



Regulatory Developments

STATUS

1. The report is open, but the appendices are considered confidential and certain sensitive paragraphs are also redacted in blue.

EXECUTIVE SUMMARY

2. This paper highlights recent news stories and other developments in professional services regulation that may be of interest to the IRB. There is a summary of consultations and consultation feedback in the **Appendix**, however the main body of this report outlines particular items of topical interest.
3. This document discusses the following in more detail:
 - a) FRC updates 'Our Approach to Audit Supervision'
 - b) FRC conversation starters for Investors & Audit Committees
 - c) FRC research into non-PIE audit market
 - d) Parliament launches inquiry into local government financial reporting
 - e) White paper on Regulating AI
 - f) LSB investigation report published into CILEx & CRL dispute
 - g) BSB reviewing enforcement procedures
 - h) LSB not pursuing further reserved legal services
 - i) Increase in claims to SRA compensation fund
 - j) Thematic review of in-house solicitors
 - k) CBI Director General fired
 - l) SRA publish workplace culture guidance
 - m) Latest case on professional behaviour

RECOMMENDATIONS

4. The IRB is asked to consider whether any of these developments could be of relevance to ICAEW's own regulatory activities and whether it wishes PSD senior management to follow up any of the developments noted here. The appendix is for note, but the board may ask questions of staff where further information is required.
5. The IRB is asked to approve the classification of the paper as open and identify where redaction may be appropriate, as has been highlighted in yellow. Also agree to the non-disclosure of the appendices.

FRC UPDATES APPROACH TO AUDIT SUPERVISION

[FRC-Approach-to-Audit-Supervision-FINAL.pdf](#)

6. The Financial Reporting Council ('FRC') has published an updated document outlining how it supervises audit firms. **Our Approach to Audit Supervision** details significant additions to the FRC's supervision approach that have been established over the last two years. These include the introduction of a Public Interest Entities Auditor Registration, Supervisor letters, and Single Quality Plans.
7. The FRC's audit supervision approach involves three teams: Audit Firm Supervision, Audit Market Supervision, and Audit Quality Review. The FRC comment that these teams are dedicated to promoting audit quality and fostering resilience among firms.
8. The document includes highlights from recent FRC work, including a new Overview Report, first issued with the Tier 1 public reports in July 2022. This Overview Report included the challenges and key matters arising, increased interaction with smaller firms and the nature and extent of the thematic work undertaken. The depth of the Supervisors' knowledge and understanding of the firms has resulted in more focused engagement and facilitated a broader understanding across the FRC.
9. Other highlights from the last two years include the introduction of PIE Auditor Registration, Supervisor letters and Single Quality Plans; an increased focus on Tier 2 and Tier 3 firms; and the development of the Audit Firm Scalebox initiative.
10. Also mentioned is the FRC's participation in Project Spring, a collaborative project with audit committee chairs exploring high-quality auditing and reporting. The FRC has also become the shadow system leader for local audit while awaiting legislation to create ARGAs.
11. The FRC comment that as they transition to ARGAs, their future priorities include the implementation of the Audit Firm Scalebox, reporting to the firms on the implementation of operational separation, increasing the supervision of audit firm culture and, through the Developing AQR project, improving the transparency and effectiveness of their AQR inspection process.
12. The priority related to operational separation of the firms may warrant further review given the recently aborted Project Everest, the operational split of EY which was abandoned in April this year.

CONVERSATION STARTERS FOR INVESTORS & AUDIT COMMITTEES

[Audit committees and assurance: conversation starters | Financial Reporting Council \(frc.org.uk\)](#)

13. The FRC has also announced the launch of a new web page providing conversation starters for discussions between investors and audit committees. The FRC comment that this is aimed at promoting better engagement between investors and audit committees to facilitate better understanding of companies and their approach to financial reporting and internal control.
14. The conversation starters are structured by topic, with an initial broad question followed by several more detailed follow-up questions. These are aimed at investors wishing to engage with audit committees and companies on assurance-related topics. The FRC hope that these conversation starters will lead to greater transparency and investor confidence

15. The conversation starters have been developed in consultation with stakeholders, including investors, audit committees, and other interested parties, and the FRC says it will continue to work with these stakeholders to ensure that they remain relevant and useful.

