender, giving them no choice in who they were able to appoint. While the decision to bid for an audit tender is dependent on the capacity and appetite of the audit firm, it is interesting to see that the three larger societies deemed that there were four audit firms which would have been acceptable for the role as external auditor, and they each received four tenders from those firms at the tendering process.

This shows that that competition and appetite of audit firms for the audit market of large building societies is much better and stronger than it is for small and medium building societies. It is positive that audit firms have an appetite to carry out the audits of the UK's largest building societies. However, it would be even more positive to see better competition and audit firm appetite for the audits of small and medium sized building societies. By directly comparing the average costs of audit for large building societies with good auditor choice to average costs of audit for small and medium building societies with poor audit choice, the following trends emerge:

- In 2023, the average audit fees of small and medium societies increased nearly twice as much as the average increase for large societies (18.8% increase compared to 10.5%)
- Audit fees for small and medium societies in 2023 cost nearly twelve times as much equivalent to profit as compared to large societies (3.86% compared to 0.35%)
- Audit fees for small and medium societies have risen significantly more in five years than the audit fees for large societies (167% increase compared to 106% increase)

The 27 building societies who contributed to the survey also provided information on when they carried out their most recent tender. To remove identifying information, this does not contain evidence on society size and has been group to give anonymity:

Table F: Audit Firm Competition by Year	How many auditors would have been acceptable to be considered for external auditor?	At most recent tender, how many bids were submitted?	Rate of acceptable : bid
2017 and 2018 (3 societies)	Four deemed acceptable - III	Three bid – II Four bid - I	12 acceptable: 10 bids 83% of acceptable auditors bid
2019 (7 societies)	One deemed acceptable – I Two deemed acceptable – II Four deemed acceptable - II Five deemed acceptable – II	One bid – I Two bid – III Three bid – II Four bid - I	23 acceptable: 17 bids 74% of acceptable auditors bid
2020 (8 societies)	Two deemed acceptable – I Three deemed acceptable – III Four deemed acceptable – II Five deemed acceptable - I Six deemed acceptable - I	One bid – II Two bid – IIIII Three bid - I	30 acceptable: 15 bids 50% of acceptable auditors bid
2021 – 2023 (9 societies)	Two deemed acceptable – I Three deemed acceptable – II Four deemed acceptable - IIII Six deemed acceptable – I Eight deemed acceptable - I	One bid – I Two bids – IIII Three bids – III Four bid - I	38 acceptable: 22 bids 58% of acceptable auditors bid

Analysing the above information on page 15 in Table F, it appears than over the past few years, building societies have been receiving significantly fewer bids from acceptable auditors for their audits, with a small increase in the past few couple of years. While over the past few years societies have fed back that the pool of acceptable audit firms had grown, that did not feed through into any growth in the number of audit firms which bid for the tender. Grouping the tenders which ran 2017-2019 and tenders which ran 2020-2023, audit firms were bidding at a rate of 77% of the time compared to 54% of the time more recently. Accordingly, this data is demonstrating that auditor choice for building societies is poorer than it was several years ago.

Competition and choice in an audit firm is largely dependent on the appetite of the audit firm, and unfortunately, audit firms which are acceptable and suitable to do building society audits, particularly small and medium building society audits, are only bidding for slightly more than half of the audits available to them. As outlined in the February 2024 Financial Reporting Council (FRC) Report on research on the view of audit firms on entry, growth and exit in smaller PIE and non-PIE audits,[11] audit firms cited risks associated with reputational risk, regulatory penalties and audit liability claims from PIE auditing as barriers to operating in the PIE audit market. In fact, 80% of non-PIE audit firms said the regulatory regime is limiting their ability to enter the PIE audit market, requiring economies of scale to enter and maintain presence. This FRC Report also discussed the observed "cliff edge" in the requirements, supervision and inspection of PIE and non-PIE audits which are having a direct impact on appetite of audit firms to enter into and grow in the PIE audit market. All seven audit firms which have left the PIE audit market reported that the PIE regulatory regime was one of the reasons why they exited the market.

