ICAEW
REPRESENTATION 21/22

CORPORATE REPORTING – IMPROVING ITS QUALITY AND ENFORCEMENT

Issued 18 February 2022

ICAEW welcomes the opportunity to contribute to the public debate on how to improve the quality and enforcement of corporate reporting in the EU, published by the European Commission on 12 November 2021, details a copy of which is available from this link.

ICAEW is listed in the EU Transparency Register (ID number: 7719382720-34).

ICAEW believes that strengthening the overall ecosystem for corporate reporting needs to involve all key actors, including company boards, audit committees, investors, auditors and regulators. The European Commission's initiative provides the opportunity to focus on measures which could lead to important and achievable outcomes, including -

- EU action to help progress a multi-stakeholder initiative to develop indicators. These indicators need to focus on the quality of corporate reporting and supervision, alongside efforts to establish a set of overarching audit quality objectives, supported by a range of audit quality indicators;
- Clarification of the responsibilities of management and auditors for internal control frameworks, including fraud and going concern – accompanied by greater transparency across Europe over the consequences of failure;
- A more consistent role for audit committees, including stronger dialogue between regulators, auditors and audit committees;
- A strengthening of the core audit, with greater focus on fraud and going concern – as well as targeted steps to enhance audit quality, with a stronger emphasis on professional judgement;
- A more consistent and consistently robust system of corporate reporting review, based on a balanced view of the entire ecosystem;
- A broader reflection process on how to establish an affirming regulatory environment which facilitates improvement and innovation as well as ensuring compliance, informed by best practices in other sectors; and
- Greater consistency across the EU in the application of existing rules to help ensure a more comparable experience for companies and audit firms active in the internal market.

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ANSWERS TO SPECIFIC QUESTIONS

PART I - THE EU FRAMEWORK FOR HIGH QUALITY AND RELIABLE CORPORATE REPORTING

Question 1

As a user of corporate reporting (retail or wholesale investor, credit rating agency, NGO, public authority, employees, suppliers, other stakeholders), what is the relative importance of the information contained therein compared to other sources of information? On a scale of 1 (low) to 5 (high)	n/a

Question 2

On a scale of 1 (low) to 5 (high), how do you assess the overall effectiveness, efficiency, relevance, coherence and EU added value of the EU legislation, considering each of the pillars underpinning corporate reporting individually, but also in combination with each other?

Areas	I. Effectiveness in reaching its objectives	II. Efficiency: has the framework been cost efficient	III. Relevant in terms of overall needs and objectives	IV. Coherence with other related EU frameworks / internal coherence	V. EU Added value – Was and is EU intervention justified?
a) Corporate governance	2	3	3	3	3
b) Statutory audit	3	2	3	3	4
c) Supervision by public authorities of statutory auditors / audit firms	3	3	4	3	4
d) Supervision by authorities of corporate reporting	4	3	4	4	4
e) The eco-system composed of all of the above	3	3	4	3	4

Question 2.1

Please describe the main issues that you see, if any, in the four areas mentioned in the table above. Where possible, please provide concrete examples and evidence supporting your assessment.

You may want to consider the following aspects:

- ***Have any factors reduced the effectiveness / rendered the relevant EU framework less effective than anticipated? Which rules have proven less effective than anticipated?***
- ***Is there room to improve efficiency via further simplification?***
- ***Are existing provisions coherent with each other?***

1. Overall, the EU regulatory framework aims to encourage confidence in publicly available financial information through high quality corporate reporting, auditing standards and the effective regulation of companies, directors and auditors. It provides an environment in which companies which fail do so in an orderly manner, with minimum disruption and loss. The current framework largely achieves those goals, with high levels of confidence in financial reporting and in the integrity of capital markets. However, there are important differences in the degree to which the pillars of the broad corporate reporting ecosystem are regulated at both EU and national level.
2. The 2014 EU audit package introduced a significant level of new regulation. Some measures have been positive, eg, enhancing the information value of audit reports, strengthening independence requirements and improving transparency around the activities of auditors of PIEs. Other provisions have not met the intended objectives, eg, enhancing the quality of audit oversight bodies, increasing choice. To some degree, this reflects the heterogeneity of the EU, with institutional and cultural differences affecting national implementation, as well as the use of the numerous options available to member states in applying the Audit Regulation. Where this is the case greater consistency could be achieved. In other areas, this may point to the ineffectiveness of some of the 2014 changes.
3. The European corporate governance framework leaves scope for different systems and practices at national level, also reflecting diverse company law traditions. As mentioned below (Q7.1, Q9.2), we believe some specific corporate governance features, particularly audit committees and the internal control framework, merit further attention at EU level.
4. We note that the quality, competence and accountability of oversight bodies are also important factors in ensuring the effectiveness of the framework.

Question 3

Based on your own experience how do you assess the quality and reliability of corporate reporting by listed EU companies on a scale of 1 (low) to 5 (high)?	4

Question 3.1

Please provide concrete examples and evidence supporting your assessment in question 3 and explain the consequences that the quality and reliability of corporate reporting or lack thereof has on you.

5. While noting that corporate reporting does not stand still, our assessment continues to be that the quality and reliability of corporate reporting by listed companies in the EU is generally high. There has been a significant amount of research on the overall EU financial reporting framework, including on the positive benefits relating to the application of IFRS in the EU – as also identified in our major assessment of the academic evidence in 2014 (*The Effects of Mandatory IFRS Adoption in the EU: A Review of Empirical Research* - https://bit.ly/3fYuQ9v). This is in line with the Commission's 2018 fitness check on the EU framework for public reporting by companies which found that 'IFRS has become a common financial reporting language improving transparency comparability and reducing the cost of capital' (see also Q18.1).
6. Where there have been significant market failures in recent years, we encourage an in-depth assessment of the cases to identify any potential commonalities and to consider whether it highlights systemic weaknesses.

