ICAEW
REPRESENTATION 63/21

RESTORING TRUST IN AUDIT AND CORPORATE GOVERNANCE

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ICAEW welcomes the opportunity to comment on *Restoring trust in audit and corporate governance* published by BEIS on 18 March 2021.

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ABOUT ICAEW

1. ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 157,800 chartered accountant members in over 147 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

Our role as a world-leading improvement regulator

2. We protect the public interest by making sure ICAEW's firms, members, students and affiliates maintain the highest standards of professional competency and conduct.

3. ICAEW's regulatory and disciplinary roles are separated from ICAEW's other activities so that we can monitor, support or take steps to ensure change if standards are not met. These roles are carried out by the Professional Standards Department and overseen by the independent ICAEW Regulatory Board (IRB). The IRB is submitting its own response to the BEIS White Paper.

4. Our regulatory role as a professional body is to:

   - authorise ICAEW firms and members to undertake work regulated by law: audit, local audit, investment business, insolvency and probate;
   - support the highest professional standards in general accountancy practice through our Practice Assurance scheme;
   - provide robust anti-money laundering supervision and monitoring;
   - monitor ICAEW firms and insolvency practitioners to ensure they operate correctly and to the highest standards;
   - investigate complaints and hold ICAEW firms and members to account where they fall short of standards; and
   - respond and comment on proposed changes to the law and regulation; and educate through guidance and advice to help stakeholders comply with laws, regulations and professional standards.

5. As a regulator of the accountancy and audit profession in the UK, ICAEW is:

   - the largest recognised supervisory body (RSB) and recognised qualifying body (RQB) for statutory audit in the UK, registering approximately 2,600 firms and 7,400 responsible individuals under the Companies Act 2006;
   - the largest insolvency regulator in the UK. We license over 800 insolvency practitioners (out of 1,550 in the UK) as a recognised professional body (RPB) under the Insolvency Act 1986;
   - a designated professional body (DPB) under the Financial Services and Markets Act 2000. We license approximately 1,900 firms to undertake exempt regulated activities under this Act;
   - a supervisory body recognised by HM Treasury for the purposes of the Money Laundering Regulations 2017, dealing with approximately 11,000 firms;
   - an accredited body under the Financial Conduct Authority (FCA) Retail Distribution Review (RDR) arrangements; and
   - an approved regulator and licensing authority for probate under the Legal Services Act 2007. Over 300 firms are accredited to carry out this reserved legal activity. the largest recognised supervisory body (RSB) for local audit in England. We have eight firms and over 90 key audit partners registered under the Local Audit and Accountability Act 2014.

Part 1: Major points

A. HOW GOVERNMENT SHOULD PRESS AHEAD WITH REFORM

Reinforcing the UK's leading reputation in corporate governance and audit

6. We strongly support government's objective to reinforce UK audit and corporate governance. The Secretary of State has set a clear and laudable objective of reinforcing the UK's comparative economic position in the wake of large corporate failures. He aims to ensure investors and all those who depend on the largest companies in the UK can continue to rely on high quality, focused, transparent and reliable information on UK companies.

7. ICAEW believes he has set the right challenges to ensure the UK's world-class reputation in corporate governance and the ecosystem of professional services and strong rule of law which attract foreign direct investment is maintained and enhanced as the global economy recovers from the pandemic. Reinforcing reform in the stewardship of those most significant companies upon which investors, employees, supply chains and large parts of the UK's economic base relies is also a necessary pre-requisite in helping to restore trust in business.

8. 'Reinforcing', as the Secretary of State refers in his foreword to the consultation, rightly suggests strengthening rather than rebuilding. We want to work proactively with government, business, and the regulator to address weaknesses, while enhancing the international competitive advantages of UK businesses, capital markets and professions. Trust depends on strengthening all parts of the corporate reporting system to ensure it remains world-class.

Focus on fraud and unexpected failure in Britain's most important companies

9. The Government recognises that 'corporate failure can happen, but it should rarely be a surprise'. This is the right focus. Business birth, growth and failure are inevitable and necessary components of the economy, despite the pain of failure felt by many when it occurs. Reallocating capital from less productive enterprises produces more innovative and competitive businesses; more wealth, jobs and export opportunities for the UK; and better goods and services for consumers.

10. Fair, balanced and reliable corporate reporting helps highlight risk and acts as an early warning system. Audit has a vital role to play. Auditors cannot prevent corporate failure but must help ensure financial statements can be trusted. A strong core audit is key.

11. Corporate failure is caused by the action, or inaction, of company directors, not auditors. Invariably this is not deliberate sabotage, but directors, usually executive directors given their role in actively managing the company, failing to respond adequately to the needs of customers or taking excessive financial risk, both factors that should be properly controlled against and visible in corporate reporting when they occur. Failure is also caused or exacerbated by fraud. Government is right to prioritise steps designed to ensure executive director accountability for robust controls. Proper controls ensure corporate reporting shows a true and fair view of a company's position and help to guard against fraud.

12. We will ensure that we play our part as a professional body in rooting out weaknesses and errors. We are determined to act as the strong voice for audit that Sir Donald Brydon in his review demanded the audit profession deserved. Powering the UK's recovery from the global pandemic, achieving comparative advantage in key sectors like professional services and attracting more inward investment demand a thriving and improving corporate reporting ecosystem. Such a healthy ecosystem requires several key players, performing their specific

roles to a high quality and acting in a systematic way to identify and mitigate effective early warning indicators against the key risks of fraud and surprise failure.

13. Multiple checks and balances by different parties are more effective in protecting against fraud and unexpected failure than consolidating lines of defence in a single regulator. The consultation puts too much emphasis on the role of ARGA and overlooks the positive contribution of other actors. Professional accountancy bodies are central to delivering reform, reinforcing our comparative advantage and global reputation and driving up standards of behaviour. We want to focus on actions core to achieving government's objectives of tackling fraud and unexpected failures in significant companies and not be distracted by poorly considered and unjustified change in peripheral areas.

Beware of wrecking great British institutions

14. The case has simply not been made for the fundamental rebuilding of qualifications and standards for audit and accountancy. This approach is not in the spirit of the White Paper's wish to reinforce the UK's existing strengths and global reputation in existing accountancy qualifications. Such a move would be highly costly, disruptive and risks achieving the opposite to government's intentions. It would divert resources from more productive uses in the economy. It would absorb expert capacity much needed to help with the net zero transition and levelling up agenda. It would harm the international competitiveness of the UK's world-leading accountancy qualifications.

15. In reinforcing a world-class regime, chartered accountants are a force for good. The Government recognises the world-class status of the UK accountancy profession and the wider Professional and Business Services sector (PBS). Minister for Investment, Lord Grimstone of Boscobel, recently stated:

> 'From accountants to architects, lawyers to engineers, recruitment to advertising, admin to consultants – our PBS sector delivers crucial advice and support services that enable businesses in every sector and in every region, both large and small, to become more productive, profitable and competitive. The professionalism demonstrated in every corner of the sector is what makes it world renowned and a vital pillar of UK prosperity.'

16. Global accountancy firms originated in the UK and despite their presence across all parts of the world still look to the UK for leadership and quality. This is a huge source of comparative advantage for the UK. The strength of the UK accountancy profession is recognised by investors, businesses and regulators internationally.

17. The accountancy profession is an undoubted strength for the UK economy. It accounts for:
    - £59bn of GDP[1];
    - £8.9bn in tax receipts; and
    - £3.1bn in exports; 11% of all professional services exports and five times the value of accountancy imports, generating a strong balance of payments for the UK economy and demonstrating the global strength and appeal of accounting services originating from the UK.

18. High quality professional accountancy qualifications cultivate and convey soft power for the UK. ICAEW's ACA qualification is world-leading, attracting talented people across the world to study it by virtue of its rigour and high ethical and professional standards. Key to the attractiveness of the ACA is its long-proven success as entry to a wide variety of careers.

[1] Oxford Economics, The Accountancy Profession in the UK and Ireland, November 2018.

19. The proven attractiveness of our qualification comes from its rigour and high quality but also from its versatility. In 2020, 9,349 students began to study for the ACA, of which over 30% were located outside the UK. The ACA enables young professionals with a foundational grounding and highly valuable training in audit, equipping them with a qualification that is readily transferable into a wide range of commercial and public sector roles. The broad-based ACA qualification gives high value both to individual professionals that hold it and to the wider economy from the skills and expertise it provides. Because of this, chartered accountancy is a potent engine in levelling up.

20. The accountancy profession is meritocratic: in the Social Mobility Foundation's 2020 index on UK employers taking most action to access and progress talent from all backgrounds, the top three places were awarded to accountancy firms: PwC, Grant Thornton and KPMG.

B. ICAEW'S ROADMAP FOR REFORM: FIVE STEPS FOR RAPID ACTION

Step 1. Set up ARGA and focus it on encouraging improvement in corporate reporting and audit

21. As a crucial and urgent first step, government should establish the new regulator, ARGA, to replace the FRC and properly equip it with appropriate, targeted powers. An effective and trusted new regulator is a pre-requisite for effective reform. That should not mean an 'FRC on steroids' with a broad remit; such a move increases the risk that the regulator would fail to affect meaningful change. A new regulator operating under the principles of BEIS's Regulators' Code would ideally: support those they regulate to comply and grow; hear their views; communicate clearly and transparently with them; and, focus its activities where risks are highest. That would be transformational in reinforcing corporate governance standards and improving audit resilience and quality.

Step 2. Make directors accountable for high standards of internal control

22. We agree with the proposals to give ARGA enforcement power against the directors of Public Interest Entities closest to evaluating the internal control framework of their company. Such a measure is an integral part of driving up standards across all directors and ensuring ARGA is a strong and focused regulator. The regulator should be equipped to take effective action against PIE directors where they breach their duties for reports, accounts or audit.

23. A more robust UK regime for accountability over internal control could make real and rapid improvements to company resilience, reduce the risk of fraud and, as evidence from the United States suggests, reduce the cost of capital. We urge the Government, and ARGA, to prioritise appropriate levels of accountability for internal control. The Sarbanes-Oxley (SOX) regime in the US requires the CEO and CFO to certify that the internal control system provides them with all the information needed to monitor and manage the company and that they have evaluated the internal control system and found it either sufficient or identified key weaknesses. This measure, in conjunction with a focused and stronger regulator, could be the consultation's single biggest gamechanger in improving the governance of companies and reducing the risk of fraud and unexpected failure.

24. The UK regime must first and foremost provide a high-quality reporting framework and guidance for directors, particularly for specific directors designated by the Board to certify the directors' statement and take responsibility for ensuring their company has high standards of internal control. This is a key lesson from the SOX regime. The quality of the framework and guidance will determine the regime's success or failure. It must be scalable for all the entities

it is applied to – another key lesson from the US, and external auditors must be involved for the regime to have credibility. We support Option C.

Step 3. Reinforce the core audit with targeted action on fraud and resilience

25. A stronger core audit, with improved audit quality, will be the measure of the success of these proposals. Improved regulation, market opening and increased resilience in the audit market will be of limited value if they do not result in better audits, and of questionable value if they compromise audit quality. In the long-term, competition and resilience in the audit market, and improved audit quality go hand in hand. But efforts to drive through market opening must not be at the expense of audit quality in the short and medium-term. Government's focus on a stronger core audit, and on fraud and resilience, is therefore important.

26. The public and Parliament rightly expects the audit product to do more to tackle fraud. No audit firm wants to miss a material fraud and there are practical steps many are already taking to increase the rigour of work around fraud. ARGA has a leading role to play as a strong improvement regulator designed to disseminate good practice. It should maintain a fraud register, with due safeguards, and by encouraging sharing of experience and raising awareness, improve quality. The new internal control regime also has a vital role in tackling fraud.

27. Requiring a statement on fraud will focus directors' attention on the steps they have taken or should be taking. However, investors often wish to focus on the *evaluation* of the quality of directors' action. Those steps in improving fraud controls, for example by performing a risk assessment, are necessary to ensure that directors focus on the processes, controls and behaviours which can cultivate fraud, and take action to mitigate them. In turn, investors often wish to focus on the *evaluation* of the quality of directors' action.

28. BEIS is right to bring a renewed focus to resilience. Viability Statements have not been a success and to effect real change, it is important that the proposals for a Resilience Statement do not simply result in a different type of boilerplate reporting. To ensure meaningful improvements to the quality of reporting, ARGA must emphasise directors' accountability for the quality of this statement and ensure it is not seen simply as an extended Viability Statement.

Market opening measures

29. We support the need to increase competition in the market for the largest audits. Although the market is moving slowly towards opening up, government intervention is needed to achieve this. It is critical however that any market opening measures are effective and timely in making the audits of FTSE 350 companies more resilient, provide audit committees with more choice and enable challenger firms to win audit tenders outright. Managed shared audit, the Government's preferred option, will be by its nature incremental. It will not achieve substantial change quickly, and as well comes with significant managerial and coordination challenges. This risks undermining overall audit quality while failing to inject greater choice and resilience into the market in a sufficiently timely fashion.

30. While some challenger firms, particularly those which are members of Group A and Association of Practising Accountants, are positive about the concept and ready to invest in managed shared audit, we found little support elsewhere for the proposals on managed shared audit in wider stakeholder groups. Managed shared audit is a long-term and incremental endeavour without direct precedent, and some challenger firms have significant concerns that it will be impractical, difficult to deliver, fail to make much of an impact for many

years and could impact audit quality adversely. Demand-side reform, in which audit tender processes guarantee the inclusion of a challenger of the shortlist, would work with the grain of what is happening in the marketplace already. Without completely disregarding the use of managed shared audit, to achieve the objectives of reform, and more quickly, a market share cap might be easier to deliver and be less disruptive.

31. Although a combination of a market share cap and managed shared audit may provide some changes to the audit market, greater intervention is needed to improve resilience, competition and choice. Regulation and liability both have important implications on efforts to increase competition in the market for FTSE 350 audits. Liability is a major barrier in the ability of challenger firms to participate in the market. If government wants to make real and significant progress in making the audit market more resilient and open to new entrants, alterations to the liability regime, for instance by mandating proportionate liability or introducing a statutory liability cap, should be given serious consideration.

32. The approach, attitude and culture of the new regulator will also be crucial in determining whether the FTSE 350 market is an attractive proposition for new entrants. If operating in the PIE market continues to require significant additional time for audit firms to respond to regulatory demands, then barriers to entry will persist. There is also a tendency for the regulator presently to impose ever greater sanctions to audit firms, not just confined to Big 4 firms but to others of much more limited resource in dealing with regulation. While we fully agree with a regulator able to issue significant fines for poor quality work, the intrusive and lengthy inspection process currently used by the FRC acts as a strong deterrent for these firms to enter the market. The Head of Audit from a challenger firm told us: *'The number of PIE auditors in the market will depend on how open to competition this market really is, and how onerous the regulation in this market is'.* Without compromising on audit quality, ARGA should emphasise its credentials as an improvement regulator to encourage greater participation in the market.

33. In addition, the current situation for reporting an unexpected departure of an auditor and their subsequent replacement by another firm is unsatisfactory. The resignation of an auditor outside of the normal contract cycle could act as an effective early warning system and identify areas of focus for the regulator and incoming auditor. Instead, notification to the regulator of an auditor's resignation is slow and there is no statutory requirement to inform the regulator of the successor audit firm. This statutory omission should be rectified to ensure the regulator can readily identify the incoming audit firm and work with them to address issues and ensure capacity is available to maintain or improve high audit quality.

Step 4. Legislate as soon as possible to introduce the Audit and Assurance Policy

34. The Audit and Assurance Policy (AAP) offers an opportunity to strengthen proposals to address the risks of fraud and failure, by enabling companies to enhance their core financial statement audit with assurance over key strategic risk areas, such as adaptation to climate change and cybersecurity. Investor engagement is crucial to the success of the AAP. Reflecting it in the Stewardship Code could help, but broader efforts are necessary if it is to achieve its potential. That could start by highlighting to investors the value of the AAP in achieving the greater reliability they are seeking around ESG data.

35. If the AAP is to fulfil its potential, the UK's corporate ecosystem will need to engage fully and follow the nine recommendations in Developing a meaningful Audit and Assurance Policy. ICAEW is ready to work with BEIS and the FRC to implement the AAP.

Step 5: Equip ARGA to deliver robust corporate reporting review

36. High quality corporate reporting is at the heart of an effective system of corporate checks and balances that enable users of such information to take meaningful decisions. It is vital ARGA is effective in achieving this. We agree the FRC's current power to seek a court order should be replaced with a power to direct changes to reports and accounts. This will enable issues of non-compliance with accounting and other reporting requirements to be dealt with more directly and efficiently. Without reconstructing the current system of recourse to a court, in the interests of fairness checks and balances will be needed, and an appeals mechanism is essential. An independent arbiter should also be considered to assist in these important decisions.

37. We also agree that ARGA needs powers allowing it to publish correspondence entered into during the course of a Corporate Reporting Review (CRR), as well as summary findings. ARGA's powers in these areas should extend to the whole Annual Report.

C. DISTRACTIONS THAT UNDERMINE SUCCESSFUL REFORM

Extending the PIE regime too far will not capture the right companies, will risk overwhelming the system and risk undermining competition and resilience in the audit market

38. Some large private companies with large numbers of stakeholders should be brought into scope as a PIE, but the proposals include far too many entities that are not reasonably in the public interest. This increase risks overwhelming the system and does not capture significant companies reasonably expected to be defined as PIEs.

39. It is right the Government want increased scrutiny for public interest entities (PIEs). We welcome some large private companies being subject to stronger regulation – employees, pensioners and suppliers benefit from strong governance at companies they rely upon. Some entities have hundreds of thousands of stakeholders, dominate markets providing essential services or operate strategic infrastructure or facilities.

40. But the consultation includes far too many entities for which a reasonable public case cannot be made. It provides two options for expanding the PIE regime to private companies and includes large AIM-listed firms. Option 1 would mean approximately 2,063 entities would be brought into scope of the PIE regime, more than a doubling of existing public interest entities, with Option 2 producing an additional 1,163, an increase of 40 per cent.

41. Option 1 would extend PIE status to coffee shops, bookstores, and caravan parks, while Option 2 additionally captures flour millers and a pillow manufacturer. These are all dynamic businesses that power the UK economy and benefit from its proportionate regulation. But we question whether their failure would be a matter of public interest.

42. Bringing AIM companies into the scope of PIE could deter fast-growing and innovative companies from listing in the UK. The UK Listings Review, chaired by Lord Hill, was an important part of a Government plan to reinforce the UK's position as a leading global financial centre; extending the scope of PIE into AIM would jeopardise that ambition.

43. Such a wide definition would overwhelm the entire audit and assurance system through insufficient capacity. It would frustrate efforts to increase competition and choice and improve audit quality. It would divert skilled professionals from productive work in the UK economy such as supporting business growth or the mergers and acquisitions that are vital for vibrant capital markets and efficient and productive businesses.

44. It is possible – and indeed desirable – that an increased size of the PIE audit market may bring in new entrants and encourage existing players to invest further. However, the time and cost involved in recruiting and training staff to undertake audits and to invest in suitable processes to ensure compliance may delay matters and deter such action. The calibration between attracting players to an expanded PIE market while not deterring them by increasing regulation and complexity and the risk of significant sanctions is finely balanced. Indeed, experience in the UK and in the Netherlands following audit reform and the segmentation of PIE audits suggests that audit firms may choose to withdraw from the PIE market because of increased regulatory cost and potential reputational risk. In the Netherlands in 2018, there were nine audit firms licensed to audit PIEs; by the middle of 2020, three firms had chosen to leave the PIE market.[2] Such potential developments are in the context in the UK of falling numbers of audit firms registered to carry out statutory audit work. Although this fall is concentrated predominantly with those audit firms that are sole practitioners, this still places pressure on capacity throughout the entire audit market.

45. The definitions also miss entities whose survival have an obvious and legitimate public interest. For example, the UK-based steel industry is vital to the country's manufacturing base and achieving Net Zero targets. But key UK steel industry entities have less than 2,000 or even 500 employees and fall below the turnover/balance sheet thresholds. They would not be captured as PIEs in either of the options proposed in the consultation. Neither would HS2.

46. The failure of one of these entities would rightly arouse strong political and public attention. It would have serious adverse effects on employment and supply chains, hit net zero transition and hold back levelling up. By any qualitative test, such entities should be classed as a PIE.

47. The regulator would also be put under strain to deliver. The FRC failed to deliver its inspections due to resourcing constraints and broadening the scope of its operations; there was a reduction in Big 4 firm inspection by 26% between 2018/19 and 2019/20. Notwithstanding a change in regulator from the FRC to ARGA and an increase in budget and staffing, the combination of a transition phase and a significant broadening of the new regulator's responsibilities, it is questionable whether ARGA will be able to meet all requirements with the capacity it will be able to call upon.

48. We urge government to think carefully about the entities they want to be PIEs. Clear, robust, and objective criteria incorporating both quantitative and qualitative factors are essential to ensure the right entities are captured and the capacity of the ecosystem is not overwhelmed. Government would then be faced with consequences completely at odds with its intentions: a market which is overwhelmed by insufficient capacity, putting downward pressure on audit quality, and deterring audit firms from entering or remaining in the PIE audit market, thereby reducing competition and choice.

Don't set up ARGA to fail through unnecessary extension of powers

49. ARGA's powers need to be better targeted. There is no good reason, for example, for introducing statutory regulation of individual chartered accountants. ICAEW already has effective oversight by a range of regulators. The objectives are better served through pursuing erring accountants engaged by PIEs through the proposed powers in Chapter 5 and applying a governance framework for accountancy that leverages the independent RSBs.

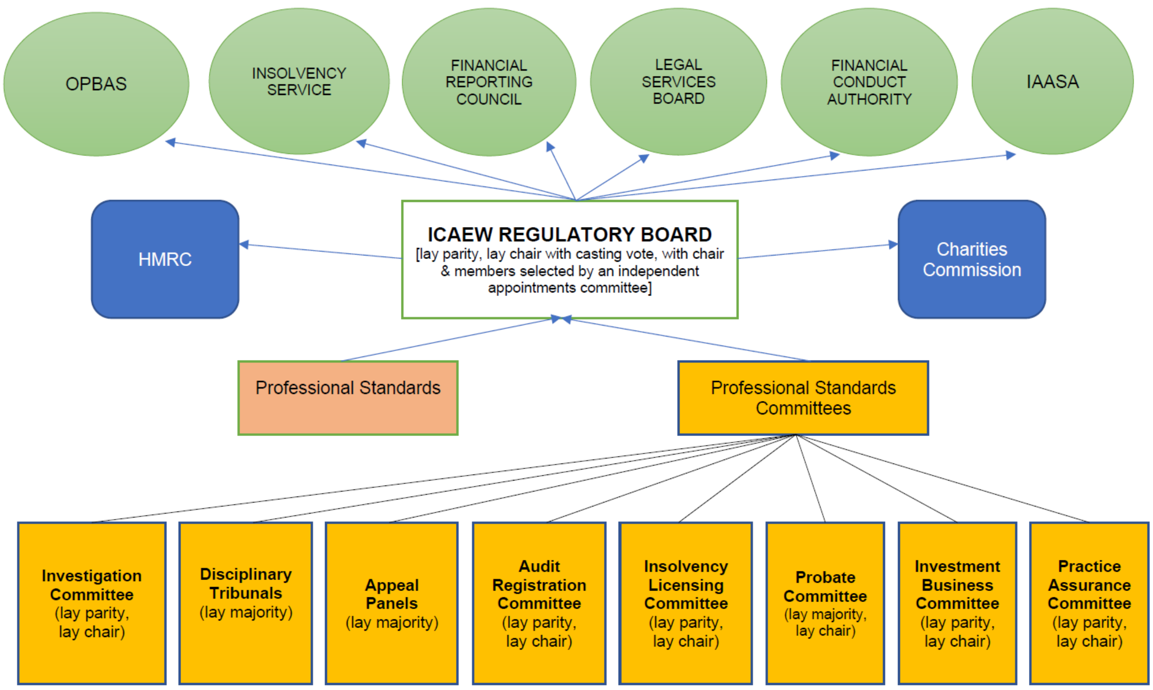
50. We do not agree with the proposed power for ARGA to require an auditor to take on an audit. This would produce an unintended consequence of a perceived conflict of interest – ARGA

[2] Audit Analytics, 'Shrinking Auditor Market in the Netherlands' 30 July 2020.

may appear not to be wholly impartial and independent if it exercises both appointment and oversight powers.

51. As it stands, Chapter 11 reflects summary recommendations in the Kingman Review (the Review), but Kingman was concerned with creating a new regulator to replace the FRC and strengthening audit regulation for PIEs. The Review did not examine in any detail ICAEW's regulation of chartered accountants. We are concerned the consultation has adopted and acted on a passing reference in the Review to professional bodies operating as 'self-regulatory'. This is wrong: ICAEW is overseen by a range of regulatory bodies, as figure 1 shows. This is not self-regulation.

Figure 1 – oversight of ICAEW by external and independent regulators.



52. Such an incorrect view appears to be based on a concern that pre 2010 FRC thematic review recommendations were not implemented in full. However, they pre-date the introduction of independent regulatory boards and increased oversight by external bodies. It ignores significant recent governance changes by ICAEW and other professional bodies and the many oversight regulators checking ICAEW's performance in different aspects of chartered accountants' work. If such an examination had taken place for ICAEW, it would have concluded:

- all strategic, policy and budgetary decisions, and all decisions in respect of key regulatory matters and disciplinary cases are made by either lay parity or lay majority committees or boards with the work of those boards/committees and staff being inspected frequently by independent committees and oversight regulators. This is not 'self-regulation'; and
- there was no need for ARGA to have a statutory duty to monitor 'public interest issues arising' in chartered accountants' work outside of audit or for ARGA to have a backstop power to ensure performance improvements.

53. These proposals lack a firm evidential basis, contrary to the Better Regulation Executive's principles. They risk stretching resources even more thinly at ARGA and distracting the regulator from the real improvements needed in its core areas of focus.

54. It is not clear why there is a need for a new code of ethics or what issues exist in the existing ICAEW Code which is taken from the International Ethics Standards Board for Accountants (IESBA) Code of Ethics for accountants. As members of the International Federation of Accountants (IFAC), ICAEW and other UK professional accountancy bodies must comply with IFAC's Statements of Membership Obligations. These include adopting in full and implementing the IESBA Code of Ethics. UK member bodies of IFAC are permitted to supplement the IESBA code with additional local requirements. But should bodies depart from the IESBA code without exceptional circumstances or without using their best endeavours to ensure compliance, they may be suspended or removed from IFAC membership. Such a step would undermine our enviable global status as a strong magnet for foreign direct investment.

55. Given the increasing cross-border work of chartered accountants, we consider it imprudent and impractical to create a stand-alone code for UK chartered accountants. The proposal also fails to consider the fact that all the accountancy professional bodies have increasing numbers of international (non-UK) members so would end up applying two different codes to their members depending on the country of practice. The FRC already sets and maintains an ethical standard for audit independence purposes for audits performed under UK auditing standards and we do not believe the case has been made to go beyond this.

Delegation to the competent authorities should be put in statute

56. When the Statutory Auditors and Third Country Auditors Regulations (SATCAR) were introduced in 2016, Baroness Neville Rolfe issued a Ministerial Direction on delegation to competent authorities. The Direction allows ICAEW, as a key component of the corporate assurance ecosystem, to maintain rigorous inspection while allowing the FRC to focus attention on the areas that really matter – supervision and inspection of PIE audits. The proposal to extend the PIE definition requires that direction to be amended, and in doing so Government should consider why the rationale for it still exists. Professional bodies who regulate non-PIE audits rely on the direction. It gives them the assurances needed to allow them to invest in technology, know-how and people to ensure that they were able to discharge their delegated duties to the highest possible standards.

57. If the direction were revoked without equivalent replacement in statute ARGA could, at short notice and without cause, reclaim delegated regulatory tasks. Such a step would cause further capacity problems within the ecosystem and undermine the role of key actors. It is unnecessary and counterproductive.