FRC RESEARCH INTO NON-PIE AUDIT MARKET

[Audit partners needed to complete FRC survey | ICAEW](#)

16. Consultancy firm Touchstone Renard has been commissioned by the FRC to gather the views of audit partners about the non-Public Interest Entity (non-PIE) audit market. The survey aims to provide the FRC with a deeper understanding of the supply side of the audit market and the drivers of firms' entry, growth and exit in the market. The survey is completely confidential and all responses will be anonymous.

17. This move follows the FRC's December 2022 policy paper on competition in the audit market, which was responded to by ICAEW's Audit and Assurance Faculty. ICAEW expressed its support for the FRC's policy objectives regarding competition and choice in the audit market and noted its shared interest in establishing a resilient audit market that consistently delivers high-quality audits. As part of its efforts to achieve this goal, ICAEW has engaged with Touchstone Renard to provide technical input on a survey for audit partners.

18. [REDACTED]

PARLIAMENT LAUNCHES INQUIRY INTO LOCAL GOVERNMENT FINANCIAL REPORTING

[Parliament launches local govt financial reporting inquiry | ICAEW](#)

19. Following ICAEW's campaign, a call for evidence has been issued as part of a House of Commons committee inquiry into local government financial reporting and audit. An [inquiry into financial reporting and audit in local authorities](#) has been launched by the House of Commons' Levelling Up, Housing and Communities Committee (LUHCC), following calls by ICAEW for more understandable local authority financial statements.

20. The inquiry will explore the "purpose, understanding and impact" of local authority accounts and audit, seeking answers to a range of questions centred on four key themes:

- users and uses of local authority accounts and audit;
- understandability and accessibility of local authority accounts and audit;
- making local authority accounts meet the needs of users better; and
- addressing findings in audits and sharing best practice.

21. "Effective financial reporting at the local council level is important not only for delivering value for money for these services, but is also key to democratic accountability," says Chair of LUHCC Clive Betts MP. "As a committee, we are keen for our inquiry to examine how local authority financial reporting could be improved to better engage with taxpayers and other stakeholders."

22. Oliver Simms, ICAEW's Manager for Public Sector Audit and Assurance, comments: "We're pleased that the LUHCC has listened to our calls and launched this inquiry. We hope it will have a positive impact on the accessibility and understanding of local government financial reporting, in the same way that the 2016 PACAC inquiry, Accounting for Democracy, had on central government financial reporting. If local authority financial statements were better used and scrutinised, some recent financial failures might have been avoided and residents would have been aware of the risks their council was taking, so this is an important inquiry for the sector."
23. PSD fed into the ICAEW response to the initial call for evidence and we await next steps as the inquiry continues.

WHITE PAPER ON REGULATING AI

[UK unveils world leading approach to innovation in first artificial intelligence white paper to turbocharge growth - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/consultations/uk-unveils-world-leading-approach-to-innovation-in-first-artificial-intelligence-white-paper-to-turbocharge-growth)

24. The government has published a white paper that sets out a new approach to regulating artificial intelligence to build public trust in cutting-edge technologies and make it easier for businesses to innovate, grow and create jobs
25. Five principles, including safety, transparency and fairness, will guide the use of artificial intelligence in the UK, as part of a new national blueprint for our world class regulators to drive responsible innovation and maintain public trust in this revolutionary technology.
26. As AI continues developing rapidly, questions have been raised about the future risks it could pose to people's privacy, their human rights or their safety. There are concerns about the fairness of using AI tools to make decisions which impact people's lives, such as assessing the worthiness of loan or mortgage applications.
27. Currently, organisations can be held back from using AI to its full potential because a patchwork of legal regimes causes confusion and financial and administrative burdens for businesses trying to comply with rules.
28. The government comment that they will avoid heavy-handed legislation which could stifle innovation and take an adaptable approach to regulating AI. Instead of giving responsibility for AI governance to a new single regulator, the government will empower existing regulators - such as the Health and Safety Executive, Equality and Human Rights Commission and Competition and Markets Authority - to come up with tailored, context-specific approaches that suit the way AI is actually being used in their sectors.
29. Over the next 12 months, regulators will issue practical guidance to organisations, as well as other tools and resources like risk assessment templates, to set out how to implement these principles in their sectors. When parliamentary time allows, legislation could be introduced to ensure regulators consider the principles consistently.
30. Government comment that businesses warmly welcomed initial proposals for this proportionate approach during a consultation last year and highlighted the need for more coordination between regulators to ensure the new framework is implemented effectively across the

economy. As part of the white paper, the government is consulting on new processes to improve coordination between regulators as well as monitor and evaluate the AI framework, making changes to improve the efficacy of the approach if needed.