7. Overall, we consider that it may be opportune to reflect further on how to ensure a more consistent and consistently robust system of corporate reporting review, based on a balanced view of the entire ecosystem.

Question 4

There are no generally accepted standards or indicators to measure the quality of corporate reporting and of statutory audit, nor the effectiveness of supervision. In light of this, what are your views on the following questions on a scale of 1 (strongly disagree) to 5 (strongly agree)?

Questions	Scale
Would it be useful to have specific indicators to measure the quality of corporate reporting, of statutory audits and the effectiveness of supervision?	5
Is it possible to have clear and reliable indicators to measure the quality of corporate reporting, of statutory audit and the effectiveness of supervision?	4
Should the European Commission develop indicators on the quality of corporate reporting, of statutory audits and the effectiveness of supervision?	2

Question 4.1

Please provide any further explanation supporting your views, and, where relevant, please suggest possible indicators of the quality and reliability of corporate reporting, statutory audit and supervision, where possible with concrete examples.

8. It is important to look at the quality of corporate reporting and supervision as well as audit quality.
9. We are not aware of a set of generally accepted quality indicators for corporate reporting and supervision, although Grant Thornton has tracked corporate governance reporting in the UK annually for two decades. We strongly support efforts to develop such indicators; greater consistency in these areas could be an important and achievable outcome of the consultation process.
10. Audit quality indicators (AQIs) have been a key feature of large audit firm reporting in the UK since 2015 (eg, covering external investigations, internal/external quality reviews, investment in audit, partner and staff surveys, investor liaison). A growing range of AQIs are used by audit firms and audit regulators, within and across jurisdictions. Audit regulators, audit committees, investors and auditors have different priorities.
11. A set of overarching audit quality objectives is needed, supported by a range of AQIs at firm and engagement level, calculated on a widely understood and accepted, transparent and consistent basis. A framework for the development, measurement and evaluation of a wider basket of measures, such as AQIs, requires the involvement of all parties (audit regulators, audit committees, investors and auditors) interested in audit quality. This will be an iterative process and take time. The EU could help facilitate progress, perhaps with the involvement of the academic community.
12. AQIs have value in context and collectively. Individually, they may not always be reliable indicators of audit quality. AQIs also have an important role to play in supporting the exercise of professional judgement. Our 2021 paper, *Audit quality: how to raise the bar* (https://bit.ly/3GYK4rd), examines issues around AQIs in more detail (see also Q13.1).
13. It may be appropriate to consider ways in which indicators could help reviewing the effectiveness of supervisory regimes (see Q19.1.1).

Question 5

In your view, should the Commission take action in the areas of the

- ***Corporate governance pillar***
- ***Statutory audit pillar***
- ***Supervision of PIE auditors and audit firms***
- ***Supervision of corporate reporting***

to increase the quality and reliability of reporting by listed companies?

- ***Yes, there is a need to improve some or all of the areas listed above***
- ***Yes, there is a need to improve some or all of the areas listed above as well as other areas***
- ***No, but there is a need to improve other areas than those listed above***
- ***No, there is no need to take further action in any area***

Please indicate on a scale of 1 (strongly disagree) to 5 (strongly agree) to what extent you think the Commission should take action in each of the areas below to increase the quality and reliability of reporting by listed companies:

Improve the corporate governance pillar	4
Improve the statutory audit pillar	3
Improve the supervision of PIE auditors and audit firms	3
Improve the supervision of corporate reporting	3

If you think there is a need to improve other areas than those listed above please indicate which areas you have in mind:

14. We agree that, despite the absence of significant concerns, it makes sense to consider what steps would further increase the quality and reliability of corporate reporting. We note again the importance of understanding any common factors underlying cases of fraud or collapse. Any eventual measures will need to involve all key actors: company boards, audit committees, investors, auditors, regulators and standard setters. To our mind, some of the concerns on the effectiveness of the current EU framework relate to issues of implementation which call for greater consistency in how rules are applied rather than a significant re-write of legislation.
15. We emphasise the importance of considering the corporate governance, audit and supervisory pillars together, with a view to improving the overall ecosystem, while ensuring that the broad regulatory framework is aligned to the realities of business and stakeholder needs in the next decade or so.
16. Despite the consultation's focus, many of the rules intended for EU regulated markets are being applied to other entities too. A period of reflection on the PIE definition and its purpose may be timely. Member state-level decisions on which entities are captured by the PIE definition and how this is then monitored has a bearing on the rest of the ecosystem. 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 system is not overwhelmed. We refer to the work of IESBA, which proposes changes to the internationally recognised definition of a PIE within the global Code of Ethics. This project considers several criteria for deciding whether an entity is of significant public interest, including the importance of the entity within its sector, the number and nature of its stakeholders, and the likely systemic impact should the entity fail.

Question 5.1

Please provide any further explanation supporting your views, and where appropriate describe what actions you would prioritise and why, with concrete examples.

17. We support efforts to ensure that investors and all those who depend on the largest companies in the EU can continue to rely on high quality, transparent and reliable information. The focus should be on strengthening, rather than rebuilding, parts of the corporate reporting system so that it is best-in-class for 21st century needs.
18. High quality corporate reporting provides users with a clear view of business model risk, enabling informed decisions about their continuing relationships with an entity. In a healthy ecosystem all key players perform their roles to a high quality, acting in a systematic way to identify/mitigate early warning indicators against the key risks of fraud and unexpected corporate failure. The regulatory framework sets out what directors, auditors and others are required to do, what they should refrain from doing, and what will happen when those requirements are not met.
19. It is important to reduce the number and impact of high-profile corporate failures, but it is not possible to fully eliminate the risk of failure. Failure tends to result from broader economic shocks, capital reallocation for risk and/or the action/inaction of company directors. It is rarely due to deliberate sabotage but can be attributable to or exacerbated by fraud. Directors may respond inadequately to customer needs or take excessive financial risk: factors that should be properly controlled against and, when they occur, visible in corporate reporting.
20. This calls for focus on proper controls to ensure corporate reporting shows a true and fair view of a company's position and to help guard against fraud. Auditors also have a vital role to play, helping to ensure that financial statements can be trusted.
21. We underline the importance of an effective enforcement regime (see Q19.2). Improved corporate reporting should be a central remit for all relevant oversight bodies; regulators need to help facilitate improvement and innovation, as well as ensure compliance.