Establishing a separate professional body for corporate audit will be duplicative, costly, distracting and compromise UK competitiveness

58. The existing recognised qualifying bodies and recognised supervisory bodies already deliver a profession that clearly and distinctly supports auditors, drives high audit quality and is inclusive for wider corporate auditors. Establishing a separate professional body for corporate audit risks reducing the attractiveness of entering a profession and obtaining a high-quality qualification which is a source of UK global competitive advantage.

59. ICAEW is ready to develop its qualifications and training to support the Government's objectives. We are already in the process of expanding our Continuing Professional Development requirements to encourage the development of the skills and attitudes needed to deliver better audits. We are ready to develop our statutory auditor qualification to confer

more differentiated status on those who hold it. We are willing to explore how we can offer incremental specialist qualifications to those providing additional assurance services within corporate audit.

D.IMPLICATIONS FOR SMES AND THE PUBLIC SECTOR

Keep SMEs out of corporate governance reform

60. The consultation appears to add little regulatory burden for small and medium entities (SMEs) and small and medium audit practices (SMPs). Most of the headline measures are limited to PIEs or targeted at them. However, there may be indirect impacts on smaller entities, and a very real risk of 'scope creep'. For SMEs, struggling to recover from the economic damage caused by COVID-19, an additional regulatory burden, caused inadvertently, could prove to be their death knell.

61. In audit, the FRC has already caused alarm among smaller firms by suggesting that operational separation might be considered by firms outside the Big 4. Proposals in relation to internal controls cover many smaller entities that would not be caught by SOX in the US. There is also a real risk that the managed shared audit proposals will draw staff away from smaller firms. The capacity constraints this would cause in an already stretched market for professional talent are a real concern for SMEs. Over extension of the PIE definition will draw in resources from elsewhere in the system, undermining audit quality and capacity for smaller companies. Over regulation of SME audits could further deter small businesses from seeking an audit, where they are not required by statute to have one.

Consider public sector audit

62. While the focus of the consultation is understandably on large private sector companies, greater clarity is required over the extent to which the proposals might capture state-owned organisations, including state-owned companies. Many of the proposed new requirements for PIEs could also improve governance and audit for large public sector bodies, including reporting on the effectiveness of internal controls, but there are significant differences between public and private sector bodies that mean many of the proposals cannot be directly transferred to the public sector. Our view is that the Government should explicitly exclude public sector bodies from the scope of the PIE criteria, including government-owned companies, and instead carry out a separate exercise to explore which elements of the reforms could be adopted by and, where necessary, adapted for larger public sector organisations. We have also set out the public sector perspective in a separate letter to HM Treasury, a copy of which has been sent separately to BEIS.

E. ICAEW'S CONSULTATION WITH MEMBERS

63. The consultation we have had with our 157,800 members in writing this response has been the most extensive in ICAEW's recent history. We established a special hub-page for the consultation and published 28 articles and podcasts to inform members and the general public. We held roundtables in Manchester and Birmingham with Lord Callanan, and the London Society of Chartered Accountants with Mark Holmes and Andrew Death, and also held two national roundtables for our members in business. We hosted two online conversations with Sir Jon Thompson.

64. Our internal due process in hearing and balancing member views has been extensive. We had a feedback form on our hub page and newsletters to gather views from any members who wanted to share them with us. We held extensive consultation with our active member

groups: Regional Strategy Boards across England, Wales and Scotland, our Technical Advisory Committees, Practice Committee, Business Board and our expert technical committees: the Audit & Assurance Faculty Board and Technical and Practical Auditing Committee, the Ethics Standards Committee, Corporate Governance Committee, Financial Reporting Committee, Business Law Committee, Research Advisory Board, Corporate Finance Faculty Board, and Risk and Regulation Committee. We have also discussed the White Paper with the PRG, the six largest firms, as well as challenger firms from Group A and the Association of Practising Accountants. This response reflects views from all these groups and was reviewed by the Technical Strategy Board and ICAEW's Council before final approval by ICAEW's Board.

Part 2: Answers to specific questions

CHAPTER 1. THE GOVERNMENT'S APPROACH TO REFORM

Chapter 1.3 Resetting the scope of regulation

ICAEW major point: Some large private companies with significant numbers of stakeholders should be brought into scope as a PIE, but the proposals include far too many entities that are not reasonably in the public interest. This increase risks overwhelming the system and does not capture significant companies reasonably expected to be defined as PIEs.

ICAEW review of Impact Assessment: costs increase dramatically as the scope of regulation is extended

65. **Public interest entities:** BEIS's impact assessment calculates that widening the definition of PIEs might cost £144.6m if the scope of regulation is extended to cover a further 1,163 entities (105 AIM companies and 1,058 '500 test' large private companies) or £198.8m for 2,063 entities (105 AIM companies and 1,963 'Wates criteria' large private companies), equivalent to £124,300 or £96,200 per company per year (with first year and set-up costs spread over 10 years).

66. Assuming the wider definition of PIEs, this reflects an average of £36,000 per company per year for audit committees, £6,600 for familiarisation and non-financial reporting directive statements and £53,700 in additional audit-related costs, of which the largest component relates to the mandatory retendering and rotation of audit firms.

67. These cost assessments are likely to be significant underestimates, as they do not take account of the full costs that might reasonably be expected. For example, recruiting audit committee members and the time spent on meetings is included in the cost of the audit committee proposals, but the additional costs to companies in supporting audit committees are not. The estimated annual costs per PIE of £400 for a directors' statement on anti-bribery and corruption and £2,200 for an enhanced strategic report appear extremely low given the additional due diligence that companies might reasonably expect to undertake in making such public statements.

68. Companies are also likely to incur higher transaction costs as a consequence of being designated as a PIE. Audit independence and non-audit fee caps may require multiple firms to be engaged on transactions or restrict competition by reducing the choices available.

69. **Internal controls statement:** The above costs do not include the £170m to £270m estimated average annual cost of the potential internal controls regime that would apply to around 250 premium listed companies not already subject to US Sarbanes-Oxley (SOX) and around 1,527 other PIEs. This estimate is based on data from US listed companies applying SOX in an established system; it does not reflect the original experience of US SOX where costs were higher than the average of £75,000 to £150,000 per issuer used as a basis for this estimate – particularly in the early years of implementation. Government acknowledges that its estimate should be treated as the lower estimate of estimated costs. We are concerned that actual implementation costs will be significantly higher.

Question 1. Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.

70. Yes. The size of a company can be a significant factor in determining whether it is a public interest entity. However, the proposed scope is too wide under both Option 1 and Option 2.

71. The corporate failure of BHS in 2016 highlighted the need for large private companies with a significant presence in the community to demonstrate greater transparency and accountability. BHS had 11,000 employees and 20,000 pensioners at the time of its collapse. Stakeholders impacted by the activities of large private companies, such as employees, suppliers and other creditors, and sometimes even customers, are often heavily reliant upon those companies. The unexpected failure of such a category of company may have a disproportionate effect upon a local or regional economy and community, as well as its supply chain and the wider sector within which the company operates. We therefore support the inclusion of those largest private companies within the definition of a PIE.

72. We support the Wates Principles of Corporate Governance for Large Private Companies. We recommend that government uses the list of companies that apply these Principles as the starting point to evaluate which entities have the most significant public interest, using relevant qualitative factors such as those mentioned by the International Ethics Standards Board for Accountants (IESBA) in their recent project on 'Definition of a PIE'. A sharper and more targeted set of criteria could then be designed to capture the identified companies.

73. However, it is important that thresholds are set carefully so the additional administrative and regulatory burden arising from PIE categorisation is proportionate to the risks the Government is seeking to address. Government should be mindful of what can realistically be achieved through extending the PIE definition – it will not be a silver bullet to prevent all business failure among these companies – and of which entities it wishes it to apply to.

Question 2. What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.

74. A more focused definition is needed than those proposed in the consultation. Both options would significantly increase the number of entities brought into scope. If Option 1 were adopted, the number of entities subject to the PIE regime would more than double; with Option 2, the number of entities brought into scope would increase by 40%.

Capacity concerns

75. The proposed inclusion of large private companies would result in a significant increase in the size of the PIE audit market, regardless of which of the two proposed options were used. There would be a large increase in the volume of Audit Quality Reviews (AQRs) that ARGA would be obliged to perform. This will require a significant resource within ARGA, which should not be underestimated. The practical consequences of bringing some large private companies within the definition of a PIE also militates for a tighter definition.

76. Moving more private companies into PIE status will result in widespread prohibitions on the provision of non-audit services to these entities. While increasing the number of PIE audits may bring a greater number of firms into the PIE audit market, and increase competition for PIE audits, it could have a negative effect on the market for non-audit services as more firms are prohibited from providing these. For smaller PIEs it might not always be practical or economic to source these services elsewhere and therefore they may simply lose access to skills and advice necessary for business growth and strong control.

Qualitative criteria

77. Both options for a revised definition of a PIE risk missing some entities that have a strong public interest case – for example those operating nationally or strategically important infrastructure or facilities, such as HS2 or large steel plants, or those dominating a sector providing critical services to large numbers of the public.

78. The number of employees may be a helpful measure to indicate the systemic importance of an entity and its wider public impact. The general public would understand the damage arising from the collapse of a company which employed large numbers of workers. The Option 1 threshold of 2,000 employees is more appropriate but would still capture many entities where the public interest case is questionable. In most cases, 500 employees will be too low a threshold to consider for PIE status. In isolation, using only employee numbers – alongside balance sheet and turnover measures – is a blunt instrument.

79. We therefore refer the Government to the work of IESBA, who are proposing changes to the internationally recognised definition of a PIE within the global Code of Ethics. This project considers several criteria in deciding whether an entity is of significant public interest, including:

    - the importance of the entity within their sector;
    - the number and nature of their stakeholders; and
    - the likely systemic impact should the entities fail.

80. Government must first consider which entities it believes have the greatest public interest, and then set objective criteria to capture those within the definition of PIE. While we do support a quantitative threshold for inclusion, other factors must also be considered in producing criteria – and these criteria must be clear and objective. Draft criteria should be published for consultation.

81. If the number of employees does become one of the main criteria for determining whether an entity is a PIE, thought will also be needed on how to capture large companies who engage workers outside of traditional employment arrangements – for example in the gig economy. A broader definition of the workforce may be needed.

82. We note that both Option 1 and Option 2 refer to the balance sheet of the company; it should be clarified whether this means gross assets or some other measure. We further note that financial services institutions can quite often establish levels of investment that exceed £2bn without that entity being systemically important. Equally the number and extent of creditors could also be a relevant factor.

Guard against structuring around the definition

83. Whichever criteria are used it is important that all companies within a group are brought into the PIE definition rather than entity by entity within a UK group structure. That would be duplicative and costly. While there are some subsidiary entities that have a high level of public interest in their own right – for example entities with a banking licence – it is difficult to justify the cost of an entity individually complying with the regime when it already benefits from the parent applying it in their group accounts, into which they are consolidated.

84. Careful consideration needs to be given to international groups, where UK subsidiaries might qualify as PIEs but where the overseas parent company falls outside the UK corporate governance regime. Indeed, groups might deliberately be structured, for example through parallel ownership by parents outside the UK, to avoid exceeding the threshold in individual entities or the UK portions of a group under common ownership. Consideration will also be

needed on reconciling the group criteria for PIEs with the entity-only criteria for Other Entities of Public Interest (OEPI).

Ensure reporting thresholds are consistent

85. There needs to be consistency of definitions and clarity of PIEs' application. Thought should be given to the contexts in which this new definition of a PIE will apply. There is a risk of confusion if there are multiple definitions that apply for different purposes, for example one for the FRC's enhanced auditor independence requirements and another for auditing standards.

86. In introducing the new regime, government should carry out a comprehensive review of reporting thresholds. There is now greater flexibility to change or consolidate these following the UK's departure from the European Union. Multiple thresholds for reporting already exist and although there are typically good reasons for each threshold when introduced, they accumulate over time. This leads to confusion and unnecessary cost. For example, modern slavery reporting uses the large company turnover threshold in isolation, payment practices reporting uses the full large company definition, while the statement of corporate governance arrangements introduced in 2019 uses the Option 1 threshold of 2,000 employees or turnover of £2m and balance sheet of £2bn.

Question 3. Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.

87. No. AIM is the world's most successful growth market over the past 25 years and was the best-performing of the world's major stock markets through the pandemic period. Listings on AIM have a significantly higher proportion of innovative, tech-focused and small but high growth companies than its FTSE 350 equivalent. By their nature, these companies are unlikely to have the necessary systems and controls in place to deal with the additional audit and corporate governance requirements bestowed by PIE status. In particular, the requirements of an internal controls regime inspired by SOX are extensive and represent a significant step change from the existing UK internal controls expectations for these entities.

88. Including large AIM companies as PIEs may deter rapidly growing companies from listing on the market in the UK. The number of listed companies in the UK has already fallen by 40% since 2008. Attracting high-growth companies to list in the UK (as opposed to markets in the US, Asia or Europe) is rightly a government priority; the proposal in question would be at odds with government's intentions, as well as the UK Listing Review led by Lord Hill, which aimed to attract companies to AIM as a strong and respected first step to a subsequent main market listing.

89. The use of market capitalisation as part of the criteria for whether a company should be classified as a public interest entity would be problematic. Market capitalisation is a volatile metric and outside the control of company directors. This could result in perverse outcomes, such as a company which is experiencing financial problems dropping out of scope because of falling market capitalisation, at precisely the time when additional reporting and audit requirements could be most useful as early warning indicators for a company vulnerable to failure. If companies were to move into and out of the PIE definition due to fluctuations in market capitalisation, this would cause significant disruption for the company itself, as well as its auditors and ARGA. We therefore suggest that alternative metrics were included in the criteria.

90. AIM companies with a market capitalisation of more than €200m are already treated as Other Entities of Public Interest (OEPIs) under the FRC's revised Ethical Standard. These AIM listed entities are therefore already subject to additional auditor independence provisions.

91. We note that the proposed market capitalisation threshold is denominated in Euros. Following Britain's withdrawal from the EU, it would seem appropriate to move to measures denominated in GBP.

Question 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?

92. No. It would be more effective to prioritise the scope of the PIE regime to ensure that it only includes entities where there are persuasive reasons to do so, and that the burden of the new regime is proportionate to the benefits it would bring. The increased requirements should then apply to all companies within scope equally, without a period of temporary exemption for new listings.

93. There is a balance to be struck between ensuring newly listed companies are prepared for additional reporting and attestation requirements, and realistic expectation for companies and their stakeholders on the requirements that listed status brings.

94. We note that the consultation raises the option of newly listed companies complying voluntarily to build investor confidence. We do not agree with this. We are concerned that inconsistent application of requirements for newly listed companies could cause confusion in the market.

Question 5. Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.

95. No. It is right to expect strong governance and reporting from Lloyd's syndicates. Lloyd's syndicates are already subject to prudential and conduct regulation. They are required to maintain syndicate level assets and members' funds at Lloyd's to protect policy holders and have access to Lloyd's central resources and its Central Fund. Prudential and conduct regulations that already apply are designed to reduce the risk of bad behaviour and limit the consequences where it does occur. In addition, there are 76 Lloyd's syndicates; including them in the definition of PIE would add to capacity concerns.

96. Lloyd's syndicates are already subject to enhanced auditor independence requirements as OEPIs which restricts the non-audit services that their auditor can supply. We are not aware of any evidence that stricter auditor independence requirements are necessary above those in relation to OEPI, or that stakeholders are concerned about the quality of the audit work performed on Lloyd's syndicates.

Small insurance companies

97. Government should also revisit the need for smaller insurance companies to be within the definition. A significant number of relatively small insurance companies (with less than £50m turnover) are already classified as PIEs. Although we agree that it is appropriate for insurers to be subject to some extra controls due to their nature, it would seem disproportionate for these entities to have to comply with an increasing number of regulatory and disclosure requirements relating to control systems, board operations, and environmental reporting. Smaller insurance companies may have limited social impact and a large operational burden to deal with. We encourage government to consider whether a size threshold could be

applied to determine whether insurance companies should be subject to the full range of obligations under the PIE regime.

Question 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?

98. No. Government should give careful thought to the entities it intends to catch in the increased governance and reporting requirements for PIEs. We would not expect third sector entities to be included in a regime designed to identify commercial entities.

Charities

99. We believe charities should be excluded from the scope of PIE. We agree it is vital that charities are subject to appropriate reporting, audit, and governance due to their public interest nature. However, the regimes for charities do not need to be the same as those applied to commercial entities. Charities are already registered and regulated by the Charity Commission for England and Wales for the purpose of ensuring that 'the public can support charities with confidence'. In Scotland and Northern Ireland this role falls to the Office for Scottish Charity Regulation, and to the Charity Commission for Northern Ireland respectively. The Charity Commission also issues guidance relating to the strengthening of corporate governance and management on matters such as internal controls and managing difficulties and insolvency. Charity law also applies in addition to company law for corporate charities.

100. Due to the diverse nature of charities – their structure, activities, and funding – setting thresholds based on size would be too blunt. For example, some large charities and foundations are established by wealthy benefactors and do not raise funds from the public at all. The public interest in these entities is arguably less than a smaller charity which raises most of its funding from public donations.

101. If charities were to be included in the definition of a PIE, there would be further implications. Imposing incremental responsibilities on Trustees and Directors and increasingly the complexity of regulation could deter volunteers and hinder diversity efforts on charity boards. The additional cost of compliance with the PIE regime would reduce available funds for good causes, as well as create unintended consequences with charities seeking to avoid merging, for example, to ensure they do not fall within the PIE definition.

102. If government did conclude that charities should be brought within the definition of a PIE, any criteria for inclusion must be clear and unequivocal.

Universities

103. The regulation of higher education is already undertaken by the Office for Students. We do not believe that higher education institutions should be brought into scope as PIEs. Universities with publicly listed debt are already PIEs for auditor independence purposes and we do not believe that other universities should be brought into scope. We are unconvinced that the large additional administrative burden on affected universities would be proportionate to the resulting benefits.

104. We acknowledge that universities with large numbers of students may well be systemically important and have a significant impact on their local community should they fail. Large universities can be one of the main employers in an increasing number of towns and cities; our comments on the relevance of employee numbers in Question 2 above are therefore relevant here. However, given the need for additional regulation to be proportionate to the

costs and risks, and in the wider context of whether the sector is experiencing systemic regulatory failure, as well as our comments above regarding market capacity, we would urge government to exclude universities from the PIE definition.

105. Were some universities to be included as PIEs at a later stage, we note that the structure of collegiate universities (such as Oxford and Cambridge) could lead to inconsistent application of the PIE thresholds to universities of similar overall sizes. While many other universities exist as one main entity, the collegiate structure of some universities could mean that the main university entity were classified as a PIE, but that its colleges were not, or vice versa.

Social housing

106. As with the charity sector, we are concerned that the additional cost of compliance with PIE regulation would reduce funds available for the vital purposes for which social housing associations exist. We do not believe that the additional administrative burdens would be proportionate to the benefits that would arise beyond the regulation to which providers of social housing are already subject.

107. Many of the largest social housing associations are already PIEs for auditor independence purposes by virtue of holding listed debt. We do not believe that expanding the definition of a PIE to other social housing associations would be of benefit.

108. This sector is already subject to substantial regulation including oversight by the Regulator of Social Housing. This regulation takes a tailored approach with differential requirements for larger associations, and some other associations are subject to further regulation dependent on their activities. There is also a governance code of practice issued by the National Housing Federation and the Regulator's Accounting Direction. The FRC's Practice Note 14 provides further guidance for auditors. Expansion of the PIE definition to this sector is unnecessary.

Question 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?

109. We do not believe the PIE regime is appropriate for third sector entities.

Question 8. Should any other types of entity be classed as PIEs? Why should those entities be included?

110. Yes. We believe there are some entities that government, Parliament and the general public are likely to deem to have a strong public interest case, but which may not be caught by these proposals. The definition of PIE needs to be much more targeted, taking into account qualitative criteria in its design, such as the importance of the sector to the national economy or regional economy, as well as quantitative considerations. Key business entities within the UK steel industry, for example, would be recognised as being in the public interest because of their contribution to the sector and their importance to a local community. They may therefore come into scope using such revised definitions, but at the moment would not be classified as PIEs, because of relatively low employment or turnover levels.

111. A small number of public sector companies like Network Rail and NHS Property Services meet the proposed thresholds to be a PIE, but some large central government-owned companies funded by grant-in-aid or capital funding do not. An example is HS2 Ltd, which only generated £109,000 of income alongside the £3bn capital contribution it received from the Department for Transport and only had an average of 1,415 employees in 2019-20. Given HS2 has assets of £6bn already and intends to spend over £40bn building a critical piece of national infrastructure, the Government should clarify, for example, whether it

intends for grant funding to be treated as revenue for the purposes of implementing an appropriate PIE regime for the public sector.

112. While it can be argued that these public sector organisations should be held to the highest standards of corporate governance given their importance to the UK economy and public services, it may not be possible for them to comply fully with regulations applicable to PIEs. For example, some government-owned companies are not able to carry out transparent audit tendering or rotate auditors because of the statutory role of the Comptroller and Auditor General. Furthermore, many of the reforms are not relevant for many public sector entities. The majority cannot pay dividends under their founding legislation or framework agreement with their sponsor department; it would not be a useful exercise for government-owned companies to invest resources in calculating and reporting distributable reserves.

113. Central government and local authority-owned companies should therefore be explicitly excluded from the PIE definition. Government should run a separate exercise to consider which elements of the proposals should be adopted and adapted for large organisations across the public sector, irrespective of whether they are set up as companies.

Other Entities of Public Interest

114. The audit independence requirements for OEPIs have been in force for a short time. The impact that such requirements have had on the audit and reporting of the entities within scope should be assessed before considering bringing any other OEPI entity categories within the definition of PIE.

115. We note that the consultation does not specifically refer to pension schemes as a potential category of PIE. On the basis that large pension schemes are already caught within the OEPI provisions for auditor independence, and are subject to comprehensive regulatory oversight, they should not be included within the definition of a PIE.

116. As mentioned in paragraph 72, IESBA are considering expanding the definition of a PIE to include several broad categories that local standard setters can refine to serve national conditions. We would encourage government to use the recommendations from IESBA, so any changes to the definition of a PIE or OEPI can be properly co-ordinated.

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

117. At best, the proposed increase in the number of PIEs may incentivise a greater number of audit firms to enter or expand into this segment of the market, encouraged by a greater number of opportunities. Audit firms may invest in staff, additional training, and technology.

118. However, even in this optimistic scenario, the need to fulfil increased demand will result in short-term capacity constraints, as firms will take time to recruit, train and deliver increased capacity. The introduction of managed shared audit may exacerbate supply-side constraints, as a greater number of audit teams and personnel could be required to undertake the work.

119. The market may try to solve this short-term capacity by recruiting from other firms, particularly those who do not wish to enter or stay in the PIE market. Such a step would have unintended consequences for those affected audit firms, unable to carry out their own work on behalf of their clients due to depleted resources. This may ultimately lead to a reduction in the supply of auditors able to carry out the audit of smaller companies, leading to a reduction in those smaller entities seeking assurance. Such a development would be detrimental to the assurance regime of much of the UK business ecosystem.

120. International experience suggests that an expanded PIE market may result in the unintended consequence of audit firms leaving the PIE market, reducing competition and choice. The UK and the Netherlands saw a reduction in the number of audit firms willing to undertake PIE audits, on the grounds of increased regulatory scrutiny, possible increase in reputational risk, and disproportionate pressure on capacity and management attention relative to the possible level of fees earned.

121. Although the same auditing and quality management standards apply to PIE and non-PIE audits, some firms who are considering entering the PIE market may conclude that they do not wish to perform the proposed wider corporate audit activities. The investment needed to recruit and train staff to deliver the wider remit of work may prove to not be commensurate with the returns. This may especially be the case where specialist skills and knowledge are required.

122. We have also received feedback from some audit firms that they would withdraw from the audit of certain companies if they became PIEs due to the disproportionate costs of complying with the current FRC Audit Quality Review regime.

123. In addition, the recent sharp increase in financial sanctions imposed by the regulator may act as a deterrent to firms from considering entering the PIE market. The FRC trebled its sanctions from £15.5m in 2017/18 to £42.9m in 2018/19. While we agree that enforcement activity backed by robust use of financial sanctions can be a strong incentive to improve audit quality, a disproportionate use of ‘punishments’ seen as excessive will not act as an incentive to prospective new entrants, especially if those new entrants are considering matters of resilience, capacity and capability. The Head of Audit from a challenger firm told us: *‘The number of PIE auditors in the market will depend on how open to competition this market really is, and how onerous the regulation in this market is’.*

124. Some challenger firms who currently specialise in audit work may conclude that there are greater rewards and fewer risks in providing non-audit services to PIE entities rather than becoming their auditor, therefore limiting audit choice and quality.

Question 10. Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?

125. Yes, but transition at the whole economy level will also be eased by significantly reducing the proposed number of entities within scope.

126. We have consulted members involved in SOX introduction in the US, and they estimate that an implementation period of up to five years would be necessary for the UK market.

127. The time that will be required for companies to prepare will depend on the extent to which the companies in scope are already equipped for the requirements of the new regime, for example the internal control requirements. It is also important that adequate time is allowed for capacity to develop in the audit market.

128. Companies who are to become PIEs will need to consider changes required in their governance, reporting and use of firms for non-audit services, the latter likely requiring a tendering process. A suitable period for implementation will be needed.

Question 11. Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?

129. Yes. We recommend that government adopts a clear and phased approach that first includes those entities considered to have the most significant bearing on the public interest.

130. A proportionate balance must be struck to ensure that economic damage sustained by companies during the pandemic is not worsened through a rapid implementation of these proposals. That said, we acknowledge that questions about going concern and general viability of a company in the wake of COVID-19 will legitimately be in the public interest. A review of the impact of the first phase should be performed to assess how successful the widening of the PIE regime has been, and whether further refinement is needed.

131. Reflection should also be made on whether further phases of extending the PIE definition remain an appropriate policy to achieve the stated aims of high-quality financial information and increasing confidence in these entities.

132. Members have told us that future uncertainty around which entities might be brought within the scope of the PIE definition is unhelpful to business. We encourage government to provide an assurance that the PIE threshold or the types of entities defined as PIEs would not change for a period of at least five years.

CHAPTER 2. DIRECTORS' ACCOUNTABILITY FOR INTERNAL CONTROLS, DIVIDENDS AND CAPITAL MAINTENANCE

Chapter 2.1 Stronger internal company controls

ICAEW major point: A more robust UK regime for accountability over internal control could make real and rapid improvements to company resilience, reduce the risk of fraud and, as evidence from the United States suggests, reduce the cost of capital. We urge the Government, and ARGA, to prioritise accountability for internal control. To focus minds the directors' statement should be signed by specific directors designated by the Board to take this authority.

Question 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?

133. Yes. There is a strong case for strengthening the internal control framework for UK PIEs. We believe that the single biggest measure which could reinforce the corporate ecosystem in the UK, reduce the risk of fraud and unexpected failure and enhance the competitiveness of the UK in attracting foreign direct investment is to strengthen the corporate governance regime, with specific attention given to the internal control framework.

134. The principal benefits of the introduction of such a regime are expected to be similar to those experienced in the US under the Sarbanes-Oxley (SOX) regime. They include better corporate discipline, consistency, a more robust challenge to management, fewer restatements, and fewer opportunities for individuals to undertake material fraud without being detected. Such benefits are not guaranteed though: much depends on the quality of the UK framework to be developed.

135. Twenty years after its implementation, the SOX regime is widely held to have resulted in better quality financial reporting, better corporate governance, and enhanced confidence in US businesses. The number of internal controls issues disclosed has also declined over the years as the regime has matured and controls have improved. While corporate discipline and reporting in the US in 2003 are not the same as in the UK in 2021, there is more broad support for the proposals in this area than there is in virtually any other area among investors, preparers, and auditors. However, the regime is not benign. Academic evidence[3] suggests that, among other things:

- companies with control weaknesses or deficiencies pay significantly higher audit fees, are more likely to receive a modified audit report, and experience longer audit report delays, higher debts costs, lower credit ratings and less accurate forecasts;
- equity markets react negatively to the disclosure of serious internal control weaknesses, even though the reporting of weaknesses or deficiencies enhances earnings credibility; and
- material IT-related control weaknesses are associated with subsequent auditor dismissals or switching.