While we support the need for a robust auditing standard, the PIE auditing regime is overly burdensome and disproportionate to the needs of the building society sector, restricting the appetite and ability of audit firms to bid. For example, under PIE auditing standards, an audit engagement partner can be in post five years before being rotated off and must then wait five years before auditing that client again, whereas under non-PIE auditing standards, an audit engagement partner can be in post for seven years and must then wait only three years before auditing that client again. For smaller building societies, the benefits of rotating after just five years instead of at seven years are not readily apparent. Within audit firms, this reduces audit firm capacity to carry out building society audits and means that other engagement partners must be found to continue audits after just five years, pushing up audit costs for the firms and tightening the commercial attractiveness of building society audits. This is just one example of the ways that a disproportionate PIE audit regime is impacting auditor competition, choice and cost in the building society market, and we believe the best way to address it would be taking the vast majority of building societies, out of scope of the PIE auditing regime.

[11] https://www.frc.org.uk/news-and-events/news/2024/02/frc-takes-systemic-look-at-barriers-to-competition-in-uk-audit-market/

Chapter 3 - Background and Context

Building Societies

Building societies serve almost 26 million consumers across the UK and have total assets of over £515 billion.[12] Together with their subsidiaries, they have helped over 3.5 million families and individuals to buy a home with mortgages totalling over £385 billion, representing 24% of total mortgage balances outstanding in the UK. They are also helping over 23 million people build their financial resilience, holding over £385 billion of retail savings, accounting for 19% of all cash savings in the UK. With all of their headquarters outside London, building societies employ around 51,500 full and part-time staff. In addition to digital services they operate approximately 1,300 branches, holding a 28% share of branches across the UK.

Building societies are owned and run for the benefits of their members. This means the people who use the services of a building society such as depositors and mortgage holders. Under legislation, building societies must have as their principal purpose the making of residential mortgages, funded substantially by their members.[13] Residential mortgage are recognised as being less risky compared to some other banking services which are provided by other institutions such as commercial lending.[14] Due to their model, building societies are much more restricted in their ability to raise capital compared to others, and accordingly are incentivised to be more risk averse than others in financial services.

Public Interest Entity Scope and Application

Building societies are defined as PIEs following the UK's continued application of EU auditing standards and legislation originating in 2006[15] when all building societies fell within the definition of a credit institution,[16] regardless of their size or complexity. It is notable that all UK credit unions were exempted from the definition of PIE in EU directive on the grounds of their more limited scale and complexity.[17] Other entities which fall within the definition of PIE are entities whose transferable securities are admitted to trading on a regulated market, which includes the London Stock Exchange, thereby including all publicly traded companies. The current definition does not include companies trading on the Alternative Investment Market or other Multilateral Trading Facilities.[18]

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12 Full list of UK building societies along with their asset size is available here; https://www.bsa.org.uk/information/consumer-factsheets/general-information/building-society-assets

13 Building Societies Act 1986 c. 53, Part II, s.5

14 Residential mortgages assets are risk weighted at 35%, whereas commercial lending is to be risk weighted at 100%

15 The Statutory Auditors and Third Country Auditors Regulations 2016 Part 1 s.2, implementing EU Directive 2014/56/EU, originally from the Directive 2006/43 - Statutory audits of annual accounts and consolidated accounts

16 The Statutory Auditors and Third Country Auditors Regulations 2016 Part 1 s.2 which exempts credit unions from scope of being a public interest entity by virtue of EU Directive 2013/36/EU Article 4(1)

17 Directive 2013/36/EC, Article 2, 5(1)(2)

18 They do however fall within the purview of the FRC under both the Audit Quality Reviews ("AQR") and Corporate Reporting Reviews ("CRR")

The legislation which underpins auditing regulation is owned by the Department for Business and Trade, with auditing and ethical standards created and maintained by the FRC. The FRC's primary responsibility is to oversee the regulation and supervision of auditors by the professional accountancy bodies.