Question 5.2

If you responded that you think that there is a need to improve the quality of corporate governance, audit, audit supervision and/or supervision of corporate reporting, at what level should action be taken, rating the relevance of each level on a scale of 1 (strongly disagree) to 5 (strongly agree)?

Companies themselves should take action to improve their reporting	4
Auditors themselves should take action to improve audits	4
Audit supervisors themselves should take action to improve their functioning	4
Individual Member States should take action if the situation in their market requires this	4
The EU should take action	4
Several of the above should take action	4

Question 5.3

Please provide any further explanation supporting your views expressed in question 5.2:

22. Strengthening the overall ecosystem for corporate reporting needs to involve all key actors, including company boards, audit committees, investors, auditors and regulators.
23. We believe that there are measures that merit particular consideration and which could lead to important and achievable outcomes, including: –
    - Consideration of how the EU could help progress a multi-stakeholder initiative to develop indicators which focus on the quality of corporate reporting, alongside efforts to

establish a set of overarching audit quality objectives, supported by a wider basket of measures, including AQIs (Q4.1)

- Clarification of the responsibilities of management and auditors for internal control frameworks, including fraud and going concern. This should be accompanied by greater transparency across Europe over the consequences of failure (Q7.1, Q9.2, Q14.2)
- Encouraging a more consistent role for audit committees, including stronger dialogue between regulators, auditors and audit committees (Q7.1, Q9.2)
- Strengthening the core audit, with greater focus on fraud and going concern – as well as targeted steps to enhance audit quality, with a stronger emphasis on professional judgement (Q8.1, Q13.1, Q14.1.1, Q17.2)
- Consideration of how to ensure a more consistent and consistently robust system of corporate reporting review, based on a balanced view of the entire ecosystem (Q19.2)
- A broader reflection process on how to establish an affirming regulatory environment which facilitates improvement and innovation as well as ensuring compliance, informed by best practices in other sectors (Q13.1, Q17.1.1, Q19.1.1)
- Greater consistency across the EU in the application of existing rules to help ensure a more comparable experience for companies and audit firms active in the internal market (Q11, Q16.1).

Question 6

To what extent is there a need to modify the EU framework on corporate reporting to support the following objectives (on a scale of 1 (not at all necessary) to 5 (highly necessary)?

I. The green transition	5
II. The digital transition	4
III. Facilitating doing business by SMEs	4
IV. Reducing burdens and/or simplify	3
V. Better Corporate Social responsibility, including tax transparency and fair taxation	5

Question 6.1

Please provide, if needed, any further explanation supporting your views expressed in question 6:

24. While we are fully supportive of the overall EU objectives listed above, important work is already underway to modify the corporate reporting framework accordingly. In particular, we point to the proposals for a Corporate Reporting Sustainability Directive currently under legislative scrutiny. As noted in our response to the Commission's related feedback consultation in July 2021, we fully support the move towards a globally aligned corporate reporting system that encompasses financial and sustainability reporting.
25. Some of the current requirements may be excessive for smaller listed entities. Initiatives such as that on Less Complex Entities by the IAASB should be drawn on to ensure greater proportionality.
26. We note that initiatives such as the European Single Electronic Format (ESEF) are an important part of broader measures to enhance the digitalisation of capital markets information in the EU. For ESEF to deliver against its intended objectives, it will be important to ensure proper assurance of digital tagging (see also a related 2019 briefing paper by Accountancy Europe - https://bit.ly/3raO8iF).

PART II - CORPORATE GOVERNANCE

Question 7

On a scale of 1 (low) to 5 (high), how do you assess the effectiveness, efficiency, and coherence of the key features of the EU framework on corporate governance, considering how they underpin quality and reliability of corporate reporting?

Topic	I. Effectiveness in reaching its objective	II. Efficiency: has the framework been cost effective	III. Coherence with relevant EU rules
a) Board responsibilities for reporting	3	3	3
b) Liability of company boards for reporting	3	n/a	3
c) Obligation to establish an audit committee	3	3	3
d) Rules on the composition of the audit committee	3	3	3
e) Tasks of the audit committee	3	3	3
f) External position of the audit committee (eg, in relation to shareholders)	2	2	2

Question 7.1

Please describe the main issues you see, if any, as regards corporate governance (role boards, audit committee role, shareholders and other stakeholders) and, where possible, please provide concrete examples and evidence supporting your assessment.

You may consider the following aspects:

- ***Are there factors that have reduced the effectiveness / rendered the relevant EU framework less effective than anticipated? Which rules have proven less effective than anticipated?***
- ***Is there room to improve efficiency via further simplification?***
- ***Are existing provisions coherent with each other?***

27. A more robust regime for accountability over internal control could make real improvements to company resilience, reduce the risk of fraud and reduce the cost of capital. 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 (see also Q9.2).

28. Audit committees are a key feature of effective corporate governance but differ widely between sectors, types of entity and countries. For instance, the role and impact of audit committees in the financial services sector can be substantively different to those in other, less heavily regulated sectors. This makes it very difficult to provide single assessments of effectiveness and efficiency.