136. We understand that attitudes towards the importance of robust controls and high standards of behaviour are considerably tougher in the US, attributable to SOX and the Securities and Exchange Commission's (SEC) effective sanctions regime, as well as the US legal system. In the US, directors consider the quality of controls and the standing of their fellow directors

[3] *Internal control in accounting research: A review* Chalmers *et al,* 2019. This review of post 2013 US and global studies brings together over 90 papers covering the determinants and economic and other consequences of internal control quality on the decisions of managers, creditors, investors, auditors, financial analysts and other stakeholders.

both before and during their appointment. Directors expect deficiencies in conduct to be publicly reported and for the record to be actively searched.

137. We believe the strengthening of the corporate governance regime must start with effective control over company reporting. Evidence suggests that despite significant problems in the early years, once established SOX in the US was able to be sustainably maintained by companies, resulting in an overall strengthening of their internal controls.

Designing a UK regime

138. A UK regime should comprise high-quality testing and evaluation of controls, a UK-specific reporting framework, and proper, phased implementation to get it right first time. A simple transplant of the SOX regime is unlikely to be successful because:

- the export of this regime to other jurisdictions has had very mixed results, with poor outcomes in Germany and Japan, for example; and
- the SOX regime involves many exemptions for emerging growth companies and was never designed for companies of a scale outside the FTSE 100, still less AIM or large private companies.

139. The introduction of the SOX regime in the US was beset with challenges, from which lessons can be learned when applying something similar in the UK. Although companies were given two years' notice of the requirements of the new regime, the scale of the work required, the unfamiliarity with the new requirements, and the risk aversion of company directors, meant that preparation was a huge undertaking.

140. Many US companies took an initial approach that was very cautious in terms of the numbers of controls needing to be documented – we understand some identified in excess of 5,000. The resulting work involved in documenting and reviewing the effectiveness of these controls was a significant burden for business. There was also a skills and experience gap in the market until companies and auditors were able to educate themselves on the SOX regime.

141. For UK companies that are brought within the proposed internal controls regime, we envisage that there may be similar challenges and the time needed to prepare for the new regime should not be underestimated. It is unlikely that sufficient control documentation will exist, and the work to achieve this will be complicated for companies who operate in multiple locations and have different reporting systems for each location. There will also be a shortage of suitably skilled advisers to support companies in meeting their obligations.

142. Our discussions identify support for the early development of a UK framework based on, but not identical to, the SOX regime, building on the work of the Audit Committee Chairs' Independent Forum (ACCIF). This work is based in part on the UK's Financial Position and Performance (FPP) regime with which all companies seeking a UK listing must comply.

143. Preparers and audit committee chairs note the pandemic has prompted more detailed consideration of the control infrastructure as a means of helping to identify and understand the scope and responsibility for effective controls, especially in a fast-moving crisis. They also stress that the development of the framework must involve the regulator in setting objectives, managing expectations, and ensuring resources are not wasted in the way that they were, initially, in the US. They note the need for the regulator to acknowledge it is important that the framework has value to the business, as well as the regulator, that the UK corporate governance regime is not broken, and that it is held in high regard internationally, and that the emphasis on enforcement presumes a level of indiscipline that does not exist.

144. Preparers and audit committee chairs are also rightly concerned that the UK regime should be compatible with the US regime, and that it should dovetail with the UK Senior Managers

Regime (SMR). They also believe that market-driven assurance is preferable to mandatory assurance. Some remarked on the relative inflexibility of SOX and the need to be mindful of perceptions of the UK as a good place to invest from a regulatory standpoint.

145. Those with experience of SOX audits suggest that a UK regime must comprise of the following principles:

- for a large company, a high-level, light touch regime must still comprise of at least the documentation and testing of, commonly, 300-400 key controls; otherwise there remains a strong possibility of failure. There needs to be meaningful and effective granular detail to ensure real improvements in the internal controls framework;
- the definition of deficiencies, and material weaknesses is critically important; and
- the involvement of external auditors performing integrated audits of internal controls in the US enables audit committees to challenge management more robustly than at present in the UK.

146. Regulatory action where management does not address deficiencies is also critical. ARGA's proposed extension of powers should facilitate this in a way that the FRC could not have achieved. That may compensate for the absence in the proposals of one of the key drivers in the US regime: that of criminal sanctions, which plays a key role in focusing the minds of executives in the US.

Costs and timing

147. The costs of a new internal control framework include significant educational costs for both entities and auditors, if auditors perform an integrated audit, as in the US. They and the other costs are only a disadvantage if they do not result in the benefits noted above, so the system must work. But disadvantages of these proposals, and of stronger regulation more generally, also include the unintended and counter-productive potential to drive smaller firms away from the PIE market and discourage growth among smaller entities.

148. Good quality guidance will be required at an early stage. This guidance needs to precede the development of guidance for auditors. We have heard significant concerns about the timing and ordering of these proposals. There is a risk of regulatory asymmetry if the proposals relating to auditors, which can be progressed without delay, precede those relating to directors and companies. Delay might occur because of the need for legislation or other changes that will take longer. This is one of the most important lessons learned from the implementation of SOX in the US.

149. Companies need to be regulated directly, rather than indirectly through their auditors. It therefore makes sense that the regulation of audit committees by ARGA is coupled with the development of the key elements of a draft reporting framework by ACCIF. We believe that this is the right starting point for a UK framework, but that more work is needed.

Scope of controls to be reported on

150. Preparers and many auditors are clear that the only practical way forward for a new UK regime is to focus on Internal Controls over Financial Reporting (ICFR), at least initially. But more work is needed to clarify what this means within guidance, which must cover the extent to which Tech controls are in scope.

151. Where investors are looking for assurance on controls more widely, they can ask for this via the Audit and Assurance Policy. It is essential that legislation to introduce the framework for this is expedited.

152. There was little support for the table of factors to consider when determining the approach to the effectiveness statement. It does not go beyond what is already required by the UK Code and listing rules. As they stand, existing requirements will not change corporate behaviour unless they are much more aggressively enforced.

Question 13. BEIS proposes three options to achieve stronger company internal control:

- Option A: Directors' statement on the effectiveness of internal control / risk management;
- Option B: Auditors say more about control effectiveness in existing reports; or
- Option C: Option A with the addition of auditor attestation.

If the control framework were to be strengthened, would you support the Government's initial preferred option (option A)? Are there other options Government should consider? Should external audit and assurance of the internal controls be mandatory?

153. No. We strongly support Option C, with suitably phased implementation, because independent external assurance is necessary for the regime to be truly effective. The directors' statement should be signed by specific directors designated by the Board to take this authority; experience from the US shows that it is suitably senior management taking responsibility that focuses minds and ensures that the company suitably priorities this exercise. External assurance should be mandatory. Evidence suggests that if external assurance is not mandated, it will not be obtained by the companies that most need to improve their internal controls. Options A or B do not represent any meaningful change to the status quo.

154. A more transparent and accountable approach to a company's system of internal controls could enhance investor confidence. Any legislation on internal controls must have strength and the regulator must be empowered to act if internal control is seen to be weak. In the US, the regime is effective in not only focusing minds within companies, but in enabling the regulator to encourage or require higher standards where companies fall short, which is important in providing a framework for proactive and constructive dialogue between companies and the regulator.

155. We acknowledge that Option C potentially erodes the 70% non-audit fees cap. Any assurance provided should not count towards this cap level. This is because we expect, based on what happened in the US, that auditors will approach this work as an integrated audit that can only be performed by the external auditor at the same time as the financial statement audit. Any necessary changes to ethical standards must be made to reflect this.

Question 14. If the framework were to be strengthened, which types of company should be within scope of the new requirements?

156. Implementation of a strengthened framework should commence with listed companies. As stated in our response to Chapter 1.3, we consider that the proposed PIE definitions would capture too many companies, causing issues with capacity, as well as failing to bring relevant entities into scope. Such entities would also be unsuited and unprepared for a new UK internal control regime comparable with SOX. If the extension of PIE as set out in the consultation goes ahead, a comparable and simultaneous roll-out of a SOX-type regime cannot be allowed to be implemented on the same timescale.

Chapter 2.2 Dividends and capital maintenance

Question 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?

157. Yes. We agree that ARGA should have stronger responsibilities for defining what should be treated as realised profits and losses for these purposes and support adoption of either of the options suggested. We believe that this issue has occupied the attention of the BEIS Select Committee and action in this area is important to help restore parliamentary and public trust in business. Nevertheless, there are some practical difficulties and potentially significant costs involved – so government will need to reach a pragmatic balance. We explore this further below.

Case for a completely new regime

158. The consultation asks for views on alternatives to the current capital maintenance regime (which includes the regime on realised profits and losses). It mentions solvency-based systems used in certain other jurisdictions including Australia. We have previously suggested that government consider wholesale reform of this kind and continue to believe that this would be worthwhile. As the UK has left the EU, there is now more opportunity to pursue an alternative, as the current regime for public companies was incorporated from EU law.

159. The perceived shortcomings of the current regime have been explored at length in various studies, including the Rickford Report of 2004, which aimed to review company law on capital maintenance and develop accounting standards. They involve not only aspects of the linkage between a company's accounts and distributable profits but also broader aspects of the company law regime. The report acknowledges that a mechanism is required to ensure that assets of companies are not returned to shareholders in a way which gives rise to disproportionate risks to creditors.

Case for ARGA to assume responsibility for defining realised and unrealised profits

160. As noted in the consultation, the current regime defines distributable profits by reference to 'principles generally accepted… with respect to the determination for accounting purposes of realised profits or losses' (s853A (4), CA 2006). These principles are currently set out in the guidance produced by ICAEW and ICAS.

161. The consultation states that guidance is required to ensure consistent practice. ICAEW, together with other accountancy bodies, first provided guidance on this in 1980; ICAEW and ICAS have since updated the guidance periodically with the objective of providing clarity and greater understanding of a complex part of company law. We have drawn on the expertise and knowledge of leading practitioners.

162. If government wishes to provide more certainty regarding relevant accounting principles by referring to guidance in legislation, it would be necessary to identify who will be responsible for creating guidance and ensuring necessary arrangements are made for it to be updated. If government wishes to shape relevant accounting principles rather than merely codify them, it would be appropriate for ARGA to assume responsibility.

Which option – guidance or rules?

163. The ICAEW / ICAS guidance sets out what we understand to be the relevant generally accepted principles based on public consultation. It is intended to reflect the climate of

prevailing professional practice as to how best to satisfy the legal framework of paying dividends from a company's net accumulated realised profits.

164. If the current position is to be maintained, then Option 1, guidance, would be the most straightforward option for government to choose. Section 853 of CA 2006 would still refer to realised profits being determined by reference to relevant generally accepted principles. But it could be slightly amended without changing the purpose of the legislation to refer to guidance issued by ARGA as to what the principles are at any given time. This would provide a statutory basis for guidance, which is currently lacking. We agree that Option 1 would be an improvement on the current position.

165. If government wishes for ARGA to have responsibility to define realised profits, s853, CA 2006 would need to be amended in a more significant way. It would not seem appropriate that ARGA be empowered to create and amend rules on this important matter without that being on the Statute Book. Setting the legislative objective or function would also dispose of the question of the Secretary of State's consent to new rules proposed by ARGA, which would no longer arise. Such an amendment might involve, for example, a purposive test, such as specifying the competing interests that are to be balanced and to what degree; or it might be a more closely specified objective such as to determine which species of profits are sufficiently close to being realised in cash.

166. If ARGA is to be given power to change established principles, then Option 2 appears more appropriate. In this case, s853, CA 2006 should be changed to require distributable profits to be calculated in accordance with rules made by ARGA. This would involve greater change to the legislation but would remove any question of ambiguity about the applicability of ARGA's material.

167. If Option 2 is adopted, it cannot be expected that binding rules will comprehensively cater for every circumstance. We suggest that the rules would still need to be principles-based, so they would not seek always to exclude judgement in their application. Much of the guidance produced by ICAEW and ICAS has been devoted to providing examples, but it does not purport to be exhaustive, and it is necessary for users to exercise their own judgement in applying the principles.

168. Government would need to consider whether the same sanctions or remedies for paying dividends other than out of distributable profits would apply, or whether there would be additional sanctions, because of any change from guidance to rules.

What should ARGA consider when determining what should be treated as realised profits and losses?

169. We believe that the ICAEW and ICAS guidance addresses the issues most frequently encountered regarding application of relevant generally accepted principles, and thus would be a good starting point for ARGA in that respect. ARGA could then consult publicly to identify any areas of contention and update or amend the guidance (or rules) as appropriate. For example, to address an issue raised by the BEIS Select Committee, ARGA would need to consider whether, and if so, to what extent, prevailing practice is to be scaled back with respect to accrued profits not yet collected in cash counting as realised. We suggest that ARGA might achieve this, for example, through introducing a purposive test.

170. If government's objective is to substantially alter what should be treated as realised profits and losses, then it is unclear to us why it would not take the opportunity to consider broader reform of the capital maintenance regime referred to above.

Question 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?

171. Yes. We consider that information on distributable reserves has the potential to be useful to investors when presented as part of a wider package of information relating to the company's capital maintenance policy. We believe:

- the requirement for companies to disclose their distributable reserves is of most use when reported as part of a wider package of information on the company's overall capital maintenance policy;
- more specifically, this package of information should include details of the company's (or parent company in the case of a group) overarching policy on distributions / dividends, how the policy has been implemented, the availability of cash, and any associated risks, judgements, and constraints (including across the group for a parent company);
- information on a company's distributable reserves should be provided on a 'not less than' basis; and
- in the absence of a clear and comparable way of disclosing estimates of group dividend-paying capacity, any such disclosure should not be mandatory. Should government proceed with this proposal, we suggest that further consultation on disclosures relating to estimates of group dividend capacity, or similar, would be essential.

172. We envisage that the information noted above would be presented in the 'front end' of the Annual Report, for example, as part of the Strategic Report and would require changes to UK legislation. Introducing the new disclosure requirements in this way would ensure that they are brought within the scope of any extended corporate reporting review powers as discussed in Question 28.

Scope - limited to listed and AIM companies or extended to all PIEs?

173. Information on distributable reserves and a company's wider capital maintenance policy will be of most relevance to equity investors, who will receive these dividends. This differs from the proposed statement on the legality of dividend payments and the effect on the solvency of the business (as discussed in Question 17) which in our view will be of most relevance to creditors.

174. With this primary audience in mind, yes, the scope of the proposed disclosures discussed in Questions 16 and 18 should be limited to listed and AIM-listed companies.

175. We do not believe that the disclosures should be extended to PIEs, to the extent that the definition captures companies with no external investors for example, private companies or wholly owned subsidiaries.

Disclosure of distributable reserves as a wider package of information

176. We agree that providing information on the distributable reserves of an individual company (or, in the case of a group, the parent company only) can be helpful. It could help reduce errors in calculating dividends with respect to the level of distributable reserves available. However, to be truly meaningful to investors, it needs to be presented as part of a wider package of information relating to the company's capital maintenance policy.

177. This information should include details of the policy on distributions/dividends, how the policy has been implemented, the availability of cash, and any associated risks, judgements, and

constraints (including across the group for parent companies). The Financial Reporting Lab's 2015 Report 'Disclosure of dividends – policy and practice' considers these disclosures.

178. Disclosing the information as a wider package would provide reassurance that dividends proposed are in accordance with law and contribute to analysis of the company's ability to cover future dividends, and hence future investor returns. It could also help investors assess stewardship, hold the board to account, and generally raise the profile of this wider set of considerations at board level when dividend policy is discussed.

Distributable profits disclosed on a 'not-less-than' basis

179. The company's distributable reserves figure should always be permitted on a 'not-less-than' basis. We disagree with the proposal that a 'not-less-than' basis would only be permitted when it is considered 'impossible' to calculate this figure exactly. Indeed, we find the reference to 'impossible' questionable here. The focus should be on the costs associated with providing this information, which might sometimes be unduly high due to the complexity (but not impossibility) of reaching an exact amount.

180. We also note the Government's assumption in the Impact Assessment that 'companies have the information for required disclosures readily available to them at negligible additional cost.' We agree that companies should already have sufficient information available regarding their distributable reserves to make decisions on dividend payments / distributions. However, companies do not necessarily need to know the exact amount for the purpose of assessing whether distributions comply with legal requirements. Companies will not always already have this exact amount readily available. There would be a cost involved to disclose an exact amount, and this may not be negligible.

181. Permitting disclosure of distributable reserves on a 'not less than' basis is a far more proportionate approach, providing investors with an appropriate level of detail for their own assessments without adding any undue cost or burden on preparers.

Disclosure of estimates of a group's dividend-paying capacity

182. In the absence of a clear and comparable way of disclosing estimates of a group's dividend-paying capacity, any disclosure should not be mandatory. The costs associated with disclosing this information can be high and the benefits tempered by the conditional nature of the numbers disclosed. This is because it will often involve estimations and judgements, and in some cases this will be highly complex. For example:

   - adjustments might be needed for overseas subsidiaries operating under different distributable profit regimes; and
   - parent companies may need to assess whether, in their own individual financial statements, the value of their investment in a subsidiary would be impaired because of a distribution, in turn affecting its own distributable reserves.

183. Providing this estimate may not provide a true indication of profits available to the parent, for example, if there are business or legal reasons for subsidiaries to retain profits.

184. Some of the complexities noted above are acknowledged in the consultation and the Government would allow a degree of discretion about how to present these estimates allowing parent companies to select, on a reasonable basis, which group companies to include in the assessment. It is also proposing that guidance would be issued by the regulator.

185. However, the extent of flexibility and estimation needed to meet this mandatory reporting obligation would result in an amount which for some groups will be incomplete and ultimately

of limited use, while being costly to produce. The absence of any agreed methodology or principles by which to follow in reaching this estimated amount would also result in a lack of comparability between companies.

186. We understand that some investors are interested in gaining an overview of the company's capital maintenance policy across the group. Providing this narrative disclosure together with the parent company's individual distributable profits (as discussed above) would help to provide the information needed in this area by investors. If a parent company can estimate the dividend paying capacity across the group, it would be helpful to include this as part of the wider narrative, albeit on a voluntary basis. As an alternative, a more helpful and proportionate disclosure might be for parent companies to disclose whether there is sufficient capital resource across the group to meet the group's dividend policy.

Question 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?

187. Yes. We agree that requiring explicit statements will help address some of the concerns arising and that the requirements should apply to all listed and AIM companies and PIEs. We comment on each of the proposed statements and scope of application below.

Confirmation on compliance with laws

188. The first confirmation proposed is that the directors have satisfied themselves that the dividend is within known distributable reserves and have had regard to their general duties under s172(1) of the Companies Act 2006 and their wider common law and fiduciary duties.

189. Directors should have satisfied themselves on these matters in any case, and so we do not see this as being particularly onerous. While it certainly will not ensure compliance, it ought to raise compliance levels to some degree.

190. The proposed timing of an explicit directors' statement should be clarified. We assume that it will need to be made every time a dividend is declared and that it will need to be filed with Companies House.

191. Government should consider whether and how the requirement might apply to distributions other than dividends for example, not only share buybacks but undervalue transactions such as debt forgiveness intra-group.

192. It will also be necessary to identify consequences of a breach. For example, will a payment of dividends that does not comply with the new formalities concerning the statement be unlawful (along the lines of the interim accounts requirements)?

193. The capital maintenance regime is intended to protect creditors. It is therefore unclear to us why government proposes that this measure would extend only to listed companies and PIEs. We believe that small companies are often most at risk of paying unlawful dividends inadvertently and requiring this statement might improve compliance.

Confirmation on solvency

194. The second confirmation proposed is that it is the directors' reasonable expectation that payment of the dividend would not threaten the solvency of the company over the next two years. We support a requirement along these lines.

195. Common law on capital maintenance and insolvency laws are complex. They may not be fully understood by directors until it is too late, and the impact of insolvency law may be uncertain until after insolvency. These matters are, however, at least as important in protecting creditors as the formulaic rules on distributable profits referred to above, and it may be that this approach will bring about a better emphasis on these aspects of the current regime.

196. A statement such as this could help build confidence that long-term implications of dividend payments have been properly considered. We expect breaches of existing law would be less likely to arise in cases where directors make this statement. Directors might wish to seek independent assurance before making the statements; while this would add to costs, it would improve confidence in the regime.

197. However, as a new obligation, we believe that the potential implications require careful consideration. For instance, government should assess whether the requirement is likely to lead to an unduly risk-averse approach from directors so that dividend payments would be reduced below what is permitted by current common/insolvency law (and which would otherwise occur). If this is likely, then there could be a significant economic impact and we suggest that this should be included as part of the overall impact assessment of the proposal.

198. There are several areas that we believe require further development in designing this regime which are addressed individually in the following five paragraphs.

199. The legislation will need to make clear for whose benefit the statement is made and what sanctions/remedies apply if it is made without reasonable grounds. If new sanctions are introduced, it will be important to ensure that they are proportionate. For instance, if giving a false statement were to be made a criminal offence, the resource devoted to the matter might become disproportionate compared to other elements of the regime (or other duties of directors).

200. Further guidance (or detailed rules) may also be required to provide certainty as to what directors are required to consider and ensure consistency of approach, which will be necessary for building external confidence. One of the Government's reasons for not replacing the current regime with a solvency regime is that it would not ultimately be as simple as some might believe; it will be important that this proposed requirement does not provide something similar.

201. The two-year look forward period gives rise to several questions. If the period were aligned to that of a resilience statement, the work done for resilience statements might make it easier to produce a solvency statement for dividends proposed at the time. But if the statements are made at the same time, it might be better to combine them.

202. It is unclear to us why government has not adopted the form of solvency statement used for capital reductions under s643, CA 2006. This is a tried and tested regime with similar underlying objectives. It would be helpful if government could provide an explanation for any proposed differences. For instance, s643 requires the directors to believe that the company will be able to pay its debts, but the proposed new test requires that its 'solvency' will not be 'threatened'. The s643 statement has a one-year look forward period.

203. As with the compliance statement referred to above, the requirements on timing of the solvency statements should be clarified. We assume that it would be required whenever a dividend is declared. In that case it would be harder to rely upon work done for the resilience statement and it would be even more important for the requirements to be proportionate and fully defined.

Should these requirements be limited to listed and AIM companies or extended to all PIEs?

204. We believe that the requirements should apply to listed and AIM companies and all PIEs.

205. As with the proposed distributable reserves statement, if the requirement is intended to protect creditors, it is unclear why it would not apply to all companies.

Question 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?

206. No. We agree the introduction of the s172 statement combined with encouragement from the investment community has helped progress disclosures by companies on their distribution and capital allocation policies. However, we do not believe that these factors alone are sufficient to ensure that companies provide the full package of information that investors need on this matter. Therefore, we strongly believe that there is a need for additional reporting requirements for companies to provide information on their capital maintenance policy more broadly. Part of this package of information would include the disclosure of the company's distributable reserves, on a 'not less than' basis as discussed in Question 16.

207. This wider package of information should include details of the company's overarching policy on distributions and dividends, how the policy has been implemented, the availability of cash, and any associated risks, judgements and constraints relating to distributable reserves and cash across the group.

CHAPTER 3. NEW CORPORATE REPORTING

Chapter 3.1 Resilience Statement

ICAEW major point: BEIS is right to bring a renewed focus to resilience. Viability Statements have not been a success and to affect real change, it is important that the proposals for a Resilience Statement do not simply result in a different type of boilerplate reporting. To ensure meaningful improvements to the quality of reporting, ARGA must emphasise directors' accountability for the quality of this statement and ensure it is not seen simply as an extended Viability Statement.

Question 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?

208. No. We do not agree that the matters listed should be included by all companies. The list of risk factors will encourage boilerplate reporting, with companies believing that they need to address the risk factors cited. We do, however, welcome a renewed focus on the critical area of resilience. Achieving better visibility of resilience would be a good objective for ARGA. Viability Statements have not been a success and reform is necessary, but it is important that the proposals do not simply result in a different type of boilerplate. Avoiding a repeat of the failure of the Viability Statement will not be easy.

209. Importantly, to achieve positive change and communicate clearly what good looks like ARGA will need to act as a strong improvement regulator. It will need to be very clear about the objectives of the new requirements for reporting on resilience, as well as remonstrating with companies who fail to provide sufficiently high-quality reporting. The FRC's Financial Reporting Lab work on 'Going concern, risk and viability' is relevant here, as is the FRC's work on enhanced auditor reporting. ARGA must emphasise directors' accountability in producing a high-quality Resilience Statement, rather than simply an extended Viability Statement requiring a 5-year cash flow statement instead of a 3-year one. The emphasis must be on qualitative disclosures.

210. While we welcome this renewed focus on resilience, we have concerns about the proposals regarding the new Resilience Statement:

    - **The proposed content of a Resilience Statement is too similar to the current Viability Statement to engender meaningful change**. The Viability Statement was consulted on three times before its introduction, differences of opinion between preparers and investors were never resolved and the regime has produced boilerplate reporting which does not encourage use by investors and other users of financial statements. It is hard to see, given the similarities, how the proposals in of themselves would result in less boilerplate;
    - **There is excessive focus on failure and the binary risk assessment**. The Resilience Statement should better reflect why an entity is viable, in addition to what it has done to mitigate the risk that it might not be viable. This would encourage a bespoke approach to the company under consideration. We have found no support from those we consulted for the list of factors BEIS proposes should be considered, mainly because they are a list of risk factors that will encourage boilerplate; and
    - **The additional 3-5-year period covered is challenging**. The additional 3-5-year period will involve more speculation than earlier periods and companies will feel the need to issue caveats to that effect, diminishing the perceived value of the disclosures made.

Some of those we consulted suggested that it would be better to focus harder on the 1-3-year period, namely beyond the short term but before the longer term, which by its nature requires more speculation. Nevertheless, some suggested that, despite the above, the proposals would shift the focus of audit committees to the long-term resilience of a company by putting the 3-5-year period on the agenda, requiring action, sharpening the focus on longer-term risks generally, and demonstrating how seriously directors are taking them. In this, then, a longer-term focus, despite the challenges, would be a positive step.

211. We support the wider use by companies of reverse stress testing (RST), as explained in our 2020 publication, 'Coronavirus: Introducing reverse stress testing'. In that publication we note that RST adds value to an entity's risk management process and provides management with a tool that can be used in planning and decision-making and can reveal hidden vulnerabilities and scenarios not identified by traditional stress testing. A requirement for RST might be helpful if the detailed requirements are framed appropriately, learning from the experiences of companies reporting during the pandemic. We stand ready to assist with further consideration of the scope and content of any proposed new requirement. One issue to consider further in due course would be whether any requirement for mandatory RST should apply to PIEs other than premium listed companies, drawing on the experience of those listed companies in applying the new requirement.

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

212. If a Resilience Statement is introduced, yes, it should be a vehicle for Task Force on Climate-related Financial Disclosures (TCFD) reporting.

213. Climate change is a long-term viability issue for all businesses to varying degrees. For some there are short-term climate-related issues that will need to be ringfenced. Others will require reconsideration of their entire business model, but for many the impact may be less obvious. It is important in all cases climate is considered, with specific regard to the business and in terms of opportunities as well as threats, rather than as an afterthought. However, climate change should not be considered the only long-term issue, and TCFD disclosures still warrant separate consideration.

Question 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?

214. No. We accept that public interest entities should be able to demonstrate their resilience against unexpected failure, and that directors have been seen to take steps to address resilience issues. However, the proposed definition of PIES is too broad; too many companies would be captured by this and some of those potentially in scope will be unprepared to produce a Resilience Statement, particularly where they do not currently prepare a Viability Statement.

