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A response by UK Finance to BEIS consultation on:
Restoring trust in audit and corporate governance

Introduction

UK Finance is the collective voice for the banking and finance industry. Representing around 300 firms, we act to enhance competitiveness, support customers, and facilitate innovation.

This paper has been prepared in response to the Government's proposals to improve the UK's audit, corporate reporting and governance systems as set out in the Consultation Paper 'Restoring trust in audit and corporate governance' (CP) issued by, the Department for Business, Energy and Industrial Strategy (BEIS)[1] in March 2021. Specifically, the proposed measures are designed to:

- *"restore public trust in the way that the UK's largest companies are run and scrutinised*
- *ensure that the UK's most significant corporate entities are governed responsibly*
- *empower investors, creditors, workers, and other stakeholders by giving them access to reliable and meaningful information on a company's performance*
- *keep the UK's legal frameworks for major businesses at the forefront of international best practice"*

Our members who have contributed to this consultation range from globally systemically important banks, both UK and international, mid-tier banks and building societies as well as newer banks.

Key messages and recommendations

We acknowledge that the failure of significant corporations can have material social and economic consequences and in the wake of a handful of recent high-profile corporate failures support the government's policy objective to tighten certain audit, disclosure and corporate governance requirements. However, we do not believe that there has been a pervasive breakdown in public trust in the way that the UK's largest companies in all sectors are run, governed, audited and scrutinised

The UK already has an enviably strong international reputation for high quality corporate reporting, demonstrating good corporate governance and audit quality, albeit we agree there will always be room for improvement and evolution. This is acknowledged in the executive summary of the consultation as "*The UK is consistently placed as one of the leading destinations for foreign investment in Europe and around the world….This includes the UK's internationally-respected system of audit and corporate reporting, which is mirrored by many countries around the globe…The UK has long had a hard-earned reputation for high standards of corporate governance and robust practice for investors and others stakeholders*". As the UK makes its way out of the Covid-19 related economic crisis and sets its global agenda in a post Brexit environment, it is important that any reform relevant in addressing the issues identified through the various reviews, is proportionate in appropriately balancing benefit and cost.

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[1] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/970676/restoring-trust-in-audit-and-corporate-governance-command-paper.pdf.

The calibration of the new rules will need to be considered carefully to ensure the proposed measures do not have the unintended effect of undermining the UK as a desirable location to establish and develop businesses. If implemented without due consideration and evaluation, the proposals would result in new, overly burdensome requirements undermining the recent governmental efforts to increase the attractiveness of the UK markets through the UK Listings Review[2] by Lord Hill as well as rendering the post of non-executive directors less effective by deterring top talent. In addition, excessive and overly complex reporting could further deter investors and stakeholders, or by rendering boards excessively risk adverse, harming innovation, constraining market forces or in extremis, creating situations where organisations deliberately operate under the thresholds to avoid the burden of compliance.

It is essential that certain criteria are met across the package as the government implements its audit and corporate governance reform: notably quality, proportionality and consistency with other UK and international requirements and frameworks, with the ultimate goal that the UK continues to be 'a world-class destination for investment'. While we fully accept that there is benefit in the UK having, and being seen to have, the highest standards of audit and corporate governance, we also see a need to guard against unwarranted and unworkable intrusion.

We summarise below our views and observations, on the government's proposals together with, where appropriate, recommendations as to how we believe the Government could best achieve its objectives. In evaluating and responding to this consultation, where possible, we have commented on behalf of our members, as firms subject to the proposals in their own right, and from the perspective as lenders, counterparties, advisors and investors in other industries and sectors.

The government's proposals are widely drawn and, in our view, impose more onerous requirements than are needed to address the perceived concerns, consequently, the power provided to the regulator must be balanced by equivalent requirements for transparency, accountability and appropriate cost/benefit analysis. Stakeholder confidence in the UK corporate market, including that of the international investment community, will not be restored by an excessive and overtly interventionist regulatory regime. While we generally support the overarching principles of the government's proposals, we are concerned that significant parts of the package and the timing for implementation require fundamental revision. We have grave concerns that the proposals in total, as constructed, would significantly reduce the UK as an attractive location for business.

The following are our main views on the proposals. In the appendix we have answered the questions in the consultation and provided detailed reasons for these views and recommendations.

1. The government's approach to reform and the scope of proposals

- The determination of public interest should be more holistic, regardless of sector.
- We recommend including in the scope only FTSE listed companies and other large companies (Option 2 "500" criteria) as an interim measure, thereby excluding smaller non-listed entities caught by virtue of being a credit institution or insurer.
- The financial services sector has numerous PIEs under the current PIE definition, let alone after either of the suggested options – for example, some of largest UK systemic banks have approximately a dozen within each banking group, with multiple banking entities, listed special purpose entities, service companies etc.
- Due to the complexity and cost of the implementing these proposals for multiple PIE's in a single group we propose allowing directors to elect to apply them only at consolidated level e.g. UK systemic banks; UK conglomerate, and / or at individual PIE level e.g. non-UK international bank or corporate.

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[2] https://www.gov.uk/government/publications/uk-listings-review.

2. **Director's accountability for:**
   - **Internal controls**
     - We strongly support the government's preferred Option A for directors' sign off only - with auditor attestation being at the discretion of the board / shareholders / members.
     - We recommend that the scope of director accountability statement include only internal controls over financial reporting.
     - It is essential that the requirements allow for consistency with existing international regimes for example, US SOX so to reduce duplication and costs and potentially provide relief where a firm is already subject to an "equivalent" framework.

   - **Dividends and capital maintenance**
     - No further reporting requirements should be considered until it can be assessed whether the recent changes to s172 of the Companies Act have been effective.
     - Current guidance is highly technical and not easily understood. This is a good opportunity to develop solvency and liquidity measures that address business resiliency.
     - There should be a recognition that the financial services sector already has specific requirements to maintain capital / liquidity at an entity level, so there is a concern that disclosures could be mis-interpreted.
     - We do not believe a directors' statement of legality of dividends is required.

3. **New corporate reporting**
   - **Resilience statement**
     - We recommend the creation a single, coherent piece of reporting that provides insight into the future prospects of the company including material uncertainties facing the company, Directors must be free to consider company circumstances rather than having a prescribed list of risk factors to disclose.
     - We believe that the time horizons for viability statement should be the remit of directors, and linked to the planning horizons of the companies and sectors.
     - We have major concerns over how stress tests and reverse stress test results may be communicated with a particular concern over reverse stress tests. We believe overwhelming majority of shareholders and stakeholders would not understand how to interpret the results and therefore may draw incorrect conclusions. There is a further concern that management actions would be commercially sensitive and therefore should not be disclosed.
     - There are ramifications for corporates of changing the going concern assessment beyond 12 months due to the way banking arrangements are structured. This would also have unintended consequences for banks' regulatory capital requirements.

   - **Audit and Assurance Policy**
     - We broadly support greater disclosure of audit and assurance, but the proposals are too widely drafted to enable consistency and comparability across organisations. There is a role for regulators (FRC / ARGA and PRA / FCA) to advance the debate in this area.
     - It is important that this does not create a thirst for more external assurance (statutory auditor or other third party), since internal assurance / monitoring functions, including internal audit have an important role in this area.
     - The assurance policy provides an avenue for the development of 'audit' market resilience by involving, and thereby upskilling challenger audit firms in smaller companies without internal audit functions.

   - **Payment practices**
     - We do not support the proposal of additional disclosures relating to payment practices.
     - Current regulations on reporting provide enough transparency on supplier practices.

4. **Supervision of corporate reporting**
    - Corporate reporting review should be extended to include interim statements and analyst presentations.
    - We suggest adopting an approach similar to the US SEC with private comment letter process, with publication only after resolution and redaction of any price sensitive or proprietary information.
    - The international attractiveness of the UK market needs careful consideration, aligned to the Hill Review of UK listing requirements.
    - This requires careful co-ordination of activities with the PRA and FCA, so that existing regulated entities are not subject to regulatory and listing inefficiency.

5. **Company directors**
    - There should be alignment between SMCR and proposed ARGA powers – no double jeopardy.
    - We discourage actions that negatively impact the attractiveness of the UK market.
    - The statutory basis for ARGA and its powers relating to company directors is poorly defined and delineated and need to be carefully and consistently designed.

6. **Audit purpose and scope**
    - Auditors should take account of wider information in the conduct of their audit, but implementation should not require auditors to increase their search for wider information.
    - We support the "purpose of audit" statement being adopted, with the goal of building and maintaining stakeholder confidence. This needs to be well defined so as not to exacerbate the 'expectation gap' problem.

7. **Audit committee oversight and engagement with shareholders**
    - There is already a significant and sufficient regulation and guidance on the duties and responsibilities of directors on audit committees. Changes are not needed, appropriate or proportionate.
    - We do not agree with ARGA having the power to appoint an auditor – this puts the company and the audit firm in a potentially adversarial relationship from the outset so the audit is not set up for success.
    - We support ARGA setting clear minimum standards.

8. **Competition, choice and resilience**
    - We recognise the value in increasing audit choice and resilience but it must not be at the expense of audit quality.
    - Financial services audits are complex and require a wide range of specialist skills both in the UK and overseas.
    - It is difficult to carve out meaningful challenger audit portion given central shared services and risk management functions. Consequently, we do not support managed shared audits or market share caps as these will lead to reduced quality and higher cost.
    - Our members have evidence that there is at best limited appetite from credible challenger firms for this work or to invest in building out capability to be able to take on a significant number of such audits. There are major challenges in implementing a UK silo approach as in these proposals given the international dimension for FTSE 100 and beyond, resulting in an adverse impact on the attractiveness of the UK.
    - There has been insufficient time for the efficacy of the 2016 EU Audit Directive to be assessed and its benefits to be seen.
    - We consider that assurance work by challenger firm, starting with smaller companies, can go towards addressing audit market resilience.
    - We propose audit firms are subject to "Living Wills" style Recovery & Resolution Planning legislation similar to UK banks post the last financial crisis.

9. Supervision of audit quality

- The Audit Quality Review (AQR) grading regime is complicated. We recommend that simplifying the gradings to “Good”, “Satisfactory” and “Poor”.
- We disagree with the full publication of AQR reports that name or identify the company audited as it tarnishes the company unfairly when it is the auditor that is under scrutiny.
- Disclosure of privileged material is disproportionate and unnecessary and would not be appropriate. ARGA would stand apart from law enforcement authorities and other regulators if it were able to see privileged information. This is an inappropriate precedent which may damage the rule of law in the UK and the interests of all concerned.

10. Strengthened regulator

- The creation of separate quality and competition objectives is confusing without clarity on primacy
- The measures ostensibly aimed at increasing competition – such as shared audit or market share caps – come at the cost of quality
- “Working closely with other regulators in the UK and internationally”. is not strong enough. This is especially important given the likely overlap of responsibilities in respect of governance and reporting with sector specific regulators and listing authorities.
- A Memoranda of Understanding must be established between key regulators (such as for ARGA and the FCA) in order to set out how the regulatory bodies will work together to avoid overlap while achieving their own objectives.

11. Changes in regulator’s responsibilities

- The expectations of director oversight are unclear
- The proposals will result in an increase in costs and endanger unitary board principle as companies are pushed to buy additional assurance. The proposals also create inappropriate conflict between executive and non-executive teams, threatening the core corporate governance principle of a unitary board
- We agree that the PIE auditors should in principle have a duty to report directly to regulators, but that this should be focused on matters relevant to the remit of the regulator and not be all encompassing

We would be happy to discuss our response and to support BEIS on its endeavours on these proposals.

If you have any questions relating to this response, please contact Nala Worsfold (nala.worsfold@ukfinance.org.uk)

Appendix 1

Responses to questions

1 The Government's approach to reform

1. ***Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.***
2. ***What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.***
3. ***Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.***
4. ***Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?***

Holistic public interest entity determination
The government is considering the scope of public interest more broadly as part of this consultation. A more holistic, relevant and appropriate method of determining public interest is required other than based on listing on an exchange and the financial services sector – banking (banks and building societies) and insurance industries - as set out in the EU Statutory Audit Directive.

As pointed out by ICAEW's 'Audit reform: this definition of PIE is hard to swallow' "*The current criteria are broad, but still limited. They catch thousands of additional businesses where the public interest case might be quite weak, while missing others where there would be a clear public interest if they were to fail." "It's not just about quantitative elements, but about qualitative elements. That's what is needed in order to produce a definitive list of what constitutes a significant company acting in the public interest*". "*There are questions, for example, on how well the reforms would work for public sector entities. Under the proposals, HS2 would not count as a PIE, despite the clear public interest around it. Conversely the Student Loans Company would be classed as a PIE. Which has the greater public interest?"*

Some of these public interest considerations could be the level of existing regulation and supervision of the industry, regional concentration, number of employees, size of the organisation, size of pension schemes, complexity of the organisation, structure, products or supply-chain. We reiterate that public interest should be more widely but appropriately and proportionately drawn rather than differentiate the financial services sector. For example, in the UK, the NHS, HS2, Big 4 audit firms, utilities, pharmaceutical industry, oil & gas, social media are just some of these possible considerations. Further, we consider that financial services firms should not automatically be scoped-in as PIEs, but rather should be subject to the same scoping criteria as other regulated sectors. We recommend that the government undertake further work to reach this determination.

Interim approach
However, we appreciate that a more holistic approach may not be easy to implement in reasonable timescales and hence propose an interim approach be considered that links into investor and public interest protection.

Our recommendation is that the proposals be scheduled as follows:

- Phase 1: Premium listed entities
- Phase 2:
    - Standard listed entities
    - Large' entities – public, private and third sector – based on Option 2 in the consultation of 500 employees and £500 million turnover
- Phase 3: holistic public interest implementation

We would recommend that the above approach should apply regardless of industry, such that financial services firms are included to the extent that they meet one (or more) of the above criteria but not simply by virtue of their credit union or insurance company status.

Implement UK Corporate Governance Code 2018 first
Premium Listed companies already comply with the UK's extremely high standards of regulation and corporate governance. They benefit from a lower cost of capital through greater transparency and through building investor confidence. As the London Stock Exchange indicates, *"A Premium listing of equity demonstrates that the company meets London's world-class standard of regulation − the highest and most trusted globally − based on the requirements of the UK Listing Authority (UKLA) and often referred to as 'super-equivalent. Premium listed companies subscribe to the principles laid down in the FRC Corporate Governance Code (the Code), which sets out methods for best practice corporate governance or must provide an explanation why they do not. Effective corporate governance helps boards achieve their strategic objectives and builds value in the business which ultimately benefits shareholders."*

Later implementation of the proposals for companies other premium listed companies
We consider that applying the standards of corporate governance – under the evolving Code - as currently practiced and evidenced by the UK's premium listed companies may be sufficient and recommend a phased approach to bringing newly designated PIEs to the same standard as appropriate for their non-listed status. As noted in the consultation, legislation would be required to bring the wider range of companies into scope. We think this appropriate as the Corporate Governance Code 2018 covers areas of governance outside financial reporting which may not be appropriate to impose on-non-premium listed PIEs, particularly large private companies or other third sector and public sector entities. We note that the government's proposals do not seem to take account of the Wates Corporate Governance Principles for Large Private Companies, launched in December 2018 by the FRC, which set out (albeit voluntary) standards for large non-listed companies.