29. Qualitative research undertaken by ICAEW and Deloitte (https://bit.ly/3H0OuxQ) covering audit committees in 13 member states in 2017 and 2019 suggests that they generally have a positive impact in relation to core areas of responsibilities but face a number of issues, including:
    - Challenges in ensuring an appropriate mix of skills and experience as well as a diverse representation of individuals with an independent mindset
    - Significant increases in demands on time, particularly for regulated entities
    - Mixed levels of support provided by boards and/or management, including inconsistent access to training
    - Very differing approaches to assessing audit committee performance
    - Varying levels of engagement with shareholders and regulators, strongly influenced by an entity's corporate structure, ownership and sector of activity
    - Challenges in finding the appropriate balance between engaging and challenging management and the external auditor
    - Limited systematic assessments of audit quality
    - Differing approaches to risk management, often dependent on corporate form.

Question 8

Considering the level of material departures from IFRS reported in the ESMA report on Enforcement and regulatory activities of European enforcers in 2020, to what extent (on a scale of 1 (not at all) to 5 (to a very large extent)) can such departures be attributed to deficiencies of the EU framework on corporate governance?	2

Question 8.1

Please explain the main issues you see, and, where possible, please provide concrete examples and evidence supporting your assessment.

30. As noted in our response to Q18.1 we have concerns over the consistency and comparability of the member state data underlying the ESMA report which may point to issues of application and/or divergent inspection approaches between member state authorities.
31. Nonetheless, we consider that there is room to improve features of the existing EU framework on corporate governance to help raise the overall quality of corporate reporting. The starting point for any such improvements should be a focus on targeted measures to better enable companies to manage and/or mitigate key risks, including fraud, going concern, digital and sustainability matters. Recent Accountancy Europe papers provide some useful thinking on fraud and going concern (https://bit.ly/3unkSqF). As set out above (Q7.1), such measures should strengthen effective controls over company reporting while bringing greater consistency to audit committees.
32. We note the importance of encouraging a broader ecosystem of scrutiny that has the time and resources to properly consider corporate reporting. Corporate reporting must inform – not substitute – rigorous analysis of information and sound judgement on the part of users (and regulators).

Question 9

How effective and efficient would the following actions be in increasing the quality and reliability of reporting by listed companies, on a scale of 1 (Not effective/efficient) to 5 (Very effective/efficient)?

Areas	**I. Effectiveness**	**II. Efficiency in terms of cost / benefits of action**
a) Strengthen the (collective) responsibilities of the board / tasks for reporting / liability of boards for incorrect reporting	4	4
b) Require proper expertise of specific board members in relation to corporate reporting (internal controls, accounting framework, sustainability reporting, etc.)	4	4
c) Increase the responsibilities of specific board members (eg, Chief Executive Officer) or the Chief Financial Officer) and their liability on corporate reporting	3	3
d) Give company boards an explicit responsibility to establish effective risk management and internal control systems for the preparation of corporate reporting, including as regards controls for risks of fraud and going concern	5	5
e) More transparency of company boards about the effectiveness of the companies' risk management and report on the actions undertaken during the reporting period	5	5
f) Remove exemptions in EU legislation for establishing an audit committee	5	5
g) Increase the tasks of the audit committee, eg, for providing assurance on internal control systems for the avoidance of risk and fraud and going concern	4	4
h) Strengthen the external position of the audit committee (eg, vis-à-vis the auditor or by reporting to shareholders)	4	4
i) Require the setting up of specific whistle blowing procedures inside listed companies and supervisors of corporate reporting to strengthen the protection of whistle blowers	4	4
j) Require auditors to provide assurance on the systems and internal controls implemented by the board, including fraud, going concern and related reporting requirements	5	5
k) Strengthen the role of shareholders on corporate reporting	4	4

Question 9.1

Have you identified other actions that would effectively and efficiently increase the quality and reliability of reporting by listed companies?

33. Yes

Question 9.1.1

If you have replied 'yes' to question 9.1 please explain which action(s) you have in mind.

34. In the UK there has been considerable focus on the benefits of introducing a Resilience Statement. We believe achieving better visibility of resilience, without leading to boilerplate reporting, could help affect real change. If done properly, a Resilience Statement could pave the way to more qualitative disclosures on why an entity is viable in addition to what it has done to mitigate the risk that it might not be viable. This could be accompanied by wider use by companies of reverse stress testing. We explore the benefits of reverse stress testing in our 2020 paper, *Coronavirus: Introducing reverse stress testing* (https://bit.ly/3AvKYZU).

35. As noted in our responses to Q5.1 and Q19.1.1, we believe that improved corporate reporting should be a central remit for all relevant oversight bodies, focused on the creation of an affirming regulatory environment which facilitates improvement and innovation as well as ensuring compliance. This should include greater sharing of best corporate governance practices at both national and European level.

Question 9.2

Please provide any details to support your views. Any evidence, including on expected benefits and costs of such action is welcome.

36. We would strongly support clarification of the responsibilities of management and auditors for internal control frameworks, including fraud and going concern. This should include enhanced responsibility for internal controls, as well as a public statement on the effectiveness of internal controls, with auditor attestation. It should also be accompanied by greater transparency across Europe over the consequences of failure.

37. The principal benefits of such a regime are likely to be broadly similar to those experienced in the US under the SOX regime, including better corporate discipline, consistency, more robust challenge to management, fewer restatements, and fewer opportunities for individuals to undertake undetected material fraud. A simple transplant of the SOX regime into the EU is unlikely to be successful. Rather, consideration should be given to strengthening the internal controls framework around the following principles:
    - A high-level regime focused on the largest PIEs which ensures documentation and testing of key controls, accompanied by meaningful and effective granular detail to ensure real improvements
    - The involvement of external auditors and enabling audit committees to challenge management more robustly.