215. There is an argument for excluding early-stage companies and perhaps some smaller companies from these requirements because there is likely to be less for them to say, and the costs are more likely to exceed the benefits of introducing new requirements. However, company size and categorisation do not necessarily correlate, and we believe it is more important to focus on the quality of statements by listed PIEs in the first instance and consider whether to extend the scope at a later in light of all the evidence then available.

Chapter 3.2 Audit and Assurance Policy

ICAEW major point: The Audit and Assurance Policy (AAP) offers an opportunity to strengthen proposals to address the risks of fraud and failure, by enabling companies to enhance their core financial statement audit with assurance over key strategic risk areas, such as adaptation to climate change and cybersecurity. Investor engagement is crucial to the success of the AAP. Reflecting it in the Stewardship Code could help, but broader efforts are necessary if it is to achieve its potential. That could start by highlighting to investors the value of the AAP in achieving the greater reliability they are seeking around ESG data.

216. The Stewardship Code has an important role to play in setting expectations with investors. The AAP gives investors a tool to get greater scrutiny over areas of concern or interest to them and is relevant to Principle 5 in the Code which requires investors to explain the assurance they have obtained on stewardship. We understand investors are increasingly interested in the reliability of ESG information, so this may be a good place to start in encouraging investors to see the value in the AAP. We therefore welcome the proposal for an Audit and Assurance Policy AAP that describes the company's approach to seeking assurance of its reported information. Such a proposal mirrors the ICAEW Audit and Assurance Faculty's ideas for 'User-Driven Assurance', as well as our thought leadership report on 'Developing a meaningful Audit and Assurance Policy'.

217. Our thinking is based on extensive outreach and evidence-gathering, which indicates that introducing the AAP could render corporate information more informative: improving understanding and value of audit and assurance, enabling them to be driven by the user needs, and making them more accessible. 76% of respondents to our questionnaire – which provided the foundations for our report recommendations, along with a series of roundtables and interviews – felt that the AAP could help increase trust in management and their actions.

Question 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?

218. Yes. In 'Developing a meaningful audit and assurance policy', we support the introduction of guidance and regulation with a focus on underpinning principles, creating flexibility through a proportionate and pragmatic response, alongside a small number of minimum mandatory elements for comparability. This approach should evolve, recognising that many organisations will not have the information available immediately, and allowing for transparency in discussing how they are progressing.

219. We encourage government to request additional information be made available to enable users to better understand how the system of risk management and internal controls operate and how audit and assurance (both internal and external) are applied to the organisation and business model on an ongoing basis. For example, we also identified the following minimum mandatory disclosures:

    - a summary of the significant outcomes arising from audit and assurance activity;
    - an overview of the material matters arising from all forms of audit and assurance activities and the impact of the evaluation of the findings;
    - a reconciliation of significant changes from the AAP that was previously reported; and
    - an assessment of emerging risks where audit or assurance is being considered for the future.

Question 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?

220. In 'Developing a meaningful audit and assurance policy', we recommend adoption of the proposals for a regularly updated AAP with a shareholder vote. We say a 'comply or explain' approach could be permitted to 'enable flexibility in the three-year plan if this timeframe is not appropriate to business circumstances'. We believe that the AAP should be published annually, but subject to an advisory shareholder vote in the case of listed companies every three years or when there is a fundamental change in the approach within it. Consideration should also be given to a legal mechanism to enable a significant percentage of shareholders to request a vote should there be a significant change in business circumstances, for example, a major data breach.

221. The advisory vote should help to drive proactive dialogue between shareholders and directors. The proposals do, however, raise excessive expectations about the AAP being investor-driven. It remains the case that investors do not tend to become involved in audit and assurance matters, even though the audit is carried out on their behalf. The diffuse and dispersed nature of shareholders limits the involvement of investors. The proportion of UK shares held by the rest of the world at the end of 2018 was at a record high, at 54.9 per cent of the UK stock market.[4] Traditional portfolio theory ensures that shareholders reduce their overall risk by holding a range of assets from different classes, such as stocks and bonds, as well as a number of companies, which in turn limits their capacity to actively challenge management and participate in governance, audit and assurance matters. Many institutional shareholders hold positions based upon tracked indexes, meaning that trading may automatically occur when a share price deviates from a value relative to the rest of the market, making governance and audit of a company often very much a secondary consideration to investors.

222. Nevertheless, better stewardship, defined as the responsible allocation, management and oversight of capital to create long-term value, is a positive and much needed aspect of the corporate governance ecosystem which can act as a strong early warning indicator to potential company failure. An AAP can be a key component of better stewardship. In the roundtables and interviews we held, most discussions concluded that 'any mechanism that encourages an active discussion of risk and commissioning of audit and assurance should be seen as positive' and that 'shareholders are more likely to engage with issues where they are being asked to express an opinion'.

223. Investors need to be prepared to vote down measures with which they disagree. History suggests that more will need to be done to achieve this than is contained in these proposals. 83% of respondents to our questionnaire believe this will require a more proactive approach by the audit committee. The AAP must therefore be owned by the audit committee. Internal auditors also have a significant role to play in developing and maintaining it.

224. Investor engagement could also be encouraged if audit and assurance providers were required to engage directly with shareholders within the forum of the Annual General Meeting (AGM). External auditors, internal audit and any other significant providers of assurance should be present at the AGM to address shareholder questions. Investor representatives we consulted suggested that audit and assurance should become agenda items on discussions between major investors and companies, as a further means of encouraging better engagement, dialogue and ultimately improved stewardship.

[4] ONS, Ownership of UK quoted shares, 2018.

225. Some investors may perceive this engagement as taking on responsibilities that they neither have, nor want, nor have the capacity to deal with. But without a real change in investor engagement the progress that can be made by audit committees, whilst it might usefully create a level of good practice, will be limited. Investor engagement with smaller PIEs is particularly rare. Encouraging better investment engagement should be an objective in itself.

Question 24. Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?

226. Yes. The AAP has the potential to improve accountability and clarify responsibilities. It offers an opportunity to create a comprehensive, coherent and integrated picture that captures how a company views its risks, system of internal control and risk management, risk cultures and behaviours, disclosed financial and non-financial information (including ESG measures), and regulatory requirements. It can clearly, and transparently, communicate how a company verifies that the risks it is taking and mitigating are in accordance with its strategic objectives and risk appetite, how regulatory obligations are being complied with, and how information provided to users is fair and balanced.

227. We therefore believe that initially, premium listed companies should be required to prepare and publish an AAP, with an expectation that other listed and unlisted PIEs will be required to do so later. In 'Developing a meaningful audit and assurance policy' we encourage UK plc to 'seize the moment to create a Policy that builds on existing activities, rather than waiting for this to become mandatory' with 'encouragement for a broad range of companies and other organisations, recognising the potential value for all users and in particular in providing clarity for regulators across many sectors.' We encourage government to legislate to provide the framework to introduce the AAP and ask ARGA to expedite guidance to implement it.

Chapter 3.3 Reporting on Payment Practices

Question 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?

228. No. We do not agree with the proposal to require large companies to disclose a summarised record on supplier payments over the previous 12 months as part of their strategic report.

229. We agree that the issue of late payments acts as a negative drag on the economy, is unfair and may result in the loss of jobs and businesses and needs to be tackled. We support the work of the Small Business Commissioner and note the Commissioner's point that if all small companies were paid on time the economy would be boosted by £2.5bn every year.

230. There have been several different disclosure requirements for supplier payment practices, including the current requirement for large companies to report details of supplier payments on a government-run digital repository in line with the Payment Practices Reporting Duty (PPRD).

231. We note that an earlier requirement for companies to disclose details of the policy and practice on payment of creditors within the directors' report was abolished in 2013 as part of the introduction of 'The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013'. We understand that part of the rationale for removing this requirement was that it was generally not considered to provide sufficiently useful information and had limited impact in influencing behaviours in relation to supplier payments.

232. Our concerns with the proposals are twofold. First, it would introduce unhelpful duplication of information already required by large companies reporting under the PPRD. Secondly, there is limited evidence to suggest that requiring similar (summarised) information in the annual report would achieve the intended objective of providing greater transparency over supplier payments and incentivising companies to pay suppliers more promptly.

233. The objective for requiring information, and the intended users of that information should drive the location and level of detail of any requirements. There is a clear public policy objective here – to improve payment practices by large companies. We believe this information is likely to be of most interest to current and potential suppliers. In our view, this does not align with the overall purpose of the strategic report, which is to inform shareholders and help them assess how the directors of a company have performed their duty to promote the success of the company for the benefit of its members.

234. Requiring the proposed information in the strategic report risks adding clutter to the overall report and would go against the intention to promote ‘brevity’ and ‘usefulness’ of corporate reporting as discussed in Chapter 4 of this consultation. We believe the existing requirement for large companies to report on how they have had regard to the need to foster business relationships with suppliers as part of their s172 statement is a more appropriate vehicle for companies to report on this matter as part of the strategic report.

235. In our view, current and potential suppliers already have access to detailed information on supplier payment practices under the PPRD. This information is updated on a regular basis and therefore is more likely to be of greater relevance when making business decisions than that proposed. It is difficult to see how the proposed disclosures would provide better or more timely information than that already publicly available. If the Government considers that the PPRD is not achieving its intended policy objective, we suggest that other practical measures should be considered, rather than imposing additional and duplicative disclosure requirements elsewhere.

236. We also have concerns with the proposal that the summarised information on supplier payments would be provided at a group level in the case of parent companies. There is a risk that providing summarised information on a consolidated basis would reduce clarity of supplier payment practices by the individual companies within the group. Such an approach risks masking poor payment practices in individual subsidiaries of a group. As suppliers engage with individual companies, and not the group as a whole, we suggest that to promote a better payment culture this information should be required (or disaggregated) at an individual company level.

Question 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?

237. Notwithstanding our comments on Question 25, should the Government proceed with this proposal we believe it should be required of all PIEs, rather than only PIEs with more than 500 employees. The number of employees alone is not necessarily a good indicator of which companies should be reporting on supplier payment practices. Indeed, there is growing evidence that late payment is not merely a problem of larger companies failing to pay smaller suppliers on time but also applies to payments between smaller companies. We do not support introducing a new category of PIE for those also within scope of the Payment Practices Reporting Duty (PPRD) regime.

Chapter 3.4 Public Interest Statement

Question 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?

238. Yes. Directors of all large companies are already required to produce a s172 statement outlining how they have performed in their duty to promote the success of the company for the benefit of its members as a whole, considering a wide range of matters as set out in law.

239. We acknowledge that there is growing demand for companies to provide information to a wider range of stakeholders with details of their obligations in respect of the public interest. We also appreciate that s172 reporting has not historically provided meaningful reporting on directors' duties and how directors have promoted the success of the company in a holistic sense. However, we agree with the Government's conclusion that introducing a new and separate public interest statement would risk disruption and unhelpful overlap with existing requirements. Instead, we believe that the focus should be on continuing to encourage and develop best practice in relation to s172 reporting.

240. Over time, it may be appropriate for ARGA to consider again how companies report in relation to their obligations with respect to the public interest. Indeed, we note that this was considered as part of the FRC's recent discussion paper, 'The Future of Corporate Reporting'. While we do not repeat our observations of the FRC's discussion paper here, we believe it is important to note that any proposals to expand reporting on public interest matters should be developed with proper consideration of the overall purpose and primary users of the annual report.

CHAPTER 4. SUPERVISION OF CORPORATE REPORTING

Chapter 4.4 Influencing the corporate reporting framework

ICAEW major point: High quality corporate reporting is at the heart of an effective system of corporate checks and balances that enable users of such information to take meaningful decisions. It is vital ARGA is effective in achieving this. We agree the FRC's current power to seek a court order should be replaced with a power to direct changes to reports and accounts. This will enable issues of non-compliance with accounting and other reporting requirements to be dealt with more directly and efficiently. Without reconstructing the current system of recourse to a court, in the interests of fairness and balance checks and balances will be needed, and an appeals mechanism is essential. An independent arbiter should also be considered to assist in these important decisions.

We also agree that ARGA needs powers allowing it to publish correspondence entered into during the course of a Corporate Reporting Review (CRR), as well as summary findings. ARGA's powers in these areas should extend to the whole Annual Report.

Question 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?

241. We agree with proposals to strengthen powers of the regulator with regards to corporate reporting, strengthening the corporate reporting review activity, as well as the regulator's role in influencing the corporate reporting framework. We do, however, have specific comments on several of the proposals.

Power to direct changes to company accounts

242. We agree with the proposal to replace the regulator's current power to seek a court order with a power to direct changes to reports and accounts. We believe this will enable issues of non-compliance with accounting and other reporting requirements to be dealt with more directly and efficiently. It will, however, be important to ensure that checks and balances are also put in place to accompany these new powers to ensure they are used sparingly and in specific, clear circumstances. It will be necessary to establish an appeals mechanism to the regulator from companies. We also strongly suggest that consideration is given to the need for an independent arbiter to assist in these important decisions.

Power to publish CRR correspondence and summary findings

243. We agree with the proposal to provide the regulator with powers allowing it to publish correspondence entered into during the course of a Corporate Reporting Review (CRR), as well as summary findings.

244. We agree with the need to incorporate safeguards into the process regarding commercially sensitive information. Even if the regulator moves to an approach that requires full publication of correspondence, there should be a mechanism in place for companies to request that commercially sensitive information is not disclosed.

245. We also suggest that decisions on whether or not the 'summary of findings' provides sufficient transparency for investors and other stakeholders should not lie solely with the regulator. As noted above, there is a need for appropriate checks and balances to accompany the increased powers. In this instance, it may be that an independent arbiter should be used to help with decisions on whether full publication of correspondence is needed.

Extension of corporate reporting review powers to the entire annual report

246. We agree with the proposal that the existing power to request information from companies and the new power to direct changes to accounts should cover the entire content of the annual report. To achieve this, government will need to address the issue of how the CRR will be able to enforce compliance with respect to voluntary information included in the annual report. One option suggested to us is to introduce a statutory requirement that ‘any material published together with the accounts and reports must not include any untrue or misleading statement.’ The intention would be to allow flexibility within the legislative framework while giving CRR leverage to exercise its powers with regards to any additional information included in the annual report.

Power to offer a pre-clearance service

247. Government is proposing to ensure that the regulator has the necessary powers to provide a pre-clearance service, including a statutory exemption from liability where it offers this service. However, due to a lack of strong demand, the Government considers that the decision on whether to offer a pre-clearance service should be a matter for the regulator. We agree with the decision not to proceed with this proposal at this stage. In our view, this is a complex matter which requires detailed discussion and analysis before being progressed, even on a trial basis.

Focusing CRR activity on reporting by Public Interest Entities

248. We agree that while the regulator should focus most of its proactive CRR work on PIEs, it is important that it retains its current powers to investigate reporting by non-PIE companies.

Other

249. Having reviewed the proposals to expand the strength and remit of the regulator’s corporate reporting supervisory activities, we conclude that significant extra technical accounting resource will be required. At the same time, there is a limited pool of technical accounting expertise within the UK. We suggest that efforts to expand the technical resource of the regulator should be undertaken at a measured pace, at least in the short to medium term. This may be necessary to avoid depletion of resources from elsewhere, risking the quality of reporting due to lack of technical accounting expertise available to companies, and exacerbating the pressures on capacity elsewhere in the corporate and regulatory ecosystem, as we noted in our response to the proposed expansion of PIEs.

CHAPTER 5. COMPANY DIRECTORS

Chapter 5.1 Enforcement against company directors

ICAEW major point: We agree with the proposals to give ARGA enforcement power against all directors of Public Interest Entities. Such a measure is an integral part of driving up standards across all directors and ensuring ARGA is a strong and focused regulator. The regulator should be equipped to take effective action against all PIE directors where they breach their duties for reports, accounts or audit.

250. ARGA will have the power to apply sanctions to all PIE directors who breach their statutory duties for corporate reporting and audit. This includes the duty to keep accounting records and to approve accounts only if they give a true and fair view. We are particularly pleased that directors' failures to provide information or explanations to auditors is in scope, as this has been a traditionally neglected area.

251. Removal of the current inconsistency between the regulatory treatment of directors who happen to be members of professional bodies such as ICAEW and other directors is welcome, but it is important that new inconsistencies are not created in the process. The same high standards of behaviour should apply to all PIE directors, but this does not require the creation of new written standards for directors who do not belong to a professional body. Existing norms are sufficient. Any additional written standards will overlap with the standards which already apply to ICAEW members who are directors, and this could cause confusion.

252. We question whether equipping ARGA with the full extent of powers envisaged puts it in the best position to perform what is intended and what the wider implications of such an empowered regulator would be. The issues stem from the wide and unclear objective for ARGA which suggests 'holding to account' companies for corporate governance failings in a broader sense. To be effective, ARGA needs to focus squarely on failings in relation to the directors' duties in the Companies Act 2006, Part 15 (Accounts and Reports) and Part 16 (Audit).

253. We welcome government's focus on clawback and malus, as this is important in helping to restore trust, but powers in this area do not sit naturally with a regulator focused on reporting and audit. Moreover, the proposals do not get to the heart of the problems surrounding recovery. In fact, we are concerned they may hinder the likelihood of recovery.

Question 29. Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?

254. Yes. We outline our thoughts in the paragraphs below.

UK regulators

255. Government is proposing to expand the powers of Companies House following its 'Response to the consultation on options to enhance the role of Companies House and increase the transparency of UK corporate entities' published in September 2020, and subsequent consultations. The proposals include new powers for Companies House to reject or query filings (including filings of accounts). There is potential overlap here with proposed powers of ARGA. This needs to be resolved. It is important that the respective roles of ARGA and Companies House are clear to companies and their directors. Depending on how PIEs are defined, there is also risk of overlap with regulators such as the Charity Commission and Regulator of Social Housing.

256. It is positive that government has confirmed that only in exceptional circumstances will the FCA and ARGA investigate directors of financial institutions. Simultaneous investigations running in parallel should be avoided as this would be particularly resource-intensive for regulators, financial institutions and directors. On this basis we welcome the clarification that the FCA will go first, followed by ARGA. Formal confirmation of this sequencing must be provided once ARGA is established.

257. Another pertinent arrangement is the respective roles and responsibilities which the FCA and ARGA will have for the Corporate Governance Code. We anticipate that ARGA will take the same role as the FRC, with the FCA retaining responsibility for the listing rule which applies the code. But coordination between the regulators will be essential to ensure robust oversight of directors' reporting under the Code.

Foreign regulators

258. The Government should consider the powers of foreign regulators. As well as ARGA's arrangements with the FCA, we suggest that ARGA also pursues a memorandum of understanding with each relevant foreign enforcement authority.

Litigation

259. The Government should consider the potential overlap with litigation which can be pursued by shareholders.

260. Derivative claims can be brought by shareholders against directors (including former and shadow directors) on behalf of the company[5]. Shareholders' ability to bring a derivative claim is not conditional upon a minimum number of shares, but courts do consider the size of shareholding when deciding whether to allow such a claim to proceed. By contrast, in theory at least, unfair prejudice petitions can be brought by a single shareholder regardless of the number of shares they own[6].

Question 30. Are there any additional duties that you think should be in scope of the regulator's enforcement powers?

261. No. There are no additional duties that should be in the scope of the regulator's enforcement powers. Reporting on directors' duty to promote the success of the company should be within the scope of the regulator's enforcement powers[7]. Putting directors' reports in scope will go some way to achieving this aim.[8]

262. Although the limitation to directors' duties for corporate reporting and audit may pose practical challenges for ARGA, it is realistic. However, this makes the general objective for ARGA misleading because it suggests a broader corporate governance remit in 'holding to account'…'companies and professional advisors'.

263. There is a serious risk that this divergence between ARGA's objectives and its powers will create its own 'expectation gap'. This risk is compounded by ARGA's role in respect of the Corporate Governance Code which covers a wide range of areas. Our recommendation to rectify this potential failing is to focus both ARGA's objective and its powers tightly on corporate reporting and audit.

[5] Shareholders allege negligence, default, breach of duty or breach of trust by an individual director.
[6] Section 994, Companies Act 2006 allows shareholders to petition for relief where the affairs of the company are being or have been conducted in a manner which is unfairly prejudicial, or an actual or proposed act or omission of the company is or would be so prejudicial.
[7] Section 172, Companies Act 2006.
[8] The Companies (Miscellaneous Reporting) Regulations 2018 require different aspects of stakeholder engagement to be reported in strategic reports and directors' reports.

264. We particularly welcome the prospect of regulatory enforcement for directors' failures to disclose to auditors, and for their failures to provide information or explanations at the request of auditors. This important area has been neglected for too long. Auditors should be able to voluntarily alert ARGA to these problems as an effective early warning system and decisive action should follow.

265. The regulator must also be able to take action against companies if their indirect policing of directors relating to corporate reporting or audit proves to be inadequate.

Question 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?

266. No. The powers of ARGA should be limited to the directors' duties in the Companies Act 2006, Part 15 (Accounts and Reports) and Part 16 (Audit). The duties under Part 15 relating to the Directors' Report should encompass the Strategic Report and reporting on the Corporate Governance Code – it is important that ARGA has authority over reporting in these areas. Those duties listed in 5.1.21 would benefit from elaboration where there is uncertainty about their application, difficulties in enforcement, or where ARGA is seeking to achieve a particular objective. In all cases, consistent and rigorous due process should be followed in developing elaborative material.

267. The status of the elaborative material must be made clear; the problem with the ambiguous nature, form and status of guidance issued by the FRC must not be repeated. Promulgation of this material must also be within strict guidelines. How some Part 15 and Part 16 duties are carried out is defined, at least in part, in auditing and accounting standards.

268. The regulator must be responsive and take effective action when issues are identified, but that action must follow the appropriate route. In some cases, the appropriate response will be to seek action by international standard-setters. Here the regulator's objectives should include raising issues in a timely manner, given competing agenda priorities at international level, and maintaining effective influence with international bodies. It is vital to understand the importance of choosing the right channel and holding the regulator to account for being effective in that channel. The consultation says little on these dimensions; this requires further development.

Question 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?

269. Yes. A range of standards and requirements already exists. However, what is missing is regulatory action for shortcomings. ARGA should only be able to take enforcement action for directors' breaches which occur in the context of corporate reporting and audit[9].

Should those standards be set by the regulator? What standards should directors have to meet in this context?

270. No. The existing Companies Act, other instruments such as the Corporate Governance Code and existing norms are enough. The regulator should ensure compliance with existing standards, focusing on corporate reporting, accounting and audit.

271. Any new codification should only ever be high-level. This is because it would be inappropriate for ARGA to attempt to codify behaviours which are specific to directors such

[9] Part 15 (Accounts and Reports) and Part 16 (Audit), Companies Act 2006

as ‘skilful challenge’ and ‘wilful recklessness’. These are legal concepts and therefore can only be subject to judicial interpretation. The regulator must take extreme care not to fetter courts’ discretion.

272. Codification of high-level standards would add little to the existing norms. Attempts at codification could lead to opposition to perceived ’new’ requirements and extra prescription and have the opposite result of setting back practice rather than advancing it. That would be unfortunate when existing norms are adequate for enforcement.

273. Another reason why the regulator should not set standards is because it would confuse what is already in place. Directors’ duties are set out in the Companies Act 2006. For consistency, any personal conduct code would need to apply to all PIE directors, but directors who belong to professional bodies such as ICAEW are already subject to a behavioural code [10] which applies to their behaviour holistically. This includes all of their professional and business activities whether carried out with or without reward, and in other circumstances where to fail to do so would bring discredit to the profession[11]. On this basis, there is scope for confusion and overlap which may hamper the enforcement of standards by the professional bodies and ARGA.

274. The relationship between professional bodies and their members fundamentally differs from the relationships which statutory regulators have with their regulated communities. Individuals voluntarily join professional bodies, and they do so at the commencement of their careers on completion of their qualification. On this basis, it is better for professional bodies to set and enforce high-level behavioural codes. ARGA should prioritise its other areas of activity. However, if there is codification then it must be undertaken by ARGA to ensure credibility and that enforcement is a central consideration.

Question 33. Should the Government’s proposed enforcement powers be made available to the regulator in respect of breaches of directors’ duties?

275. Yes, to the extent that they specifically relate to the duties contained in the Companies Act 2006 Parts 15 and 16, regarding corporate reporting and company audits. Our support for these proposals comes with two important conditions.

276. First, although the unitary board concept lends itself to common threshold for both executive and non-executive directors, in practice ARGA (and other regulators) must take the different roles of directors and subsequent information asymmetry of executive and non-executive directors into consideration. The consultation refers to the regulator considering directors’ backgrounds and the size and complexity of the entity concerned. Even the most diligent non-executive directors do not have the same exposure or access to information as executive directors. By necessity, non-executives must rely on the accuracy of information they are given.

277. Secondly, our support is also conditional upon the regulator using a quasi-judicial process for considering alleged breaches. Directors (or their legal representatives) must have an opportunity to put forward a defence that a breach has not in fact taken place. Decisions as to whether a breach has taken place must be reached by an appropriate panel. The FRC and ICAEW use disciplinary panels comprising three persons. ARGA’s triumvirate panels which consider cases against company directors should include an experienced director who is familiar with such matters as approving financial statements. This should be a non-executive

[10] ICAEW’s Code of Ethics is based on five fundamental principles: integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.
[11] The Code of Ethics of the International Ethics Standards Board, R1.2.

director for cases taken against non-executives, and it should be an executive director for cases taken against executives. There must also be an appropriate appeals mechanism.

Chapter 5.2 Strengthening clawback and malus provisions in directors' remuneration arrangements

Question 34. Are there other conditions that should be considered for the proposed minimum list of malus and clawback conditions?

278. Yes. We fundamentally disagree with the creation of a minimum list. If there is a minimum list other conditions must be considered, and the list will also need to be regularly reviewed. The Deloitte guide to directors' remuneration in FTSE 100 companies refers to other conditions in which provisions may be applied, such as fraud, inappropriate behaviour censure from a regulatory authority, breaches of health and safety codes, and where there has been an exceptional negative event.[12] Given the need to focus on early warning indicators to detect fraud and unexpected failure, we would recommend that fraud and regulatory censure should be included as core reasons for malus and clawback.

279. However, we maintain a prescriptive list of minimum conditions is unhelpful because this is a developing area and companies need flexibility to reflect their business in the conditions selected.

280. In addition, even if a list of conditions is presented as non-exhaustive, such a list as outlined in 5.2.5 as the minimum conditions within which clawback provisions can be triggered, such as material misstatement of results, misconduct or unreasonable failure to protect the interests of employees and customer, while laudable may in practice become to be regarded as the complete and definitive list. If so, executives and their representatives may be reluctant to negotiate alternative or additional conditions.

281. An illustration of this is that until recently only two conditions tended to be included in the relevant contractual clauses: misstatement of the accounts and misconduct. However, the number and nature of conditions has expanded to reflect the increased focus on directors' non-financial performance. We welcome the possibility that new conditions could be added over time as new risks emerge, such as climate and cyber security.

What legal and other considerations need to be taken into account to ensure that these conditions can be enforced in practice?

282. The Corporate Governance Code is already applied in the Listing Rules.[13] A listing rule specifically for clawback and malus would mean that 'comply or explain' would no longer be relevant, and there are variations between the companies within the scope of the listing rules or code. However, at best a specific listing rule will mean greater chances of enforcement against companies for having inadequate contractual arrangements with their executives. This is insufficient to address this area, so we strongly suggest the Government prioritises improving the chance of companies successfully, formally exercising clawback and malus in the public domain.

283. We disagree with the proposal to add to the Corporate Governance Code a 2-year minimum period for clawback after the award is made. We see more disadvantages than advantages. Even if the period is presented as the minimum, it could still become accepted practice. This would be counterproductive because longer periods are already being used in practice. The Deloitte guide on executive remuneration in FTSE100 companies found that the most common period of application for clawback among these companies was 2 to 3 years, except

[12] Your Guide - Directors' remuneration in FTSE 100 companies.pdf (deloitteacademy.co.uk), p.64.
[13] FCA Disclosure and Transparency Rules Sourcebook, 7.2.2.

for certain financial companies, some of which are PIEs, which typically use 7 to 10 years[14]. Such a practice involving longer time scales gives directors a strong incentive to consider the long-term value creation of decisions made.