Level of PIE application and company discretion
We also consider that where appropriate the proposals could be applied either at a consolidated level or at all relevant individual entity or subsidiary level, to be elected by the directors. Subsidiary level flexibility is particularly relevant and important for UK subsidiaries of international companies and for diverse groups.

Financial services sector
The financial services sector is already heavily regulated and has been through significant reform since the 2007-2008 global financial crisis with wide-ranging enhancements to corporate governance, risk management, market transparency and public interest considerations. The Prudential Regulation Authority (PRA) is responsible for the prudential regulation and supervision and the Financial Conduct Authority (FCA) is responsible for regulating conduct of financial services firms and financial markets. Both regulators are established as parts of the Bank of England and through their vast array of rules and regulations also cover public interest by focussing not just on depositors and borrowers but also on products and services the financial services provide and behaviours relating to them. This interlock between sectoral rules and frameworks and the government's proposals are set out in the appendix. The Bank of England also has other regulatory powers, as does the Payment Systems Regulator.

Therefore, we believe further changes to corporate governance and reporting are not necessary in the financial services sector in order to address any perceived public interest deficiencies. However, should further requirements be deemed necessary, they should be implemented incrementally through changes to existing frameworks operated by the industry's regulators, the PRA and the FCA through a Memorandum of Understanding (MoU) as contemplated by BEIS in the consultation. This would ensure streamlined implementation, avoid overlap and duplication, and in the process clarify expectation.

PIEs in the banking industry
The financial services sector has numerous PIEs under the current PIE definition, let alone after either of the suggested options – for example, some of largest UK systemic banks have approximately a dozen within each banking group, with multiple banking entities, listed special purpose entities, service companies etc.

For smaller banks and building societies, the PIE status imposes a burden that is disproportionate to the perceived potential benefits of such status. In addition, the majority of public interest failure is covered by the Financial Services Compensation Scheme which provides protection over the deposits of individuals and most small businesses to a limit of £85,000. The current definition of PIE acknowledges that it is not appropriate for credit unions. The larger credit unions are bigger than most of the smaller banks and building societies and automatic inclusion of these latter entities in the scope of these proposals is therefore counter to this.

PRA's strong and simple framework
The PRA's discussion paper on a strong and simple regime for non-systemic banks and building societies, discusses a strong but simpler prudential framework to reduce the burden for smaller banks and building societies. BEIS proposals appears to be heading in the opposite direction with corporate reporting and governance reform in applying the proposed gold-plated requirements to all in the banking and insurance industry irrespective of size, scale or simplicity.

Publication of list of PIEs by ARGA
We also recommend the publication of the list of public interest entities and the basis of that determination for each entity caught by these proposals as part of the implementation of this reform so there is a consistent understanding. The list should be updated annually with an explanation of additions and exclusions.

5. ***Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.***
6. ***Should the Government seek to include large third sector entities as PIEs beyond those that would already be included in the definitions proposed for large companies? If so, what types of third sector entities do you believe should be included and why?***
7. ***What threshold for 'incoming resources' would you propose for the definition of 'large' for third sector entities? Is exceeding £100m too high, too low or just right?***
8. ***Should any other types of entity be classed as PIEs? Why should those entities be included?***

We suggest that a consistent set of PIE criteria be used for determining public interest irrespective of level of listing, sector, private or public; as noted above, we propose that financial services firms be subject to the same scoping criteria as other sectors (i.e. removing the presumption that financial services firms are always scoped-in as PIEs). As indicated above, we recommend that the government considers that the definition of PIE applies to other regulated entities such as utilities or public entities e.g. NHS, HS2. Generally, regulated sectors and government entities have a wide public impact but in some cases measures of employees and turnover may not always fully capture the level of public interest.

9. ***How would an increase in the number of PIEs impact on the number of auditors operating in the PIE audit market?***

Greater audit risk
An increase in the number of PIEs at the levels envisaged in the consultation will lead to greater risk attaching to these companies for audit purposes, with the additional requirements resulting in greater complexity in the audit. As pointed out by ICAEW's 'Audit reform: this definition of PIE is hard to swallow' *"The major issue with this is that the market for accountancy talent may not have the capacity to handle this many PIEs. It raises the question of whether there are enough skilled professionals in*

the market to staff all the PIE audits, prepare their accounts and fill newly created roles at an enlarged regulator – and what other work in the economy will have shortages as a result."

If the talent and resource is spread too thin then there is a risk to the framework itself which would have the adverse effect on improved corporate governance, risk management, market transparency and public interest considerations.

Perspective from The Building Societies Association

The Building Society Association (BSA) highlights the particular challenge for a number of building societies in their response to this consultation. "*PIE status imposes a burden out of all proportion to the (perceived) potential benefit such status confers. Taking, as an example, a one branch building society, employing c20 FTE, their experience of recent years has been:*

- *Audit costs have already doubled, as the FRC has put pressure on auditors of PIE entities through their own audits, to significantly raise their game. Alarmingly, an initial review of the impact of the current proposals by some of our members shows a fourfold increase in costs associated with the external audit. These disproportionately high audit costs for smaller building societies will rise further should further elements of IFRS 9 be included in FRS 102.*
- *The pool of auditors prepared to audit small PIEs has contracted and is far too small. The society in question, along with several others, started looking for a new audit firm when its auditor, one of the Big 4, exited the small/medium building society market. Another had paused new banking clients effectively leaving only two of the Big 4 to pick from (although two mid-tier firms have recently entered the market). For many societies the two remaining Big 4 firms already carried out their internal audit. Choice of alternatives was limited, risking an ineffective tender process.*
- *The annual audit work for the simple one branch building society, takes seven weeks each year (pre and post year-end). PIE status means the audit work for both sides is disproportionately great, driven by the pressures of it being a PIE audit on which the auditor could itself be audited, with the results publicised.*
- *Given the focus of PIE, the length and complexity of the statutory accounts is getting ever longer each year and the cost and effort of production is increasing commensurately. Very few building society members download or otherwise access the full accounts (as opposed to the summary financial statements that all building societies are required to send to all their members), no doubt put off by the highly detailed level of disclosure within. This begs the question of who these accounts are for? If they are intended for shareholder-owned organisations, the government must consider their value in relation to mutual."*

Further concentration in audit market

The same ICAEW article referenced earlier also highlights another related potential unintended consequence – *"Evidence from Europe after audit reform in 2016 suggests that many firms, when faced with the extra time and work required to audit PIEs, will decide that they don't want to be in the market at all." "The Netherlands saw the withdrawal of quite big firms from the PIE market after reform. That runs completely counter to the Government's wishes to see more competition and choice in the audit market, certainly at the large company end."*

This is therefore likely to result in a further concentration in the audit market with significant focus on controls effectiveness and could create a resource stretch and unwelcome concentration within the wider audit industry, leading to increased costs for users of audit services, during a time of continued economic uncertainty.

10. ***Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?***
11. ***Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?***

Staged approach
We recommend that any measures resulting from these proposals be promulgated in stages to allow businesses and entities to adapt and implement changes over time. UK businesses across all sectors are already under significant extra pressures due to Brexit and Covid. The impact of these two events will have a significant impact for some time to come. This should be considered when the implementation dates are set for these reforms.

Post implementation review
We recommend that a post implementation review takes place after implementation of the government's initial proposals that are brought forward before further changes are introduced. This will allow time for the changes to be bedded in and their effectiveness assessed before further change programmes are commissioned.

Entering and leaving PIE status
Also, any entity qualifying or ceasing to qualify as a PIE should be given certainty as to when it is brought into or falls outside of the requirements, including provisions for changes in group structure or composition. Pragmatically we would suggest that an entity be required to meet the threshold for two consecutive financial years before it qualifies. Likewise, similar provisions should be in place when an entity ceases to qualify.

2 Directors' accountability for internal controls, dividends and capital maintenance

Stronger internal company controls

12. ***Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?***
13. ***If the control framework were to be strengthened, would you support the Government's initial preferred option (Table 2)? Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?***
14. ***If the framework were to be strengthened, which types of company should be within scope of the new requirements?***

Existing high-quality frameworks
As set out in the consultation there are already frameworks for internal controls in place for UK listed companies through a combination of Listing Rules, UK Corporate Governance Code and Companies Act 2006. In addition, in the financial services there is a requirement to establish systems and controls under the PRA and FCA handbooks. In order to ensure a set of proposals that the government can implement smoothly and robustly we suggest that these requirements that are already met by premium listed companies should also be applied to entities that newly come into scope such as 'large' entities. This would ensure consistency and ease of implementation as opposed to the various options being considered in the consultation which all have similar and different implications, as highlighted by previous respondents to earlier consultations.

However, there is perhaps an argument that investor and stakeholder confidence is improved by strengthening internal control and corporate governance frameworks. This may be relevant for example in large private companies, third sector and government entities that are of public interest but not yet caught by existing regulation and codes. .

Option A preferred with the scope limited to internal controls over financial reporting
In the event that new internal control requirements are introduced, we support the government's preferred option - Option A - to give companies – via the audit committees, shareholders and similar stakeholders - the decision on the level and extent of external audit assurance. However, we believe that some guidance and public education from the regulator on general assurance levels and mechanisms will help to ensure consistent understanding and application across companies. In this area, learning from international experience is likely to be valuable, especially in models developed subsequent to US SOX regime such as Australia, which include evidence of how companies responded to legislated requirements on internal control. The introduction in the UK should leverage

learnings from these implementations and should result in a framework that is not inconsistent with these regulations but on a principles basis, rather than a bespoke framework.

Auditor certification

We do not believe it is necessary to mandate external audit of the directors' certification. In practice we expect many companies will choose some form of external audit comment on their controls – either because they already do so for US purposes or because there is demand from stakeholders. However, we believe there may be cases where directors and shareholders may conclude that assurance can be appropriately provided internally, by internal audit as is common in the banking industry for non-financial reporting controls. Equally there may be options to split – for instance seeking external assurance on financial reporting controls and internal assurance for non-financial disclosures and other risks.

Increasing the level of work required of the external auditor will inevitably increase the audit complexity and place greater reliance on the larger audit firms. In contrast, flexibility in assurance models will allows companies to be more selective in the work providers. This will in turn help alleviate concern over audit market resilience and competition.

Principles-based and proportionate version of UK SOX regime

Should it be considered necessary to introduce further internal control requirements, we recommend the introduction of a holistic and importantly proportionate version of the US Sarbanes-Oxley regime on internal controls. US "SOX" was introduced after the Enron and WorldCom scandals in early 2000, and it includes requirements for companies to maintain and report on internal controls and measures to prevent fraud, as well as specifying the responsibilities and liability of directors. However, the government should acknowledge that some businesses will fail. It's the nature of capitalism and is inevitable – obviously we agree that any concerns should be flagged as early as possible. We acknowledge that there will be significant cost and lengthy timeframe to any internal controls framework that resembles US SOX.

Consistency with existing international regimes

While supporting, in certain circumstances, the proposals to strengthen internal company controls, we believe that any requirements should not be inconsistent with other existing international requirements such as US SOX. There are a number of UK banks and corporates that already comply with US SOX. There are also a vast number of subsidiaries of international banks and corporates operating in the UK, some of whom are part of their parent's US SOX regime. This is the case for most of non-UK international banks who also tend to be globally systemically important banks, and are already subject to significant regulations, governance, internal controls and audit and other scrutiny. However, it should be noted that US SOX requirements are significant and would increase the cost of control for those UK companies not subject to US SOX, even if a SOX-lite approach were to be adopted.

Reducing duplication and cost impacts

Ensuring the proposals are not inconsistent with other existing international requirements / frameworks is key to ensuring that the proposals are non-duplicative and proportional to the increased cost of control. To strike a better balance, we suggest relief where a Group is subject to 'equivalent' controls reporting. If the proposals are inconsistent this will create some confusion especially in international investors and stakeholders which will not deliver the confidence that the recommendations seek. The proposal has the potential to disincentivise directors, particularly if applied to less significant entities in larger groups.

Scope of the internal control framework

The scale of the increase in the cost of control is dependent on the scope of the proposed framework. We would be concerned if the scope of the proposals were wider than US SOX, specifically in considering:

- all internal controls rather than those specific to Internal Controls over Financial Reporting (ICFR)

- increase of scope from the current statutory audit scope (e.g. climate reporting, ESG)
- application of the framework for groups; as noted above, we propose a directors' election between applying at the consolidated group-level or individual entity-level
- For information outside the financial statement scope and related controls, our members intend to consider additional assurance and communicate this through the audit and assurance policy.

There will be some companies, including smaller banks and building societies, that due to their nature, are subject to a lower level of general concern and it seems unnecessary to force the position for these companies, where shareholders are happy to rely on the internal assurance that the directors set out in their Audit and Assurance Policy.

Collective board responsibility

We recommend collective board responsibility for internal controls for financial reporting as contemplated, in line with the Corporate Governance Code 2018 in terms of overall controls.

Dividends and capital maintenance

15. ***Should the regulator have stronger responsibilities for defining what should be treated as realised profits and losses for the purposes of section 853 of the Companies Act 2006? Would you support either of the two options identified? Are there other options which should be considered? What should ARGA consider when determining what should be treated as realised profits and losses?***

The current guidance is highly technical and since there is limited reporting on the subject, it is not easily understood. This is evidenced by the extensive guidance that the ICAEW and ICAS have developed and maintained in the public interest. Most of our members suggest that the government take the opportunity to review the capital maintenance and dividend framework and develop a new system that is based more directly on solvency and liquidity which may be better at protecting a company's creditors and helping it to maintain sufficient capital for business resiliency.

We agree that it would be helpful if the regulator has more responsibility in this respect. Whilst we have no strong opinion on the appropriate body to continue the guidance, there may be benefits of having segregation between the body establishing the rules and ARGA's role in enforcing the rules.

16. ***Would the proposed new distributable profit reporting requirements provide useful information for investors and other users of accounts? Would the cost of preparing these disclosures be proportionate to the benefits? Should these requirements be limited to listed and AIM companies or extended to all PIEs?***

We believe the primary users of this information would be investors. Therefore, we recommend the requirements be limited to listed companies, including AIM, and larger companies where there is a broader investor base and not to companies that are owned by single shareholders within the same Group.