38. Audit committees can be a key component in an effective corporate governance and audit ecosystem. Where effective, they help ensure that the interests of investors and other stakeholders are adequately protected. Stronger dialogue between regulators and audit committees would enable issues of concern to be aired and good practice shared. "Improvement regulators" will need to be able to obtain evidence and disseminate best practice and areas requiring improvement in relation to audit committees.

PART III – STATUTORY AUDIT

Question 10

On a scale of 1 (low) to 5 (high), how do you assess the effectiveness, efficiency and the coherence with other relevant EU frameworks of the key features of EU audit legislation in so far as it applies to PIE auditors and audit firms:

Topic	I. Effectiveness in reaching its objective	II. Efficiency: has the framework been cost effective	III. Coherence with relevant EU rules
a) The rules on independence of auditors/audit firms and absence of conflicts of interest	4	3	2
b) The rules on the content of the audit and of the audit report	2	3	3
c) The rules applicable to non-audit services	3	3	3
d) The rules on auditor/audit firm rotation	3	3	2
e) The rules on transparency (transparency report, additional reports to other parties / audit committees/ supervisors)	4	4	4

Question 11

Please describe the main issues you see, if any, in the audit pillar and, where possible, please provide concrete examples and evidence supporting your assessment:

You may want to consider the following aspects:

- ***Are there factors that have reduced the effectiveness / rendered the relevant EU framework less effective than anticipated? Which rules have proven less effective than anticipated?***
- ***Is there scope to improve efficiency via further simplification?***
- ***Are existing provisions coherent with each other?***

39. We note that institutional and cultural differences between European countries impacts implementation of EU legislation. Recent academic research on the implementation of the 2014 EU audit package in Italy and the UK highlights the differential impact on auditors in the two countries with different corporate governance traditions (https://bit.ly/3rKID9j).

40. Use of member state options in applying current EU audit rules has led to a patchwork approach, particularly in relation to the prohibition of non-audit services and mandatory audit rotation. Research undertaken by Accountancy Europe suggests that there are 13 different auditor rotation regimes in place across the EU (https://bit.ly/3Gq1UC4).

41. Inefficient implementation can also undermine effectiveness. This may point to the need for greater consistency of implementation rather than a substantive re-write of the framework. Greater focus on how rules are applied across the EU could help ensure a more consistent experience for both companies and audit firms active across the internal market.
42. While EU legislation already sets strict rules on the provision of non-audit services, we would encourage more attention to the core ethical principles underpinning such rules. Consideration might also be given to promoting greater commonality of definitions. Such reflections need to be future-oriented, focused on areas where additional assurance services may help enhance audit quality in the public interest. We note here that the terminology adopted by the revised IESBA Code of Ethics which centres on non-assurance services rather than non-audit services may be helpful.
43. While the consultation is focused on PIEs, we caution against 'scope creep' to SMEs.

Question 12

On a scale of 1 (strongly disagree) to 5 (strongly agree), please share to which extent you agree to the following statements.

Question	Scale
I. Statutory audits contribute as much as is possible to the quality and reliability of corporate reporting by PIEs	4
II. I am satisfied with the role of the statutory auditors / audit firms of PIEs	4
III. The work of auditors is reliable so I trust their assessment and reports and their work inspires trust in capital markets	4
IV. There is not enough choice for public interest entities in finding an audit firm at appropriate costs	4
V. Joint audits contribute to the quality of audit	3

Question 12.1

If you want to add any comments, and/or mention specific issues you see you can insert them here. Where possible, please provide concrete examples and evidence supporting your assessment:

44. The FRC's 2021 Audit Quality Review based on a sample of UK PIE audits points to professional scepticism and challenge of management as areas which may need enhancing. ICAEW's latest non-PIE audit monitoring report suggests that audit quality remains broadly stable; evidence, documentation and identification/assessment of risk are areas for improvement. As the largest UK Recognised Supervisory Body, ICAEW monitors non-PIE audits undertaken by firms of all sizes.
45. We recognise that more choice is needed, particularly in the market for the largest audits. The Commission's market monitoring report and Audit Analytics data show fewer firms undertaking PIE audits. ICAEW saw a 23% reduction in registered audit firms (2015-2019). The declines may reflect increasing regulatory obligations, merger activity and/or loss of customers. Better understanding of the causes of decline would facilitate the design of policies to help reverse (rather than worsen) this trend (see also Q14.2, Q15.1).
46. Joint/shared audits are rarer than they used to be. The global reach of the largest firms means that a single firm can perform the entire group audit. In theory, the involvement of two firms should improve audit quality by encouraging different perspectives, greater levels of review and other quality control processes, and stronger management challenge. But it can

create scope for duplication or for issues to be overlooked. Measuring the effect on audit quality is challenging. It is difficult to separate the effects of involving another firm from other factors (eg, business environment, legal systems, insurance considerations, regulator behaviour, corporate governance requirements). The research evidence (eg, ECRI 2021, https://bit.ly/3J2XtiF) does not provide compelling positive support for the impact of joint audits on audit quality, nor does it suggest any significant deterioration in audit quality where joint audits have been replaced with audits by a single firm.