31. Organisations and individuals working with AI can share their views on the white paper as part of a new consultation which will inform how the framework is developed in the months ahead. ICAEW's Tech faculty is responding to the consultation, and PSD have had an initial discussion with the Head of Tech policy about the proposed content of the response.

LSB PUBLISHES CILEX/CRL INVESTIGATION REPORT

[LSB investigation CILEX and CRL final report \(legalservicesboard.org.uk\)](https://legalservicesboard.org.uk)

32. The LSB investigation into the long-running dispute between the Chartered Institute of Legal Executives ('CILEX') and CILEx Regulation Limited ('CRL') has now concluded, and the LSB have published their investigation report.
33. The investigation, which started in October 2022, looked into three areas: delegation of regulatory functions, a range of financial matters and consultation. The report sets out the LSB's determinations, findings, and recommendations in full.
34. The dispute arose when in January 2022, CILEX informed CRL that it intended to enter into formal discussions with the Solicitors Regulation Authority with a view to transferring the delegation of its regulatory functions from CRL to the SRA. This triggered a series of disputes and disagreements between CILEX and CRL.
35. In summary, the LSB has determined that CILEX has the power, in principle, to explore and give effect to alternative delegation arrangements to those currently in place through CRL. The investigation has also identified areas where both CILEX and CRL have not been compliant with the Legal Services Act and the IGR:
 - a) The LSB finds that the manner in which CILEX first approached CRL in January 2022 with its proposals for redelegation of its regulatory functions to the SRA was not consistent with the regulatory objectives, in particular the protection and promotion of the public interest and the interests of consumers, and did not meet its obligations in rule 2(3) of the IGR.
 - b) The LSB considers that CRL has not approached its dialogue, communications and relationship with CILEX in a manner that was liable to protect and promote the public interest and interests of consumers, and was not consistent with its duties under s. 28 of the Act.
36. CILEX and CRL have agreed voluntary undertakings to fulfil the recommendations in the report. The LSB comments that at this time, the LSB does not consider it necessary or proportionate to take formal enforcement action against CILEX or CRL. The LSB will keep this question under review as it monitors progress on the undertakings in fulfilling its recommendations.
37. The LSB comment that it hopes the investigation process will enable CILEX and CRL to reflect on what has transpired between them so that they can take the necessary steps to rebuild the positive working relationship that is necessary for the effective regulation of chartered legal

executives. The LSB say that whatever model may be adopted in the longer term for the regulation of chartered legal executives, both CRL and CILEX will need to work together constructively for at least the immediate future, which is in the public interest and interest of consumers, as well as the interests of the community of chartered legal executives and the legal profession more generally.

BSB REVIEWING ENFORCEMENT PROCEDURES

[The Bar Standards Board invites tenders for a review of its enforcement system](#)

38. The Bar Standards Board (BSB) is seeking expressions of interest from tenderers with the knowledge, expertise, and experience to carry out a review of its enforcement system.
39. The scope of the work is to carry out an end-to-end review of the BSB's enforcement processes. The review will look at all the BSB's systems, processes and policies with the aim of establishing:
 - whether they remain fit for purpose, risk based and proportionate and reflect good regulatory practice;
 - whether the processes are effective in facilitating the taking of robust, consistent and legally sound decisions; and
 - whether there is scope for greater process and/or operational efficiency in how enforcement cases are handled and decisions taken, including the interface with the BSB's supervisory function.
40. It will be for tenderers to set out how they propose to approach the review, but it should include, but not necessarily be limited to:
 - assessing the relevant enforcement regulations and associated policy, procedures and guidance;
 - seeking views of relevant internal and external stakeholders including the Bar Tribunals & Adjudication Service; and
 - considering best practice and its application in the context of the Bar.
41. The precise timetable for completion of the review will be open for discussion but it is hoped that the review can be completed by the end of 2023.
42. This planned review by the BSB follows criticism by the LSB of the BSB's enforcement processes, and concerns over delays in processing of complaints about barristers.