For the relevant companies, we agree that it is helpful and appropriate for companies to report their level of realised profits. However, consideration should be given to whether limitations on distribution should be highlighted. For instance, regulated entities may need to maintain capital bases, which may prevent distribution of available reserves. Therefore, the level of realised profits i.e. (those legally permitted for distribution) may not match the level of available profits (i.e. those that the company can distribute practically).

It would seem sensible to require all companies with broader investor bases (and not just public interest entities) to make this disclosure. The cost of determining the level of realised profits is not (for most companies) that complex and once derived is straight forward to maintain.

The cost of implementing a new disclosure requirement should also be proportionate. If these proposals are adopted, we recommend that companies should be permitted to report a "not less than" figure for its distributable reserves, with any proposed dividend payment not being allowed to exceed

this figure. This would address the potential risk that companies are unable to accurately identify the splits of cumulative unrealised gains and similar items. We also recognise that for complex group structures, perhaps with international operations, there will be difficulties in calculating a distributable profit figure. Likewise, some companies will experience difficulties in calculating this as they may not have sufficiently detailed historic records.

17. ***Would an explicit directors' statement about the legality of dividends and their effect on the future solvency of a company be effective in both ensuring that directors comply with their duties and in building external confidence in compliance with the dividend rules? Should these requirements be limited to listed and AIM companies or extended to all PIEs?***

Directors' statement on legality of dividends
Our members do not support the proposal for directors to make a specific statement about the legality of dividends and their effect on the future solvency of the company.

Directors of companies are legally required to act in the best interests of a company and sign a directors' responsibilities statement that covers, amongst other matters, the financial position and profit / loss of a company. These requirements already cover any distributable profits; therefore, we do not consider that additional requirements as envisaged by the consultation are necessary.

Additionally, directors are prevented by law from making illegal dividends. Requiring a director to make a statement about the legality of dividends is superfluous. It would result in an additional and unnecessary disclosure in the annual report. The consultation recognises that "*A statement along the lines proposed could be perceived as unnecessary given that it would cover legal obligations with which directors must already be compliant. However, … It might also make it easier to pursue existing legal redress routes for a breach of directors' duties*". If there are issues with the current mechanism to pursue directors for making illegal dividends the government should consider a change in the law rather than require directors to make a statement on the legality of dividends.

Consolidated realised profits
We disagree with the proposal to report consolidated realised profits. Subsidiaries are likely to require capital to support operations, particularly those operating overseas which may have legal limits on distribution, tax restrictions or other regulatory requirements. As a result, it is highly likely that the ability to upstream funds to the parent company is smaller than the level of accumulated realised profits within the group. This would make the disclosure potentially misleading. Should a consolidated group wish to provide additional information that provides shareholders with a better understanding of dividend availability this should be supported but since this would generally be seen as value enhancing, it does not require a legal requirement forcing that disclosure.

Assurance
We agree that the current requirements are sufficient and for larger companies it is fairly common practice to have public statements on dividend practice. As a result, we do not feel there is a need to legislate for specific disclosure. While there may be a case for requiring directors to provide information on whether/how they received assurance on the legality of a dividend, this information could easily be included within the Audit and Assurance Policy that sets out the directors' use of assurance and would allow shareholder interaction as to whether/when this information should be subject to external or internal assurance.

Banking industry perspective
In the banking industry, the existing regime provides flexibility for the level of dividends a bank can currently pay and we do not believe changes to the existing regime are required. Some banks currently disclose distributable reserves but there are concerns whether banks might need to report constraints to dividend payments such as those which can apply under the bank capital framework. The proposed directors' statement on dividends and future solvency raises some issues with the

disclosure of confidential information to support the statement such as forecasted capital ratios and results of stress tests.

18. *Do you agree that the combination of recently introduced Companies Act section 172(1) reporting requirements along with encouragement from the investment community and ARGA will be enough to ensure that companies are sufficiently transparent about their distribution and capital allocation policies? Should a new reporting requirement be considered?*

Distribution and capital allocation policies

We recommend that no further reporting requirements should be considered until it can be assessed whether the recent changes to s172 have resulted in companies being sufficiently transparent about their distribution and capital allocation policies. There is concern that the government is proposing implementing several obligations on companies and directors which seek to address the same or similar issues. If there is a requirement for directors to disclose realised profits, then there is already a point of comparison to consider whether the dividend is legal. Any changes should also be made in a proportionate manner.

If the government considers that such policies are required, we recommend that the requirements for the policy are not prescriptive and allow companies the flexibility to draft their policies to reflect their individual circumstances.

M&A considerations

There are also M&A considerations:

- Pre-completion dividends in private M&A may be impacted and will not be so desirable if directors are required to prepare a two-year forward look statements. This could additionally impact purchase price and tax aspects.
- During the M&A process, the buyer may go from a private company to public interest entity. This would bring increased regulatory and corporate burden and costs. Additionally, if the merger/acquisition is near the headcount threshold it may force companies post-deal to go below the employee threshold. These are consequences for private M&A. It is possible that buyers may demand additional warrantees around corporate reporting.

3 New corporate reporting

Resilience statement

19. *Do you agree that the above matters should be included by all companies in the Resilience Statement? If so, should they be addressed in the short or medium term sections of the Statement, or both? Should any other matters be addressed by all companies in the short and medium term sections of the Resilience Statement?*

Single coherent integrated statement on risks and uncertainties

PwC's paper The Future of Audit: Perspectives on how the audit could evolve *"sets out priorities for reform based on extensive research into the views of businesses, investors and other stakeholders and says:*

- *Create a single, coherent piece of company reporting that provides more insight into the future prospects of the company – including the scenarios in which the business model could fail.*
- *Provide more insight about the material uncertainties facing a company.*
- *Consider the need to provide assurance over other forms of risk.*
- *Reporting and assurance need to expand to cover critical performance measures.*
- *Provide additional assurance over the companies that need it, without expanding the statutory audit"*

We generally concur with the above and recommend that the government adopt a similar principles-based and relevant approach. Companies should have the flexibility to determine which specific matters are addressed in the resilience statement. Whilst there may be resilience issues common to many businesses, these may not apply to all businesses and resilience matters will also differ from

sector to sector. Importantly risks will evolve over time and it is wrong to think that these can be recognised in advance. For example, prior to 2020 pandemic risk and / or supply chain risks would not have featured in most companies' consideration of key viability risks. Having to include a statement on a matter that is of less relevance may result in that issue being given more priority than another, more relevant, issue. This will not provide shareholders with clear and transparent information about the specific risks a company faces. It will be contrary to the proposed duties of ARGA to promote high quality corporate reporting and to promote brevity, clarity and usefulness in corporate reporting. It is important that the content of the resilience statement is proportional to the size and complexity of the entity.

Enhancing principles-based viability statement and top and emerging risks
As set out in the consultation. *"All large and medium sized companies must already disclose in their annual accounts, any material uncertainties that could affect the company's ability to continue as a going concern"* and premium listed companies must publish a viability statement and an assessment of the company's emerging and principal risks and an explanation of how they are being managed or mitigated. We recommend that these recommendations be extended to all entities that come within the scope of the proposals. We agree that the existing viability statement would benefit from a review and we agree that it makes sense to split it into short, medium- and long-term considerations. We therefore recommend that these considerations be part of the combined assessment of resilience statement and principal risks and uncertainties.

Reverse stress tests
We do not support the mandatory disclosure of two reverse stress tests. In systematically important sectors like banking, disclosure of failure events risks de-stabilising the financial system and creating runs on banks if users of accounts misinterpret the information reported. We agree that the use of severe scenario stress tests provide important information that informs directors in the consideration of resilience and agree that companies should use stress testing as part of this evaluation. We consider that whilst internal and regulatory stress testing would be a key component of risk management within companies, market disclosure of such stress tests should be carefully considered. It would be counter-productive, leading to confusion among users of financial statements, and likely to reduce companies' willingness to consider impacts of more extreme scenarios, for fear that these are misinterpreted as forecasts.

Banking industry perspective
In the banking sector, this can be easily informed by the scenarios that the Bank of England asks systemic banks to run each year. It may be appropriate to recommend that other sectors use the same scenario data/descriptions to inform a suitable stress test that has an equivalent level of adverse stress as part of their resilience assessments.

Management actions
It is important to recognise that it is normal for companies to take 'management actions' to mitigate the effects of stress. These are actions taken if stress indicators are hit but are not otherwise necessary. These actions may be commercially sensitive and disclosing these potential actions exist may also lead others to conclude that the exercise of those actions is evident that the company has hit a trigger – this is likely to be damaging to the company and may be a mistaken conclusion. While we do not support the publication of stress tests results, to the extent the government proceeds with this proposal, it is therefore important that the results of any stress tests do not involve publication of the mitigating actions taken but are reflected after rather than before those actions – since reporting results pre-mitigation will again paint a negative view that is unrealistic as management would intervene. Any comment should only discuss actions in the most generic of terms.

20. Should the Resilience Statement be a vehicle for TCFD reporting in whole or part?

Resilience statement and TCFD reporting

We do not believe that the Resilience Statement should be a mandated vehicle for TCFD reporting. This focuses on a particular risk (climate) that is nascent and not fully understood. In addition, it mixes considerations of viability with climate awareness. We acknowledge that investors and stakeholders are increasingly focused on climate matters and companies need to address these concerns. For many this will mean factoring climate matters into future planning and strategy. However, this is best tackled separately, and allowed to evolve as market thinking develops.

We also reiterate key messages from our response to the BEIS consultation on the same, summarised below:

- the requirement for disclosures being made at a group level should also extend to disclosures made by UK subsidiaries of overseas firms providing this delivers the expected standard
- Underlining the importance of BEIS drawing the right conclusion on the climate-related financial information that must be provided in the Strategic Report but ensuring that there is nothing in statute precluding the provision of additional, more detailed information separately.
- Seeking an undertaking that BEIS will give close consideration to the nature of climate-related financial disclosures that can be included in either the Strategic Report or the proposed mandatory resilience statement and the need for certainty as to the legal definition of the primary users of these statements.

21. Do you agree with the proposed company coverage for the Resilience Statement, and the proposal to delay the introduction of the Statement in respect of non-premium listed PIEs for two years? Should recently-listed companies be out of scope?

Time horizons for viability statement
We disagree with the proposal to fix the medium-term view at five years and believe that the appropriate time horizon to use for medium-term view should be a decision for the directors, based on their assessment of what is suitable given their sector and company.

Companies currently use a range of three to ten years to support their viability statements. Individual sectors tend to use common ranges that reflect planning horizons. For some sectors, like utility providers and infrastructure companies, that rely on substantial long term capital investment projects, a longer horizon may be relevant whereas for others, like banking, are far more reactive to changes in the economy and it is unhelpful to pretend that a longer horizon is appropriate.

Planning horizon
We also welcome the increased focus on longer term risks, being those that will arise beyond the company's budgeting and planning horizon. We suggest that maybe this is set as being at least five years. The medium-term horizon should be directly linked to the planning horizon used by the company. The auditor needs to agree with the going concern assessment, and we believe should be required to report if their review of "wider information" points to evidence that the Resilience Statement is inconsistent.

Various time horizons in the consultation
Across the consultation we observe that there are a number of different ranges:

- 1 – 2 years: going concern,
- 2 years: dividend solvency
- 5 years: viability
- Over 5 years: long term resilience.

It is important to understand how these may relate to each other and the relevance to company strategy and planning horizons and also help investors and stakeholders.

Extending the time horizon for going concern assessment
We support the idea of extending the range of going concern statements, but our members highlight some ramifications of that change:

- Annual reports are published at 12-month intervals and therefore a one-year horizon from the date of signing represents a regular update that serves to the next publication.
- For most organisations they will need to align their banking arrangements to demonstrate they have funding in place to meet expected cash outflows over the period of the going concern assessment. A two-year horizon would require companies to carry two-year banking commitments when standard market practice is for most of these fixed commitments to be on a one-year basis.
- Banks attract regulatory capital requirement for commitments greater than one-year, so the consequence of extending longer commitments to companies is that banks will consume more capital. Unless regulatory rules flex to mitigate this the result is likely to be an increase in the costs of providing this commitment which the companies will bear.
- Auditors will often consider whether companies have funding in place to meet possible liabilities that fall due over the period of assessment. There is a risk that auditors will instead look to see whether companies have funding in place to meet all liabilities that arise in stressed scenarios and this will either lead to more negative comments on going concern or companies having to over-fund themselves. This carries a significant cost and the potential to undermine companies' trading ability.

Auditing the Resilience statement
We note that the Government does not mandate the audit of the Resilience Statement and we welcome the idea that this is something that could be subject to other assurance approaches, as determined by the company's Audit and Assurance Policy. Our members' experience is that external auditors may not necessarily be the best judge of the soundness of forecasting and in some cases insight of other professionals may be of more value – these may include bankers, risk consultancies, or at a more bespoke level climate experts or those with very specific specialism for the company in question (such as for decommissioning liabilities). Equally there may be value in a more diverse spectrum of opinion that would add colour to the directors' considerations – using a broader set of specialists would enable this.

New and newly listed PIEs
We agree that newly scoped PIEs should be given time to implement new corporate reporting requirements in line with our suggested interim approach for PIEs as discussed in responses to Chapter 1 above. In line with our previous suggestion of two years evaluation for PIEs, the same time period seems reasonable for newly listed companies.

Audit and Assurance policy

22. ***Do you agree with the proposed minimum content for the Audit and Assurance Policy? Should any other matters be addressed in the Policy by all companies in scope?***
23. ***Should the Audit and Assurance Policy be published annually and subject to an annual advisory shareholder vote, or should it be published and voted on at least once every three years?***
24. ***Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?***

Organisation-specific assurance policy and roadmap
The introduction of the requirement to publish an Audit and Assurance Policy may provide a mechanism for directors to set out to investors and stakeholders on how they seek comfort on information they publish. However, it is possible that these disclosures may not drive any real investor engagement or interest and may instead end up being another burden on companies to produce and stakeholders to vote on. This is especially true for companies that are owned by single shareholders within the same Group.

However, should the government go ahead, the guidance as currently written is broad and will not necessarily result in consistency and comparability across firms nor be beneficial to the users unless there is an education programme by FRC / ARGA. Also, if going ahead as a public interest requirement then all entities within scope, as they are phased in, should be covered and not just premium listed companies.

We welcome the move towards “wider audit”, which establishes a broader dialogue on the information published externally and the steps being taken by directors to ensure accuracy. We do not object to auditors having a wider remit, but we recommend that the government refrain from referring to such work as audit so as not to undermine the meaning of a statutory audit.

Assurance roadmap
Organisations would benefit from publishing an “assurance map” as part of its audit and assurance policy, explaining how it sees its own risks and how the directors have obtained assurance regarding these risks. This includes internal and external audit and may also include non-financial forms of assurance, such as an engineer reporting on oilfield reserves or health and safety risks. Many larger companies already publish information in this format.