Question 13

The audit quality issues that occur most often at EU level are

- ***deficiencies in audit firms' internal quality control system***
- ***the lack of, or inappropriate, monitoring of high-risk audited entities***
- ***and the lack of audit evidence and documentation***

To what extent can these quality issues be attributed to deficiencies in the EU legal and supervisory framework for statutory audit (on a scale of 1 (not at all) to 5 (to a very large extent))?	3

Question 13.1

Please explain, and where possible, provide evidence for your assessment under question 13:

47. It is not straightforward to define or measure audit quality. One approach, common in some European countries, confines audit quality to compliance with auditing standards and legal requirements. If compliance is the sole determinant of audit quality, it is critical that standards and regulations are fit for purpose and that changes to them demonstrably impact auditor behaviour. A second approach, applied in other countries with varying degrees of rigour, requires auditors to do more than just comply with standards and rules in order to achieve audit quality. If this approach is right, it is critical that auditors, audit regulators, auditing standard-setters and other stakeholders are all clear, at least in general terms, about what more is needed and when.
48. Changes to legislation, regulation and standards all take time; in the meantime there are immediate steps that can be taken to improve audit quality. In our paper, *Audit quality: how to raise the bar*, we suggest a series of measures which could be taken (see Q4.1, Q14.1.1). We also note that most firms are in the process of implementing ISQM1, which should further enhance their systems of internal control and management. We suggest that this is given time to bed in.
49. We stress the importance of an affirming regulatory environment which facilitates improvement and innovation as well as ensuring compliance. This could include better sharing of audit quality results and best practice. The aspirations of the US PCAOB and the Canadian Public Accountability Board could provide inspiration. In the UK, a recent FRC paper *What Makes a Good Audit?* (https://bit.ly/3J6styh) also sets out good practice. We believe a stronger emphasis on professional judgement and a better exercise of scepticism should underpin oversight bodies' inspection regimes. Use of tools such as root cause analysis could help firms boost quality in cases where audit deficiencies are identified.

Question 14

How effective and efficient would the following actions be in increasing the quality of statutory audits of PIEs? On a scale of 1 (not effective/efficient) to 5 (very effective/efficient)?

Areas	I. Effectiveness	II. Efficiency in terms of cost / benefits of action
a) Ask auditors to disclose how they have assured the directors' statement on material fraud, and what steps they have taken to assess the effectiveness of the relevant internal controls and to detect any fraud	5	4
b) Strengthen the informational value of audit reports	4	3
c) Improve the internal governance of audit firms	4	n/a
d) Incentivise or mandate the performance of joint audits for PIEs, including to enhance competition on the PIE audit market	3	3
e) Further harmonise the rules on mandatory rotation	3	3
f) Limit the scope for statutory auditors and audit firms to provide non-audit services	3	3
g) Increase or eliminate caps on auditor liability, at least for cases of gross negligence of statutory auditors	1	1
h) Limit the number of Member State options in the EU Audit framework to ensure consistency across the EU and to incentivise cross-border statutory audits	4	4
i) The creation of a passporting system for PIE auditors and audit firms, allowing auditors to provide their services across the Union based on their approval in a Member State	4	3

Question 14.1

Have you identified other actions that would effectively and efficiently increase the quality and reliability of statutory audits of PIEs?

50. Yes

Question 14.1.1

If you have replied 'yes' to question 14.1 please explain which action(s) you have in mind.

51. Company boards, audit committees, auditors, investors, audit regulators and auditing standard-setters all have a role to play and a responsibility for audit quality. Our paper, *Audit quality: how to raise the bar* (see also Q4.1, Q13.1), sets out a number of recommendations, including:
    - Boards should do more to ensure that audit committees are properly equipped to provide a robust level of challenge to management and auditors. Audit regulators should do more to align the behaviours of audit inspectors with their aims and objectives

- Audit regulators, audit committees, investors and auditors need to work together to develop a basket of measures to help assess audit quality, including a framework and methodology for the calculation and reporting of AQIs
- Audit firms should continue to develop tools and techniques for flagging and managing manipulative and deceptive behaviour. Auditing standard-setters and policy makers should consider the additional tools auditors need to deal with such behaviour effectively
- Entities and audit firms should evaluate the costs and benefits associated with enhanced engagement with experts and specialists
- Firms of all sizes should consider adopting at least simple forms of root cause analysis at the engagement level
- Auditors and audit committees need to work to raise the profile of transparency reports. Audit regulators and investors need to use the information now available to further the debate on their role in promoting audit quality
- Standard-setters should take the opportunity to consider alternatives to the existing assumptions and models underlying auditing standards with a view to ensuring that high quality audit remains a relevant and valued service.

Question 14.2

Please provide any details to support your views. Any evidence, including on expected benefits and costs of such action is welcome.

52. The introduction of an Audit and Assurance Policy could improve understanding over the levels of assurance obtained over different elements of corporate reporting. Enabling companies to enhance their core financial statement audit with assurance over key strategic risk areas (eg, climate change adaptation, cybersecurity) could also help address the risks of fraud and failure. We would be happy to share details.
53. No audit firm wants to miss a material fraud. Many are taking practical steps to increase the rigour of work around fraud (eg, mandating training, use of sophisticated analytical techniques, developing new forensic tools and skills). Supervisors can play a key role in disseminating good practice, potentially also establishing fraud registers with due safeguards. This needs to go together with an enhanced internal control regime (see Q9.2).
54. We support the need to increase choice in the market for the largest audits. Most options discussed may not achieve substantial change quickly. In a UK context, we have noted that a combination of market share cap and managed shared audit may lead to positive change. Regulation and liability have important implications for efforts to increase competition and encourage innovation. If operating in PIE markets requires significant additional time for audit firms to respond to regulatory demands, then barriers to entry will persist. Fewer regulatory disincentives and less regulatory fragmentation will also help choice in the market. Addressing issues around passporting of qualifications, removing barriers to raising external capital, facilitating use of digital tools and encouraging more proportionate liability frameworks (also easing access to commercial insurance) could attract new and alternative entrants to the market. It could enhance the evolution of governance and investment in quality-of-service provision across countries by all firms, providing a more consistent experience for companies active across the EU.

PART IV – SUPERVISION OF PIE STATUTORY AUDITORS AND AUDIT FIRMS

Question 15

On a scale of 1 (low) to 5 (high), how do you assess the effectiveness, efficiency, and coherence of the key features of the EU supervisory framework for PIE statutory auditors and audit firms?

