

# BEIS consultation: ‘Restoring trust in audit and corporate governance’

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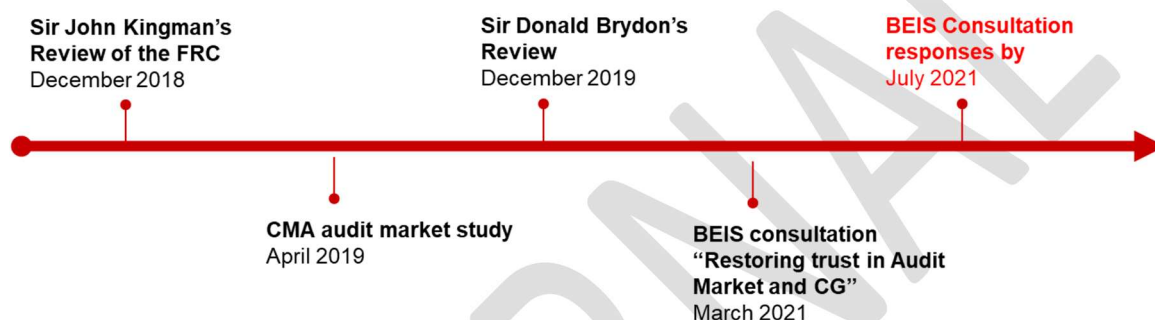
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# 1. Introduction

The Department for Business, Energy and Industrial Strategy (BEIS) has published its consultation, '[Restoring trust in audit and corporate governance](#)'. This consultation is the next step in the process of audit reform, including the setting up a **new regulator (ARGA)**.

## Timeline of audit reform reviews

This consultation's proposals respond to recommendations made by 3 independent reviews commissioned by the government: Sir John Kingman's Independent review of the FRC, the CMA audit market study and Sir Donald Brydon's independent review of the quality and effectiveness of audit, as shown in the timeline below.



## Reform objectives

The proposals aim to:

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

In the analysis below, we have followed the suggested *thematic analysis* presented by the FRC. For each section, the chapters of the BEIS consultation and the respective questions are outlined. This summary intends to highlight the key points raised by the BEIS consultation but does not intend to replace the 232-pages document. For a more detailed understanding, please refer to the original document. A list with the **key BEIS questions** for our stakeholders to consider has been included in the **Appendix** at the end of this summary.

## 2. Regulatory Framework<sup>1</sup>

### 2.1 Definition of PIE

The **Government proposes to extend the UK's PIE definition to include large companies within certain limits regardless** of whether they are admitted to trading on a regulated market. This will, for example, ensure that certain large private companies are now included within the definition of a PIE.

The consultation lays out two alternative approaches which could be used to identify the large companies which ought to be added to the PIE definition **on the basis of their size**:

<sup>1</sup> This theme covers Chapters 1, 2 and 4 of the BEIS consultation, and questions 1-11,12-18 and 28, respectively.

**Option 1: adopt the test used to identify those large companies<sup>2</sup> which are already required to include a corporate governance statement in their directors' report.**

**Option 2: a narrower test which incorporates the threshold for additional non-financial reporting requirements for existing PIEs<sup>3</sup>.**

## **2.2 Internal controls framework**

The section on internal controls frameworks refers to the **introduction of a UK version of a Sarbanes-Oxley ('SOX') style regime.**

The Government proposes a number of options (please see below **A, B and C**) about how that **new internal controls framework** might operate, including its preferred option (**option A**) which builds on and develops the UK's existing provisions.

**Option A:** Require an explicit **directors' statement** about the effectiveness of the internal control and risk management systems (estimated costs £168.8m)<sup>4</sup>

**Option B:** Require **auditors to report** more about their views on the effectiveness of companies' internal control systems (estimated costs £168.9m)

**Option C:** Require **auditors to express a formal opinion on the directors' assessment** of the effectiveness of the internal control systems (estimated costs £269.8m)

As noted above, the Government's preferred option is **option A**. In terms of external audit and assurance it suggests that: "**Companies should be required to have their internal controls assured by an external auditor in limited circumstances (e.g. where there has been a serious and demonstrable failure of internal controls or whether material control weaknesses have persisted over several years)**"(p.49).