LSB NOT PURSUING FURTHER RESERVED SERVICES

[LSB kicks reserved activities review into long grass | News | Law Gazette](#)

43. The Legal Services Board has decided to not seek to amend the list of reserved legal activities after concluding there was not a case to consider reform at this stage.
44. The Legal Services Board voted in favour of agreeing to take no further action in relation to the scope of work that can be carried out by regulated professionals. The Legal Services Act 2007 restricts the exercise of right of audience, the conduct of litigation, reserved instrument activities, probate activities, notarial activities and the administration of oaths.
45. The LSB revealed last October that it would examine the rationale behind the list of reserved activities, after publishing research showing the system causes some detriment to consumers. This analysis has been completed, a paper before the LSB board reveals, with the LSB concluding there is no current basis for reform.
46. On rights of audience and conduct of litigation, the oversight regulator states that there had been no 'significant shift' that would create a serious demand for change.
47. [REDACTED]

INCREASE IN CLAIMS TO SRA COMPENSATION FUND

[Metamorph closures have cost profession £1.4m so far - Legal Futures](#)

48. The closure of 16 offices of the Metamorph Group by the Solicitors Regulation Authority (SRA) has so far cost the profession £1.4m, it has emerged. The payments were made from the SRA Compensation Fund, which reported last week that overall there has been a significant jump in the value of claims made against it.
49. The SRA Compensation Fund is a discretionary fund of last resort funded by the profession that can pay out up to £2m where a solicitor has stolen or not accounted for client money – and it is not covered by the firm's professional indemnity insurance – or did not have insurance in place. Insurance will generally pay out where there is an innocent partner at the firm.
50. Papers from a recent meeting of the SRA board recorded that following the multiple closures of Metamorph firms in December and January – one of the regulator's largest ever interventions – it was in the process of collecting just over 65,000 files. The SRA commented: "We are also receiving and processing a large volume of compensation fund claims relating to the matter and have so far paid out £1.4m in emergency funds." The SRA will hope to recoup some of this money if it is in the various firms' client accounts.
51. The compensation fund's annual statement, also released last week, showed that interventions cost £4m in the year to 31 October 2022. Overall, in those 12 months, the fund paid out £15m in grants – compared to £27m in 2020/21 – but there has been a sudden jump in the value of open claims. An SRA spokesman said this rise was linked to a number of claims made from victims of fraudulent investment schemes involving solicitors.
52. For the current practising year, the profession paid £9.7m towards the fund – £30 per individual and £690 per firm which held client money – which was £1.9m less than the previous year. The proposed figure for the coming year should be announced shortly.

53. The high level of activity of the SRA Compensation Fund shows the important role it plays in compensating victims of fraudulent activity by a legal professional, who would otherwise be left with a significant financial loss.

THEMATIC REVIEW OF IN-HOUSE SOLICITORS

[SRA | In-house solicitors thematic review | Solicitors Regulation Authority](#)

54. The SRA thematic review of the role of in-house solicitors has now been published (the launch of the review was included in the January Regulatory Updates paper). The aim of the review was to understand how solicitors support an ethical culture in their organisations, the challenges they face in meeting their professional obligations, and how the SRA can help support in-house solicitors.

55. The review has found that there are a number of challenges facing in-house solicitors:

- Safeguarding independence
- Managing risk with policies and controls
- Managing pressures and meeting regulatory obligations
- Maintaining continuing competence
- Ethical leadership and ethical risks

56. The SRA review concludes that most in-house solicitors felt positive about their role in organisations and also felt that their legal function was valued. However, solicitors also highlighted significant political and economic pressures, increasing workloads and challenges in retaining and recruiting talent. For these reasons, without adequate safeguards and systems in-house teams may struggle to manage conflicting duties and ethical and regulatory risks. They must, therefore, carefully consider how they can deliver organisational objectives while maintaining independence.

57. The findings of the SRA review are of interest given ICAEW's introduction of mandatory ethics CPD for all members, including those in business. ICAEW's ethics CPD course that has been developed as part of the support available on the new CPD regulations contains sections aimed at members in business. It also reminds members about the sources of support available to all members facing ethical issues, including the framework for resolving ethical problems.