We suggest that in the spirit of increasing the focus on internal controls outside financial reporting, companies should be encouraged to use the assurance policy, to cover for example APMs, KPIs, fraud, cyber risk, TCFD as a rolling programme, similar to internal audit assurance work in the banking industry. For those entities that are smaller and may not have an internal control function we also suggest that companies should be encouraged to widen the range of firms and experts used for assurance work, including challenger audit firms, valuation and subject matter expert firms. This would also help towards building resilience in the audit market over the longer term. However, the regulator will need to have in place clear standards used for additional assurance providers.

Lenders’ perspective
As lenders, the banking industry see the benefits in promoting the extension of assurance activities in certain instances. But we acknowledge that there is a risk that stakeholders may push for “everything” to be subject to external assurance. We think this misunderstands the capabilities possible from internal assurance and over-estimates the value of some external assurance activity.
Therefore, most of our members’ preference is that the Audit and Assurance Policy is published and voted on a three-yearly shareholder or similar (for member-led organisations) cycle. This would mirror the practice of the Directors’ Remuneration Policy where the time commitment from companies and investors in the run up to the triennial votes is significant. Introducing a further engagement and voting cycle on an annual basis (either in respect of a Directors’ Remuneration Policy or an Audit and Assurance Policy) would be particularly challenging and likely result in a less meaningful level of engagement.

- This would provide organisations time between votes to use and explain different assurance models and provision and articulate the results of this work along with their future plans.
- A proper risk-based approach to assurance would not typically require that all activities and metrics require annual validation, and some areas may appropriately be validated on a less-frequent basis. Most such models would tend to operate on a three-year cycle so this naturally aligns to a three-year cycle with shareholders.
- Similar to the Remuneration Report this would allow reporting of the Audit and Assurance Policy to be a combination of results and delivery over the past period and the proposals/plans for the upcoming period.
- While the shareholder or stakeholder advisory vote would be 3-yearly, companies should be encouraged, to publish a report on the Policy each year. This would summarise the key elements of the policy, results obtained over the year and plans for the subsequent year.

Some of our members do not see any value in singling out Audit and Assurance policy for advisory shareholder or stakeholder vote as annul reports, containing such policy, and remuneration reports are already subject to such votes.

Internal audit and cost / benefits of external assurance

Internal audit is pivotal to the success of assurance policy model, It requires this part of the organisation to be suitably resourced to cope with the additional demands, resulting in additional costs to an organisation. We believe it is important that the Audit and Assurance Policy covers the role, resourcing and use of internal audit as a third line of defence.

The rise in assurance costs has been a market trend due to disclosures required for regulatory capital and climate/ESG as examples in the banking industry.

- In many cases the limited external assurance model is applied. In reality, this is a low form of assurance, and work tends to focus more on correct extraction and audit trail for the reported measures rather than a more holistic understanding that a reasonable assurance or audit model provides.
- To this end, there is a danger that companies may be led down a route to adopt low value assurance simply because it offers a published statement from an external audit firm. There is likely to be a significant expectation gap between what the audit firm believes it is delivering and the comfort that a stakeholder will take.
- If this development is at the expense of internal assurance, especially from internal audit functions then this would be detrimental to overall quality. Most larger companies have well-staffed and competent internal audit functions – and these are typically externally evaluated on a periodic basis.
- A forced increase in external costs is likely to lead companies either to reduce internal assurance resources or face a significant overall increase in the cost of compliance. It is questionable whether this would appropriately balance the costs and benefits of the change. The more considered approach should mean that companies are able to achieve control benefits from the appropriate application of assurance methodologies and delivery channels.

ARGA education programme on assurance models

There are greater expectations from investors and other stakeholders than ever before. We propose that ARGA provides a broad education programme on the range of assurance models, methodologies and providers, including approaches such as the “Three Lines of Defence” model – and how the use of risk and internal audit functions provides strong internal assurance for management on the activities of their businesses and functions. It is also essential to very clearly articulate the differences between audit, reasonable assurance and limited assurance models and the levels of comfort that these offer and to put these in the context of internal assurance delivery. However, the decision of when to apply assurance and to what level should remain a matter for the directors to determine as part of the Audit and Assurance Policy, as discussed earlier.

Audit and Assurance policy to be part of UK Corporate Governance Code

We also recommend that the Audit and assurance policy requirements be implemented through the UK Corporate Governance Code.

Reporting on Payment Practices

25. ***In order to improve reporting on supplier payments, should larger companies be required to summarise their record on supplier payments over the previous 12 months as part of their annual Strategic Report (applying at a group level in the case of parent companies)? If so, what should the reporting summary include at a minimum? Do you have alternative suggestions on how to improve supplier payments reporting?***
26. ***To which companies should improvements in supplier payments reporting apply: companies which are PIEs and already report under the Payment Practices Reporting Duty, or PIEs with more than 500 employees?***

We do not support the proposal of additional disclosures relating to payment practices to be included within the annual report. We consider that the current regulations to report onto the Government portal provide enough transparency on supplier practices:

- The 2017 Payment Practices Reporting Duty (PPRD)
- S172 – Large companies to report on how they meet their duty to suppliers

Most of the companies that would meet PIE definitions on the expanded employee category (>500 employees) will already report through this mechanism.

ARGA will have as a regulatory principle "brevity, clarity and usefulness". This is a sensible aim given the fact that corporate reporting is already extensive and detailed – arguably obscuring important information and becoming difficult for users to understand.

- The addition of disclosure in respect of payment practices will, in most cases, clutter the annual report with information that is not of the highest importance nor relevance for users.
- For some companies, supplier relations are more critical and such companies, particularly these with significant purchasing power, should be encouraged to provide information on payment practices – though in many cases this is probably already the case.
- It would be preferable that the regulator gave guidance on best practice around when additional disclosure was appropriate and what that disclosure might look like rather than applying a blanket mandate which includes companies for which there are far fewer supplier relationships and disclosure would be of less importance.

Public Interest Statement

27. ***Do you agree with the Government's proposal not to introduce a new statutory requirement at this time for directors to publish an annual public interest statement?***

We agree that there is no present need to legislate for a public interest statement. Investors are expressing greater demand to see companies demonstrate their capacity to deliver sustainable returns. Companies are increasingly setting out this sense of "purpose" with information regarding their effect on, and engagement in the communities within which they operate. As a result, we believe that investor pressure is already leading companies to articulate their wider contribution to society and reporting on metrics to support this. This demonstrates that the market is already evolving to address this challenge.

4 Supervision of corporate reporting

28. ***Do you have any comments on the Government's proposals for strengthening the regulator's corporate reporting review function set out in this chapter?***

Corporate reporting review

We would agree with the proposal to extend corporate reporting review to include interim statements and analyst presentations. We would also generally agree with the proposal that greater attention is given to public interest entity accounts and less time incurred reviewing smaller companies.

- We agree with the continued use of "issues" letters to discuss matters arising with the company.
- However, we note elsewhere consideration of an ability to force companies to re-issue their accounts. We do not agree with this proposal. Company law currently only requires that accounts are withdrawn if they are fundamentally incorrect. There is provision, with Court approval to voluntarily revise accounts that do not comply with the Companies Act. Unlike the US, there is not a general expectation that published accounts are re-issued and instead the general approach is to make corrections in the subsequent accounts published.
- We believe this is sufficient to address defective accounts, and do not support a change to a more directive approach to correct previously published financial statements except in the circumstances already set out in the Companies Act. We would agree that the regulator would qualify as a "person authorised by the Secretary of State".

Level playing field
Strengthening of the corporate reporting and audit regulator is inevitable and overdue. However, some of the powers proposed would take it further than regulators in leading jurisdiction (like the US SEC) – particularly in commissioning expert reviews and the transparency of reporting of individual company findings. We recommend that the government adopt an approach similar to the US SEC such as a private comment letter process, with publication only after resolution and redaction of any price sensitive or proprietary information.

Impact on UK listings market
The international attractiveness of the UK market needs careful consideration in this context, aligned to the Hill Review of UK listing requirements. We want to see careful co-ordination of activities with the PRA and FCA, so that existing regulated entities are not subject to regulatory inefficiency

5 Company directors
Enforcement against directors

29. ***Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?***
30. ***Are there any additional duties that you think should be in scope of the regulator's enforcement powers?***
31. ***Are there any existing or proposed directors' duties relating to corporate reporting and audit that you think should be specifically included or excluded from further elaboration for the purposes of the directors' enforcement regime?***
32. ***Should directors of public interest entities be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audits? Should those standards be set by the regulator? What standards should directors have to meet in this context?***
33. ***Should the Government's proposed enforcement powers be made available to the regulator in respect of breaches of directors' duties?***

Overlap with SMCR and Companies Act 2006
Directors within the UK financial services already operate within a highly regulated environment as overseen primarily by the PRA and the FCA and are subject to authorisation under, among other things, the Senior Managers' and Certification Regime ("SMCR") as well as being subject to the framework of fiduciary duties as set out in the Companies Act 2006. Our concerns with the proposals concern how they might operate alongside these existing frameworks and the unintended consequences of any duplication and conflict between them.

It is not clear what benefit or added protection would be derived from an additional, potentially duplicative, set of duties or behavioural standards being introduced and brought within scope of ARGA's enforcement powers. We consider existing provisions such as the FCA's 'fit and proper' regime and the Companies Act 2006 (including its established framework of fiduciary duties and an enhanced framework around s.172 duties in particular) sufficient to ensure directors meet the appropriate standards of behaviour contemplated by the consultation. It may be that more effective application of existing statutory frameworks could meet the same objectives as those set out in the consultation but without the need for additional regulation which, at best, amounts to duplication and, at worst, could cause confusion.

Behaviour standards
On behaviours specifically, we do not believe there is a need for any additional behavioural standards beyond the comprehensive standards and requirements already applicable, derived from a number of sources, including Companies Act 2006; Individual and Senior Manager Conduct Rules prescribed under SMCR; The Corporate Governance Code as well any memberships of professional bodies. Shareholders have powers to appoint and remove directors from company boards. The FCA, in its capacity as the UKLA, also has powers over directors in relation to their compliance with the Listing Rules, DTRs and in relation to Market Abuse Rules.

Should the Government wish to consider the application of any additional duties or behavioural standards, enforceable by ARGA, we recommended that careful consideration and guidance is given as to the criteria against which ARGA intends to measure (and if necessary, enforce against) directors to ensure such criteria is transparent, proportionate and fair. In line with the comments above, the perceived benefits of any additional duties should be carefully balanced against the risks and potential unintended consequences of duplication and conflict with the existing framework of directors' duties and the associated enforcement mechanisms already in existence. We would also be grateful for confirmation that the defences provisions, contained in section 463 of the Companies Act (relating to directors' liability for the directors' report (which includes the business review), the directors' remuneration report and summary financial statements) will remain available and unchanged by the proposals set out in the consultation.

Concerns on ARGA's enforcement powers over directors

We are concerned with the potential impact and unintended consequences of ARGA holding proposed enforcement powers over all directors.

- Each director of a company brings different skills to the board. This supports the effective functioning of a board and it encourages board members to have constructive debates and challenge the opinions of others. If ARGA is given the power to act against all directors where there are concerns about financial reporting, it may result in unintended consequences, The proposals could deter directors with non-financial expertise from seeking to serve on boards, potentially diminishing the breadth and diversity of skills and experience that contributes to an effective board. In our view, the costs for companies will increase without any corresponding benefit. An example of this is demonstrated by the recent increase to directors' / officers' insurance premiums for policies which provide limited value as a result of the increasingly extensive carve outs from their protection.
- Such proposals would likely make it more difficult to source candidates of the required calibre and financial expertise to join boards and, in particular, to chair board audit committees where qualifying candidates are required to demonstrate long, successful and unblemished executive careers. The number of candidates willing to subject themselves to a new and potentially duplicative and undefined sanctioning regime (to be enforced by a new and untested regulatory body, whose approach would be an unknown matter) on top of the existing duties framework and enforcement mechanisms is questionable.
- We do not agree with the government's analysis that the "*risk of deterring candidates from non-financial backgrounds from applying for board positions is small*". Increasing enforcement powers by what is, essentially, an accounting regulator may increase the propensity of boards to recruit individuals with accounting skills and reduce the propensity of other candidates to apply for roles. This would be detrimental to ensuring boards are appropriately balanced with a diverse range of skills and perspectives. There is a danger that the risk of inadequate oversight (and potentially corporate failure) is therefore exacerbated by a weakening of company boards and the availability (and willingness) of high calibre candidates to take up positions.

Negative impact on attractiveness of UK market

We would discourage any action that could risk negatively impacting the attractiveness of the UK market to high-quality prospective directors. The UK has successfully championed its "principles-based" approach to Corporate Governance and we would welcome a reassertion of such an approach as a means of delivering transparency and integrity in business. We would reflect that high-profile corporate failures cannot always be legitimately attributed to the fraud, dishonesty or negligence of company directors. Certain failures may, instead, be attributed to judgements taken by directors which (although subsequently may be deemed to be have been poor) would not have contravened a director's statutory or regulatory duties. We therefore do not believe that movement from a principles-led to a rules-based approach necessarily correlates with a reduction in the risk of corporate failure. In our view, if any of the proposals are to be implemented, such changes would be best delivered through amendments to The Corporate Governance Code which, with its inherent flexibility, already recognises the very different nature of premium listed companies.

Calibration of enforcement actions
There is also a concern as to how its enforcement action would be calibrated. Informal assurances that action would only be taken in the most serious circumstances are insufficient. It is also unclear what the scope of ARGA's powers would be. The measures proposed in the consultation already significantly extend its oversight beyond the financial statements. The intention is to extend its reach into other areas of preparing the report and accounts. It is not clear how the limits of ARGA's enforcement role will be applied. There is a risk that the regulator is reaching into areas of corporate behaviour which are very different from the traditional role of regulating the preparation of the report and accounts.

ARGA's skills and expertise
Given this, it is also unclear that ARGA has the necessary skills and expertise to undertake such a role. Clearly there would be an option for ARGA to recruit to fill these gaps, but this creates a significant risk of regulatory overreach. The statutory basis for ARGA is poorly defined and delineated. We believe that the new regulator should not be given additional powers to sanction all directors, regardless of their membership of a professional body. The current mechanisms are sufficient. If the government intends to take these proposals forward, ARGA should set out specifically the scope of these enforcement powers and how they will be exercised proportionately with proper regard to adequate mechanisms, including a clear right of appeal. Additionally, if the government advances with its proposals, the duties in scope of the new enforcement powers are strictly limited to breaches by directors of the existing statutory duties relating to corporate reporting and company audits and require the same criminal standard of proof with the same penalties as currently set out in statute for these offences.. These should not extend to any other aspect of directors' duties. Increasing the circumstances and scope for potential director liability may have an impact on both the cost of appointing and retaining directors (including independent directors) and the willingness of directors to serve, which may lead to a smaller pool of candidates and could make management of conflicts of interest more difficult. These considerations may also lead to an increase in premium for directors' and officers' insurance, adding further to the costs of governance for companies.