Further, in relation to the enforcement powers, the Government suggests that "there should be **effective powers to sanction directors** where they have failed to establish and maintain an adequate internal control structure and procedures for financial reporting" (p.50).

## **2.3 Set up of ARGA**

Some key aspects of the set-up of the new regulator (ARGA) which are important to be taken into consideration are the following. ARGAs will be:

- Established as a **company limited by guarantee**
- Given clear statutory objectives and functions
- Governed by a new, smaller board to improve effectiveness and responsiveness
- **Given strategic direction by Government** and **accountable to Parliament**
- **Funded by a statutory levy**

In regard to the later, at the moment, **the costs incurred by the FRC** in carrying out its regulatory activities relating to audit, corporate reporting and corporate governance **are mainly met by the professional bodies and preparers of accounts.** Around half of these

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<sup>2</sup> This provision covers all companies with either: More than 2,000 employees; or a turnover of more than £200 million and a balance sheet of more than £2 billion.

<sup>3</sup> This would mean the definition of a PIE was only extended to large companies with both: Over 500 employees and a turnover of more than £500 million.

<sup>4</sup>Based on the "[Consultation Impact Assessment](#)" also published by the Government along with the BEIS consultation. This report provides an exercise of the *impact assessment* of the BEIS recommendations.

costs are met by the audit and accountancy professional bodies who either have a statutory obligation to meet them or do so under contractual arrangements. The remaining half is voluntarily met by “preparers of accounts”; these include companies listed on the London Stock Exchange, large private companies, and public sector organisations.

### 3. Corporate Reporting and Governance<sup>5</sup>

#### 3.1 Resilience statement

The Government proposes to introduce a **statutory requirement on public interest entities to publish an annual Resilience Statement**, consolidating and building on the existing going concern and viability statements.

- The statement will be required initially for **premium listed companies** only.
- The government intends to extend the requirement to provide a Resilience Statement to other Public Interest Entities within two years of it coming into force for plcs.
- Mandatory assessment period should be five years
- At least two reverse stress testing scenarios in their Resilience Statement

In terms of content, the Resilience Statement aims to address **business resilience over the short, medium and long- term**.

**Short-term section:** Companies’ existing going concern statement, including disclosure of any material uncertainties considered by management during their going concern assessment, which were subsequently determined not to be material after the use of significant judgement and/or the introduction of mitigating action.

**Medium-term section:** Incorporate the existing viability statement requirements to provide an assessment of the company’s prospects and resilience, and to address matters which may threaten the company’s ability to continue in operation and meet its financial liabilities as they fall due.

**The Government proposes to require further specific disclosures in both the short and medium-term sections of the Resilience Statement.**

These might include:

- Threats to liquidity, solvency and business continuity in response to a major disruptive event (such as a pandemic) which disrupts normal trading conditions
- Supply chain resilience and any other areas of significant business dependency (e.g. on particular markets, products or services)
- Digital security risks (both including external cyber security threats and the risk of major data breaches arising from internal lapses)
- The business investment needs of the company to remain productive and viable
- The sustainability of the company’s dividend and wider distribution policy
- Climate change risk

#### 3.2 Audit and assurance policy

The Government proposes to introduce a **statutory requirement on public interest entities to publish an annual audit and assurance policy**.

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<sup>5</sup> This theme refers to chapter 3 of the BEIS consultation, covering questions: 19-27

- The audit and assurance policy describes the company's approach to seeking assurance of its reported information **over the next three years**.
- The consultation sets out some possible content for the audit and assurance policy.

#### *Proposed timing*

The Government is minded that the Policy would be **required initially of premium listed** companies and extend to other public interest entities two years later. In the case of quoted public listed entities, the Policy would be subject to an advisory shareholder vote at the time of its publication.