284. We would suggest that the regulator do all it can to help companies meet usual contractual standards so that the conditions themselves are not void for uncertainty, and the circumstances when the conditions can be triggered are sufficiently clear. For example, ‘unreasonable failure to protect the interests of employees and customers’ is on the suggested list, but it is not in common use and is too vague.

285. In addition, BEIS should liaise with the Ministry of Justice and others working in civil litigation to explore ways to increase companies’ willingness to enforce their contractual rights for malus and clawback and discourage executives from defending claims brought against them by their ex-employers. The length, uncertainty, evidential burden, and cost of this type of litigation justifies a review by the Law Commission. This review should differentiate malus from clawback as the challenges differ for both.

286. We believe a review would confirm that companies tend to be more willing to exercise malus than clawback, i.e., companies are more willing to risk being sued than they are to initiating litigation which may ultimately be unsuccessful. The uncertainty and costs of any litigation, particularly for claimants, are well known. Companies often argue that initiating clawback carries a particular reputational risk. Win or lose, companies may be concerned about retaining their existing executives or recruiting new executives if they are perceived to be too aggressive in this area. Even when remuneration is clawed back, cost and reputation for both sides lie behind the preference for private settlements rather than court judgements which are publicly available. This is an unusual situation because the public interest lies in encouraging open litigation rather than diverting cases away from the court system through alternative dispute resolution. For these reasons, the regulator should discourage private agreements and encourage litigation.

287. Complete inaction by companies should also not be acceptable. Companies can avoid judicial criticism through inaction, but it should not be so easy to avoid regulatory criticism. We also suggest greater empowerment of shareholders in respect of clawback and malus which would be consistent with their existing voting rights for remuneration.

288. Companies need regulatory guidance to help them understand how their remuneration structures improve or damage the chances of successful clawback. For example, Long Term Incentive Plans (LTIPs) are commonly based on an ability (known as an ‘option’) to buy shares at a certain price, but this can make clawback unviable because ‘options’ automatically become completely worthless if the share price drops by any amount.

289. Payment in ‘restricted stock’ can be better for clawback. However, investors tend to dislike restricted stock because executives still benefit even if the share price falls.

290. If payment is made in restricted stock (a set number of shares) there will always be some funds that can be clawed back. However, it is worth noting if the executive has sold their shares and the share price has subsequently dropped then the monetary amount that can be clawed back may be less that the financial benefit that has been realised by the executive.

[14] Deloitte 2018.

CHAPTER 6. AUDIT PURPOSE AND SCOPE

ICAEW major point: A stronger core audit, and improved audit quality, will be the measure of the success of these proposals. Improved regulation, market opening and increased resilience in the audit market will be of limited value if they do not result in better audits, and of questionable value if they compromise audit quality. Government focus on a stronger core audit, and on fraud and resilience, is therefore important. The principles of corporate auditing will help.

291. Carillion was a watershed in highlighting that auditors need to be better equipped to tackle fraud and failure. We have taken action ourselves, in advance of government reforms, for example, in publishing our recent Audit and Assurance Faculty thought leadership report, 'Audit Quality: raising the bar'. Nevertheless, we believe there is a significant risk that unrealistic and wholly inappropriate expectations are being raised. Corporate failure is necessary within a market economy and these proposals, however well-crafted and implemented, will not eliminate corporate failure or fraud. They should mean that those who perpetrate fraud have fewer places to hide, and reduce the scope for disorderly corporate failure, but BEIS and ARGA must avoid promoting the view, however indirectly, that corporate failure can or indeed should be eliminated.

Fraud

292. More needs to be done on fraud and going concern. Societal expectations are high, which demands a strong and coordinated response from companies, investors, auditors, audit regulators and standard setters. A key issue in this area is delineating the point at which honest 'error', or aggressive accounting, becomes fraud: the auditor is not judge and jury, only the courts are. But there are practical steps that audit firms are already taking to increase the rigour of work around fraud, such as mandating training, the use of increasingly sophisticated analytical techniques, and the development of forensic tools and skills.

293. Government proposes to require PIE directors to 'report on the steps they have taken to prevent and detect material fraud'. Auditors will need to report on the work they've done to ensure this statement is 'factually accurate' and a fraud register is to be maintained by the profession. On the face of it these proposals are unobjectionable, but there is a risk that nothing will change unless there are specific requirement for directors to do more than they already do. Investors need to be able to distinguish between companies that effectively address fraud risks and those that do not. Simply stating what they already do, and having auditors confirm that, is not enough. Changes in director behaviour, accompanied by reporting, is required.

294. We believe that the fraud register should be maintained by ARGA, as it has access to more information than the firms.

Resilience

295. Government's specific proposal on going concern is to adopt Sir Donald Brydon's recommendation of a Resilience Statement to combine and extend existing disclosures in the going concern and viability statements. This would include two 'reverse stress test' scenarios and extended disclosure of risks. Similar aspirations were given for Viability Statements when they were introduced, and their value in delivery has often been criticised, as we note in our response to the questions on Resilience Statement above. Nevertheless, more informative disclosure in this critical area is to be welcomed.

Chapter 6.1 The purpose of audit

Question 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?

296. No, but only because we question the assumption implicit in this question, that auditors are ignoring information that they should consider. Please see our answer to Question 43.

Question 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?

297. Yes. An audit purpose statement may be helpful as a guiding principle, but this should be supported by the proposed new principles of corporate auditing. By themselves, neither the purpose statement nor the principles will likely make any significant difference to the work of either ARGA or auditors due to their high level, aspirational nature, even if supported by a great deal of additional detailed guidance for auditors and directors.

298. We therefore agree with government that a non-binding purpose statement has most value as a 'broad ambition' for itself and ARGA. Reform must deliver an effective regulator that succeeds where the FRC is seen to have failed. If the non-binding purpose statement invigorates and guides ARGA as it goes about its duties, that is to be welcomed.

Chapter 6.2 Scope of audit

Question 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?

299. No. Further development is needed in this respect. We welcome government's efforts to address the long-standing audit expectation gap and support corporate audit as a means to achieve that. We are pleased to see that the proposal for a regulatory framework for corporate audit covers statutory financial statement audits and wider auditing activities. However, the latter will only be regulated to the extent they are covered by the company's Audit and Assurance Policy (AAP), and 'done to the relevant standards'. It is vital that it is clear to users of company information which elements of those reports have or have not been subject to regulated corporate audit. Failure to do so will simply create new expectation gaps. Moreover, we assume it is the intention of government that all providers of assurance within the AAP would be regulated and not just those who are already regulated for statutory audit.

300. We note the following significant concerns with these proposals:

- **regulatory arbitrage**: the proposals note that they would not preclude entities from procuring assurance services outside the AAP which are overseen by the regulator. This might (a) disincentivise a wider AAP, to avoid regulatory oversight and, for the same reason (b) discourage the development of necessary and valuable assurance standards;
- **competition issues**: competition issues would arise from the provision of similar assurance services in the market by both regulated and unregulated providers, which might result in driving companies to obtaining services from the unregulated. Paragraph 6.2.6 suggests that this unregulated assurance could be provided 'to the same standards'; we strongly disagree that unregulated services can be considered equivalent; and

- **regulatory overstretch**: the prospect of currently unregulated assurance providers being regulated by ARGA and the extensive range of non-audit assurance services provided means that ARGA will need to call on a much wider range of highly technical specialist expertise than it does now. This further calls into question capacity issues and the ability for ARGA to focus on core objectives mentioned in our answer to Question 74. To attempt to regulate such activities with limited access to that expertise seems likely to result in regulation acting as a drag on the growth and development of such services.

301. To help address these issues, it is vital that it is made clear in the Annual Report which elements have been subject to corporate audit and which have not. If any assurance opinions are included in the annual report that fall outside the AAP, it needs to be made very clear that these do not form part of the corporate audit. The provisions necessary to put this into effect need to be considered when introducing the AAP.

302. The proposals note that directors would decide on what should be audited beyond the elements required by statute. In doing so they should take account of shareholders' views, and the interests of lenders, suppliers and employees, among others. Our discussions with investors raise concerns about engaging with companies on these issues. Investors do not believe that it is for them to drive the AAP; as we have noted earlier in our response to the AAP, there are concerns that unrealistic expectations are being raised by government about investors responsibilities in this area.

303. Investor engagement certainly will not be improved simply by exhorting companies to do more. It is inappropriate to describe an after-the event vote by shareholders on the AAP as 'investor led'. Efforts should start with the Stewardship Code. Principle 5 of the Code already requires explanation of assurance obtained on 'stewardship', and we believe this could be further developed. Well-regarded brands in the market for asset management should be expected to have an interest both in audit quality and in extending audit to areas of heightened risk or significance. Explanations under the Code could be expected to bring visibility to their efforts. Investors' growing interest in ESG and demand for better information on ESG performance may also drive improvements in this area. The 2020 Code principle 7 requires signatories to explain their approach to ESG issues and reference to assurance is a natural extension to this.

Question 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?

304. Yes. We are supportive of an extended monitoring role. Where assurance needs to be undertaken by statutory auditors, it is logical for inspections to cover those. Where third parties are used to give assurance, it therefore follows that they should also fall inside the enforcement framework; otherwise 'quality inspection' seems of limited benefit if some assurance has been quality inspected and some not. The annual report needs to make this distinction clear to users.

305. Where the assurances include specialist knowledge, those undertaking the inspection need to have equivalence in competence to pass judgement on the methodology applied and the quality of the opinion. This could require a wider range of staff and competency within ARGA's Audit Quality Review unit and the quality inspections teams of the Recognised Supervisory Bodies (RSBs) such as ICAEW. These skills take time to acquire and develop and there could be a shortage of appropriate resource in the short to medium term whilst the requirements are bedded in and an appropriate methodology for inspection developed and agreed between ARGA and the RSBs.

306. ICAEW recognises this and is committed to developing additional specialist qualifications to support the wider matters examined by corporate audit. These qualifications could sit alongside other professional qualifications and, for example, enable those who had trained as financial statements auditors to extend these transferable skills into providing wider corporate audits. Access to these qualifications from ICAEW and other providers would help build capacity in the market.

Question 39. What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?

307. There is a role for ARGA in determining the competence and acceptability of individuals and firms giving assurance to PIEs on specialist areas, such as valuers, fraud specialists or environmental experts, where these fall within the corporate audit.

308. ARGA will need to decide which principles should apply to the work of these wider assurance providers. For example, in accrediting probate firms to carry out authorised work, ICAEW requires such firms to:

- act with independence and integrity;
- maintain proper standards of work;
- act in the best interests of their clients; and
- keep the affairs of clients confidential.

309. There may be trade bodies whose members have appropriate competencies as part of their membership criteria which could help demonstrate these attributes.

Chapter 6.3 Principles of corporate auditing

Question 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?

310. Yes. The proposed principles of corporate auditing can help support the audit purpose statement and underpin the particularly important principle of professional scepticism. This should set the right mind set for both ARGA and auditors. However, ARGA will struggle to enforce the principles *per se* because of their high-level nature. The principles bear a resemblance to the two decades old Auditors' Code, and those we consulted were sceptical about the capacity of such principles to affect performance and behaviour without further guidance and support. Quality improvement needs to be achieved in other ways.

Question 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?

311. No. We agree that auditors need to be more accountable, but this question about future development of the principles is muddled and will not achieve the objectives planned. It oversimplifies the process around the creation and maintenance of auditing and ethical standards. Such a process will often need to start with the appropriate international boards. In this case ARGA needs to be effective in raising emerging issues with such international bodies at an early stage and in achieving strong influence over international standards so issues can be addressed effectively and in good time.

312. We agree that the principles can help focus ARGA in its standard setting work and thereby influence the future development of standards. However, it would not be helpful to suggest that the principles have authoritative status of their own or in some way could take precedence over standards.

313. As regards the individual principles, we do not agree that it is auditors' responsibility to make definitive risk assessments. Such a step would absolve other stakeholders of the responsibility for making their own assessments, which would not be conducive to the quality and accountability of reporting.

Chapter 6.4 Tackling fraud

ICAEW major point: The public and Parliament rightly expect the audit product to do more to tackle fraud. No audit firm wants to miss a material fraud and there are practical steps many are already taking to increase the rigour of work around fraud. ARGA has a leading role to play, and as a strong improvement regulator designed to disseminate good practice should maintain a fraud register, with due safeguards to encourage raising awareness and improving quality through the sharing of experiences. Requiring a stronger statement on fraud will focus directors' attention on the steps taken. The new internal control regime also has a vital role in tackling fraud.

Question 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.

314. Yes. There is more to be done on fraud. Expectations are high from government, Parliament and the public, all of whom rightly expect and demand a stronger and more coordinated response from companies, investors, auditors, audit regulators and standard setters.

315. A key issue in this area is the point at which auditors can be expected to detect an emerging fraud. There is a widespread assumption that fraud is (or should be) obvious to anyone looking, particularly to auditors. In practice, it emerges from the shadows over time. Many start small, or as an error. At some point they cross a line and become a significant fraud – which can be much easier to identify with hindsight. However, auditors are not judge and jury; only the courts are. Corporate fraud trials are complex and take years to complete because of the depth of the issues involved. The fraudulent nature of an accounting approach is a highly skilled legal judgement.

316. No audit firm wants to miss a material fraud. Practical and positive steps are already being taken by audit firms to increase the rigour of their work around fraud, such as mandating training, the use of increasingly sophisticated analytical techniques and the development of forensic tools and skills.

317. Fraud is difficult to address and report upon because of the auditor's duty of confidentiality. Some audit firms maintain databases of fraud that they use in their planning exercises, but cannot make these public, nor share insights and information from them. Unlike the FRC, they do not benefit from Crown immunity.

318. To address this weakness, and to encourage improvement in this key area based upon a shared approach, the regulator should maintain a fraud register. This is an area where ARGA could put in place real improvement measures and processes to help firms learn from best practice. ARGA will have a more comprehensive view of issues affecting and impacting on fraud; firms will struggle more than the FRC to scrub some data, because of the association with a particular firm.

319. We agree with the proposed fraud package. However, while requiring a statement will focus directors' attention on the steps they have taken, we have concerns that the auditors' statement about its factual accuracy will be of little value if what the directors have done is of poor quality. Some change in director behaviour, in addition to evaluation, assessment and assurance, is required. Investors and wider stakeholders value an *evaluation* of the quality of the action directors have taken. Bearing in mind the users of such information, consideration should be given to dealing with this through the s172 Statement.

320. Priority should be given to ensuring the steps directors take have value and impact. Requiring directors to perform a risk assessment would be an effective step towards improving controls to better prevent and detect fraud, although many companies already perform this task. We hope and expect that the framework for reporting in the UK will address this important issue, especially in the context of a more robust internal controls framework.

321. If government does proceed with the proposal to require the profession to develop a fraud register, it will be necessary to clarify such questions as whether the register is to be open or closed, who will have access to it, whether it is to deal with common generic frauds or more high-profile frauds and how, in the case of the latter, liability issues are to be dealt with. The ICAEW Audit and Assurance Faculty and the Fraud Advisory Panel stand ready to work with firms to develop common examples of fraud for the benefit of small and medium sized entities and practices in particular.

Chapter 6.5 Auditor reporting

Question 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? Please explain your answer.

322. No. We have significant concerns about the lack of clarity or boundaries surrounding these proposals and about the creation of unrealistic expectations.

323. Paragraph 6.1.10 states that government is *'therefore minded to give auditors a specific responsibility to consider relevant director conduct and wider financial or other information in reaching their judgements'.* The preceding paragraphs offer no clue as to what 'relevant director conduct' or 'wider financial or other information' might be, nor any example of the sort of 'conduct' or 'information' that government believes auditors are not currently taking account of.

324. There is already a requirement for auditors to consider relevant director conduct and wider financial or other information in reaching their judgements. ISA (UK) 500 on audit evidence states that such evidence is necessary to support the opinion and, while obtained primarily from audit procedures performed during the course of the audit, may also include information obtained from other external information sources. Such evidence may include analysts' reports and benchmarking data about competitors.

325. . It is therefore unnecessary for a statutory requirement to be introduced. Auditors increasingly look to press reports, social media and other external indicators, and our overarching conclusion on this section is that the proposals simply articulate what auditors are already putting in place Any additional regulatory challenge, coupled with an expectation that auditors will need to single out procedures they have already performed and reclassify them under the heading 'wider information sought' or 'observed reality', will be counterproductive. Evidence indicates that this is already happening in the context of the 'true and fair' stand back requirement.

326. To reinforce work already undertaken during the course of an audit, the International Auditing and Assurance Standards Board (IAASB) is working on a project to update the auditing standard on audit evidence, including consideration of the extent to which auditors should be required to actively seek out 'contradictory' evidence. This initiative will also strengthen the focus on professional scepticism.

327. The statutory requirement, amplified by detailed standards that ARGA might issue, would simply create additional compliance requirements, and draw audit resources away from the 'real' audit.

328. The consultation states that the intention is that in considering the 'additional' information, auditors may reach 'different' judgements on the overall truth and fairness of the financial statements, and about individual line items such as revenue, intangibles, the Resilience Statement, and other new reporting requirements. The requirement would 'shape' the audit according to this broader understanding of the company's position and strategy. We highlight in our answer to Question 44 that we do not believe the 'true and fair' override can or should be used as an excuse to depart from accounting standards where those standards produce results that displease management; additional disclosures should instead be made in such cases, and the accounting standards fixed if there is a problem with them.

329. Technology has enabled auditors to consider far more external information affecting the risk assessment than they have ever done before. Auditors challenge management on any risk they believe is both significant and omitted from the risk report; auditing standards require them to report such omissions as an inconsistency with their knowledge of the entity obtained during the audit, which they are already required to do under ISA 720. The same considerations apply to the proposal to consider 'observed reality' in this context.

Chapter 6.6 True and fair view requirement

Question 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?

330. No. This is not the right solution and it should not be located in the Principles of Corporate Auditing. For an accounting regime involving significant judgements to be effective, two components are essential: a proper framework for disclosure, enforced by the regulator, and credibility in the disclosures, provided by auditors. The proposals appear to suggest, albeit indirectly, that the financial reporting framework is inadequate, and that the lack of credibility this causes must therefore be compensated for by auditors, and directors, using the true and fair override.

331. It is hard to understand the linkage between the proposed principles that govern auditor behaviour, and the true and fair view, which is a requirement applicable to directors. Those we consulted suggested that the true and fair *override* is much less important than the true and fair *view,* and that the emphasis should be on the latter, and particularly on the adequacy of disclosures.

332. We simply do not agree that the true and fair override is underused. Directors should not be encouraged to depart from the financial reporting framework unless there is a good reason to do so. The true and fair override is a judgement call affected by different requirements. It is a binary issue involving a disagreement, and not a question of whether something could be somehow 'truer and fairer'. By definition, such circumstances arise only rarely. The proposals suggest otherwise and will not achieve what the Government believe they will. Describing the

circumstances in which the override should be used may simply encourage non-compliance among those who do not like IFRS principles or outcomes.

333. The true and fair *view,* on the other hand, is fundamental; directors should always stand back and assess whether the financial statements, in the round, show a true and fair view. In doing so it will sometimes be apparent that an accounting standard does not fully address a matter important to a particular set of financial statements, perhaps because new or unique circumstances apply not envisaged by a standard. The solution in this case is additional disclosures, to explain how the accounts are affected by that matter and provide additional information about it. It certainly should not result in a departure from the standard.

334. This is pertinent because ARGA must remain on top of this area, for two reasons: first, a core role of the regulator is drawing attention to new or emerging issues. The FRC draws attention to such issues when it encounters them – for example, its statements on Brexit or COVID-19, its thematic reviews and the work of the Financial Reporting Lab all help highlight issues for companies to consider in their reporting. It is not that the FRC is deficient in such activities, but that it would be better if companies more consistently took regard of the issues the regulator raised. A strengthened regulator, with more effective enforcement powers over company directors as planned through these reforms, should help ensure that standards are held in high regard.

335. Nevertheless, there will be circumstances where ARGA believes disclosure of a matter is of sufficient importance that it should be required. It would be helpful for there to be a consistent and transparent way in which ARGA could require disclosure in the front-end of the Annual Report in those exceptional instances. Use of such a mechanism would need to be strictly limited and allow for disclosures to be reviewed and removed when no longer needed. In most instances, reacting to new or emerging issues identified by ARGA will be best left to companies' discretion.

336. The second reason relates to the maintenance of the accounting standards themselves. On occasion, a solution to issues identified will require changes to accounting standards. Most PIEs will apply International Financial Reporting Standards (IFRS); the effectiveness of UK influence in this area is an important consideration. We strongly welcome the establishment of the UK Endorsement Board (UKEB), which we expect to bring a stronger UK voice and thereby have more influence to achieve timely maintenance of international standards where issues are identified. It is therefore surprising, given the importance and strong potential of the UKEB that this is not considered further in the consultation.

Chapter 6.7 Audit of Alternative Performance Measures and Key Performance Indicators linked to executive remuneration

Question 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?

337. Yes. This should not be mandated and is better decided by shareholders through the Audit and Assurance Policy (AAP), where they deem it important. Nevertheless, a great deal hinges on voluntary engagement by shareholders, the absence of which is quite possible. Those we consulted did not believe that the market will drive this type of assurance. The AAP regime is intended to generate shareholder engagement, but there is no backstop if it does not.

338. ARGA should therefore consider developing a framework for reporting by directors on the more common APMs and KPIs that have a substantial financial element, and guidance on

how, and to what extent, assurance might be provided. This might encourage such assurance to feature more often in companies' AAPs and make it easier to obtain and more consistent where they do commission it. ICAEW is ready to assist in this regard.

339. The nature and extent of APMs and KPIs varies widely. Some elements of KPIs are close to the financial statements, others are not. Some, such as those in the extractive industries, rely on highly specialist valuations of reserves upon which investors rely considerably. APMs and KPIs are not a homogenous group, which is why the nature and extent of work that would be required to provide assurance would vary extensively. There is little extant auditing guidance in this area and no framework for reporting.

340. Nevertheless, there is a widespread expectation that auditors do in fact provide assurance on these metrics and the nature and extent of procedures in practice applied by auditors to these metrics varies considerably, all of which is unsatisfactory. Doing nothing is not appropriate.

Chapter 6.8 Auditor liability

ICAEW major point: Liability is a major limiting factor in the ability of challenger firms to participate in the FTSE 350 audit market. Action by government could make it easier, less risky and more practicable for challengers to participate. One option is to alter the liability regime, for instance by mandating proportionate liability. A statutory liability cap could be considered.

Question 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?

341. We understand that some firms did ask companies to agree to LLAs when the law was changed to permit this, but that companies were reluctant to do so.

342. Investor groups may be best placed to explain the reasons why, but it seems that SEC regulations prevented the largest listed companies with US listings from participating. There was subsequently a reluctance within other listed entities to be a first mover in an area which carries risk and which would need to be explained to shareholders.

343. This can be inferred from FRC 2008 guidance on LLAs (para 3.12), which suggests that if a company decides to propose an agreement which is different from those previously considered and supported by institutional shareholders, the directors should be able to explain any changes that may impact on the legal effect of the agreement and the reasons for making those changes.

344. We obtained and published legal opinion to the effect that agreeing to an LLA would not necessarily conflict with breach of directors' duties, but directors would still need to be satisfied that an LLA is in the interests of the company. The perception that directors may wish to reduce the level of assurance and audit quality through use of an LLA to mask deficiencies in the company's financial statements, also deters directors from taking this option. In a competitive market where companies are able to obtain services at a reasonable price without having an LLA, it is apparent that companies have concluded that any potential cost savings would not justify any resulting risk.

Question 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?

345. Yes. This is a major issue underlying several areas of the consultation, including – crucially – increasing competition in the audit market by encouraging new entrants through the removal of barriers. Litigation risk will always be a consideration for a service provider; even if risk may be mitigated by contract (for example, if the statutory restrictions on liability were not to apply to a given new service), there may be residual risks, particularly to matters such as reputation, that might deter the development and provision of a new and innovative service.

346. Liability will be a major limiting factor in the ability of challenger firms to participate in the FTSE 350 audit market. Action by government could make it easier, less risky and more practicable for challengers to participate. Auditors are required to have insurance cover, and availability and cost of insurance will be a relevant factor in relation to any new product. Challenger firms wishing to enter and participate in the statutory audit market are unable to self-insure - an option available to Big 4 firms due to their size - because of prohibitive costs and restrictions. An audit failure in the FTSE 350 market would in all likelihood put a challenger firm out of business. This is a major barrier to increasing competition, choice and resilience in the audit market and the Government should look to address this matter.

347. We recognise the argument that reducing audit liability may be perceived as trying to limit exposure for an audit firm and reduce audit quality. However, the prohibitive costs and risks involved in unlimited liability is not only undermining audit innovation and potential improvements in audit quality, but is acting as a significant barrier to firms wishing to undertake FTSE 350 audits. If government wishes to promote services that might otherwise be constrained by cost-benefit and risk-reward considerations, it should consider altering the liability regime, for instance by mandating proportionate liability, whether for audit generally or for the sort of additional and innovative services it wishes to encourage. A statutory liability cap is also a solution that could be considered.

Chapter 6.9 A new professional body for corporate auditors

ICAEW major point: Establishing a separate professional body for corporate audit will be duplicative, costly, distracting and compromise UK competitiveness. The existing recognised qualifying bodies and recognised supervisory bodies already deliver a profession that clearly and distinctly supports auditors, drives high audit quality and is inclusive for wider corporate auditors.

348. We welcome the encouragement by Brydon to modernise audit to be relevant to the future and consider that we, as a leading professional body, are ideally positioned to build on our existing strong foundations in support of government's objectives for audit.

349. We do not consider the creation of a new institute for 'corporate auditors' to be a practical or effective way to achieve the policy objectives set out by the Secretary of State. It is highly unlikely that a wholly different, new corporate audit body could achieve quickly enough a presence, reach and effectiveness akin to the current Recognised Qualifying Bodies (RQBs) and Recognised Supervisory Bodies (RSBs). A new institute that is separate from the existing professional bodies would face significant challenges and would be highly costly and disruptive to establish - it would divert significant resources and attention from more urgent reform priorities.

350. There is much in Sir Donald Brydon's vision that we support, not least ensuring that audit has the status to attract and keep the best talent, and that auditors can operate effectively in competitive and hierarchical organisational environments. We have also reflected on his central observation that the 'audit profession' lacks a clear identity – '*Audit in the UK is not broken, but it has lost its voice'*. We are willing and able to provide that strong voice, while accepting that we must adapt and reform to be relevant to the future of audit.

351. To demonstrate our commitment, we have already pressed ahead with work on reform. This includes our 'Audit Manifesto', and ideas for differentiated training and status based upon different aspects of audit and assurance.

352. We believe that existing RQBs and RSBs should remain the source for financial statement audit qualifications and CPD. Membership of an existing RQB should be a pathway to becoming a corporate auditor. We support the suggestion that 'corporate auditing' as a concept should accommodate public sector audit, as the core audit skills are common with the private sector. Auditors must be able to transfer flexibly between sectors after obtaining the appropriate knowledge as this will encourage recruitment and retention in all sectors. This is best achieved by building upon existing qualifications rather than the establishment of a new professional body.

Establishing a new professional body for corporate audit would incur major, unnecessary, and duplicative costs for no clear benefit

353. The consultation fails to provide any estimates for the costs of establishing a new professional body for corporate auditors. Given that this is envisaged to encompass audit professionals from multiple disciplines, incremental costs could exceed £50m a year, in addition to the one-off setup costs. Audit firms are likely to cover membership fees for those who join such a body and would pass this cost onto the businesses that they audit.

354. There is a significant risk of duplication of costs, with existing professional bodies continuing to serve professionals within each discipline. For example, many financial auditors subsequently move into industry to pursue a career in financial management and so are likely to maintain their ICAEW or other accountancy body membership in addition to being a member of an audit professional body. The likelihood is that there will be duplicate costs incurred by both institutes in serving the same individuals.