Strengthening clawback and malus provisions in directors' remuneration arrangements

34. ***Are there other conditions that should be considered for the proposed minimum list of malus and clawback conditions? What legal and other considerations need to be taken into account to ensure that these conditions can be enforced in practice?***

Prescriptive regime
We would not recommend adding further conditions to the proposed minimum list of malus and clawback conditions. Having an overly prescriptive list of triggers may be detrimental where other circumstances arise, and it is clear the company would wish to apply the recovery provisions. Moreover, Remuneration Committees should have the flexibility to set any additional triggers that are right for their specific business, taking into account the risks that need to be managed. This approach is supported by the PRA's policy statement SS2/17 in relation to setting the malus and clawback procedure, stating: "*These criteria should be indicative and non-exhaustive. Remuneration committees should retain full discretion to introduce additional criteria where appropriate*".

Overlap in the financial services sector
As the financial services sector is already subject to certain minimum malus and clawback triggers, we would encourage the government to work closely with the UK regulators when finalising the list of conditions to ensure the minimum criteria are broadly aligned.

We would also seek clarification on the intended scope of the proposals. Page 20 of the consultation paper confirms that Chapter 5 on Company directors sets out proposals to "*strengthen malus and clawback provisions within executive directors' remuneration arrangements*". However, within Chapter 5 itself the references appear to have been shortened to "directors' remuneration arrangements", i.e. a broader population, the majority of which receive no variable pay. The

consultation paper goes on to state the triggers would be implemented through the Code. Our understanding is the strengthened malus and clawback triggers would apply to executive directors only, as is the case with the current recovery provisions under the Code.

Malus and unvested awards
In terms of enforcement, companies would normally seek to apply malus to unvested awards before pursuing clawback. The longer deferral periods that apply to larger financial services firms, up to seven years for executive directors, provides significant scope for applying malus. Whilst it is being proposed as a minimum, BEIS may wish to consider whether the two-year period in the consultation paper is a sufficiently long enough period for serious failures to emerge and for investigations to progress to the point where employees in scope can be identified and vesting suspensions be put in place.

In the event that there are insufficient unvested awards to apply malus to, companies would then consider clawback. This may include seeking to withdraw sums from the individual's share nominee account and/or requesting return of the funds from the individual and, if this is not forthcoming, the next step would be to commence Court proceedings. The legal complexities depend on the jurisdiction and even after successful Court proceedings, enforcement action may be required to recover the sums due, resulting in a significant time and cost investment for the company. The legal enforceability of clawback remains largely untested across many jurisdictions and while it remains appropriate to include clawback provisions, malus is a more practical form of recovery, where circumstances dictate this is necessary or appropriate.

No retrospective application
To aid enforcement, executive directors are asked to agree to terms that state malus and clawback may be applied when they are granted any variable pay awards. We recommend that BEIS does not seek to apply the proposals retrospectively to cover existing awards, as recipients are likely to have received details at the time of award of the intended malus and clawback policy and any stated triggers, and such awards are therefore governed by the terms and conditions agreed at grant, which create a legal contract between employee and employer. Enforcement will be more likely to be possible if the agreed triggers, once implemented, are communicated to individuals at the time of any new awards.

6 Audit purpose and scope

35. ***Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?***
36. ***In addition to any new statutory requirement on auditors to consider wider information, should a new purpose of audit be adopted by the regulator, or otherwise? How would you expect this to work?***

Use of wider information in audits
We agree that auditors should take account of wider information in the conduct of their audit and doing so is therefore not a non-audit service. It is part of audit work and should therefore have limited effect on costs. However, we are concerned that unless carefully defined there is a risk that the "search" for 'wider information' could become exhaustive, resulting in greatly elevated audit costs. We propose that 'wider information' is therefore defined as information that the auditor has access to through its existing internal networks or that of its audit client. We also propose that within the audit report, the auditor should set out the sources of wider information it used to provide clarity that underpin the audit conclusions provided. We believe these steps would allow the auditor to consider appropriate additional (non-financial) evidence without unduly inflating costs.

Purpose of audit statement
We support the proposed "purpose of audit" statement being adopted by the regulator. This underpins the overall goal of building and maintaining stakeholder confidence. However, having a wider remit, as drafted, which is not sufficiently well defined will contribute to the 'expectation gap' problem.

Investors will expect the auditor to be looking at all information published by or about a company. In setting the scope of the audit, there is a need to retain a focus on the company's own system of controls and oversight and those elements that are formally within the scope of the audit.
Therefore, we recommend that amendments to the purpose statement are made as follows:

"The purpose of an audit is to help establish and maintain deserved confidence in a company, in its directors and in the information ~~for which they have responsibility to report, including the financial statements~~ presented within and alongside the financial statements to which the audit attests."
This is to clarify that the audit scope remains focused on the financial statement supported by the "wider audit" elements set out in the Audit and Assurance Policy. For many companies this coverage will still not cover all elements of the Annual Report presented and therefore it would be misleading to give the impression that the audit does cover this wider reporting. This is ever more important as companies move to modular reporting where there are additional reports published alongside the financial statements and strategic report.

37. ***Do you agree with the Government's approach of defining the wider auditing services which are subject to some oversight by the regulator via the Audit and Assurance Policy?***
38. ***Should the regulator's quality inspection regime for PIE audits be extended to corporate auditing? If not, how else should compliance with rules for wider audit services be assessed?***
39. ***What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?***

Audit & Assurance policy & 'audit' market resilience
We believe the proposal for Audit & Assurance policy potentially allows for some welcome innovation, differentiation and resilience in the audit market. We believe it is important that assurance options exist that allow for provision by either the auditor, or other internal or external providers. This optionality allows for competition in the provision of assurance services, and it would be important that it is not expected that any additional assurance agreed be provided by the statutory auditor. This would allow for smaller niche providers of specialist assurance (e.g. climate risk, cyber risk, ESG or remuneration matters) to widen the audit market and enable a wider set of providers.

Annual shareholder vote
We believe an annual shareholder vote is unhelpful as it may perpetuate this possibility. A three-yearly vote would allow a company to build up evidence of its use of assurance to support its future intentions and enable more meaningful debate on where additional assurance is of value.

Regulator's inspection regime
We believe the scope of the regulator's inspection regime should cover any published report on assurance activity by an external provider. Where a company and its shareholders have agreed that a published assurance report has value is a clear indication that the information content of that report is of significance and as such the quality of the assurance work is important.

- We note that this would lead to instances of activity that is not undertaken by audit firms and this will need to be considered in the scope of the regulator's powers.
- We do not believe the regulator should have the power to review work undertaken by internal assurance providers – that role should rest with the directors themselves.
- This issue also points to how the principles of corporate auditing are evaluated.

40. ***Would establishing new, enforceable principles of corporate auditing help to improve audit quality and achieve the Government's aims for audit? Do you agree that the principles suggested by the Brydon Review would be a good basis for the regulator to start from?***
41. ***Do you agree that new principles for all corporate auditors should be set by the regulator and that other applicable standards or requirements should be subject to those principles? What alternatives, mitigations or downsides should the Government consider?***

Corporate auditing and learning from Basel committee approach

In much the same way as the Basel committee sets standards/recommendations that are then adopted by central banks and regulators around the world, we support the idea of the regulator establishing clear best practices as to the delivery of corporate auditing.

- It would be for individual professional bodies, both the chartered accountancy bodies as well as other bodies (such as the Institution of Internal Auditors), to elect to adopt these
- The regulator would have the ability through its oversight of the chartered accountancy bodies to review their adoption of these standards but could not enforce adoption by other bodies. This ensures that the regulator is motivated to ensure that the standards it seeks to develop are worthy of adoption.

Gold-plating UK corporate auditing

We do not support the idea that the principles of corporate auditing should override other requirements. For example, the UK already goes beyond international auditing standards in many instances (gold plating) but does not seek to create requirements that are inconsistent with those standards.

- To establish principles that are capable of being read in an inconsistent manner to international standards would reduce compatibility and understanding from international users would likely to reduce confidence in the UK market.
- It is unclear what circumstances would give rise for a need to not to follow an international standard as brought into UK auditing standards.
- BEIS should have regard to international practice and standards. Most large UK corporates operate internationally, and it is not helpful to have different auditors in different jurisdictions express a different array of standards as this will be confusing and unhelpful to investors and users of accounts.

Auditor's reporting of differences of view with management

We do not entirely agree with the principle that states "*Auditors ask the directors to report any material information that may legitimately be disclosed to assist the understanding of users of an audit report, and, if necessary, disclose it themselves*". Whilst the auditor should ask the directors to report such information, if the directors are unwilling, then the auditor should not disclose that information. There may be a number of reasons why the directors are unwilling to report such information, for example it may be commercially sensitive. Ultimately, if an auditor disagrees with a company on a certain matter or considers the annual report and accounts to be misstated or misleading or has been unable to form an opinion, then a qualified, adverse or disclaimer of opinion may be provided. We also recommend that the principle that "*Auditors' reports give transparency to any differences of view with management and how they were resolved*" be limited to any "*material differences*". This will focus the attention on only those matters which will be of primary concern to the user.

42. ***Do you agree with the Government's proposed response to the package of reforms relating to fraud recommended by the Brydon Review? Please explain why.***

Fraud & the Bryon review recommendations

Our members support the Government's proposals. We note that:

- To be effective, these proposals will need good guidance on the level of detail required within the new directors' disclosure.
- This level of detail should be meaningful but not overwhelmingly detailed for the readership. There is a need to clarify the specific forms of fraud that are subject to this standard considering various facets of financial- and cyber-crime and how those affect financial statement preparation.
- The distinction between material and immaterial fraud is something that would benefit from broader public education.
- The proposals could place more emphasis on the difference in responsibilities of bodies such as internal and external audit to support management in its development and monitoring of controls over fraud.
- There will always be a risk of fraud arising in a small number of companies and this is

particularly hard to detect where there is collusion. If there is demand from boards, or stakeholders, or sector regulators, companies could be required to engage a reporting accountant or other appropriate consultant on an ad hoc basis to review parts of their businesses where there is an increased concerns in relation to fraud. This could include reporting on a company's systems or the other internal controls that are in place to detect or prevent fraud.

Whistleblowing vs auditors
We would like to highlight that whistleblowing uncovers just under a half of all identified frauds uncovered, according to a PwC survey[3]: "While professional auditors were only able to detect 19% of the frauds on private corporations, whistle-blowers exposed 43%. Executives surveyed estimated that the whistle-blowers saved their shareholders billions of dollars." This suggests whistleblowing protocols should be considered a control.

43. ***Will the proposed duty to consider wider information be sufficient to encourage the more detailed consideration of i) risks and ii) director conduct, as set out in the section 172 statement?***
44. ***Do you agree that auditors' judgements regarding the appropriateness of any departure from the financial reporting framework proposed by the directors should be informed by the proposed Principles of Corporate Auditing? What impact might this have on how both directors and auditors assess whether financial statements give a true and fair view?***
45. ***Do you agree that the need for specific assurance on APMs or KPIs, beyond the scope of the statutory audit, should be decided by companies and shareholders through the Audit and Assurance Policy process?***

Audit and Assurance Policy and APIs / KPIs
Yes, we agree that the duty to consider wider information is likely to be sufficient in considering other matters set out within the Annual Report (such as s172 statement) and more broadly director conduct.

We also agree that the need for specific assurance on other APMs/KPIs should be informed by the Audit and Assurance Policy process. Companies and their Remuneration committees often have independent advisors in place who advise them on performance and remuneration matters, independently of management. It may be helpful to explicitly reference if companies can obtain specific assurance on APMs and KPIs for their investors through targeted engagement with such advisors and corresponding public disclosure of findings. The Voluntary Code of Conduct of Remuneration Consultants used by such advisors could be updated to reflect the scope of such remit on APMs and KPIs and provide further reassurance for investors as to the input being provided.

True and fair overrides
Overrides of the reporting framework, such as "true and fair", are increasingly rare and existing auditing standards appear to have been adequate in supporting those conclusions. Since the principles of auditing should underpin these, it is likely to be appropriate that they can be used to underpin auditor's judgments on any departures when they arise. However, we note the Government's separate recommendation to replace "true and fair" with "presents fairly in all material respect" which presumably affects the need for override.

46. ***Why have companies generally not agreed LLAs with their statutory auditor? Have directors been concerned about being judged to be in breach of their duties by recommending an LLA? Or have other factors been more significant considerations for directors?***
47. ***Are auditors' concerns about their exposure to litigation likely to constrain audit innovation, such as more informative auditor reporting, the level of competition in the audit market (including new entrants) or auditors' willingness to embrace other proposals discussed in this consultation? If so, in what way and how might such obstacles be overcome?***

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[3] PwC 4th biennial global economic crime survey.

Limited liability for audit
While our members do not, in principle, object to the idea of limited liability for audit, the issue has never been raised. The fact that there is not more widespread use of limited liability for auditors is likely down to an unwillingness by the audit firms to push the matter with their clients, and to a nervousness for the companies themselves in making a change out-of-step with peers.

- As a result, if there was a clearer framework supporting limited liability and establishing guidelines on suitable levels of liability, we believe they would be relatively quickly adopted.
- In our discussions with challenger firms, it is clear that unlimited liability is a barrier to their desire to engage with more complex audits

Reputational damage and audit firm failures
However, the history of accounting firm failures points to reputational damage as being the primary cause of that failure rather than unlimited liability, for example in the case of Arthur Andersen in 2002. As a result, the unwillingness of audit firms to take greater risk on innovation or approach in their audit is the fear of strong censure from regulators (such as through audit quality reviews) and the actual failure of the company itself. This leads to an over-reliance on what is seen as a 'tried and trusted' model.

- We believe that the Audit and Assurance Policy potentially gives the ability to engage a broader range of firms in assurance and this may enable greater innovation.
- We would recommend that the regulator should be encouraged to highlight best practices in audit approach and innovation that it identifies across its AQR work and that it encourages and endorses new ideas.
- Equally, a continued focus on detailed substantive testing and precision of audit evidence (especially on matters that are not themselves contentious) risks deterring firms taking measured risks in their audit approach.