PROFESSIONAL BEHAVIOUR

CBI fire director general

58. Following the scandal around behaviour at the CBI, the director general, Tony Danker, was sacked following an investigation into allegations of sexual harassment in the workplace. The dismissal of Danker followed an investigation by the law firm Fox Williams which has rocked the business organisation and spawned further allegations that do not relate to Danker.

59. Three other CBI employees have been suspended pending further investigation into a number of allegations, the CBI confirmed.

60. The CBI said the allegations in recent weeks had been “devastating” for the organisation and that Danker’s conduct had fallen “short of that expected of the director general”.
61. The sacking is amid many large organisations distancing themselves from the CBI, including EY resigning as auditor.

SRA publishes wellbeing at work guidance

[SRA | Guidance | Solicitors Regulation Authority](#)

62. Following the consultation last summer, the SRA have now issued updated guidance to help law firms and those who work for them understand what new rules on health and wellbeing in the workplace mean for them.
63. The new rules were introduced earlier this month following approval by the Legal Services Board (LSB). They include specific obligations in the Codes of Conduct for both firms and individuals to treat colleagues fairly and with respect, and not to engage in bullying, harassment or unfair discrimination. They also clarify the SRA’s approach to situations where a solicitor’s health issues may affect their ability to practise or to participate in enforcement processes.
64. The SRA comment that they carried out an extensive consultation prior to introducing the rules. As a result of feedback, the SRA amended initial proposals to require all solicitors to challenge any unfair treatment they witnessed. The rules now place this requirement on the top managers of firms such as partners. The new guidance also explains how the SRA expect firms to build a working culture in which more junior staff feel able to complain without fear of recriminations.
65. SRA Chief Executive, Paul Philip, said: ‘The legal sector can be a very fast-paced and demanding environment in which to work. While it is up to firms how they run their individual businesses, it does become a regulatory issue if poor working cultures start to impact staff wellbeing, behaviour and ultimately standards of service to the public. That is where we have a duty to act.’
66. ‘In order to make sure the public are protected, the rules also clarify the position where a solicitor’s health raises regulatory risks. This can include situations where a solicitor is too unwell to take part in an enforcement process.’
67. The SRA’s Workplace Culture Thematic Review, published last year, found that while three quarters of respondents reported working in a broadly positive environment, there were still concerns and issues about the pressures on solicitors.
68. Previous research, including by the charity LawCare and the Junior Lawyers Division of the Law Society, had already highlighted high levels of stress, and even bullying and discrimination in the sector. There have been a number of cases in recent years where it has been suggested that a firm’s working culture has contributed to individuals, especially junior solicitors, committing misconduct.
69. The revised SRA guidance is of relevance to the ongoing ICAEW project to review the requirements of the Code of Ethics as it relates to Professional Behaviour.

Latest case on professional behaviour

CA: Barrister's conduct of own litigation "not a private matter" - Legal Futures

70. The Court of Appeal has found that it was within the BSB's jurisdiction to discipline a barrister for poor conduct when she conducted litigation in her own right. The court found that the conduct in question, although occurring in litigation conducted by the appellant on her own behalf, was capable of amounting to conduct which breached core duty 5 (acting in a way likely to diminish public trust and confidence in the barrister or the profession) and as undermining the barrister's honesty and integrity" (rule 8).
71. The court was hearing an application for permission to bring a second appeal by Sophia Cannon, who at the time of the Bar disciplinary tribunal hearing in January 2020 was an unregistered (ie, non-practising) barrister. She was disbarred after the tribunal found four charges of professional misconduct proved against her, three of which were upheld by the High Court in October 2020 and one overturned.
72. She was found to have misled a court and not complied with four court orders during family court proceedings she brought involving the father of her children. The Court of Appeal said there was "no doubt at all" that the conduct would be professional misconduct if committed in the course of a barrister's professional practice.
73. This case is of relevance to our ongoing project to review and update the content in ICAEW's Code of Ethics about Professional Behaviour.

APPENDICES

	Appendix Name	For consideration or for reference	No of pages
Appendix A	Review of consultations and feedback May	Reference	3
Appendix B	Review of consultations and feedback March and prior	Reference	8

Author	Sophie Wales, Head of Regulatory Affairs and Policy
Date of report	10 May 2023