The Government is inviting views on whether the policy should include the following new disclosures **at a minimum**:

**An explanation of what independent assurance, if any, the company intends to obtain in the next three years in relation to the annual report and other company disclosures beyond required by statutory audit.**

This should include an explanation of what independent assurance, if any, the company plans to obtain in relation to:

- The company's **Resilience Statement** in whole or part, and other disclosures related to risk
- The **effectiveness of the company's internal controls framework**
- **A description of the company's internal auditing and assurance processes**. This might include how management conclusions and judgements in the annual report and accounts can be challenged and verified internally and whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years.
- A description of what policies the company may have in relation to the tendering of external audit services (for example, whether the company is prepared to allow the external company auditor to provide permitted non-audit services).
- An explanation of whether, and if so how, shareholder and employee views have been taken into account in the formulation of the audit and assurance policy.

**“While the Government is not mandating an extension of statutory audit, it recognises that an Audit and Assurance Policy can be expected to lead to more companies considering whether independent assurance is desirable on elements of company reporting that require specialist knowledge and skills which financial auditors may not be able to provide. In this respect, the Brydon Review proposal for a corporate auditing profession, underpinned by a common purpose and set of principles and extending to the auditing of all kinds of company reporting, will help enable existing and future auditors to meet increased business needs for assurance within a consistent auditing and assurance framework” (p.67)**

### **3.3 Capital maintenance**

The Government seeks views on proposals for **strengthening the law on dividends and capital maintenance in a proportionate way**.

The Government's proposals include:

- Assigning **responsibility for defining realised profits and losses to ARGA** and enhancing the legal status and enforceability of the definition
- Introducing some new statutory reporting requirements.

Regarding the definition of realised profits, the Government proposes the following two alternative reform options:

**1. Giving ARGA a duty to prepare guidance on what should be treated as realised profits and losses in accordance with generally accepted principles prevailing at the time.**

This guidance **would be given authoritative status** by providing in the Companies Act 2006 that, in interpreting what are realised profits and losses according to generally accepted principles, regard should be had to the guidance produced by the regulator.

**2. Giving ARGA powers to make binding rules as to the meaning of realised profits and losses with which preparers would have to comply.**

The rules would be established by reference to the prevailing generally accepted principles. Before making the rules, ARGAs could also be required to obtain the consent of the Secretary of State for what is being proposed.

Further, the consultation proposes introducing some **new statutory reporting requirements**:

- Disclosure of the distributable reserves in the financial statements
- Disclosure of estimates of a group's dividend-paying capacity
- A new directors' statement about the legality of proposed dividends and the effects on the future solvency of the company

**3.4 Malus and clawback<sup>6</sup>**

Giving the new regulator stronger powers to take enforcement action against company directors for breaches of their existing statutory duties.

**The consultation suggests that the Government will initially ask the regulator to consult on changes to the UK Corporate Governance Code** to include provisions which recommend that certain minimum clawback conditions or "trigger points" are included in directors' remuneration arrangements and that these have a minimum period of application of at least two years after an award is made. Following a review, the Government will then consider whether there is a need to further extend this to all listed companies, potentially through the Listing Rules.

**The Government proposes to strengthen malus and clawback arrangements to provide better reassurance against rewards for failure.**

•The Government is clear that companies should be able to and should actively consider adding to these minimum conditions to reflect company-specific circumstances.

The following are proposed as **minimum conditions within which clawback provisions can be triggered**:

- material misstatement of results or an error in performance calculations;
- material failure of risk management and internal controls;
- misconduct;
- conduct leading to financial loss;
- reputational damage; and
- unreasonable failure to protect the interests of employees and customers.

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<sup>6</sup> The ability to recover remuneration already paid to directors (clawback) or to withhold pending awards (malus) are important mechanisms in directors' remuneration arrangements.



## 4. Audit Scope<sup>7</sup>

This chapter considers the Review's findings on audit and sets out the action the Government proposes to take. These proposals **include establishing a new corporate auditing profession, new principles** for auditors to reinforce good audit practice, **a new duty on auditors to take a wider range of information into account in reaching audit judgements**, and **new obligations on auditors and directors relating to the detection and prevention of material fraud**.

### 4.1 Purpose and scope of audit

The Government agrees that audit needs to change along the broad lines proposed by the Brydon Review.