48. ***Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.***
49. ***What would be the best way of establishing a new professional body for corporate auditors that helps deliver the Government's objectives for audit? What transitional arrangements would be needed for the new professional body to be successful?***
50. ***Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?***
51. ***Do you agree that a new audit professional body should cover all corporate auditors, not just auditors?***

New professional body for corporate auditors
We disagree with the proposal to create a new professional body:

- The Audit and Assurance Policy envisages the concept of a wider assurance model, which would not automatically fit alongside the requirement for audit of the core financial statements. Assurance can come from providers other than accounting firms,
- A good audit consists of a multi-disciplined team including auditors and other subject matter experts. Even for the senior partners and staff on the audit, their skill and ability are as much informed by wider experiences on advisory, transactional and consultancy work as it is on audit experience.
- We believe that the focus should continue to be on allowing seasoned professionals to build a wide experience that gives them different perspectives and understanding of business issues and hence audit risks. Consequently, this provides them with a wide experience on which to base informed judgments necessary in an audit. Creating a specific body for auditors as a professional qualification risks leading to the creation of a narrow career path which in the long run will detract from the qualities that senior audit partners typically have. A professional body for corporate auditors also risks undermining the accounting profession more generally. Training in audit firms provides a solid foundation for accountants to further their careers in wider industry.
- The requirements for the body are somewhat unclear, including any pre-requisites in professional experience or qualification. We would note that it is common to use non-accountants within assurance functions because of the value they bring from their areas of specialism which outweigh

formal accountancy training.

- Currently most senior audit partners are seen as strong non-executive candidates which is evidence that the current approach is developing individuals that are naturally capable of interacting at board level and exercising the sort of judgments necessary in an audit.

7 Audit Committee Oversight and Engagement with Shareholders

Audit committees – role and oversight

52. ***Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?***
53. ***Would the proposed powers for ARGA go far enough to ensure effective compliance with these requirements? Is there anything further the Government would need to consider in taking forward this proposal?***

Current high-quality framework on audit committee oversight

There is already significant and sufficient regulation and guidance in place regarding the duties and responsibilities of directors on audit committees. For example:

- Directors have legal duties to act in the best interest of shareholders
- FCA's Disclosure Guidance and Transparency Rules contain rules for audit committees of listed companies
- UK Corporate Governance Code contains recommendations which apply to the board and the audit committee
- FRC has issued guidance for audit committees

We do not consider that changes are needed, appropriate or proportionate. Should the government decide to make changes, then we strongly recommend that these be covered through the MoU with FCA and implementation and monitoring by the FCA.

Appointment of auditors by ARGA

We do not agree with ARGA having the power to appoint auditor as this puts both the company and the audit firm in the invidious position of a potentially adversarial relationship at the outset which is undesirable for both parties. In such a case the audit is not set up for success.

We do not consider that involving investors in the audit will result in any material changes as they do not always have the expertise to challenge in any meaningful way and nor do we do think they would want to. Investors do not generally engage in AGMs; if they think there is an issue, they tend to raise it directly with the Board or sell the shares. This proposal may give the impression that the government has made positive strides but in fact would significantly increase the burden for companies, again at the time of continued uncertainty and financial stress.

ARGA and minimum standards

We support the idea that ARGA would set clear minimum standards:

- We do however have concerns that the regulator could become too interventionist. Taking more direct involvement in matters such as the auditor tender processes risks blurring the lines of responsibility between the regulator and the directors/shareholders and could raise the question as to whether this role amounts to performance as a shadow director.
- Banking regulators from time to time may seek to observe board and committee meetings and we are concerned about the risk of regulatory overlap.
- The principle of proportionality is also relevant and should be strictly adhered to – both in the standards set for companies, as well as the level of intervention taken.
- We would consider it important that where the regulator has concerns that these would, in first instance, be directed at the Audit Committee chair/Board to allow for response and, where appropriate, remediation.

We would raise question of whether such matters are better addressed in the Code rather than through separate processes. This adheres better to the well-tested "comply or explain" model that

has made the UK the well-respected business environment that it is and works alongside the principles-led approach that the UK has traditionally adopted.

ARGA power to appoint observers on new professional body

The proposed powers to monitor compliance with, and to act on any breaches of, the additional requirements appear unduly extensive. We do not support the proposal to grant ARGA the power to place an observer on the new professional body.

Independent auditor appointment

54. ***Do you agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors in specific, limited circumstances (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?***
55. ***To work in practice, ARGA's power to appoint an auditor may need to be accompanied by a further power to require an auditor to take on an audit. What do you think the impact of this would be?***
56. ***What processes should be put in place to ensure that ARGA can continue to undertake its normal regulatory oversight of an audit firm, when ARGA has appointed the auditor?***
57. ***What other regulatory tools might be useful when a company has failed to find an auditor or in the circumstances described by Sir John Kingman (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?***

While we would accept that there may be a case for giving ARGA the statutory function that currently sits with the Secretary of State, we do not support the extension of the right to make an independent auditor appointment. We suggest instead that ARGA request directors to take necessary actions to remediate an identified deficiency and to keep ARGA informed on the outcome.

- Audit appointment is a responsibility of the directors, with approval from shareholders. Adoption of Sir John Kingman's proposal, primarily risks disenfranchising the shareholders who appoint the external auditor following recommendation by the Audit Committee and Board at each AGM. Therefore, superseding the responsibility should only be in extraordinary circumstances, which is what the current law envisages.
- Where the regulator has other concerns, such as regarding identified audit quality issues, then the appropriate mechanism would be for this information to be laid before shareholders at the AGM. At all times, directors of the company should be provided sufficient opportunities and support to address quality issues relating to the audit before regulatory action is undertaken, with options such as appointing an audit firm to fill any casual vacancy being explored initially. It would be helpful to prescribe in legislation that any such action required by the regulator would always be in the best interests of shareholders.
- There is already provision in the Code to deal with circumstances where there is a substantial vote against the appointment/ re-appointment of the external auditor. A meaningful vote against an auditor, in a motion that still passes, would not be appropriate grounds to replace an auditor since a majority exists to allow that auditor to continue. We would agree that a meaningful vote against would be grounds for questions being raised to the company for its response as to the reasons for that objection and the actions the company intends to take. Again, it may be appropriate for this information to be provided to shareholders.
- ARGA should allow for practical issues surrounding use of such powers -. as an example there would usually need to be significant handover period between incumbent and incoming auditor, it is not as simple as appointing a new auditor with an immediate handover of responsibility.

Any proposed external appointment would require to be strictly time limited while the circumstances requiring the intervention are resolved by the company.

We disagree that it would be appropriate for the regulator to have the right to force an auditor to take appointment. To address the situation where no auditor is willing to accept appointment, the appropriate mechanism would for the company to issue unaudited reporting and to seek guidance from the regulator on the steps necessary to re-establish an audit relationship.

Shareholder engagement with audit

58. ***Do you agree with the proposals and implementation method for giving shareholders a formal opportunity to engage with risk and audit planning? Are there further practical issues connected with the implementation of these proposals which should be considered?***
59. ***Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?***
60. ***Do you believe that the existing Companies Act provisions covering the departure of an auditor from a PIE ensure adequate information is provided to shareholders about an auditor's departure? If you believe those provisions are inadequate, do you think that the Brydon Review recommendations will address concerns in this area? What else could be done to keep shareholders informed?***

We disagree with the proposals to give shareholders or other similar stakeholders e.g. members in building societies and co-operatives a formal opportunity to engage with risk and audit planning. We are in favour of engaging shareholders over risk matters and both the audit firms and our members have hosted shareholder events on these topics and generally find a low level of interest.

There is a considerable risk of over-formalising this approach that would lead to the audit being used as a complaints channel. If this principle is accepted, there would be likely interest in why wider stakeholders did not have the same right. This would risk a considerable expansion in the requirements of consultation and related costs, with companies and auditors exposed to how activity was evaluated as being sufficiently broad/wide, thus risking repeated legal challenge.

Instead we recommend that the regulator encourages greater shareholder involvement through company organised events. This would provide an opportunity to engage in specific risk issues in a more detailed manner.

The planning of the audit is also a critical part of the process where the auditor needs to exercise judgment. This process would detract from the planning process which would lead to a reduction in audit quality. For large companies that report several times a year and hold public AGMs that the timing of shareholder engagement would be challenging. We would recommend that the Government implement any requirements in this area via updates to the Stewardship Code, rather than legislation, to allow companies some flexibility.

While we support audit issues to be discussed at the AGM we do not believe any changes are required and that there is already sufficient opportunity for questions to be raised on the audit.

Similarly, we agree that the provisions already in place for a change of auditor are adequate and enable the auditor to raise any concerns with a change of auditor directly to shareholders. We would see no issue with making available the relevant regulatory statements we have to provide in respect of a change of auditor to shareholders.

8 Competition, choice and resilience in the audit market

Market opening measures

61. ***Should the 'meaningful proportion' envisaged to be carried out by a Challenger be based on legal subsidiaries? How should the proportion be measured and what minimum percentage should be chosen under managed shared audit to encourage the most effective participation of Challenger firms and best increase choice?***
62. ***How could managed shared audit be designed to incentivise Challenger firms to invest in building their capability and capacity? What, if any, other measures, would be needed?***

While we recognise and support the ambition of the government to enhance competition in the audit market, we disagree with the proposal for shared audit.

Competition over quality

The government rightly identifies that a focus on audit quality is paramount in restoring public confidence in audit as a profession and product, and many of the recommendations set out are

directed towards that goal. However, the proposals to enhance competition will come at the expense of that quality.

- The government is proposing that the regulator should be able to take action against audit committees that do not pursue audit quality over other outcomes from their audit relationship. However, this proposal asks directors to then appoint a firm that potentially has limited experience and therefore, may not meet the quality tests it would otherwise apply. While challenger firms may have the requisite experience and expertise, the determination of this must be in the hands of the audit committee and directors and not mandated by ARGA.
- To meet the 'meaningful proportion' would require some PIE directors (in a group context) to exclude the Big 4 firms which would give a skewed position on audit quality.
- This approach appears likely to create a second concentration risk – with larger firms dominating group appointments and a small number of mid-tier firms dominating the shared appointment. This therefore does not improve overall audit choice, but simply doubles up the existing problem.
- Financial services, and especially banking, represent highly complex sectors in terms of the technical requirements and the interplay of regulation on the sector. This is exacerbated for the systemic players in that sector where there is also a broader systemic risk to consider in terms of business failure.
- The CMA thought shared audit presents a risk to audit quality as the second auditor would not sign the report but will be jointly liable. (Final report, para 6.2.). They also thought shared audits would not be effective as they would not change audit committee perception and in fact may reinforce perceptions that the challengers are less capable; and challengers would not get experience of more complex areas. (Final report, para 6.18.)

Challenger firm considerations

There is limited appetite amongst challenger firms to participate in financial services audit. As recently reported, two of the major challengers have publicly indicated no interest in taking on financial services audits and FTSE 100 audits respectively. The government need to recognise that:

- challenger firms need to develop organically, winning audit appointment of increasing size and complexity. This will allow them to develop in a manner that meets independence requirements (such as individual client fee size in proportion to overall revenues) and also maintain quality of delivery (as the demands on their staff increase and they need to recruit qualified individuals to take on this extra workload).
- smaller firms will want longer lead times to prepare for work on larger or more complex audits. So rather than a 1 - 2 year transition window we would need to consider 3-5 years to manage any transition.
- From discussions our members have had, some of the medium tier firms do not have an interest in bidding for audit work especially if they stand to lose other work, such as internal audit.
- In addition, the following are specific concerns raised by some of the UK systemic banks:
    - The bank's group audit team is the size of challenger firms' audit practice so it is not clear how the challenger form would be able to undertake even a part of the audit.
    - A portion of a FTSE 100 bank's audit fee would be disproportionately high compared with a challenger firm's total audit revenue
    - For most of these banks, the set-up is integrated and complex, and it would be very difficult to find a subsidiary that is stand-alone and simpler that a challenger firm can audit
    - International banks have audit teams in many countries, 30 in some cases. It would cause logistical issues to have a significant part of global audit performed by challenger firms. This is likely to be extremely difficult and very expensive and grave concerns that there will therefore be a degradation in audit quality.
    - Most of the larger banks have many legal entities, including those that are PIEs, many of which are supported by centrally handled processing hubs. If members had to hand over audits of subsidiaries to challenger firms, these challenger firms would also need to consider how they could rely on group auditor for analysis of central processes without having to redo the work.

- Some of the UK's larger banks which have less than 20% of their income generated in UK, the bulk of the group's audit work for challenger firms will not be in the UK. So, it is difficult to envisage how the government proposals would apply to the UK group even though bulk of the work will have to be performed overseas.
- Banks that have a simple legal entity structure, with one operational entity, pose a challenge in a managed shared audit scenario as it is unclear how and whether the second audit firm would get real exposure to the more complex areas of the audit.

Overall, we believe the proposals will lead to significantly higher costs, directly proportionate to the complexity of the organisation, with a questionable impact on audit quality improvement.

Silo UK approach for international companies
It is inappropriate that the solution for a UK-specific issue has such international reach with consequential complications as highlighted by our members' concerns above. Challenger firms will need to have a significant audit team presence in multiple locations such as London, other parts of UK, India, Far East, Europe, US and Americas, just to service the financial services sector. It is likely to require time to build the local infrastructure and audit staff base for a smaller firm. We would suggest that even after the infrastructure is in place it might be necessary to exclude/grant an exemption for those that are more complex – as many financial services firms will be – or for those organisations that require a sector specialism that the challenger firms may not have (again, financial services, but possibly other sectors too).

We also note that the government is seeking to provide a solution that addresses a concern around UK auditors and therefore the proposal is limited to UK elements of the audit. This means that the proposal is unworkable for companies that have significant overseas presence or are wholly owned subsidiaries of overseas shareholders, as highlighted by members above at least in the financial services sector. We would question how practical it is for the UK to introduce some of these proposals in isolation, with complexities for international groups - shared service centres, conflicting regulations and policies for overseas parents and subsidiaries - and for the audit firms themselves. The combination is very likely in our view to also inhibit the UK's global agenda.

As pointed out by ICAEW's 'Audit reform: this definition of PIE is hard to swallow' "*Evidence from Europe after audit reform in 2016 suggests that many firms, when faced with the extra time and work required to audit PIEs, will decide that they don't want to be in the market at all." "The Netherlands saw the withdrawal of quite big firms from the PIE market after reform. That runs completely counter to the Government's wishes to see more competition and choice in the audit market, certainly at the large company end."*

Banking regulator perspective
The PRA, which was set up after the financial crisis to protect the stability of Britain's banking industry, requires that an auditor of a British bank has the "required skill, resources and experience to perform its function under the regulatory system", according to its rule book. The PRA has subjected new entrants to banking audits to scrutiny in the past, including questioning the incoming auditor, about its resources and skills when it was appointed to the audit Royal Bank of Scotland in 2014, which was then its biggest financial services client. More recently in 2018, the regulator was reported to question whether an American investment bank may appoint an accountancy firm outside the Big Four as its British auditor over perceived concerns that a challenger firm lacked the resources of its larger rivals. While audit committees may, after full assessment and consideration, determine that a particular audit firm does meet its audit quality requirements, these regulator perspectives also highlight that experience and impact on quality is a relevant concern that must be in the hands of companies and their audit committees to decide.