Topic	I. Effectiveness in reaching its objective	II. Efficiency: has the framework been cost effective	III. Coherence with relevant EU rules
a) The supervision of PIE statutory auditors and audit firms in the EU	3	3	3
b) The establishment and operation of national audit oversight bodies	3	3	3
c) The Member State systems for investigations and sanctions	3	3	3
d) The role of the CEAOB	3	3	3

Question 15.1

Please describe the main issues, if any, you see in relation to the supervision of statutory auditors and audit firms and, where possible, please provide concrete examples and evidence supporting your assessment:

You may want to consider the following aspects:

- ***Are there factors that have reduced the effectiveness / rendered the relevant EU framework less effective than anticipated? Which rules have proven less effective than anticipated?***
- ***Is there scope to improve efficiency via further simplification?***
- ***Are existing provisions coherent with each other?***

55. There are significant differences in supervisory structures and approaches across the EU (and beyond), making it difficult to provide a single assessment of their effectiveness and efficiency. Such differences may reflect the level of maturity of oversight bodies, the resources available to them, organisational culture as well as the broader administrative and legal context.

56. Based on peer-to-peer exchanges, including via the Quality Assurance Network for non-PIE Audit initiated by ICAEW, areas that could be considered with a view to promoting greater consistency in oversight approaches include:
    - The development of risk-based methodologies and investments in human resources to enhance professional judgement for effective quality assurance schemes
    - Addressing ‘legacy’ issues where audit qualifications and experience were formed prior to present-day expectations
    - Monitoring the adequacy of audit work, including with reference to adequacy of audit fees

- Development of a common principles-based approach to audit monitoring as well as a consistent audit file grading system
- Greater exchange of information on the impact of technological change
- More effective coordination between PIE and non-PIE audit monitoring which is efficient for the audit market and enables sustainable investment in quality assurance schemes by professional bodies where they have delegated responsibilities in this area.

57. Despite the focus of this consultation on the PIE market, there is a need to recognise that many of the rules intended for this part of the market are being applied to other entities too. Member state decisions on what falls under the PIE definition and how this is monitored have a bearing on how the rest of the audit system functions, with important consequences for audit firms, particularly smaller ones, as well as on the oversight process. Again, this may suggest the need for some focused consideration of the PIE definition and its purpose (see Q5).

Question 16

Considering the findings in the Commission monitoring report and reports of national audit oversight bodies how would you rate (on a scale of 1 to 5) the quality of audit supervision?	3

Question 16.1

If you want to add any comments and/or provide evidence for your assessment in question 16, you can provide it below. You may also include the consequences that your assessment of the quality of audit supervision or the lack thereof has.

58. As indicated in our responses to Q13.1 and Q14.2, we consider that this consultation process provides an opportune moment to consider how the overall European supervisory framework could evolve to ensure a more consistent experience for audit firms active in the internal market and that is aligned with the realities of business and stakeholder needs in the next decade(s).
59. We underline the importance of effective and focused regulators, governed by clear principles that set a tone and culture of "improvement" (see Q17.1.1). This should also include consideration of a proportional approach to the publication of outcomes of inspections. Bad performance needs to be called out, but more effort should be made to publicly convey improvements in standards and to portray a balanced view of the overall quality in a country.

Question 17

How effective and efficient would the following actions be to increase the quality and effectiveness of supervision of PIE statutory auditors and audit firms? On a scale of 1 (not effective/effective) to 5 (very effective/efficient)?

Areas	**I. Effectiveness**	**II. Efficiency in terms of cost / benefits of action**
a) Ensure better the independence and appropriate resources of supervisors of auditors and audit firms	4	4
b) Increase the transparency of audit supervisors	4	4
c) Increase the consistency of supervision of cross-border networks of audit firms	5	5

d) Ensure supervision of audit committees	5	4
e) Harmonise and strengthen the investigation and sanctioning powers of audit supervisors	3	3
f) Ensure that at European level there are legal instruments available that ensure supervisory convergence as regards statutory audit of PIEs	3	3
g) Grant a European body the task to register and supervise PIE statutory auditors and audit firms	3	3

Question 17.1

Have you identified other actions that would effectively and efficiently increase the quality and reliability of the supervision of PIE statutory auditors and audit firms?

60. Yes

Question 17.1.1

If you have replied 'yes' to question 17.1 please explain which action(s) you have in mind.

61. We believe regulators should support those they regulate to comply and grow, hear their views, communicate clearly and transparently with them, and focus activities where risks are highest. Encouraging such an approach across the EU regulatory spectrum could be transformational in reinforcing corporate governance standards and improving audit resilience and quality.
62. In our paper, *Principles for Good Financial Regulators* (https://bit.ly/3KIbyUh), we stress the importance of an iterative, improvement-based approach to regulation, focused on building trust and confidence, including in regulators themselves. Regulators should recognise the paramount importance of developing and embedding a culture of strong ethics, supported by robust monitoring and supervision. There should be a firm expectation in the marketplace that regulatory requirements will be enforced in both spirit and letter. Through this prism, the need for enforcement action represents regulatory failure, rather than success.
63. The tone and attitude of regulators is crucial in helping to build greater resilience, competition, choice and quality in the PIE audit market. As indicated previously (Q13.1, Q14.2), the threat of ever-greater regulatory risk and burdens discourages new entrants and can lead to existing firms withdrawing from the PIE market.

Question 17.2

Please provide any details to support your views. Any evidence, including on expected benefits and costs of such action is welcome.