This results in two key areas of focus:

- Giving auditors a specific responsibility to consider relevant director conduct and wider financial or other information in reaching their judgements. This would be a statutory requirement of auditors.
- Adopting the Brydon Review's proposed purpose of audit as a broad ambition for its own programme of reforms, and to ask the new regulator to incorporate that ambition across the relevant parts of its work.

### The Government's position

The Government agrees with the Brydon Review that **it should generally be for companies and their shareholders to decide the scope of the external auditing** which is obtained beyond the statutory audit of the financial statements.

Brydon's suggested purpose is:

***"To help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements."***

"Although the principle of considering wider information is relatively simple, the Government considers that statutory auditors are likely to benefit from having detailed requirements set out, in a similar manner to auditing standards. These requirements would be set by the regulator and enforceable on statutory auditors, much as existing auditing standards are." (para 6.1.12, p.95)

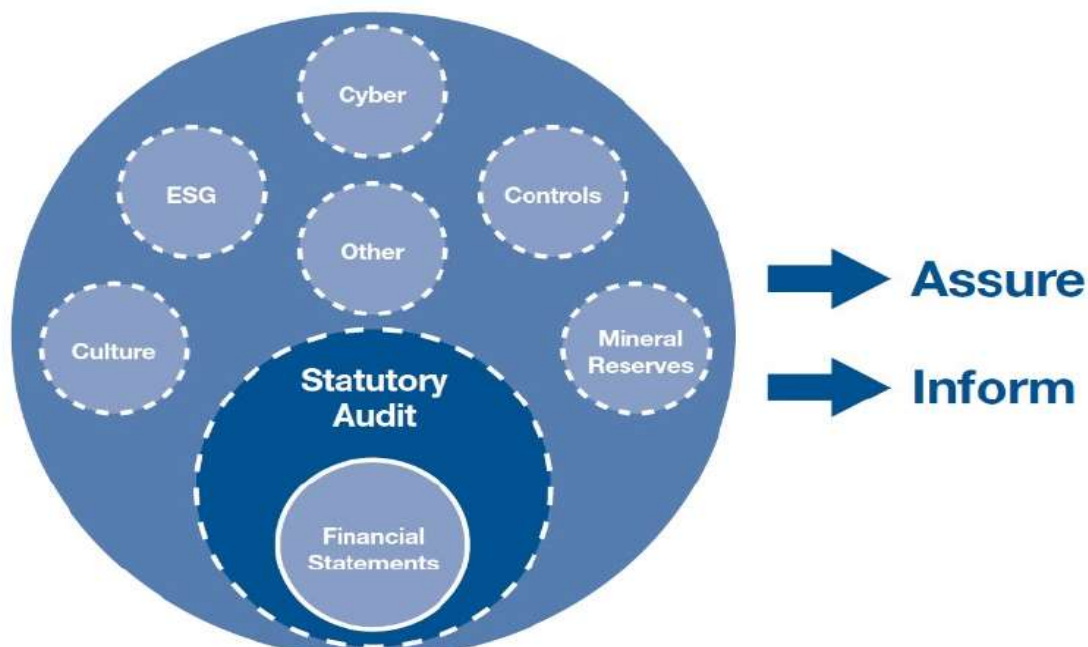
The Government agrees with the Brydon Review **that it should generally be for companies and their shareholders to decide the scope of the external auditing (and communicate this via its Audit and Assurance Policy<sup>8</sup>) **which is obtained beyond the statutory audit of the financial statements**. The external auditing which a company chooses to obtain via its Audit and Assurance Policy should be subject to oversight by the regulator.**

<sup>7</sup> This theme covers Chapter 6 and questions 35-51

<sup>8</sup> For a better understanding of the Audit and Assurance Policy (AAP), please refer to section 3. Above.