Recommendations
We therefore recommend that the challenger firms start with smaller companies, such as those on

the lower end of FTSE-350 or those with lower market capitalisations, which will enable these firms to grow faster. But we highlight that smaller does not necessarily mean simpler or less risky. Mid-tier banks face very similar audit risks and accounting issues as their larger counterparts. Members' experience from recent audit tenders would suggest that this approach could impinge audit quality. Directors of smaller organisations are equally required to act in the best interest of the shareholder (as do directors of larger companies) – a requirement to appoint a challenger auditor firm may not meet that obligation. There is also a need to consider international arrangements – where a wholly owned subsidiary operating in the UK may need to consider a wider group context in appointing an auditor.

As an alternative approach, the government could exempt certain sectors e.g. financial services, due to complexity or other reasons, but consider instead selective periodic peer reviews.

See also other recommendations below on addressing audit market resilience - assurance work, Big 4 outsourcing to smaller firms, efficacy of EU Audit directive and living wills for audit firms.

Unrealistic 5-year checkpoint
The consultation envisages a 5-year checkpoint. This is unrealistic, given that the rate of change will be reliant on audit tenders hitting their ten-year anniversary and the capacity of these firms to take only a few engagements between them each.

63. ***Do you have comments on the possible introduction in future of a managed market share cap, including on the outlined approach and principles? Are there other mechanisms that you think should be considered for introduction at a future date?***

Efficacy of EU Audit Directive
We disagree with the proposal for a market share cap. However, we believe that insufficient time has been allowed to observe the efficacy of the changes introduced in 2016 under the EU Audit Directive. We have not yet had the first 10-year cycles to observe whether firms are more inclined to rotate or whether they hold to 20-year appointments.

The most important element of the audit reforms should be the actions that improve audit quality and then the mechanisms which allow smaller firms to build their capability. Secondly, it must be recognised that this is a 10-20 year programme given the ability to allow changes to happen in a sustainable manner.

Therefore, a managed change approach needs to leverage the ability of the Big 4, support rapid organic growth in smaller firms and be built bottom up.

Audit and Assurance policy and 'audit' market resilience
The Audit and Assurance policy offers a potential route to enable wider participation in larger organisations to enhance challenger firms' skills and expertise. We suggest that the Government consider encouraging companies to engage firms other than the statutory auditor for the delivery of wider audit or assurance services. In some circumstances the cross-over with the financial audit is too high to merit alternative appointment but where non-financial measures are considered which do not rely on financial systems and processes there is an opportunity to use other providers. This would allow those firms Group level engagement, with the audit committee, and build capacity and capability.

Big 4 outsourcing to smaller audit firms

Our members consider that the Big 4 may have a role to play in upskilling the challenger firms and should be responsible for helping to correct competition issues that currently exist and do not believe it is appropriate that this responsibility falls on the corporate world; Big 4 need to play a bigger role to solve the clear competition issue

An alternative option may be to place a requirement on the Big 4 to outsource work to smaller firms. This option would protect the company, since the main auditor would still take on responsibility for audit quality – but would allow far wider range of smaller firm interaction and encourage smaller firms to innovate. It is also less likely to lead to the group auditor simply repeating the audit work. It also makes it far easier for the smaller firm to be able to "rotate" its activity across different business areas, managed by the Big-4 auditor, in consultation with the audit committee.

Operational separation between audit and non-audit practices

64. ***Do you have any further comments on how the operational separation proposals should be designed, codified (in legislation and regulatory rules), and enforced in order to achieve the intended outcome of incentivising higher audit quality?***
65. ***The Government proposes to require that all audit firms provide annual reports on their partner remuneration to the regulator. This will include pay, split of profits, and which audited entities they worked on. Do you have any comments on this approach?***
66. ***In the event that the Government wishes to go further than the existing operational split proposals in future and implement split profit pools in line with the CMA recommendation, do you have any comments on how these can be made to work effectively?***
67. ***The Government believes these proposals will meet its objectives. In the event that they prove insufficient to improve audit quality, and full separation of professional services firms is required, do you have any comments on how to make this work most effectively?***

We have no comments on the matters outlined in the questions. However, we observe that the government should give sufficient time for these measures to be implemented and embedded and to show the intended benefits on audit quality before rushing to other measures for audit reform such as managed shared audits or market cap.

We understand that despite operational separation there would be no intention to change rules relating to non-audit services, meaning that an audited entity could not engage the consultancy side of their auditor notwithstanding the operational separation. We would note that as a result this operational separation yields little benefit, while it risks a loss of expertise to the audit practice. Companies' auditors need ready access to specialists such as on modelling and valuation capabilities, consumer protection etc. Deep expertise is retained only if people are engaged in non-audit work with audit clients.

Resilience of audit firms and the audit market

68. ***Do you have comments on the proposed measures? Are there any other measures the Government should consider taking forward to address the lack of resilience in the audit market?***

Living wills and Operational resilience – learnings from the banking industry

Following the financial crisis of 2007-2008, the banking industry has in many jurisdictions = implemented recovery and resolution planning or "living will" or "too big to fail" measures. These living wills, implemented by the banks, enable the regulator to be prepared in the event of the failure of a key participant. Banks have also put in place measures to have operational continuity in resolution to support critical economic functions and thereby protect public interests. It would appear that lessons could be learned from how this has been put into practice and a similar mechanism could be established for the accounting industry where those that represent systemic risk would need to take some steps to enable their 'resolvability' or have 'living will; in the event of a firm failure.

We understand that the FRC had started work focussing on contingency planning, working with firms to develop "living wills" some years ago. This work should be accelerated to meet the government's overarching objective of ensuring audit market resilience.

Proportionality

We however request that any expansion of the “Living Will” regime to audit sector should not be implemented in a way that creates a barrier to expansion to the challenger audit firms, for example, they may need a grace period once they hit the threshold before they are required implement such requirements.

9 Supervision of audit quality

69. ***Do you agree with the Government’s approach of allowing the FRC to reclaim the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs?***
70. ***What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?***
71. ***In addition to redacting sensitive information within AQR reports on individual audits, what other safeguards would be required to offer adequate protection to the entity being audited whilst maintaining co-operation with their auditors?***
72. ***Do you agree with the Government’s approach to component audit work done outside the UK? How could it be improved?***
73. ***Do you agree that it is problematic if documents that the auditor reviewed as part of the audit are unavailable to the regulator because of the audited entity’s legal professional privilege? If so, what could be done to solve or mitigate this issue while respecting the overall principle of legal professional privilege?***

We agree that there is some sense in removing the legal provision that requires the FRC to delegate registration to the Recognised Supervisory Bodies (RSBs), the professional accountancy bodies recognised by the FRC, and instead make this at the discretion of the regulator.

FRC as regulator of PIE audit firms

However, we disagree that the FRC should formally reclaim the role of registrar for PIE audit firms and auditors. This would entail significant increased bureaucracy for the regulator as well as creating duplication with the RSBs which would retain the role for non-PIEs:

- Since firms and audit partners typically will have both PIE and non-PIE clients everyone would be required to register twice and maintain that registration with both organisations.
- Instead, we believe that the audit registration should remain with the RSB. However, there is a role for ARGA setting additional experience requirements or other criteria for auditors to act for a PIE. We do not believe there should be a need for a firm to re-register for PIE audits – indeed, this would seem to further reduce choice of firm available to PIEs for audit purposes.
- Equally, where larger companies require the involvement of multiple partners in the audit, it is unclear whether registration would be required solely for the signing partner or for all key members of the team
- The recommendations already propose that the regulator establish principles and guidance for corporate auditing and if these are applied by the RSBs then this should lead to appropriate registration.
- In addition, we believe it would be appropriate for the regulator to monitor and review the quality of the RSB’s registration activities to ensure effective operation.

AQR reports

We note the appetite to increase transparency in matters of audit quality. However, the lack of confidence in the audit industry is as much about the negative press associated with AQR reports as with actual instances of corporate failures. The AQR grading regime is complicated and difficult to understand and therefore there is not sufficient distinction between satisfactory and unsatisfactory audits. We would recommend that consideration is given to simplifying the gradings to “Good”, “Satisfactory” and “Poor”.

Publication of AQR reports

Further, the purpose of AQR is to assess the quality of the auditor. We therefore disagree with the full publication of AQR reports that name or identify the company audited. This tarnishes the company unfairly when it is the auditor themselves that is under scrutiny.

- We do not believe it is likely to be straight forward to redact material within the AQR report without the company's involvement
- As such, we believe that the AQR reports should be published in summary form without naming the target company. A separate report, as is provided currently, that confirms which companies were subject to audit and would retain transparency.

Audit registration from overseas component auditors

While we agree in principle with the idea of seeking audit registration from overseas component auditors, we believe that implementing this will be difficult. Many overseas jurisdictions do not permit the sharing of audit material and therefore to achieve this would require that the UK Government reach country-by-country agreement to allow the regulator to be legally permitted access to audit papers. Without this, it would not be possible to enable a level playing field. We do note that in the US this was achieved.

Legal professional privilege

We do not agree that it is problematic if documents reviewed by the auditor as part of the audit are unavailable to the regulator because of the audited entity's legal professional privilege.

In our view, disclosure of privileged material is disproportionate and unnecessary as auditors use the privileged material in a limited way and they do not assess the legal advice itself, i.e., they audit the process, rather than reviewing the legal advice. The privileged information belongs to the audited entity, not the auditors themselves, but it may often be the case that the audited entity could provide some alternative data, without the potential loss of privilege through disclosure, to enable ARGA to understand the import of the information.

Unintended consequences

We are also concerned about unintended consequences including:

- The government recognises that, "… if the regulator were able to see privileged information, it would need to be strictly limited in circulation and purpose, with appropriate safeguards". It is difficult to envisage how this could be achieved, particularly when privileged material, once in ARGA's hands, could become available to other regulators (e.g., FCA or PRA) and prosecuting authorities (e.g., Serious Fraud Office or Department of Justice) via gateway and sharing arrangements or as a result of such disclosure causing it to lose privileged status. The privileged material could expose not only the company, but also its directors, to litigation, regulatory action or even criminal prosecution.
- The right to obtain confidential legal advice is considered a human right. Any interference with the principle of legal privilege would be damaging to our justice system and in particular would have a chilling effect on the ability of companies and individuals to understand their legal responsibilities and whether proposed actions would be compliant or protected.
- ARGA will also be responsible for investigating directors. There is no effective safeguard against privileged material in ARGA's hands being used against directors.
- ARGA would stand apart from law enforcement authorities and other regulators if it were able to see privileged information. We consider this would set an entirely inappropriate precedent which would be damaging to the rule of law in the UK and the interests of all concerned.

10 A strengthened regulator

74. ***Do you agree with the proposed general objective for ARGA?***
75. ***Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?***

We agree that there should be a clear general objective, supported by secondary objectives for the regulator and these should be supported by regulatory principles. We believe the general objective should be tied back to the purpose statement underpinning the Government consultation which was maintaining and developing the internationally respected system of audit and reporting.

- The purpose of the regulator is not to prevent individual company failures; these are inevitable in an open-market economy. It is to ensure that despite any individual failures that general investors do not lose confidence in the wider UK corporate sector while promoting sound governance and transparency that is in the public interest.
- We agree with the government's proposed simplification of the principle set out in the Kingman report. The objective should retain a link to the maintenance of trust and confidence in corporate reporting. We therefore recommend a modified objective:

"To build and maintain confidence in the UK corporate sector through the protection and promotion of the interests of investors, other users of corporate reporting and the wider public interest."

Quality and competition objectives
We acknowledge that quality and competition objectives would normally go hand in hand. However, there may be instances where measures aimed at increasing competition – such as shared audit or market share caps – come at the cost of quality. Therefore, is it necessary to specify that the main objective of quality has primacy. We believe the creation of separate quality and competition objectives is confusing without clarity as to the primacy of the general objective. These additional objectives should be established as secondary principles. It should be note that the pursuit of secondary objective is inconsistent with general practice and what we are seeing from the PRA.

For instance, with the approach to the appointment of auditors there is a potential conflict between quality and competition. The only clear way to address this conflict is to ensure that the steps taken tie to the overarching primary objective and cannot conflict with it:

- As noted in the audit section above, we are concerned that the pursuit of competition in the audit sector might be through the sacrifice of quality.
- Without a clear hierarchy there is a risk that regulatory activity and actions become unclear and this may lead to a loss of confidence in the actions of the regulator. This would lead to a loss of respect in the UK market as a whole if regulatory activity was inconsistent or continually switching priorities
- The quality objective may sit better as a regulatory principle – in that the promotion of quality should underpin any/all actions considered rather than necessarily being considered as an objective.

Working closely with other regulators in the UK and internationally
The principles include "working closely with other regulators in the UK and internationally". We would question whether this is strong enough.

- There is a risk of regulatory duplication or overlap, and in the most extreme cases this could manifest as a conflict of objective.
- In the UK, we believe there should be a clear expectation that Memoranda of Understanding are established between key regulators (such as for ARGA the FCA) that set out how the regulatory bodies will work together to avoid this overlap while being able to achieve their own objectives.
- This is especially important given the likely overlap of responsibilities in respect of governance and reporting with sector specific regulators and listing authorities.
- While we recognise that the UK assumes a leadership role in the development of governance, reporting and audit, it is important that UK rules do not undermine or prevent international alignment with relevant regulatory bodies. We would recommend that the principles establish the expectation that the UK would look to work collaboratively and "in step" with international bodies (like the International Auditing and Assurance Board), applying appropriate influence. Less formal alignment but appropriate engagement is then appropriate for key jurisdictions (such as European Securities and Markets Authority in the EU and the Securities Exchange Commission /Public Company Accounting Oversight Board in the US).
- The principles should also include measures to highlight the application of proportionality and cost-benefit in the development of regulatory approaches and actions.

11 Additional changes in the regulator's responsibilities

Supervision: Accountants and their professional bodies

76. ***Should the scope of the regulator's oversight arrangements be initially confined to the chartered bodies and should they be required to comply with the arrangements?***
77. ***What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?***
78. ***Should the regulator's enforcement powers initially be restricted to members of the professional accountancy bodies? Should the Government have the flexibility to extend the scope of these powers to other accountants, if evidence of an enforcement gap emerges in the future? What are your views on the suggested mechanisms for extending the scope of the enforcement powers to other accountants (if it is appropriate at a later stage?***
79. ***Should the regulator be able to set and enforce a code of ethics which will apply to members of the chartered bodies in the course of professional activities? Should the regulator only be able to take action where a breach gives rise to issues affecting the public interest? What sanctions do you think should be available to the regulator?***

We agree that initially oversight would be confined to the chartered bodies.

Director oversight expectations

The consultation sets out some expectations of director oversight, but it is unclear how this will be put into practice.