Question 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.

355. No. We share the Government's desire to improve the quality of audit, but we do not agree that the creation of a new distinct professional body for corporate auditors is in the public interest and will drive forward better quality audit.

356. A new professional body is unnecessary because auditors already have a home which they strongly identify with – namely the RQBs – with which they gained their audit qualification. Our ACA and audit qualification have been subject to rigorous annual inspection by the FRC for 15 years and at no point have fundamental concerns been raised suggesting deficiencies that would bring our Companies Act compliance into doubt. RQBs have existing expertise, resources, and passion to support auditors, while accepting that reform of the existing audit qualification and CPD support provision for auditors is needed. At ICAEW, we are already enhancing the audit, ethics, and professional mindset elements of the ACA qualification, the qualifying conditions for our audit qualification, and the post-qualification certifications and CPD needed by auditors. Creating a new institute would suck talent out of the existing bodies rather than attracting new talent or building extra capacity.

357. Audit quality improvement should be happening now without waiting for this package of reform. We recognise that and are already taking steps. Establishing another professional body, if it is to be one of quality, inclusion and effectiveness which attracts high calibre entrants, would take years – and quite possibly decades. It would be an extremely disruptive process because it would artificially separate out the audit profession from the accountancy profession at a time when focus on improving audit quality is needed. The space in which a new institute would be established is already populated by high-quality professional bodies which register thousands of auditors, have operating budgets in the tens of millions and hundreds of experienced staff. In several cases, these bodies have been operating since the reign of Queen Victoria and have built up international reputations for excellence over more than a century. The attractiveness of a profession is not easily won. It is unrealistic to expect a new body to positively replace the current structure in the medium term, if at all.

358. Creating a new professional body for corporate auditors would be extremely expensive and it is uncertain who would fund the new entity. It is unclear who is viewed as the members of this new institute – whether they would be the individual auditors, the audit firms employing them, or the existing RQBs and RSBs. However comprised, the huge financial burden for the establishment and running of the new body would surely fall upon those corporate auditors joining as members, with costs then directly passed onto businesses which are being audited. It is hard to see how anything approaching the needed operating budget could be raised. The additional monies required to create and run a new institute will be needed at the very time that ARGA is bedding in, with its much larger budget and staff than the FRC. It is of paramount importance that the true financial costs and timescales of pursuing this strategy are evaluated before large resources are absorbed by a project that will prove prohibitively expensive.

359. We are strong advocates for reducing complexity and red tape in support of UK competitiveness, and this proposed measure goes against the grain of wider regulatory trends. For example, the insolvency profession is avoiding a proliferation of bodies, which is helping the UK avoid the risks of regulatory double jeopardy, multiple inspection regimes and market confusion. The creation of a new body would increase regulation.

360. Corporate failures are not normally caused by a shortfall in technical knowledge; rather they are caused by behavioural shortfalls: being under pressure, having to do things too quickly, a corrosive culture at a firm, and either ignoring ethics or being ignorant of ethics – all factors where improved skills and attitudes would make the difference. We do not consider establishing another institute is needed to improve skills and attitudes; rather, this can be achieved more effectively and more quickly through development of existing qualifications and CPD.

361. The idea of a separate institute for corporate auditors is completely at odds with how the profession works in practice, where auditors co-exist within a multi-disciplinary firm, even considering operational separation. We challenge why government would withdraw individual auditors and firms from a multi-disciplinary professional body and put them in a standalone body. We believe it is essential to maintain the alignment of the professional bodies with the multi-disciplinary business model of the professional services firms and the wider market, supporting the attractiveness and career transitions of finance professionals. Promotion of a sustainable accountancy profession and protection of the attractiveness of the profession to individuals considering joining audit firms is paramount. Many leave the firms to take critical roles within the wider corporate governance ecosystem.

362. With global competition for talent intensifying as economies recover from the pandemic, it is vital that audit continues to attract high quality entrants who see audit as helping them achieve diverse and fulfilling career prospects. The profession has been very successful as a

driver of social mobility, providing opportunities for young people from diverse backgrounds. Undermining the attractiveness of a career in chartered accountancy puts this at risk and wrecks a source of considerable competitive advantage and reputational benefit for the UK. Currently, talented school and university leavers apply to accountancy practices and study for accountancy and auditing qualifications because they see multiple opportunities for successful careers. Typically, they do not know at the point of starting whether those careers will be in audit, accountancy, or general management and leadership positions. They want to keep their options open and evolve their thinking over the three or four years it takes to qualify. If auditing is separated from accountancy, with a separate auditing institute, there is a real risk that the auditing employers will not be able to recruit the broad range of skills and characteristics necessary to build high performing and diverse teams. We do not think that young people will be attracted by the idea of training for an audit-only professional body, especially during times when the media is very negative towards the profession. We fear that they will feel audit narrows or limits their career options. Young people may then opt for other careers that are more flexible, weakening the long-term sustainability of the UK audit profession.

Question 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?

363. We do not agree that a new, distinct professional body for corporate auditors would help drive better audit. We consider that the creation of a new institute represents a colossal undertaking and distraction, adding very significant additional costs to this package of reform and posing a myriad of implementation and operational challenges. This all serves to undermine the attractiveness of audit as a profession and the desire to improve audit quality at.

364. We consider the best way to achieve the Government's objectives is to concentrate on continuous improvement. At the heart of our solution is our view that it is better to reinforce and build on what is good.

365. We strongly believe the best and most effective way to improve and expand the audit profession is to invest in and deepen the activities within the existing professional bodies for individual auditors in firms of all sizes and across all sectors. This is recognised in the consultation, which highlights scope for auditors and others to act on their own initiative while legislation is being developed, including defining and developing the audit profession.

Raising CPD expectations on financial statement auditors, with a disciplined regime of enforcement

366. Strong, targeted and responsive requirements for Continuing Professional Development are at the core of any strategy for ensuring professionals develop and maintain the necessary skills and attitudes to deliver quality audits. We are currently reviewing as a priority our CPD regime, including the amount and type of CPD our members must complete, how compliance is monitored, the support offered, and the way members declare compliance and have their records reviewed.

367. ICAEW's current requirements are competency-based and centred around the 'RAID' approach: Reflect, Act, Impact, Declare. This requires members to reflect on their current role and learning needs, take appropriate action to address those needs, assess the impact of that action to ensure their needs have been met, and declare annually their CPD status for the previous year. Much education and training support is available via ICAEW and across

the market, for example, through the ICAEW Faculties and Academy of Professional Development.

368. We intend to strengthen and modernise our CPD requirements further by adding a mandatory ethics requirement for members on a cyclical basis and additional CPD input requirements for auditors and those in other high-risk areas such as financial statement audit.

Aligning and modernising audit regulation, including the audit qualification, ‘responsible individual’ status and ‘key audit partner’ eligibility criteria

369. ICAEW qualifies, registers, and supervises most of the registered audit firms and financial statement audit professionals in the UK. Our member firms reach across the broad spectrum of size, audit type (PIEs and non-PIEs) and sector and employ a range of specialists within their audit teams, from auditors knowledgeable in financial statements to experts in pension valuations.

370. ICAEW authorises and monitors members, firms and affiliates to undertake a variety of areas of work regulated by law including audit, insolvency and probate. The regulatory architecture allows us, for example as a probate regulator, to supervise individuals who are members of other professional bodies and indeed lay individuals such as undertakers where they can demonstrate the required competencies. This in-built flexibility demonstrates how ICAEW can effectively regulate a wider assurance market on a commercial basis. We are ready to do this for wider corporate audit, alongside other bodies, should BEIS invite us into this space.

371. We agree that action is needed to equip auditors with the skills and attitudes necessary to deliver better audits. We believe the introduction of a revised audit qualification is important and at ICAEW we have already started the process by looking at enhancement to the ACA syllabus, how the Companies Act audit qualification could be improved, new specialist qualifications and enhanced CPD requirements.

372. Moving from one basis of qualification to another is a major task. There are currently over 10,000 qualified responsible individuals for audit in the UK, with around 2,400 being sole practitioners. Many of these sole practitioners are aged 60 years or older. Expecting these individuals to undertake further new examinations is unrealistic and their sudden withdrawal from this market could place further pressure on capacity and adversely affect the SME market. Considering this, any new mandatory audit qualification would need to be phased in with an appropriate transition. The 1989 Companies Act provides an example that might be followed.

373. A more realistic step, which could be delivered more quickly is for existing responsible individuals to be transitioned to a new regime. In lieu of the new qualification, they could then be required to undertake annual update training specifically designed by the RQBs and RSBs in conjunction with ARGA, who together will inject new competencies into the audit curriculum. New applicants would be required to achieve the revised mandatory audit qualification in full. This would be the Companies Act audit qualification in a modernised guise, in addition to a further specialist qualification for those progressing to responsible individual level. ICAEW is investigating offering various specialist audit and assurance qualifications that would tailor to responsible individuals in different market sectors.

374. We have experience in requiring additional competencies over and above those normally required for UK audit. As a probate regulator, the Legal Services Board has approved our ACA qualification plus a probate top-up training certification as a basis for ICAEW licensing approved individuals for probate.

Offering a new assurance practitioner exam-based qualification on a commercial basis

375. We plan not only to revise the current Companies Act audit qualification but to explore a new specialist assurance exam-based qualification aimed at responsible individuals. This could come with designatory letters, principles of professional conduct, expectations of CPD and regulatory supervision. Any exploration will be informed by the responses to this consultation, allowing us to better understand the market demand and regulatory expectations for an assurance qualification.

376. We will build on our broadly-based business professional qualification and use our long-standing experience as an RQB. All professionals involved in audit and assurance may access the training and examination, subject to defined qualifying entrance criteria which may include current membership of a recognised professional body with its own code of ethics and enforcement mechanisms, or completion of the ICAEW ethics model and signing up to an audit code of conduct and ICAEW enforcement mechanisms. This new exam-based qualification could be introduced with proportionate transitional arrangements for current responsible individuals, including transitional grandfathering arrangements based on experience and guarded by refreshed CPD expectations.

377. As regards the public sector and in parallel to this consultation, we are part of a sub-working group of the Ministry of Housing, Communities and Local Government's 'local audit capacity and capability working group', following the recommendations of Sir Tony Redmond's review. This group is reviewing the key audit partner criteria and developing proposals to create a centre of excellence to provide public sector-specific training to local auditors. We urge government to co-ordinate thinking across both the private and public sector as a means of driving forward audit quality.

Improving two-way dialogue with society and stakeholders in audit:

378. It is important that the audit profession engages in a continuous dialogue about its purpose, and we are planning to convene stakeholder forums to allow the views of the wider ecosystem of stakeholders on auditing and corporate reporting to be heard, a role played for many years by the Audit Quality Forum. Such forums provide helpful insight to inform our thought leadership and academic research activities on the theory and practice of audit and assurance for the benefit of all stakeholders.

Question 50. Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?

379. No. We do not see it necessary to mandate membership or qualifications from an audit RSB/RQB to be able to provide wider corporate audit services (outside financial statement statutory audit where an RQB and RSB qualification and registration is already required under the Companies Act 2006). However, we believe it is important that wider corporate audit is subject to appropriate regulation to ensure its practitioners apply proper professional standards. ICAEW is willing to act as a supervisory and qualifying body for wider corporate audit and we will explore the potential to offer a specialist assurance qualification in support of this.

380. Neither the Brydon nor Kingman reviews asserted that the current professional education, training, and regulation performed by the professional bodies is flawed or no longer relevant. Indeed, we believe our members who are trained in financial statement audit will be well-suited to provide wider assurance services, with appropriate top-ups as necessary.

381. Brydon does, however, suggest that the mindset and skills of auditors need to be refined, evolved, and strengthened. We believe that the best solution to achieve what Brydon

envisages is to build on the existing broad-based business qualifications, through the long-standing experience of the RQBs, and strengthen and modernise qualification and CPD requirements for auditors as set out above, including regular mandatory ethics training and new CPD inputs requirements. This will enable extra education and training and elevate auditors with a higher status and 'distinctive mindset'. These new arrangements could be introduced with proportionate transitional arrangements for current responsible individuals and guarded by new CPD requirements.

382. In addition, we plan to revise the existing mandatory audit qualification often obtained at the same time as becoming a chartered accountant and explore a new specialist exam-based assurance qualification in the post-qualification period. We believe we can design an approach that would allow assurance professionals to access the necessary training, exam-based and competency-based assessment. This approach would consider defined qualifying entrance criteria which may include current membership of a recognised professional body with its own code of ethics and enforcement mechanisms, or completion of the ICAEW ethics model and sign-up to an audit code of conduct and enforcement mechanisms.

Question 51. Do you agree that a new audit professional body should cover all corporate auditors, not just PIE auditors?

383. No. We agree that all providers of 'corporate audit' should be subject to appropriate regulation, but we oppose the creation of a new audit professional body for corporate auditors. We also do not believe that sub-dividing the statutory financial statements audit profession into PIE auditors and non-PIE auditors is the right solution.

384. Evidence from across the world points to a keen awareness within the professional body community of the advantages of a wider approach to professional body membership beyond statutory auditors. Outside of countries which have followed the UK tradition of a broad professional accountancy membership base, there are a number of important facts and emerging trends to consider.

385. In some countries, where permitted by law, 'audit-only bodies' or 'audit chambers' encompass members who, in addition to holding statutory audit rights, are also entitled to practise in other areas, for example in tax services. We understand that some bodies have moved relatively recently in this direction to encompass professionals providing other assurance and wider accountancy services and consultancy on the basis that this better reflects the needs of the market. We are aware that other bodies would very much wish to pursue the same path, but national law does not permit them to do so. Equally, we understand that in some countries the professional bodies have made and continue to make representations to policy makers to allow membership beyond public practice, and specifically the inclusion of members in business. It is also increasingly recognised that statutory audit requires the pooling of expertise across a variety of areas, not least information technology, and many professional bodies are subsequently reflecting on what this means for their future development and membership composition.

386. During our outreach on this consultation, our members and students, who would be the target for membership of a new corporate audit profession, decried the suggestion of a separate audit profession and the divide of the audit profession itself. Our students are concerned that such an approach would make both the audit profession and the accountancy profession unattractive.

387. There is a real fear that the brightest and best will avoid the professional qualification route. Our members consider they are more rounded professionals because of the variety of roles they can pursue in their careers and the relative freedom and portability across different

roles, sectors, and organisations. Members commented that the professional skills learnt during their audit experience is a huge strength within the ICAEW qualification and auditing across all sizes of company is one of the reasons the UK profession is held with such esteem, giving us ‘soft power’ internationally. There is a concern, if we break away the audit profession, that the UK would have much weaker qualified skills in an area in which we as a nation have a strong competitive advantage.

CHAPTER 7. AUDIT COMMITTEE OVERSIGHT AND ENGAGEMENT WITH SHAREHOLDERS

ICAEW major point: We support BEIS's proposals to give ARGA oversight powers over audit committees. We would expect stronger dialogue between the regulator and audit committee chairs to air issues of concern and share good practice to provide quicker and more effective benefits. Although we would expect the regulator's power to appoint an observer to audit committees to be used only very rarely, it is an important power to hold in reserve.

We do not agree with the proposed power for ARGA to require an auditor to take on an audit. This would produce an unintended consequence of a perceived conflict of interest – ARGA may appear not to be wholly impartial and independent if it exercises both appointment and oversight powers.

The current situation of an unexpected departure of an auditor and subsequent replacement with another firm is unsatisfactory. The resignation of an auditor outside of the normal contract cycle could act as an effective early warning system and identify areas for the regulator and incoming auditor. Instead, notification to the regulator of an auditor's resignation is slow and there is no statutory requirement to inform the regulator of the successor audit firm. Such a statutory omission should be rectified to ensure the regulator can work with the incoming audit firm to address issues and ensure capacity is available to maintain high audit quality.

Chapter 7.1 Audit Committees – role and oversight

Question 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?

388. Yes. With time and experience, ARGA may need to set additional requirements for audit committees of FTSE 350 companies, and perhaps for the audit committees of all PIEs if these committees are brought into scope in future following consultation. However, the first priority is to raise awareness that the initial requirements will be limited to the audit committees of FTSE 350 companies only.

Question 53. Would the proposed powers for ARGA go far enough to ensure effective compliance with these requirements?

389. Yes. ARGA needs adequate powers over audit committees because they are the direct interface between companies and audit. Audit committees are a key component in an effective corporate governance and audit ecosystem, ensuring the interests of investors and other stakeholders are properly protected. Given their key role, we agree with the FRC that one of the characteristics of a high-quality and well-functioning FTSE 350 audit market is that audit committees select auditors based on audit quality and provide support to auditors to carry out a high-quality audit, including challenge of management. As a means of performing its role as an improvement regulator, ARGA needs to obtain evidence and disseminate best practice and areas to improve in relation to audit committees. If the regulator requires new powers to enable it to obtain sufficient evidence on audit committees' role in improving audit quality and governance, it should be given them.

390. However, we question whether routine observations of audit committees would deliver tangible benefits. Many of the concerns about regulatory observations of audit committees can be allayed through repetition and elaboration of what the consultation already says about the regulator taking a risk-based approach and exercising its expert judgement, and by

making a formal commitment to meet with audit committee chairs before deciding whether to observe. The role of the Audit Committee Chairs' Independent Forum (ACCIF) in facilitating strong and effective dialogue with the regulator to share issues and disseminate good practice is important in this regard.

391. The regulator will need to consider use of its resources. ARGA's presence is unlikely to always give an accurate insight of how an audit committee normally functions, due to the Hawthorne effect; committees will mend or curb behaviour if they are being observed. There is also the possibility that audit committees will reach decisions outside of formal meetings to avoid regulatory oversight.

392. Despite these challenges ARGA should be able to observe audit committee meetings, just as companies must be transparent with auditors. Therefore, this proposal should be taken forward, especially as some of the challenges we have outlined could diminish over time. Regulatory powers which are unused can still be worthwhile if they positively influence behaviours.

Is there anything further the Government would need to consider in taking forward this proposal?

393. Another important way to allay concerns is to provide details of how confidential information disclosed during observations will be safeguarded, and around the exclusion of sensitive information from whatever is published by the regulator. We suggest that these details are provided as soon as possible, certainly before the legislative process gets underway, to allay concerns about these issues.

Chapter 7.2 Independent auditor appointment

Question 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)?

394. No. We do not support the new regulator being given this power. There is insufficient information about the practicalities of providing ARGA with such a wide-ranging new power of intervention. This is not least because of the lack of evidence as to why this new power is needed[15]. The appointment of auditors by a third party (the regulator or Secretary of State) poses a host of practical and legal challenges which have not been addressed satisfactorily. These include who decides the audit fee and whether shareholders will still approve the auditors' appointment. We believe that the existing power of the Secretary of State to appoint auditors in certain, restricted circumstances appears sufficient (such as when a company has failed to appoint an auditor or there has been a defective appointment). This is not least because of the lack of evidence as to why this new power is needed[16]. In addition, and crucially, we believe that there should be separation of powers in respect of the regulator; this principle is compromised where ARGA has both the power to appoint and then have regulatory oversight of auditors.

395. The proposal that the regulator appoints auditors when there has been a meaningful shareholder vote against the appointment overlaps with the Corporate Governance Code. Provision 4 applies to votes of 20% or more against a board recommendation for a resolution, and 'requires the company to provide an update six months after the shareholder

[15] s.486(1) and 490 (1), Companies Act 2006.

meeting and include a final summary in its annual report. This overlap is worthy of consideration even though code provisions are ‘comply or explain.’

396. The proposal may have unintended consequences. Compelling an auditor to take on an audit engagement is bound to have an impact on the relationships between all the parties, at worst compromising audit quality. Some proposed appointments might also be at odds with an audit firm’s values, such as in the tobacco or animal testing industries.

Question 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?

397. ARGA should not be empowered to require auditors to take on an audit, beyond possible delegation of the Secretary of States’ existing powers (with appropriate safeguards to mitigate conflicts of interest). This would result in an unintended consequence; enabling the regulator to appoint auditors in other circumstances risks a conflict of interest where the regulator has both appointment and oversight powers, and there would be a perception that ARGA is not wholly independent when considering an audit of a particular company when it has appointed the audit firm. Attention should therefore be focused on addressing the factors that could lead to entities being unable to find an auditor.

398. At its root, this situation reflects a culture change in audit; auditors have become more risk averse. This is partly due to the recent tendency of the FRC to impose more sanctions. No distinction is drawn by the regulator or commentators between a poor audit of a well-run company and a high-quality audit of a failing company, with criticism focused mostly on the auditor regardless of the situation. Optimism around taking on challenging audits has been replaced by fear of the potential consequences and costs.

399. The combination of independence requirements, requirements for auditor rotation and a disinclination among auditors to take on audits with a very high risk profile, creates an increasing number of situations in which listed companies may struggle to find auditors. The auditors we spoke to suggested that while few companies are genuinely un-auditable, some discussion of a safe harbour regime is needed to deal with litigation risk.

400. To date, audit regulators have been called on relatively infrequently to appoint audit firms. The desire to increase the number of firms willing and able to perform large, listed company audits is therefore understandable, to the extent it avoids calling on the regulator more often. The problem will not be addressed by forcing audit firms, against their will, to participate in a particular engagement. A better solution is to emphasise the regulator’s role as an improvement agency, spreading best practice and highlighting specific concerns as a means of driving up reporting and audit quality. The regulator should also focus on fostering a wider group of firms with the resilience and capacity to undertake these audits, giving the regulator a wider pool of firms to call on when such a situation does arise. That should help reduce the likelihood that an auditor cannot be found.

Question 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?

401. Full separation of the regulatory function for appointing auditors should not be considered because insights from the regulator’s broader functions should inform its choice of auditor. On this basis it will be impossible to avoid conflicts of interest altogether. This should be acknowledged openly.

Question 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 (, 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)?

402. In theory, ARGA's powers relating to observing audit committees and to obtain expert reviews would be useful in these circumstances. It is important to set expectations appropriately; ARGA's enforcement powers are rightly limited to corporate reporting and audit, and it will not be able to intervene to prevent failure. In some circumstances where a company cannot find an auditor, the company might not be a going concern. The power to appoint an auditor will be largely irrelevant in this circumstance.

Chapter 7.3 Shareholder engagement with audit

Question 58. Do you agree with the proposals and implementation method for giving shareholders a formal opportunity to engage with risk and audit planning?

403. Yes. There should be a formal mechanism to enable audit committees to gather views on the audit plan. In fact, some companies may already have communication channels with shareholders which can be used for this purpose.

404. We also agree that shareholders' input should be purely advisory unless the Audit and Assurance Policy of specific companies goes further, for example if the policy allows shareholders a binding vote.

Are there further practical issues connected with the implementation of these proposals which should be considered?

405. We welcome the proposal that ARGA will further consider how this will work in practice, and ICAEW would like to contribute*.* The nature of the information provided to shareholders needs particularly careful consideration. We favour simplicity. A summary of the audit plan will only be helpful for shareholders if it is easily comprehensible.

406. However, the proposal for a contractual term in auditors' terms of engagement needs further work, for example, confirmation that such contractual terms would be enforceable rather than void for uncertainty, and how and why companies would enforce these contractual terms on behalf of shareholders. It may be better to enshrine the new obligation for auditors in auditing standards.

Question 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?

407. No. Inviting the regulator to revise its guidance and encouraging attendance at AGMs does not go far enough.

408. As a minimum, Brydon's recommendations in this specific area should be implemented in full. There should be a standing agenda item for the AGM which compels attendance by a senior auditor, and auditors and audit committee chairs should answer questions.

409. We believe that external and internal auditors should routinely make presentations at AGMs. The information provided by the auditors will prompt a useful question and answer session and promote real engagement between the service provider (the auditor) and their customers (the shareholders). Our proposal would support the Government's proposals concerned with

better shareholder engagement on risk and audit planning, improvements to stewardship and better communications between auditors and shareholders if the auditor resigns.

410. Any concerns about cost are mitigated by the Government's commitment to review AGMs. If the trend away from in-person AGMs to virtual and hybrid AGMs continues post COVID, then this will reduce meeting costs.

Question 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?

411. No. The current situation is unsatisfactory. There is the potential for the premature and unexpected departure of an auditor to act as an effective red flag on the directors' behaviour, state of the internal control framework and ability of the company to be audited to a high standard. However, at the moment companies and departing auditors often agree on a form of words which provide inadequate information to shareholders. There should be greater opportunity for shareholders to question the reasons why an auditor has ceased to hold office.

If you believe those provisions are inadequate, do you think that the Brydon Review recommendations will address concerns in this area?

412. Yes. Requiring auditors to explain their decision from a detailed list of reasons would be an improvement from where we are. However, a requirement that an auditor should always give a reason for resignation would be much stronger, increase transparency and help improve the corporate governance and audit ecosystem. Resignation of an auditor may well be an early warning sign which should be thoroughly considered.

413. We also believe that strengthening of existing Company Act requirements to inform the audit regulator are needed. ARGA should be notified of the reasons for a resignation. It may well be that a resignation from an engagement is due to a change in an audit's strategy or priority. However, full and timely disclosure to the regulator – something which Brydon states is not presently happening – could help identify companies with poor quality internal control and governance. This will subsequently aid the regulator in identifying risk and focused mitigation action, thereby reducing the risk of surprising failure.

What else could be done to keep shareholders informed?

414. There needs to be continual review of the information provided to shareholders. Their focus is increasingly turning to ESG matters, but in a general sense, greater involvement with shareholders facilitates better stewardship and improved governance and decision-making.

415. An emerging area of concern is the appointment of auditors and the adequacy of procedures. While the Companies Act does contain procedures around the reporting of resignation to the FRC and Recognised Supervisory Bodies (RSBs), there is no requirement for notification about appointment to these regulators. This is a statutory omission which needs to be rectified. As a consequence of this omission, the regulator is not necessarily aware of a firm becoming a PIE auditor until they visit the firm, or the information is received on an annual return when the first audit may have already been undertaken. This does not allow an immediate review of competence and capacity of the new firm. There is the possible unintended consequence of a larger audit firm resigning as auditor because of concerns over management, to be replaced by a significantly smaller firm without the capacity to be able to address the issues which prompted the original resignation, resulting in an audit or company failure which may have been mitigated. Timely notification to ARGA of an appointment will

help ensure the regulator focuses attention on the company and addresses specific areas of concern, and issues of resilience and capacity, with the incoming auditor.

416. The volumes of companies are too high to require this disclosure in respect of all companies, but the risk may be mitigated by requiring a firm to notify ARGA and/or the RSB whenever they take on a PIE audit for the first time.

CHAPTER 8. COMPETITION, CHOICE AND RESILIENCE IN THE AUDIT MARKET

Chapter 8.1 Market opening measures

ICAEW major point: We support the need to increase competition in the market for the largest audits. Although the market is moving slowly towards opening up, government intervention is needed to fully achieve this. It is critical however that any market opening measures are effective and timely in making the audits of FTSE 350 companies more resilient, provide audit committees with more choice and enable challenger firms to win audit tenders outright. Managed shared audit, the Government's preferred option, will be by its nature incremental and will not achieve substantial change with meaningful impact by bringing new entrants into the market quickly. It also poses significant managerial and coordination challenges. This risks undermining overall audit quality and fails to inject greater choice and resilience into the market in a sufficiently timely fashion.

While some challenger firms, particularly those which are members of Group A and the Association of Practising Accountants, are positive about the concept and ready to invest in managed shared audit, we found little support for these proposals in wider stakeholder groups. Managed shared audit is a long-term and incremental endeavour without direct precedent, and some challenger firms have significant concerns that it will be impractical, difficult to deliver, fail to make much of an impact for many years and could adversely affect audit quality. Demand-side reform, in which audit tender processes guarantee the inclusion of a challenger on the shortlist, would work with the grain of what is happening in the marketplace already. Without completely disregarding the use of managed shared audit, to achieve the objectives of reform, and more quickly, a market share cap might be easier to deliver and be less disruptive.