In the wake of a number of large scale corporate failures in the 2010s, with questions raised about audit quality, competition and supervision, a Parliamentary select committee inquiry[19] and a series of independent reviews were carried out,[20] in 2021 the Government consulted on proposals to strengthen the UK's audit and corporate governance frameworks.[21] Amongst proposals which included replacing the FRC with a new Audit, Reporting and Governance Authority (ARGA), in 2022 the Government responded by saying that it intended to make changes which would bring private companies with both more than 750 employees and an annual turnover of more than £750 million within scope of requirements for PIE.[22] While this would have been an expansion of the PIE regime, the Government at the time said it would "seek opportunities to reduce regulation for smaller entities caught by requirements of retained EU law where they have proved too stringent, and use the legislation that we are developing to implement them". The Government did not bring forward legislation to deliver on these proposals before an election was called in May 2024. This report is published during the 2024 pre-election period, and accordingly we cannot speculate as to the legislative intentions and priorities of an incoming government with regards audit reform.

[19] https://committees.parliament.uk/work/6256/future-of-audit-inquiry/publications/

[20] "Independent Review of the Financial Reporting Council", Sir John Kingman December 2018, "The Quality and Effectiveness of Audit: Independent Review", Sir Donald Brydon, December 2019, "Statutory Audit Services Market Study", Competition and Markets Authority, April 2019

[21] 'Restoring Trust in Audit and Corporate Governance' March 2021 https://www.gov.uk/government/publications/restoring-trust-in-audit-and-corporate-governance

[22] 'Restoring Trust in Audit and Corporate Governance: Government Response' May 2022 https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms

Chapter 4 - Research Background and Methodology

Objectives of Research

The objective of the research was to evaluate the proportionality of the audit market on the UK's 42 building societies.[23] To achieve this objective, data was collected and analysed on:

- The cost of audit fees for building societies, increases in cost over one year and over five years, as well as cost of audit relative to profit and asset size
- The competition and choice in auditor at the most recent audit tender process for building societies
- The cost of audit fees for building societies as compared to other financial institutions, large private companies and public companies

Methodology

The research to analyse the current state of audit fees and support data analysis on auditor competition and choice for building societies comprised of analysing publicly available annual reports from each building society to collect evidence on several factors:

- Building society asset size
- Building society statutory profit before tax as reported for Year End 2023
- Cost of audit fees excluding VAR for group statutory audit services as paid in 2023, 2022 and 2018
- Auditor of 2023 annual report and accounts

This information is available either directly at each individual building society's website, the FCA Mutuals Register[24], or on the BSA's online index to building society annual accounts[25].

[23] Full list of UK building societies along with their asset size is available here; https://www.bsa.org.uk/information/consumer-factsheets/general-information/building-society-assets

[24] https://mutuals.fca.org.uk/

[25] https://www.bsa.org.uk/statistics/sector-info-performance/index-to-members-annual-reports-2015-2022

Data collection for auditor competition and choice for building societies comprised of a survey sent to all 42 of the UK's building societies in February 2024. 27 building societies across the sector responded. The questions elicited information on:

- When did the building society last carry out a retender
- How many audit firms would the societies have deemed acceptable for appointment at that time of tendering
- How many audit firms actually bid for the audit tender

As the responses to this survey are not publicly available information and are sensitive as to the competitive audit tender process, identifying details have been removed.

Additionally, further research was carried out on the current audit environment for a select few organisations for the purposes of drawing comparisons between the costs of audit for building societies compared to:

- Credit unions
- Large private companies
- Public companies

Information on the competitiveness of an audit tender process are sensitive and are therefore not public. Accordingly, no direct comparison may be made between competition and choice in the building society sector as compared to other sectors, but supporting secondary evidence from trusted sources has been referenced indicating the state of competition and choice.

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The Building Societies Association (BSA) is the voice of the UK's building societies and also represents a number of credit unions.

We fulfil two key roles. We provide our members with information to help them run their businesses. We also represent their interests to audiences including the Financial Conduct Authority, Prudential Regulation Authority and other regulators, the Government and Parliament, the Bank of England, the media and other opinion formers, and the general public.

Our members have total assets of over £507 billion, and account for 23% of the UK mortgage market and 19% of the UK savings market.