- Directors are a function of company appointment and are not a professional body. As such we do not believe ARGA should register or provide formal oversight and regulation regarding the appointment, or suitability of directors.
- Other regulatory bodies may have specific "fit and proper" requirements for directors that they will oversee, but we understand ARGA's proposed role would be to oversee the specific statutory duties of directors in respect of governance, reporting and audit.
- While we agree that the government should put the existing powers of the FRC onto a statutory basis for ARGA, we do not believe that ARGA should execute oversight of directors in a personal capacity. It is appropriate that ARGA has relevant legal tools to execute its formal responsibility (such as in terms of company access).

We recommend that the regulator sets out specific objectives that would help directors demonstrate that they have acted in an appropriate and reasonable manner, including seeking consultation either from relevant experts or the regulator itself. We believe that where relevant consultation exists, that this should represent a "safe harbour" for the directors. This is especially important of prior consultation of a matter with the regulator itself.

Increase in costs and endangering unitary board principle

We consider there is a risk that some of the recommendations proposed will lead to a rapidly increasing cost base as companies are pushed to buy additional assurance and that directors feel that their only safe approach is to "assure everything". We consider this to be a damaging potential development for the wider UK market. It also creates a risk of creating inappropriate conflict between executive and non-executive teams, threatening the core corporate governance principle of a unitary board; the role of the non-executives is to bring a broad range of experience to provide both challenge and support to the executive team. It is important that the onset of regulation does not remove the "support" pillar to create a confrontational board environment. The development of regulation should continue with a principles first basis with "rules" only applying to minimum standards and principles and guidance encouraging the development of practice.

Learning from the Basel model

We agree that the regulator should be able to set and enforce a code of ethics that applies to chartered bodies. As set out previously, we believe the Basel model of banking regulation is a good model –

where Basel sets out expectations for supervisors who then apply these and this model should apply for the interaction of ARGA with the RSBs. ARGA would establish its expectations and monitor the RSBs adoption and compliance with these expectations.

Oversight and regulation of the actuarial profession

80. ***IIs ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?***
81. ***Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?***
82. ***Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.***
83. ***Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?***
84. ***Should the regulator continue to be responsible for setting technical standards? Should these standards be legally binding? Should the regulator be responsible for setting technical standards only?***
85. ***Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?***
86. ***Should the regulator have the power to request that individuals provide their work in response to a formal request - and to compel them to do so if necessary?***
87. ***Should the regulator have the power to take appropriate action if work falls below the requirements of the technical standards? What powers should be available to the regulator in these instances?***
88. ***Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?***
89. ***Should the regulator's oversight of the IFoA be placed on a statutory basis? What, if any, powers does the regulator require to effectively fulfil this role?***
90. ***Does the current investigation and discipline regime remain appropriate? Should it be placed on a statutory basis? What, if any, additional powers does the regulator require to fulfil this role?***
91. ***Do respondents think that the regulator's remit should be extended to actuarial work undertaken by entities? What would be the appropriate features of such a regime, including the appropriate enforcement powers for the regulator?***
92. ***Should the regulator's independent investigation and discipline regime for matters that affect the public interest also apply to entities that undertake actuarial work? Should the features of the regime differ for Public Interest Entities?***
93. ***Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?***

No comments.

Investor stewardship and relations

94. ***Are there others matters which PIE auditors should have to report to the regulator? Could this duty otherwise be improved to ensure that viability and other serious concerns are disclosed to the regulator in a timely way?***
95. ***Should auditors receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator? Would this encourage auditors to report viability and other concerns to the regulator?***
96. ***How much time should be given to respond to a request for a rapid explanation?***
97. ***Should the regulator be able to publish a summary of the expert reviewer's report where it considers it to be in the public interest?***
98. ***Are there any additional powers that you think the regulator should have available where an expert review identifies significant non-compliance by a company in relation to its corporate reporting and audits?***

PIE auditors reporting directly to the regulators

In principle we agree that there should be an ability for PIE auditors to have the right/duty to report direct to the regulator.

- We do not believe this should be all encompassing. It is not appropriate that this is a general whistleblowing provision but targeted at matters that fall specifically within the remit of the regulator.
- As a general rule, the audit report provides an appropriate channel for the auditor to report issues with the accuracy and integrity of reporting and to separately require this to be reported to the regulator would undermine the whole purpose for which audit exists

- However, there are clearly cases, such as an inappropriate audit appointment process, or a failure to faithfully report the auditor's conclusion where it would be entirely appropriate for the regulator to be informed.
- Given the matters that are relevant, we believe that, even in this situation, there should be an expectation that the company is informed in parallel with the regulator. In general, the company should have the opportunity to correct its actions.

For the limited instances where it is appropriate for the auditor to report to the regulator, we believe that statutory protection should exist. However, there should be no specific need to legislate more broadly. Auditors already have duties to report concerns on illegality and have appropriate protections in place for this.

- We do not believe that it would be appropriate for the auditor to separately report on matters of viability, or other adverse audit findings directly to the regulator. This represents sensitive confidential or even potentially "inside information".
- We do however support that the regulator should be able to have a dialogue with the auditor on relevant matters where there is a need to investigate.

Investigations – learnings from the US SEC

For investigations it is appropriate for the regulator to encourage rapid response. We note that the SEC sets a 10-day timeline for a company to respond to its queries – either with an answer or to confirm and agree an appropriate timeframe for the formal response. A similar approach would support timely engagement but not prevent a company from establishing an appropriate timeframe for any additional work it would need to undertake to inform its response.

Additional ARGA powers

In general, we do not believe there is a need for additional powers for the regulator where there is perceived to be non-compliance, ARGA will already have far-reaching powers, in excess of many equivalent foreign regulatory bodies. In such cases, relevant laws and regulations already provide adequate description of relevant sanctions.

Appendix 2: BEIS proposals mapped to main (not comprehensive) Financial Services (FS) regulations

#	Chapter	Area of Focus	Desired Outcomes	BEIS Recommendations	Relevant UK FS Regulation
1.	The Government's approach to reform	• Expansion of Public Interest Entity definition	• Ensure all systemically important firms are captured – summary (CP Ref – Section 1.3.12 page 32)	Expand on existing EU PIE definitions – two options: • Option 1: companies more than 2,000 employees OR £200m turnover and balance sheet £2bn • Option 2: Companies with over 500 people AND turnover over £500m (CP Ref – Section 1.3.17 page 33)	This applies to all regulated firms irrespective of size and whether or not they are listed. Two main regulatory bodies (PRA and FCA): • PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and designated investment firms. • Prudential requirements include the following: • Capital Requirements Firms (i.e. CRDIV, MIFID, FICOD); • Non-Capital Requirements Firms (e.g., Credit Unions); • For Insurance firms: • Solvency Requirements Firms (i.e. SII, FICOD); • Non-Solvency Requirements Firms • Wider PRA rulebook • FCA is responsible for regulating the conducted of financial services firms and financial markets. • The FCA requirements include the following: • Conduct of business (COBS) • Managing client money (CASS) • Senior Management Arrangement (SMCR) • Systems and Controls (SYSC) • Wider FCA handbook
2.	Directors accountability for controls, dividends and capital maintenance	• Enhancement of Internal company controls • Strengthen requirements over distributing reserves	• Protect interests of shareholders by holding directors to account for internal controls – summary (CP Ref – Section 2.1 page 39)	The paper outlines three options over the Annual attestation on the effectiveness of company's internal controls over financial reporting (ICFR) by all the directors and potentially auditors: • Option A. Require an explicit directors' statement about the effectiveness of the internal control and risk management systems (CP Ref – Section 2.1.16 page 42) • Option B. Require auditors to report more about their views on the effectiveness of companies' internal control systems (CP Ref – Section 2.1.28 page 45) • Option C. Require auditors to express a formal opinion on the directors' assessment of the effectiveness of the internal control systems (CP Ref – Section 2.3.17 page 33)	• Senior Managers and Certification Regime (SMCR) introduces the concept of individual accountability and duty of responsibility for senior role holders within regulated financial services businesses. • SMCR is applied proportionately depending on the size and complexity of the entity, but all firms are captured under the requirements. • Senior Management Functions (SMF) are required to take reasonable steps in managing their areas of responsibility and mitigate the risk of conduct breaches (this implicitly includes internal controls). • PRA regulatory oversight and capital requirements

3.	New Corporate Reporting	• Resilience Statement • Audit and Assurance Policy • Taskforce on Climate-related Financial Disclosure (TCFD) • Supplier payment policies and procedures	• Company reporting which evidences directors plans to maintain resilience of their businesses (short, medium and long term) - summary (CP Ref – Section 3.1.6 page 61) • A framework that sets out more clearly to users the extent to which the annual report and other disclosures have been scrutinised – summary (CP Ref – Section 3.2.6 page 67)	• Publication of a Resilience statement including a going concern opinion (1 year or longer), stress testing scenarios (medium term), and a statement on long-term risks e.g. climate change – summary (CP Ref – Sections 3.1.11, 3.1.12 and 3.1.14 pages 62 & 63) • Publication of annual AAP, subject to advisory vote, providing a three-year rolling forward look at a company's approach to audit and assurance. – summary (CP Ref – Sections 3.2.9 and 3.2.12 pages 68 &69) •	• PRA - Capital requirements ICAAP (SS31/15) • PRA - Liquidity requirements ILAAP (SS24/15) • PRA - Operational resilience: Impact tolerances for business services (PS6/21) • PRA - Operational Continuity in Resolution (PS9/21) • FCA - Governance requirements (SYSC 4) • FCA – Operational resilience – (PS 21 / 3) • FCA – TCFD Requirements – (PS20/7) • FCA - CASS Requirements – (CASS rulebook) • FCA - Payment service directive
4.	Supervision of Corporate Reporting	• Strengthen powers for the regulator on Corporate reporting	• Increase the ability of the regulator to be able to proactively scrutinise company's annual accounts and increase its review activities. - summary (CP Ref – Section 4.1.1 page 76)	• Strengthening supervision of corporate reporting, company director responsibilities and Audit Committee oversight – summary (CP Ref – Sections 4.2.6 and 4.3.5, pages 78 & 80)	• FCA Governance requirements (SYSC 4) • PRA Governance Requirements (PS16/16)
5.	Company Directors	• Audit regulator investigation and enforcement powers • Malus and clawback of executive remuneration	• Provide the regulator with the ability to take punitive action against directors who fail to undertake their duties with due care. - summary (CP Ref – Section 5.1.13 page 87)	• Increase the regulators powers to include investigation and enforcement powers - summary (CP Ref – Section 5.1.10 and 5.1.25 pages 86 & 90) • Strengthen clawback and malus provisions on directors' remuneration arrangements - summary (CP Ref – Section 5.2.4 page 92)	• FCA listing rules • FCA Transparency Rules • Market Abuse Regulation • SMCR • COCON rules • Rem Code rules – deferred compensation • FCA – SYSC 19C.3 Remuneration principles • PRA - SS2/17 • FCA enforcement rules • PRA enforcement rules
6.	Audit purpose and scope	• The purpose of audit, audit practice and the organisation of the audit profession	• Restore the public's confidence in the audit profession- summary (CP Ref – Section 6.1.7 page 94) • Reaffirm audits purpose – summary	• Creation of a framework for all "corporate auditing", covering both the auditing of financial statements and also that auditing of wider information – summary (CP Ref – Section 6.2.5 page 98) • Auditors and Directors to report on the steps they have taken to detect and	• Market Abuse Regulation (MAR), including benchmarks regulation • Money Laundering and Financial Crime regulation, including SMF17 (Money Laundering Reporting Officer (MLRO)) under SMCR • FCA monitors and enforce compliance with Money Laundering Legislation • FCA SYSC 6.2 Internal Audit

			(CP Ref – Section 6.1.19 page 96) • Ensure fraud detection is part of the remit of auditors and directors – summary (CP Ref – Section 6.4.2 page 103)	prevent material fraud. – summary (CP Ref – Section 6.4.2 and 6.4.5 pages 103 & 104)	
7.	Audit Committee oversight and engagement with stakeholders	• Audit Committee's role and oversight • Shareholder engagement with audit	• Regulator to enforce additional requirements to the appointment and oversight of auditors – summary (CP Ref – Section 7.1.5 page 123) • Shareholders should propose areas of emphasis and the Audit Committee communicates if these are accepted/rejected by the auditor - summary (CP Ref – Section 7.3.1 page 130)	• Additional requirements on audit committees in relation to appointment and oversight of auditors to be monitored by regulator – summary (CP Ref – Section 7.1.15 and 7.1.17 page 125) • Audit Committees to have mechanism for gathering shareholders input on audit plan and auditors should consider them – summary (CP Ref – Section 7.3.4 page 131)	• FCA Governance requirements (SYSC 4) • PRA Governance Requirements (PS16/16)
8.	Competition, choice and resilience in the audit market	• Measures to open the audit market • Operational separation between audit and non-audit practices	• Mandatory joint audit regimes - summary (CP Ref – Section 8.1.2 page 138) • Operational split of firms to apply to the "Big Four" firms - summary (CP Ref – Section 8.2.2 page 146)	• Manged shared audit requirement – summary (CP Ref – Section 8.1.12 page 140) • Audit firms who carry out audits for 15% or more of the FTSE 350 by audit fees, should separate audit and non-audit sides of the firm – summary (CP Ref – Section 8.2.7 page 147)	• None
9.	Supervision of audit quality	• Approval and registration of statutory auditors • Monitoring audit quality	• Regulator to approve and register statutory auditors. - summary (CP Ref – Section 10.1.4 and 10.1.5 page 171)	• Regulator to determine eligibility of individuals/firms as statutory auditors- summary (CP Ref – Section 9.1.6 page 161) • Regulator to publish AQR and publicise channels through which issues can be raised- summary (CP Ref – Sections 9.2.8 and 9.2.11 pages 164 & 165)	• None

10	Strengthened Regulator	• Establishment of the Audit, Reporting and Governance Authority (ARGA)	• A regulator that protects public confidence and holds directors to account - summary (CP Ref – Section 6.1.7 page 94)	• Regulator with two operational objectives: quality and competition objectives; to be supplemented by regulatory principles – summary (CP Ref – Section 10.1.12 page 172)	• None
11	Changes in Regulator's responsibilities	• Oversight of professional bodies – accounting & actuarial • Compliance with the stewardship code	• Enhanced oversight of professional bodies by Regulator – summary (CP Ref – Sections 11.1.10 and 11.2.7 pages 189 & 199) • Regulator to assess signatories and promote compliance to the code - summary (CP Ref – Section 11.3.12 and 11.3.3 page 206)	• Regulator to provide oversight to chartered bodies and enforce sanctions – summary (CP Ref – Sections 11.1.22, 11.1.38, 11.2.13 and 11.2.14 pages 191,194, 200 & 201) • Consider outcomes of the review to commence in 2023. – summary (CP Ref – section 11.3.5 page 207)	• None