Although a combination of a market share cap and managed shared audit may provide some changes to the audit market, greater intervention is needed to improve resilience, competition and choice. Regulation and liability both have important implications for efforts to increase competition in the market for FTSE 350 audits. Liability is a major barrier to the ability of challenger firms to participate in the market. If government wants to make real and significant progress in making the audit market more resilient and open to new entrants, alterations to the liability regime, for instance by mandating proportionate liability or introducing a statutory liability cap, should be given serious consideration.

The approach, attitude and culture of the new regulator will also be crucial in determining whether the FTSE 350 market is an attractive proposition for new entrants. If operating in the PIE market continues to require significant additional time for audit firms to respond to regulatory demands, then barriers to entry will persist. There is also a tendency for the regulator presently to impose ever greater sanctions on audit firms, not just Big 4 firms but others of much more limited resources. While we fully agree with a regulator able to issue significant fines for inadequate quality work, we also recognise that greater emphasis on punishments rather than improvement steps designed to increase the capacity of smaller firms, acts as a strong deterrent for these firms to enter the market. The Head of Audit from a challenger firm told us: *'The number of PIE auditors in the market will depend on how open to competition this market really is, and how onerous the regulation in this market is'.* Without compromising on audit quality, ARGA should emphasise its credentials as an improvement regulator to encourage greater participation in the market.

417. **The current reporting where an auditor departs unexpectedly and is subsequently replaced with another firm is also unsatisfactory. The resignation of an auditor outside**

of the normal contract cycle could act as an effective early warning system and identify areas of focus for the regulator and incoming auditor. Instead, notification to the regulator of an auditor's resignation is slow and there is no statutory requirement to inform the regulator of the successor audit firm. This statutory omission should be rectified to ensure the regulator can readily identify the incoming audit firm and work with them to address issues and ensure capacity is available to maintain or improve high audit quality. Ensuring that measures intended to increase competition in the audit market for the largest audits are effective is very important. Many stakeholder groups we consulted believe that there are significant doubts about whether real enhancements in competition in a sufficiently rapid timescale can be achieved through managed shared audit for the reasons set out below.

418. Among challenger firms, there was a spectrum of views. Some believe that managed share audit would allow them to increase capacity in a controlled manner and gain a stronger foothold in FTSE 350 audits. However, some challenger firms had little enthusiasm, either because of capacity issues, or because they have capacity, but would rather be the lead auditor. There is some concern that capability would not be sufficiently addressed in the proposals; particular challenger firms may become known within the market as the expert of a particular part of the audit, embedding the firm's reputation in a particular niche but preventing exposure to all aspects of the audit. This would not help such a firm to gain experience in managing and coordinating a complex group audit.

419. While some challenger firms, particularly those who are members of Group A and the Association of Practising Accountants are ready to invest in managed shared audit, some have significant concerns that it will be impractical, difficult to deliver and could impact audit quality adversely. It is therefore time to consider whether a market share cap might be easier to deliver and less disruptive. We also believe that a package involving both managed shared audit and market share caps should be considered. The structural challenges involved in increasing competition are not straightforward and an approach that involves just one remedy may lack the sophistication needed to tackle the problem effectively.

420. ICAEW stands ready to facilitate the intensive engagement that will now be needed to ensure that a market share cap or a package involving a market share cap, as well as other issues such as liability reform, are effective.

Managed shared audit issues

421. The overall audit reform package is extensive and there are tensions between the objectives of audit quality and choice. In the long-term these two objectives should converge, but in the short to medium-term the proposals designed to increase choice have the potential to compromise audit quality.

422. Ultimately, choice in the audit market should be a means to enhance audit quality. If remedies promoting choice in the audit market compromise audit quality, they are poor remedies; we believe that the maintenance and enhancement of audit quality should be the overriding concern. There is mixed evidence about the impact of managed shared audits on audit quality and we found little support for the proposals on managed shared audits in any stakeholder group. Government proposes to mandate managed shared audit for FTSE 350 audits, requiring a challenger firm (if not the group auditor) to audit a 'meaningful' proportion of the group, between a minimum of 10% and maximum of 30%, with phased introduction.

423. Managed shared audit is intended to provide resilience in the audit market, to reverse the trend for large groups to be audited by a single firm or network and to increase the capacity of challenger firms. These are laudable objectives which should be principal components of market opening measures. In the 1980s, shared audits were common, but have been in

decline for several decades due to companies' growing scale, increasing complexity and international footprint of their operations, thereby requiring audit firms of appropriately matched scale and size. The decline has also in part been driven by the regulatory approach to such audits; ARGA's attitude would therefore be important.

424. Several audits are already shared among group and component auditors, but few of those we consulted had much enthusiasm for the options for the 'management' of these audits, as set out in the proposals. Those who believe in the benefits of joint audits suggested that many of the benefits of joint audits can be achieved through managed shared audit. However, most of those we consulted expressed little enthusiasm for joint audits and noted that while permitted in the UK, liability caps, which some believe are necessary to make a joint audit regime work, are simply not used.

425. There is usually a sound business rationale for shared audits where they exist, which would often be absent in a regime designed simply to increase the involvement of challenger firms. The preparers we spoke to saw the potential for unnecessary duplication in managed shared audit, costs associated with running two 'processes', (finance departments 'won't want the practicalities of dealing with another audit firm') and implicit inefficiencies within the shared audit process. It was also pointed out by preparers that the overall package of reforms, with increased regulation at every level, would in effect drive the market further towards the larger firms perceived as better able to manage the enhanced regulatory risk.

426. We also struggled to find support among investors for managed shared audits. Investment managers noted that some companies are already considering strategies for ensuring that they are excluded from such a regime, including whether to run a tender process, to avoid having to do so again for another ten years. This would lock in existing arrangements, which would not achieve the Government's intention of increasing competition and choice.

427. If capacity, capability and experience is to be improved, a system-wide review of all managed shared audits to determine the precise work the challenger firm is undertaking is necessary. This would be complex; as ARGA becomes familiar with its new powers, this is another example where capacity may not allow the regulator to fulfil an important role in ensuring managed shared audits are facilitating sustainable change and increased competition. Some challenger firms understandably are concerned at the 'patronising' nature of the proposal, believing that they would be considered as the 'junior partner' in the audit by key factors such as audit committees and investors, making it difficult to propel into the role of single auditor over time.

428. There are significant concerns about the capacity within the market to deliver managed shared audit. There are concerns about the fact that only UK subsidiaries (potentially) are covered and the risk that challenger firm engagement will be nominal, not result in any real increased resilience, and that audit quality may be adversely affected. A potentially large number of companies are unsuited to the proposals and the proposals do not consider the implications for network firms on a global basis. We note in our thought leadership publication, 'Shared and Joint Audits', that while managed shared audit may help firms outside the Big 4 to gain experience, it faces significant practical obstacles.

429. We are willing and able to work with government on whichever policy response it chooses. With sufficient time, effort and goodwill, managed shared audit might be made to work, but it is unlikely to do so without a critical level of support among the stakeholders involved. At a minimum, a great deal more thought would be needed regarding its scope and nature and if pursued, it would have to be piloted on suitable larger companies on an experimental basis before extending it further.

Question 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?

430. No. The meaningful proportion to be audited would have to be based on some combination of legal subsidiaries and business components to ensure an efficient audit. The focus on UK subsidiaries is only a very partial solution; if the proposals are to succeed, thought must be given to making the proposals work for global audits conducted through network firms.

431. Even in the UK, many exemptions would be needed, including exemptions for some large UK listed companies with few if any UK subsidiaries. The Impact Assessment model for managed shared audit is based on a limited number of FTSE 350 companies (149), because some will not lend themselves to being separated for managed shared audit purposes to produce the 'meaningful proportion' required, because they have no material UK subsidiaries at all.

432. Those we consulted suggested that even this figure may be overstated, because, even if there are large UK subsidiaries, in some cases they are so tightly integrated within the group structure that splitting them out would be impractical. Significant shared services companies are one such example.

433. We also believe that the 10% bare minimum suggested is too low to affect meaningful change and would not incentivise challenger firms to embrace managed shared audit. A much higher proportion is needed as the minimum, which in itself brings risks in terms of management and coordination of the overall audit.

Question 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?

434. Responses to managed shared audit will vary from firm to firm. As we stated earlier, some challenger firms we consulted have little interest in managed shared audit, preferring instead to seek sole auditor status; others are keen to engage in managed shared audit because it will provide them with an opportunity to 'get in front of' audit committees who are barely aware of their existence, and who are too often surprised to learn that challenger firms have robust international networks, capable of servicing global audits. Such firms believe that the Audit Committee Chairs' Independent Forum (ACCIF) has an important role in raising levels of awareness of their existence and capabilities. They also believe that greater transparency is needed on the part of audit committees regarding which firms have been invited to tender.

435. Audit committees have an influential and positive role to play. Challenger firms understandably complain that they may be dismissed earlier in the tender process because audit committees may not be aware of the firms' international networks and ability to undertake the work to a high standard. As a relatively easy step, audit committees could ensure that a minimum of one challenger firm be included on the shortlist and invited to interview. In the event of the challenger firm being unsuccessful in winning the audit tender, the audit committee should write to ARGA explaining the reasons why. The challenger firm could also be asked to explain to the regulator why they may not have accepted the invitation to tender or to be included in the shortlist. In this way, ARGA could demonstrate its ability to be an improvement regulator, building up knowledge from the market as to the reasons challenger firms have been unsuccessful or reluctant, identifying common themes and working with audit committees and challenger firms to address the issues identified.

Auditor liability and attitude of the regulator

436. Government might also note experience from the Local Audit and Accountability Act 2014, which failed to open the market for local authority audit as intended. Firms will not invest if the risks outweigh the rewards. More significant market intervention may be required to incentivise challenger firms to participate. The cost of an audit failure is a non-insurable event, but the largest firms are able, because of their size, to self-insure against the liabilities that may arise. This as a significant deterrent for new firms to enter the market. Germany has a ‘super cap’ on auditor liability; Government may wish to consider this option to attract challenger firms to participate.

437. The attitude of the regulator is also crucial. As we have noted elsewhere in this response, the increased use of sanctions by the FRC in recent years may deter challenger firms, as increased risk of large fines can understandably act as a disincentive for new entrants, or even for existing players remaining in the market. It is right that the regulator imposes sanctions for poor quality work to act as an incentive to improve audit quality, but it is equally important not to tip the balance whereby a sanctions regime by the regulator deters new entrants. BEIS’s Regulators’ Code states that regulators ’should carry out their activities that supports those they regulate to comply and grow' and choose proportionate approaches to those they regulate, including size and capacity.[17] Rather than allowing participants to comply and grow, there is a risk the regulator may deter and discourage.

438. A managed shared audit regime may lead to the movement of staff between firms but would not address the wider capacity challenges facing the audit profession. These capacity issues are compounded by the proposals relating to internal controls, which will also create demand, and there will be no easy or quick transition to either regime. There would therefore be a need to prioritise and select the measure most likely to lead to meaningful change, because building capacity takes time. While some challenger firms might seek to carve out a niche, there are few clear incentives for such firms to upskill, and some incentives to exit the PIE market. There will always be a short-term disincentive and uncertain long-term benefit to proposals such as these.

439. Technical issues to be addressed include the interaction with current auditing standards, particularly ISA 600 on group audits, the ability of the lead auditor to veto the appointment of the shared auditor, and to sign off without approval of the shared auditor. There are many cross-dependencies that need to be addressed, including the challenger firms being dependent on the larger firm for a proper risk analysis. Further discussion is required regarding the need for auditing standards (as in France for joint audits) and the implications for ethical standards.

Question 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?

440. There are risks that the proposal for managed shared audit is highly unlikely to drive any real resilience or increased numbers of participants into the marketplace. A managed market share cap, in conjunction with other measures designed to remove barriers for challenger firms tendering and winning work, is the measure which would produce meaningful change in the structure of the market.

441. The managed market share cap option represents a heavily interventionist and technically complex approach, but is worthy of independent consideration, not only as a backstop should

[17] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/913510/14-705-regulators-code.pdf, p.3.

managed shared audit fail. The approach involves some FTSE 350 companies with the regulator making a judgement regarding the pipeline of tenders with a view to determining which should be restricted tenders. While there is a risk that this might in effect result in ARGA appointing auditors in some cases, this should not be a bar to further development of these proposals. Short-term pain in audit committees not able to select auditors of their choice could lead to long-term gain of increased resilience, competition and choice. The unprecedented and interventionist nature of these proposals mean that further consultation is warranted before implementation. ICAEW stands ready to facilitate these discussions, which should focus on the capacity of the proposed cap to generate real and sustainable growth in both the capacity of challenger firms and resilience in the audit market.

Chapter 8.2 Operational separation between audit and non-audit practices

442. The distinction between operational separation and full structural separation, which is the proposed backstop if the former fails, is critical. Auditors describe the latter as likely to be catastrophic, resulting in the loss of large numbers of staff and an inability to recruit, causing irreparable damage to audit quality in the UK. It would profoundly alter UK auditing in an unpredictable and adverse manner, and it is therefore to be avoided. Operational separation is a pragmatic response to calls for clearer independence for auditors and it is currently already underway on a voluntary basis by the Big 4. It must work, and ARGA must have clear criteria to work to in determining its success, whether they be Audit Quality Review scores, metrics relating to non-audit services, or other measurement criteria.

443. The enhanced appearance of operational separation does appear to be an end in itself, and significant concerns have been expressed by larger firms about how its success is to be measured, and whether it might disincentivise challenger firms from scaling up.

444. Smaller audit firms are also concerned about a recent FRC suggestion that they might also voluntarily go down this route, although the regulator has denied any suggestion that pressure might be brought to bear. The suggestion is not of itself an issue, because those smaller firms that are confident in their independence measures can explain why they have not chosen to go down the operational separation route. What is an issue is the possibility that operational or even full structural separation, might be mandated for smaller firms.

Question 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?

445. We understand that the voluntary regime for operational separation agreed between the FRC and the Big 4 is operating well. The FRC reported in February 2021 that firms were on target to achieve the separation by early 2024. Some we consulted suggested that legislating for operational separation would be beneficial for smaller firms, because it would provide certainty that the scope of the regime would not be extended further without appropriate consultation. Most however suggested that even though the significance of operational separation extends beyond the Big 4, the time was not yet right to codify operational separation for the following reasons:

- the FRC suggestion that the proposals be adopted voluntarily by other firms has caused alarm. While some firms outside the Big 4 already have this in place, many see no need for it outside this group simply because even the smallest of the Big 4 is significantly larger by any measure than any firm outside that group. For some firms that operate on a traditional partnership basis, operational separation would be more akin to full structural separation because it requires a fundamentally different business model. In many practices, audit fee income is by far the largest and most important income stream;

- those we consulted believe strongly that the backstop, full structural separation, would damage the profession beyond repair in the UK (see our response to Question 67);
- there is no clear measure of success of the proposals; and
- the voluntary proposals have not yet been implemented and their impact will not be properly understood for some time. Adverse, unforeseen and unintended consequences, such as smaller firms being disincentivised to scale up because they operate on a traditional partnership model, may hinder the development of resilience in the audit market and it is important that they are not caused or exacerbated by legislating in haste. Legislation and regulation should be included as a backstop only if voluntary proposals fail.

446. Some of those we consulted strongly suggested that the proposals for independent audit boards within firms would have a particularly beneficial effect on audit quality and that there should be more focus by firms in this area.

Question 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?

447. We have no objections to these proposals.

Question 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?

448. A requirement to split profit pools does not represent a mid-point between operational and full structural separation – it is much closer to full structural separation than operational separation. The potential damage to audit quality, audit profitability and the attractiveness of the profession would far outweigh the benefits of any perceived increase in independence.

Question 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?

449. We note above that those we consulted believe strongly that the backstop, full structural separation, would damage audit quality, and the audit profession, beyond repair in the UK. Full structural separation would involve the loss of a linchpin of the business model many firms operate within. The ability to provide a suite of services is critical not only to audit firm profitability, but to audit quality. Full structural separation is a nuclear option and while we do not believe that ARGA would be willing to take it, the fear of it is enough to drive effective operational separation.

Chapter 8.3 Resilience of audit firms and the audit market

Question 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?

450. In addition to the proposed measures in relation to managed shared audit and a managed market share cap, BEIS in this section proposes a substantial miscellany of other resilience-related powers for ARGA, including the following:

- extended powers to demand information from audit firms, to carry out market studies with the CMA, to make referrals to the CMA and to monitor and report on competition and developments across the whole statutory audit market;
- to legislate for the current voluntary firm monitoring arrangements for the seven largest firms and to expand the arrangements to cover all PIE audit firms;
- the power to commission an expert review of PIE audit firms; and
- powers to secure information on audit firms' wider insurance arrangements and their capital reserves, to require firms to address any identified viability concerns and to mandate minimum insurance levels and capital requirements.

451. While on the face of it none of these proposals might seem objectionable, we have several concerns.

452. In relation to the first set of proposals, we do not disagree with a power to carry out market studies with and make referrals to the CMA. However, we doubt whether it is necessary for ARGA to have the power to demand information from very small firms that are not even PIE auditors. ARGA might argue that this is necessary to obtain and present a clear and holistic view, but the regulator has experienced no difficulties in doing so to date, because of the provision of that information by the professional bodies and their audit inspectorates.

453. The second and third sets of proposals outlined above would cover the newly defined PIE audit market, which has the potential to double the number of firms in scope. We are concerned that these proposals have the potential, when combined with other proposals, to give firms yet another reason to either exit, or not enter the PIE audit market, thus reducing even further the enhanced competition BEIS is looking for.

454. While we do not disagree with the second proposal, the third proposal would introduce FCA s166 skilled persons-type reviews into audit firms. Such intensive reviews have value, but a great deal is already covered by the newly revised quality management standards with which audit firms are required to comply. For some smaller PIE firms, this has the potential to deter the brightest and best from pursuing careers in audit. Extending this requirement to all PIE audit firms should at least be deferred until the new quality management standards have been implemented. The proposed powers relating to insurance, reserves and capital address a genuine problem, but it might first be better simply to require improved disclosures in this area.

455. When taken together and combined with all the other proposals, it is difficult to avoid the impression that the distinction between the regulator and the regulated is starting to disappear. ARGA will both in appearance and fact be a great deal more intimately involved in the day-to-day running of audit firms. If this is what BEIS intends, it must accept that as and when things go wrong it will be hard for both BEIS and ARGA to argue that they are not tainted and that the fault lies entirely with the company and the audit firm involved.

456. Operational separation should obviate the need for several other proposals in the minds of many we consulted, particularly managed shared audit, but it appears to be treated as an end in itself. The proposals may disincentivise challenger firms from scaling up.

CHAPTER 9. SUPERVISION OF AUDIT QUALITY

Chapter 9.1 Approval and registration of statutory auditors of PIEs

ICAEW major point: The professional bodies regulate most UK audits and maintaining the 2016 Ministerial Direction on delegation to competent authorities is essential to carrying out their work.

Question 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?

457. No. We agree that ARGA needs to have a close involvement in the licensing of individuals within firms that audit PIEs. Since the publication of the Kingman report, we have worked closely with the FRC to develop models for how this might function, building on the processes of the Recognised Supervisory Bodies (RSBs) where possible. We are pleased that the Government is taking forward the dual or top-up licensing system for audit registration which we suggested in our response to Kingman.

458. Government has struck an appropriate balance, with RSB's maintaining firms' main audit registration for all their non-PIE audit work and with the FRC (ARGA) then having additional and exclusive responsibility in determining eligibility for a top-up licence for firms to audit PIEs and for those who wish to be Responsible Individuals (RIs) on PIE audits. This system will see the results of reviews of PIE audit work being reported to a supervision committee at ARGA rather than to the RSB's registration committee.

459. ARGA's supervision committee and the registration committees will need to have active and effective dialogue to ensure that they are aware of all relevant information in reaching decisions. This will be necessary to ensure consistency, as many auditors perform both PIE and non-PIE audits; indeed, this number may increase if the PIE definition is extended.

460. Thought should be given to transition to enable PIE auditors to move to the system over time rather than face a single deadline for registration, which would also significantly complicate transition for the regulator. A grandfathering scheme could be considered for existing RIs with PIE experience, conditional on having a good inspection record.

461. The eligibility criteria for the new regime could be a barrier to entry to the PIE audit market and as government is also aiming to increase competition and choice through the reform package, this requires careful thought. Overly onerous eligibility criteria may restrict challenger firm RIs from qualifying, or even prevent them altogether if the criteria are based on prior experience of PIE audits. We note elsewhere in this response our concerns about capacity, and it would be unfortunate if the FRC's qualifying criteria were to excessively restrict the number of people who can perform these roles.

Statutory delegation to the competent authorities is important to enable investment in quality

462. We understand that should some of the licensing revert to ARGA, there would need to be changes to the 2016 Ministerial Direction to enable this. However, we are concerned about the direction being revoked in its entirety; a substitute needs to be put in place. ICAEW's operating contract is with the FRC through the delegation agreement, and within it there are certain protections for us supplemented by the assurance of the ministerial direction. This particularly applies to the employment terms and job security of our staff.

463. Our future investment and plans as a regulator in respect of audit for the coming years depend on the continued role defined in the current delegation agreement. If there were uncertainty over the future, then our ability to invest in innovative practices, technology and recruit quality individuals would be constrained. We believe this would not be in the public interest and damaging to audit quality.

464. The use of the direction is an unusual parliamentary tool. Ideally the protections of resilience afforded to RSBs by paragraph 3 of Schedule 10 to the Companies Act 2006 should have been replicated within 'The Statutory Auditors and Third Country Auditors Regulations' (SATCAR). The absence of this left the FRC with unlimited powers in termination which they were unwilling to constrain within the delegation agreements, and this led to the need for the direction. We recommend that should the direction be revoked, the termination powers are moderated by applying paragraph 3's constraints in legislation. This is essential to protect our own resilience and responsibilities to other oversight bodies.

Chapter 9.2 Monitoring of audit quality

Question 70. What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?

465. In our previous representations on this area for the Kingman Review, we expressed concern over the appropriateness of publishing the results of individual audit inspections. We agree there could be some further transparency in what is disclosed, but the decision to let ARGA publish these without recourse to company or market seems to us high risk and potentially damaging for companies, firms and individuals.

466. We note there are proposals for safeguards in the deployment of this power, but these are not illustrated; rather the consultation asks for ideas and comments. There appears to be little consideration given to the impact on the audit firm and individual auditor. These disclosures, even minor, may be terminal to the career of an auditor, or a fledgling challenger firm, and reduce the attraction of working in this field. This may inhibit high quality individuals from entering the profession and thereby lead to a deterioration in audit quality. The outcome of transparency would arguably be achieved, but competition and quality would be compromised. We struggle to see how this approach is consistent with the principles of BEIS' Regulators Code (see our comments on Chapter 10).

467. The report refers to investors not benefiting from highly edited reports, but they equally fail to benefit should information be published that is incorrect, unbalanced, or lacking context. Unfortunately, this could be the result should ARGA's conclusions be published without the opportunity for representations to be made where these concerns arise. Investors are also not the only stakeholders who have an interest in this area. Many public interest entities are of interest precisely because there is a wider impact on the public and the consumer from their operations. Adverse reports on a retailer or energy provider combined with adverse press commentary could rapidly put entities out of business. We do not see why ARGA should have this power to precipitate failure, certainly not at least without additional independent safeguards, and how this sits comfortably with the overall public interest. It seems that the interest of the equity investor in this case is being put ahead of the consumer and other stakeholders; this runs contrary to the wishes of more effective and meaningful s172 reporting.

Question 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?

468. Prior to publication, it is essential that the auditor and their firm have the opportunity to make representations about the quality of the audit to an independent committee. This additional safeguard could reduce the risk that inappropriate conclusions are drawn by those reading such reports. Proper due process must be followed before such information is released publicly.

469. It has to be considered what the reader of this information is expected to use it for and therefore what the consequences could be of conclusions readers may draw from it. The danger is that a report which reveals a technical breach in failing to secure a minor piece of audit evidence is interpreted by the reader as being evidence of a completely failed audit or even as deficiencies in the company that are price or credit sensitive. The Hampton rules laid down by the Legislative and Regulatory Reform Act would require the disclosures to be proportionate and targeted, thus minimising this risk, but we do not see assurance on this balance in the proposals. Disclosures along these lines could undermine further public trust in auditors rather than helping to restore it. They might even precipitate company failure.

Chapter 9.3 Regulating component audit work done outside the UK

Question 72. Do you agree with the Government's approach to component audit work done outside the UK? How could it be improved?

470. We do not have a problem in principle with this. It makes sense for ARGA to be able to ask for this information directly. However, there may be political issues to also take into consideration. A request by a regulatory body independent of the Government is one thing; a demand by a third country government body is more challenging to the autonomy of a state in its own affairs. The power if granted would need to be exercised judiciously, and probably should be negotiated alongside adequacy and equivalence agreements with country governments rather than separate to them.

Chapter 9.4 The application of legal professional privilege in the regulation of statutory audit

Question 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?

471. Yes. We agree that the audit inspector will wish to have access to any material documents that the auditor relied upon in reaching their opinion. Where the auditor has relied on privileged advice they have had access to, it is reasonable that the inspector may want also to be able to view this advice in the course of their work. Sometimes such privileged advice may be a crucial piece of audit evidence – for example where it refers to the probability of an entity wining a legal dispute.

472. Nevertheless, access by the regulator to such advice has potentially serious consequences. If an opponent were to become aware that privilege had been waived, they could demand access. It is also possible that entities may become less open with their auditors and less willing to share such advice. That would make the audit more difficult to complete and could undermine quality. Those concerns would be multiplied if the regulator was to be allowed to share such information with other government agencies.

473. Government needs to balance these two considerations. It could achieve this by designating the disclosure of a privileged legal opinion to be a limited waiver of privilege only for the purpose of the audit inspection and any resulting disciplinary action. As a safeguard, the regulator should be prohibited from using it for any other purpose or from providing it to any other party – including other regulators or law enforcement.

CHAPTER 10. A STRENGTHENED REGULATOR

Chapter 10.1 Establishing the regulator

ICAEW major point: As a crucial and urgent first step, BEIS must establish the new regulator, ARGA, to replace the FRC and properly equip it with appropriate, targeted and proportionate powers. An effective and trusted new regulator is a pre-requisite for effective reform in corporate governance and audit.

474. The priority should be to establish ARGA, without avoidable delay. An effective and focused regulator is the prerequisite for meaningful reform. We welcomed Sir John Kingman's vision of a strong and credible new regulator. Government should press ahead rapidly to replace the FRC with an effective new regulator focused on robust reporting by entities with the highest public interest. ARGA's priority should be minimising the risk that these entities fail unexpectedly or that their financial reporting is undermined by fraud.

475. It is vital that appropriate principles govern the operations of the new regulator. We disagree with the principles proposed and recommend that a new set of principles, more closely based on BEIS's Regulators' Code, be substituted. Such principles would set a tone and culture of 'improvement' for the regulator. It could draw on principles of the Regulators' Code to support those they regulate to comply and grow, hear their views, communicate clearly and transparently with them and focus its activities where risks are highest.

476. We also have concerns about the very wide scope of entities that ARGA's new regulatory powers would apply to, their extent, and the time and resources necessary to implement them. The powers for ARGA proposed in the consultation go beyond those envisaged by Sir John Kingman and indeed beyond the objectives of his review, which called for more robust oversight of the audits of those entities whose failure would raise public interest concerns.

477. The regulator envisaged in the consultation would be very powerful, with broad investigation and sanctioning powers over auditors, chartered bodies, members of chartered bodies, PIE directors, audit committees and reporting entities. There is little indication yet of how the regulator would apply these powers. Notably, there has been little transparency or consultation about the restructuring the FRC already has in progress.

478. We have significant concerns about the extent of these powers and the options given to ARGA for how it exercises them in years to come. As an example, government intends to replace the Accountancy Scheme with powers for ARGA to take enforcement action directly against accountants, removing the requirement to prove misconduct. They would also empower ARGA to set its own code of ethics. ARGA would have oversight of all aspects of chartered bodies' regulatory functions and the power to direct them to take action.