64. Auditor behaviour is heavily influenced by the behaviour of audit inspectors. The quality and clarity of audit inspection findings are important; clarity about the significance of issues helps avoid inconsistencies in remedial actions. Not all issues are equally important. Compliance should not be conflated with audit quality. Demonstrable compliance with law and regulation is important but is a means to an end: audit quality requires more.
65. Audit inspectors necessarily focus on process and compliance with standards when assessing audit quality. This must be accompanied by greater consideration of the outcome of that process, and the extent to which the audit meets the needs of users of financial statements. Regulators need to be outcomes-driven if they want auditors to be the same.
66. There are several measures that could encourage a more comparable approach to supervision across Europe, focused on improving audit quality and enhancing the reliability of the audit opinion and financial statements (see Q14.1.1) including:
    - More focus on the characteristics of good quality audit, accompanied by greater efforts to communicate oversight bodies' understanding of audit quality, including by means of

case studies. We refer again to the FRC paper, *What Makes a Good Audit?* (see Q13.1)

- Better sharing of audit quality review results – the experience of the PCAOB and Canadian Public Accountability Board could be helpful in this regard.
- A stronger emphasis on professional judgement, underpinning oversight bodies' inspections regimes.

67. We note that a plethora of different AQIs are used by audit firms and audit regulators, as well as across different countries. We encourage audit regulators, audit committees, investors and auditors need to work together to develop a framework and methodology for the calculation and reporting of AQIs. A more consistent approach to assessing audit quality could be an important and achievable outcome from the consultation (see Q4.1).

PART V – SUPERVISION AND ENFORCEMENT OF CORPORATE REPORTING

Question 18

Considering the level of material departures from IFRS in the financial statements of listed companies found in the ESMA report on Enforcement and regulatory activities of European enforcers in 2020, how would you rate (on a scale of 1 to 5) the degree to which such departures can be attributed to deficiencies in the EU supervisory framework?	4

Question 18.1

If you want to add any comments and/or provide evidence for your assessment in question 18, you can provide it below. You may also include the consequences that your assessment of the quality of audit supervision or the lack thereof has.

68. While it is both important and necessary to evaluate both corporate reporting requirements and the accompanying supervisory structure, our broad assessment is that EU reporting requirements for listed companies have been and continue to be effective in ensuring stakeholder protection and promoting a more integrated capital market in the EU. This is in line with the main findings of the Commission's 2018 fitness check on the EU framework for public reporting by companies.
69. References to the ESMA findings require further context to avoid any misleading conclusions given variations in the levels of enforcement activity reported by individual European enforcers. Indeed, the ESMA report (annex 4) points out differences between enforcers which impact comparability. This may point to deficiencies in the way departures are defined and how data is collected and reported, rather than to significant deficiencies with the overall supervisory framework.
70. Enhancing the information around such findings, for instance by encouraging more consistent labelling and prioritisation across EU enforcers, would promote better understanding of the root causes of departures from IFRS.
71. We note that a risk-based approach to enforcement will by its nature be focused on entities and reporting areas with a higher risk: care must be therefore taken in extrapolating findings more broadly.

Question 19

How effective and efficient would the following actions be in increasing the quality and reliability of reporting by listed companies on a scale of 1 (not effective/efficient) to 5 (very effective/efficient)?

Areas	I. Effectiveness	II. Efficiency in terms of cost / benefits of action
a) Clarify the role and responsibilities of the national authorities charged with the enforcement of corporate reporting and entities to whom the supervision of corporate reporting is delegated/designated, and improve their cooperation	5	5
b) Improve the system for the exchange of information between authorities and entities involved in the supervision of corporate reporting, and other relevant national authorities	4	4

c) Strengthen the rules ensuring the independence of national authorities or entities involved in the supervision of corporate reporting	3	3
d) Increase the resources of national authorities or entities involved in the supervision of corporate reporting	5	4
e) Increase the powers for national competent authorities to enforce corporate reporting, such as forensic, powers to obtain any necessary information from banks, tax or any other authorities in the country, powers to request information and corrective actions, etc.	3	3
f) Improve cooperation and coordination between national authorities of different Member States	4	4
g) Increase transparency on the conduct and results of enforcement activities by national authorities	5	5
h) Strengthen the role of ESMA on the enforcement of corporate reporting	3	3

Question 19.1

Have you identified other actions that would effectively and efficiently increase the quality and reliability of the supervision of reporting by listed companies?

72. Yes

Question 19.1.1

If you have replied 'yes' to question 19.1 please explain which action(s) you have in mind.

73. We believe that improved corporate reporting should be a central objective for all relevant authorities, focused on the creation of an affirming regulatory environment which facilitates improvement and innovation as well as ensuring compliance.
74. It would be useful to prioritise practical measures to improve implementation of existing rules on supervision in a way that provides a more consistent experience for companies and audit firms active in the internal market. These measures could include steps to further enhance dialogue between authorities, listed companies and audit firms as well as improving coordination between relevant authorities within countries as well as between countries and the European level. Soft style pre-clearance could provide a purpose to such enhanced dialogues, without setting precedents or leading to hard interpretations on issues.
75. Consideration could also be given to encouraging countries to put in place processes to enable periodic assessments of the effectiveness of their competent authorities.
76. We believe this consultation process could usefully launch a broader debate on how to encourage a regulatory framework that is aligned to the realities of business and stakeholder needs in the 21st century.

Question 19.2

Please provide any details to support your views. Any evidence, including on expected benefits and costs of such action is welcome.

77. Robust enforcement is an essential corollary of good reporting. Attention to the proper application of standards and consistent enforcement across the EU should be accompanied by greater focus on improvement and innovation.

78. Stable funding, adequate resources and appropriately skilled and experienced staff are pre-requisites for an effectively functioning supervisory system. We note that this will be particularly important given the long-term goal of a more integrated corporate reporting structure encompassing both financial and sustainability reporting.

79. We agree that regulators may need additional powers to direct changes to company accounts to enable issues of non-compliance with accounting and other reporting requirements to be dealt with more directly and efficiently. However, 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 important decisions.