479. We do not see the justification for these measures, which risk overburdening and distracting ARGA at a time when it is expected to rapidly increase the efficacy of regulation in its core remit of PIE audits and directors.

Question 74. Do you agree with the proposed general objective for ARGA?

480. No. We have concerns about the lack of focus in the objective, as we have mentioned several times in this response. The objective should say that the regulator will hold directors to account, specifically in regard to their duties under the Companies Act, Part 15 (accounts and reports) and Part 16 (audit) – and their professional advisors in respect of these areas. The objective should also be clear that ARGA's jurisdiction does not extend to where other

bodies charged with holding directors to account have responsibility, for example, the Insolvency Service, Companies House and Serious Fraud Office.

481. Accountability at an individual level has been a successful tool in achieving better outcomes in UK financial services. Financial services regulators introduced the Senior Managers and Certification Regime (SMCR), which has resulted in a reduced incidence of misconduct by individuals and firms. In short, this policy tool has had a strong deterrent effect. Financial services firms have policed themselves and managed individuals and risks ahead of the need for regulatory intervention. This has meant that there have been relatively fewer enforcement cases against individuals. We do not believe a regime modelled on SMCR is proportionate or justified for non-financial corporates, but it illustrates the impact of effective regulation on behaviour. The new regime needs to deliver greater accountability by PIE directors and effective enforcement is one element of this.

482. The Government believes there is benefit in having a widely framed objective. This mean that a lot will depend on ARGA's interpretation of its objectives; what it states as its priorities and goals may fluctuate with time, causing uncertainty. We urge the Government to take a more prudent approach and support ARGA with a more well-defined objective that will better stand the test of time. The objective should specifically emphasise the accountability of company directors for accounts, reports and audit.

483. The new and more powerful regulator will need appropriate checks and balances. A regulator with more resources will need stronger oversight, consistent with their greater and wider powers. In the past this has been done reasonably well by Parliament's Treasury Committee. But there is a risk that this existing framework could leave important gaps; solutions may include a specialist Treasury Sub-Committee, better reporting, strong and transparent due process and/or more use of impact studies and cost benefit analyses for new requirements.

484. The Government also needs to recognise the importance of other actors, including professional bodies, in the corporate reporting ecosystem. These are vital to ensuring proper checks and balances.

485. The introduction of 'public confidence', while sounding not unreasonable as a concept, needs to be articulated more clearly. We believe that this may be better done by statute rather than ARGA determining its own boundaries – and therefore its own criteria for success – which may move beyond the intent of government or fall short of what was intended.

Question 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?

486. No, not without further development. We support BEIS's 'Regulators' Code', which although it is referenced in principle 7, is otherwise conspicuous by its absence. The Regulators' Code speaks to growth and improvement – an important focus for a regulator. Although we agree it is vital for the regulator to have stronger enforcement powers, effective regulation is achieved by working constructively and proactively with the regulated – reserving sanctions for exceptional circumstances where they are needed. A core role of the regulator is to promote effective culture, which again is not referenced. We are also concerned that the principles say little about how ARGA should engage with, influence or seek to adopt appropriate international developments. International alignment is of high importance to many aspects of ARGA's work.

487. ICAEW has published 'Principles for Good Financial Regulators'. Among other things, these principles emphasise that regulators should be clear about the outcomes they are seeking, and against which they should be judged. They should build well-founded trust and promote

an appropriate culture. They should be robust but also ensure stakeholders understand their approach. This iterative, improvement-based approach to regulation is absent from the proposed principles, which appear to focus more on processes and outcomes. Good outcomes are important, but they are more likely to be achieved by a regulator with an approach that brings stakeholders along with it.

CHAPTER 11. ADDITIONAL CHANGES IN THE REGULATOR'S RESPONSIBILITIES

Chapter 11.1 Supervision: Accountants and their professional bodies

ICAEW major point: ARGA's powers need to be better targeted. There is no good reason for introducing statutory regulation of individual chartered accountants. ICAEW already has effective oversight by a range of regulators. The objectives are better served through pursuing erring accountants through the proposed powers in Chapter 5 and applying a governance framework for accountancy that leverages the independent RSBs.

Setting ARGA's scope as broadly as envisaged would incur significant incremental costs

488. The consultation estimates that ARGA might cost an additional £9m to £26m per annum depending on its powers and obligations, with these costs passed back to businesses either directly or indirectly. Businesses would also incur compliance costs amounting to a further £16m to £39m each year. There are some indications that these amounts may be underestimated; they take the FRC's pre-Kingman 2017/18 budget of £36m as a baseline, but by 2021/22 this had already increased by 43% to £51.5m[18]. This is of course prior to implementing the significant additional proposals in the White Paper. It might be assumed that some of these new functions could be absorbed by the FRC's increased headcount, but it might also be questioned whether this is consistent with the replacement of the FRC by a new regulator. A salient recommendation of Kingman was that ARGA would be able to call on high-calibre, experienced staff, which implies further funding would be necessary.

Question 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?

489. No. We do not agree with the proposals. The risks identified in the early paragraphs of the chapter would appear to be most prevalent in the unregulated sector. If the evidence suggests these are major issues that need addressing, then the targeted and proportionate approach would be to include those accountants outside a regulatory net within the scope of regulation. That would require regulation by activity rather than by title.

490. In the consultation's opening comments, both in the foreword by the Secretary of State and in the executive summary, it is made clear that the intent is to restore public trust in the audit and accountancy of the UK's largest companies. This intent is reiterated at the start of Chapter 11 of the consultation. However, the proposals outlined operate considerably beyond this remit. Under the Hampton Principles, reinforced by BEIS's Better Regulation Executive, the intent of any new regulations must be targeted and proportionate.

491. The proposal to create an enhanced oversight role for ARGA over the work of chartered accountants adopts Recommendations 39-41 of the Kingman Review without enquiry as to how much the FRC Review had considered the work of ICAEW, and the other professional bodies, in relation to the oversight of chartered accountants which was outside of its remit. Indeed, these recommendations appear to rest on the conclusion that the professional bodies are self-regulatory bodies, and that this must mean that regulation is not sufficiently robust and that professional bodies failed to implement all recommendations from the thematic reviews which the FRC carried out prior to 2010. However, both of those

[18] FRC, Strategy, plan and budget 2021/22.

observations are out of date and are not good grounds to support any change to the status quo.

492. Following an independent internal governance review led by Sir Christopher Kelly, the ICAEW Council took the decision in 2015 to devolve all oversight responsibility for regulatory and disciplinary work to the ICAEW Regulatory Board (IRB). The IRB was established with a constitution of equal numbers of lay and chartered accountant members and a lay chair with a casting vote. Michael Caplan QC was appointed as the first Chair of the IRB by an independent appointment panel led by Dame Janet Gaymer. Further changes were made at that time to ensure that the constitution of ICAEW's Investigation Committee and all regulatory committees would have a parity of lay and chartered accountant members with lay chairs, and that all Disciplinary Tribunals and Appeal Panels would have a majority of lay members.

493. The IRB's Terms of Reference provide that its primary objective is to act in the public interest. They also set out the IRB's extensive responsibilities including the oversight of the work carried out by ICAEW's Professional Standards Department (PSD), the oversight of the work of all of ICAEW's regulatory and disciplinary committees, the setting of regulatory strategy and regulatory policies, the approval of budgets and decisions on the level of regulatory fees and the setting of sanctions guidance for use by the disciplinary committees. The IRB also interacts with ICAEW's oversight regulators, reviews all reports from oversight regulators after their inspection and oversees work which is done to implement the recommendations. It should have been clear to the FRC Review in 2018 that any failures identified pre-2010 would not reoccur due to the changes made.

494. We are therefore disappointed that none of these significant changes in the operation of ICAEW and the other professional bodies were identified by the FRC Review and that the Government has adopted the recommendations in this consultation without ensuring that an up-to-date, analysis had been carried out of the current regulatory framework. The additional evidence of alleged weaknesses in the regulation of chartered accountants in paragraph 11.1.7 does not support the introduction of statutory regulation of chartered accountants. Indeed, the documents referenced in that paragraph, particularly the tax documents, suggest that the problem lies predominantly among unregulated accountants.

495. Paragraph 11.1.15 refers to the professional bodies as being self-regulatory regimes without understanding how we, and other bodies, now operate. It also makes unsupported allegations about professional bodies' regulatory processes failing to provide disincentives for unscrupulous chartered accountants and not acting robustly. The considerable improvements made in the quality of ICAEW's regulatory and disciplinary work are ignored, despite publicly available evidence including the steady series of reports of actions taken against chartered accountants on our disciplinary pages and the High Court judgement in relation to the liquidation of the Comet Group (lauding ICAEW for intervening to protect the interests of unsecured creditors) and the ultimate settlement in that matter with the liquidators and Deloitte.

496. Had a full analysis of the current arrangements been carried out, we believe there would have been no recommendation to create enhanced oversight for ARGA. In fact, such an analysis would have shown that there is no longer any need even for the longstanding informal arrangements, given the proactivity of the IRB and the independent regulatory boards of the other bodies, which have reduced the current role of the FRC to no more than reviewing infrequent complaints regarding the way in which accountancy complaints have been handled. Given how many other tasks and responsibilities are going to be handed to ARGA and the need for focus for the new regulator, we would suggest it is not necessary to provide it with further responsibility to fix something which is not broken.

497. In fact, the proposals may even be detrimental because of the additional overlap and confusion which will be created. Parliament has over the years identified the areas of chartered accountants' work likely to produce public interest issues and built statutory regimes around them, including audit, insolvency, investment business advice, probate and Anti-Money Laundering (AML). It is, therefore, difficult to identify which public interest concerns ARGA is being asked to monitor which are not already being monitored by the IRB and other oversight bodies. We have included as Figure 1 following paragraph 51 in Part One of this response, an organogram which illustrates the central role of the IRB, the number of oversight regulators and other public bodies who have an interest in the work of chartered accountants, and the constitution of the IRB and the regulatory and disciplinary committees it oversees.

498. We are also concerned that providing ARGA with this additional responsibility will dilute its focus away from its core objectives to improve audit and corporate governance, and will require ARGA to recruit a new oversight team as skillsets of the current oversight team are focused on audit.

499. If there is a concern about whether the professional bodies will maintain the current governance arrangements, and the independence of their regulatory operations, this could be dealt with easily in the new legislation by ensuring ARGA can maintain appropriate oversight of the professional bodies' internal governance rules. We would be happy to provide further guidance to BEIS on how this might be achieved. The FRC already carries out a review of ICAEW's internal governance arrangements as a condition of its continued delegation of audit regulatory tasks.

Question 77. What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?

500. The question presumes both that there is any need for ARGA to have an enhanced accountancy oversight role and that it is appropriate that it should be provided with the power to compel compliance by a professional body.

501. While we have dealt in our response to Question 76 with the first point, it is worth exploring the second point before considering the question of safeguards. As stated in our response to Question 76, the IRB board has been mandated to act in the public interest – not in the interests of members. What is now being proposed is an unprecedented and wholly unnecessary situation; Parliament is being asked to provide a power to ARGA to force a professional body to do something in the public interest, where that body's regulatory and disciplinary work is already governed by an independent regulatory board which also has a public interest objective.

502. The IRB has a close relationship with ICAEW's oversight regulators, reviews all inspection reports and oversees the work required to comply with recommendations. Therefore, the power to compel is likely only to be exercised in situations where the IRB is fully aware of the required action but has determined that it should not happen after considering itself whether the required action is necessary in the public interest. This seems to us to be a very strange proposition.

503. If, despite these fundamental concerns, the Government decides to provide ARGA with this power, it must clearly be subject to stringent safeguards; it should be a rare event for a power to compel to be used to override a conclusion reached by a board where lay members have a majority vote and are mandated to act in the public interest. Crucial safeguards include:

- the exercise of the power to compel should be authorised at the highest level within ARGA – by the ARGA board itself – and should not be left to be exercised by, say, the future ARGA Director of Oversight; and
- an independent and robust appeal process where the determination as to whether or not the power to compel should be used, is ultimately made by someone independent from both ARGA and the professional body. Such an adjudication should be made only after a proper opportunity is provided for both parties to make full representations.

504. We are also concerned about the 'power to compel' being open-ended and allowing ARGA to require ICAEW to make changes to its regulatory arrangements in circumstances where many of ICAEW's processes, particularly in relation to disciplinary proceedings, are used for all aspects of our regulatory work and the current arrangements have been approved, and are monitored and inspected, by other oversight regulators. Indeed, the Legal Services Board has a statutory duty to approve any changes to the regulatory arrangements of all legal services regulators it oversees. We believe, therefore, that government should either exclude the right to require changes in regulatory arrangements from the power to compel, or provide that ARGA will not be entitled to require changes to existing regulatory arrangements without first obtaining the consent of all of ICAEW's other oversight regulators.

505. We are also unsure how any statutory power to compel changes to regulatory arrangements would work where the regulatory arrangements are embedded in our Royal Charter and bye-laws. These can only be amended with the agreement of members and/or Council and which must also be approved by the Privy Council.

Question 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?

506. We do not agree with the premise of the question. There are a number of inconsistencies in the Government's proposed response.

507. On the one hand, the Government has determined that the statutory enforcement powers should be extended beyond the ambit suggested by the FRC Review – only to cover work at or for PIEs – and then decided that the statutory powers should only cover members of chartered bodies. This is despite there being evidence in the documents referenced in Chapter 11 to the fact that 'wrongdoing giving rise to public interest concerns' is more likely to be found among unregulated accountants, particularly in the areas of tax avoidance schemes and poor tax advice. The Government's proposition that the new powers should be limited to members of chartered bodies because unregulated accountants are rarely involved in PIE work has been undermined by the decision to extend the reach of the powers much wider than PIEs. We do not believe, therefore, that the proposals are based in the public interest or in compliance with the requirements of the Hampton Principles to be targeted and proportionate.

508. If government is not minded to make 'accountancy' a reserved title and to impose proper oversight over the work of unregulated accountants, we believe that government should at least remedy the inconsistency and unfairness by following the Kingman Review recommendation to limit the ambit of the new statutory powers to those chartered accountants who work in the financial reporting process of a PIE or those who provide services to a PIE. The principal area of concern in Chapter 11 is to ensure that ARGA is provided with a firm statutory basis to bring enforcement proceedings in the future against all

actors in a financial reporting / accounting scandal; this objective can be achieved by restricting the scope to that proposed in the FRC Review.

509. We are concerned that, instead of recognising the increasing divergence its proposals will create between already heavily-regulated chartered accountants and unregulated accountants, the Government is asking for input on how it might extend the proposed regime if it was necessary to include unregulated accountants within it in the future. We believe that the legislation should be set up to be fair and proportionate in the first place. We are also concerned at the confidence expressed that members of chartered bodies will not resign membership as a result of the implementation of these proposals.

510. While we believe that there are substantial benefits in remaining a member of a professional body, we also have to recognise the economic realities facing a practitioner. Membership comes at a price, which is weighed up by those individuals when deciding whether to continue their membership. The knowledge and skills gained from chartered accountancy qualifications are not instantly lost when membership is resigned. There is a danger that if the overhead cost of membership and the liability risk becomes too high, then it outweighs the professional and commercial advantages.

511. The exodus of practitioners would have two serious effects. First, it would impact our resources as a regulatory body and limit the regulatory improvement activity currently in place. Secondly, the consumer would lose the protections afforded them under the accountancy bodies' bye-laws, practice assurance and quality requirements. Although there is a proposal to subsequently check on trends, we do not consider it is an appropriate approach to risk prejudicing the interests of consumers. For a consultation designed to reinforce the UK's comparative advantages in matters like professional qualifications and proportionate regulation, the unintended consequences of these proposals would be to deter members from remaining as members of a professional body and reduce the quality associated with regulated members of the profession.

512. If the current proposals are implemented, government will need to keep the position under review and maintain flexibility, either to impose oversight directly on unregulated accountants or require them to become members of professional bodies. However, the latter would not be a perfect solution because professional bodies will not admit anyone who does not meet membership criteria, which include the passing of prescribed examinations; one of the concerns around unregulated accountants is that some lack qualifications altogether.

Question 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?

ICAEW major point: It is unclear why ARGA needs to set a code of ethics. It conflicts with the international commitments of the UK's professional bodies.

Scope of regulatory remit – public interest issues / change of liability threshold

513. We have already pointed out in our answer to Question 78 the inconsistency which the Government's proposals in Chapter 11 create between limiting the statutory powers to apply to members of chartered bodies and extending the ambit of the powers to 'any wrongdoing giving rise to public interest concerns'.

514. We do not understand the premise of the second question, as there is nothing in the commentary leading up to this question which suggests that the Government is

contemplating extending the powers beyond 'public interest concerns'. Indeed, this would create a far wider ambit for the statutory powers than currently exists under the Accountancy Scheme, where the FRC can only call in 'matters raising important issues in the public interest', and no evidence is put forward in the narrative to support such an extension. This would also cut across the disciplinary work being carried out by ICAEW and the other professional bodies in respect of matters which do not raise public interest issues.

515. The narrative leading up to Question 79 suggests that the real issue is whether the scope of the powers should be limited to chartered accountants who work in, or for, PIEs or extended to include 'wrongdoing giving rise to public interest concerns' which might have nothing to do with PIEs. If this was the intended question, then we have already addressed this in our answer to Question 78.

516. We do not believe that the Government should be extending the ambit beyond that suggested by the FRC Review for several reasons. Firstly, it goes wider than the main objective of ensuring that the powers include all actors in a financial reporting / accounting scandal; secondly, it will create even greater divergence between the regulation of accountants who are members of chartered bodies and those who are unaffiliated; thirdly, ICAEW's Professional Conduct Department under the oversight of the IRB has proved itself able to investigate and prosecute public interest complaints, such as the complaint brought against the administrators of the Comet Group; and, fourthly, it will create considerable uncertainty among accountants, complainants and even the regulators as to which body should be investigating a complaint and may have an adverse impact on a frail Public Indemnity Insurance market for accountancy firms.

517. Setting the ambit of the powers at 'wrongdoing giving rise to a public interest concern' creates a subjective test, presumably determined by ARGA on the facts of a complaint, which will create uncertainty as to whether a matter will be the subject of ARGA's powers or will be dealt with by the professional body. This, in turn, will create uncertainty for PII insurers as to whether their insured firms could potentially be the subject of disciplinary action by ARGA. The IRB has been concerned during recent months over the deterioration of the PII market for accountancy firms, with premiums being significantly increased and more firms having difficulty obtaining the minimum insurance required for ICAEW firms at affordable rates.

518. While PII insurers will be able to identify which firms could potentially be subject to the new statutory powers if the ambit of the powers is as suggested by the FRC Review (limited to PIE work), a more subjective public interest test will cast a far larger shadow over firms whose ability to obtain cover and / or whose premiums may be impacted due to the possibility that they might become subject to the statutory powers. It is clearly not in the public interest for accountancy firms to be unable to acquire affordable insurance as the alternative option for firms is for their principals to resign their membership and either trade without any insurance or more limited cover.

519. We do not understand why the Government has considered only one option for resolving the current misalignment between the misconduct test used for chartered accountants and the breach of any relevant requirement test in the Audit Enforcement Procedure. Nor do we understand why the Government is proposing to adopt the lower liability threshold test in the new statutory powers without having carried out any analysis to determine the usual threshold test for liability to disciplinary action for professionals in the UK. If such an analysis had been carried out, government would have noted that the change of the liability threshold in The Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR) provided auditors with a lower threshold for liability to disciplinary action than any other UK professional. We know that the IRB has taken advice from Leading Counsel in 2017, and

recently, which has confirmed that the current misconduct test in our disciplinary bye-laws is consistent with the liability tests for disciplinary action for other UK professionals. Any change now to lower the threshold test for chartered accountants will put them out of line with all other UK professionals.

520. No justification has been provided, either in the FRC Review or in the consultation document, as to why it is fair or justifiable for chartered accountants to be subject to this lower standard. It is also not clear that consideration has been given to the significant inconsistencies such a change would create.

521. Firstly, given the proposed extension of the ambit of the statutory powers to cover 'all wrongdoing giving rise to public interest concerns', chartered accountants working on matters or providing advice alongside other professionals will have a lower liability to disciplinary action than their co-advisers. Secondly, this will create a different threshold test for chartered accountants depending on whether a complaint is investigated by ARGA or a professional body. The unfairness and inconsistency will only be increased if the ambit of the powers depends on a subjective assessment as to whether a complaint does give rise to public interest concerns.

ARGA setting a code of ethics detaches the UK from international obligations

522. We question why it is necessary for the regulator to set its own code of ethics for the chartered professional bodies to adhere to. The bodies already have codes of ethics and breaches of these codes are dealt with through existing disciplinary processes. Unless there is persuasive evidence that the existing regulatory model operated by the chartered bodies is failing to uphold professional standards, we see no merit in introducing an additional regulatory activity, only cost and disruption.

523. There needs to be clarity for end users and consistency of minimum standards of conduct in the market to give confidence to consumers. Having a separate regime for members of the chartered bodies compared to other accountancy bodies, and non-professional body member accountants, fails to achieve this clarity or consistency. We also question what benefit an additional code of ethics would bring. The consultation refers to seeking consistency between the codes of ethics of the chartered bodies, but this consistency already exists. All accountancy professional bodies who are members of the International Federation of Accountants (IFAC) are already committed to abide by the Code of Ethics issued by the International Ethics Standard Board for Accountants (IESBA). This means that the chartered bodies adopt the IESBA Code of Ethics and it forms part of the codes of ethics of each chartered body. Under the terms of the agreement with IFAC, the member bodies are not permitted to make derogations away from the IESBA code, they can only make additions to it. This means that there is already full and consistent adoption of the IESBA code of ethics among the chartered bodies. While some of the chartered bodies supplement the IESBA code with additional material for their members, this does not compromise the effectiveness of the IESBA code.

524. The approach proposed by the Government, that the regulator should set a code of ethics based on the IESBA code, and then allow each body to add additional material, would entirely replicate the position that currently exists within the chartered bodies. Instead of duplicating existing ethical codes, it would be more worthwhile for government to set a code of ethics for directors (particularly of public companies) who are currently not obliged to follow any ethical code unless they are a member of a chartered body.

Principle of regulator enforcing a separate code of ethics for chartered bodies

525. Given that one of the criticisms levied towards the professional bodies is that the same organisation is both setting and enforcing the code of ethics, it seems illogical that the Government proposes the new regulator be given that remit.

526. The focus of this consultation is audit and corporate governance, and the proposed regulator is the Audit and Reporting Governance Authority. Auditing and reporting are only a small fraction of the work that chartered accountants are involved in. The vast range of other services provided, and work undertaken by chartered accountants, are separate and unrelated to the subjects of this consultation. The scope of any new proposals must be clearly defined to avoid bringing any unrelated areas into scope.

Sanctions available to regulator

527. We note the proposals for a wide range of sanctions to be available for the regulator to issue in disciplinary cases. While there is merit in flexibility in sanctions available, there would need to be clarity of indicative sanctions that the regulator could look to issue depending on the type of the disciplinary matter and the relevant aggravating and mitigating factors.

528. Any sanctions regime requires transparency in respect of the reasons for a specific finding and consistency of findings based on the set of circumstances and factors.

Chapter 11.2 Oversight and regulation of the actuarial profession

Questions 80 – 93

529. We have chosen not to answer Questions 80-93 individually. We question why regulation of the actuarial profession is included among the proposals in the consultation. Although the regulatory functions of the FRC in this regard clearly need to be carried over into ARGA, it is unclear why changes to the scope and nature of such regulation are being considered as part of this exercise. This could be a source of distraction to the new regulator. This section illustrates the ‘scope creep’ that has occurred and ARGA needs to ensure that the measures implemented are clearly focused on government’s core objectives.

Chapter 11.4 Powers of the regulator in cases of serious concern

Question 94. Are there others matters which PIE auditors should have to report to the regulator?

530. No. The existing duty is sufficient. The three areas covered by Regulation (EU) No 537/2014 Article 12: a material breach of the law or regulations governing a PIE; a material threat or doubt concerning the continuous functioning of the PIE and; a refusal to issue an audit opinion or the issuing of an adverse or qualified opinion – go beyond corporate reporting and audit. We believe existing requirements capture the required level and scale needed.

Question 95. Should auditors receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator?

531. Yes. Auditors should receive statutory protection in relation to voluntary as well as mandatory disclosures to the regulator, provided they have acted in good faith and reasonably believe that the information or opinion is relevant to the regulator’s activities.

Would this encourage auditors to report viability and other concerns to the regulator?

532. Yes. The regulator, ICAEW and others will raise awareness of the new duty, and it would be helpful if statutory protection could be mentioned at the same time. However, to be clear, 'encouragement' is irrelevant to duties save for the 'encouragement' prompted by publication of regulatory action taken by ARGA against auditors.

Question 96. How much time should be given to respond to a request for a rapid explanation?

533. The FRC Review referred to a requirement for rapid explanations rather than requests. This is a key distinction, as a prescribed time limit is more appropriate for requirements than for voluntary requests.

534. In practice, regulatory requirements to provide explanations or information are usually preceded by a request, but presumably the rapidity which is envisaged here does not allow enough time for this two-stage approach.

535. Ultimately, ARGA will benefit from the receipt of consolidated and complete information, but PIEs need sufficient time to compile it. If insufficient time is allowed, then there is a danger that ARGA will receive rapid but perfunctory explanations from PIEs. This scenario could damage the relationship between ARGA and PIEs, and perfunctory explanations are unlikely to help ARGA meet its objectives.

536. We strongly support the proposal to empower the regulator to seek expert review where it has serious concerns. Such reviews under s166 of the Financial Services and Markets Act 2000, have been a powerful tool to enable the Prudential Regulation Authority to inquire into areas of interest. Carrying out these reviews could provide a practical route for challenger firms to gain experience of large PIEs, which might help with future market access.

537. ICAEW's Disciplinary Byelaws [19] allow its Investigation Committee to call for information, explanations, books and documents from individual members or firms. The Byelaws refer to 14 days from the date of notice, but the Investigation Committee has a discretion to allow longer dependent on the circumstances, such as the nature of the information. In practice, the information is requested before the powers in our Byelaws are used, and ICAEW communications are addressed to an appropriate individual rather than a firm even if the firm is the true addressee. This process works well in practice and is understood and accepted by all parties.

Question 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?

538. No. Neither summaries nor full reports should be published[20].

539. We presume that there is greatest public interest in publishing reviewers' negative findings. However, there are several strong arguments against publication of expert reviewers' full or summarised reports, whatever the nature of their findings:

- potential publication may discourage an expert reviewer from being full and frank. Unfortunately, even very careful selection processes for expert reviewers can never fully eliminate this risk;
- even the publication of summaries, especially meaningful summaries, could give rise to litigation or market risks; and

[19] ICAEW Disciplinary Byelaw 13.
[20] The FCA's publication of a summary about the skilled persons report on Royal Bank of Scotland, and the subsequent publication of the full report by the Treasury Committee should be regarded as an anomaly.

- publication compounds auditors' dilemma about whether they should work for PIEs which have been subject to regulatory attention by ARGA.

540. ARGA should therefore follow the example set by the FCA in its treatment of skilled persons reviews [21]and not publish full reports, summarised reports, or the identity of PIEs which are being (or have been) reviewed. We note that the FCA does publish anonymised statistics, in the form of quarterly information about skilled persons reviews.

541. The possibility of disclosure under the Freedom of Information Act should be considered alongside publication. We continue to support the application of the Freedom of Information Act to ARGA if its founding legislation includes a confidentiality provision like that in the Financial Services and Markets Act 2000[22].

542. ARGA would also benefit from bilateral discussions with the FCA about several other issues related to skilled persons reviews and expert reviews.

Question 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?

543. We are supportive of the powers which have been proposed. They will provide sufficient options for the regulator to take action as a result of an expert review. No additional powers are necessary.

[21] Section 166, FSMA.
[22] Section 348, FSMA.