# New model

## Audit



The Government proposes the following:

- Introduce a regulatory framework to **cover both audits of financial statements** (referred to as **statutory audit**) and **other types of information** which companies decide to have audited via the **Audit and Assurance Policy process** ("**wider audit**").
- The new regulator should oversee the provision of these wider audit services, including through the creation of a framework for all "**corporate auditing**", covering both the auditing of financial statements and the auditing of this wider information.
- To **give the regulator some functions** in relation to all corporate auditors (i.e. statutory auditors and those providing wider audit services via the AAP), including settling and enforcing standards applicable to corporate auditing as a whole.
- For the auditing of additional information to have the benefits of increased confidence identified by the Review, it will need to be clear to users of company reporting **what level of assurance**, if any, has been obtained in respect of that information.

### 4.2 Principles of corporate auditing

The Government agrees with the Brydon Review that overarching requirements should be placed on auditors in order to direct the profession *towards a stronger ethos of scepticism, challenge and informativeness*. The Government proposes to do this through **a set of binding principles** (please see below) to be determined and enforced by the regulator. Those principles would apply to both statutory auditors and those providing **wider auditing services** via **the Audit and Assurance Policy**.



#### **Audit Principles suggested by the Brydon Review (from para 6.4.2 of the Review)**

- Auditors act with integrity, fulfilling their responsibilities with honesty, fairness, candour, courage and confidentiality;
- Auditors are appropriately qualified and exercise professional judgment and appropriate scepticism or suspicion throughout their work;
- Auditors act in the public interest and have regard to the interests of the users of their report beyond solely those of shareholders;
- Auditors maintain independence from the entity and its officers on whom they are engaged to report;
- Auditors are objective and provide findings and opinions unaffected by bias, prejudice, compromise and personal or corporate conflicts of interest;
- Auditors work to verify and encourage openness and honesty in financial and other company reporting;
- Auditors ask the directors to report any material information that may legitimately be disclosed to assist the understanding of users of an audit report, and, if necessary, disclose it themselves;
- Auditors provide appropriate challenge to management, assessing critically information and explanations received for signs of over-optimism, judgmental bias or possible fraud;
- Auditors' reports contain clear findings and expressions of opinion setting out all information necessary for a proper understanding of the opinion and its basis; and
- Auditors' reports give transparency to any differences of view with management and how they were resolved.

#### **4.4 Tackling fraud**

The Government proposes to legislate to require directors of Public Interest Entities to report on the steps they have taken to prevent and detect material fraud.

##### *Auditor reporting on fraud*

In line with the Brydon Review's recommendation, **the Government intends to legislate to require auditors of Public Interest Entities, as part of their statutory audit, to report on the work they performed to conclude whether the proposed directors' statement regarding actions taken to prevent and detect material fraud is factually accurate**. Such reporting will enable users to understand the nature and extent of the work performed and the evidence obtained by the auditors relating to the actions which the directors state they have taken.

#### **4.5 Auditor reporting**

The Brydon Review made a number of specific recommendations for improvements to auditor reporting. These include auditors being required to report on the following areas:

- The extent to which their audit work was informed by external signals of an enhanced risk profile for the company whose financial statements were being audited (Brydon Review paragraph 16.4)
- An update on Key Audit Matters reported in the previous two years, along with how the company has responded to deficiencies identified in the prior year's audit (17.3.3)
- The reasons for and basis of any sampling techniques used in the audit (24.1.11)
- The number of hours spent conducting the audit, analysed by level of seniority (25.2.5)
- Any risks omitted from the Risk Report which the auditor considers to be significant (9.1.6)
- In the light of the auditor's knowledge of the company and its processes, whether the company's section 172 statement reflects "observed reality" (8.4.3)

The Brydon Review recommended "the evolution of graduated findings be left to the marketplace for audit services" with Boards reflecting their decisions (after taking account of shareholders' views) in their Audit and Assurance Policy. It suggested that allowing freer form reporting to develop was likely to lead to users being better informed, while requiring a particular type of "graduated findings" to be reported was more likely to lead to a new form of boilerplate.

It also noted that a choice of product for directors would be good for competition in the audit market. The Review concluded that the proposed Principles of Corporate Auditing, rather than more rules, should inform auditor behaviour in this area.

The proposed new duty for the auditor to consider wider information (paragraph 6.1.10 above) should encompass assessing external signals of an enhanced risk profile for the company, any significant risks omitted from the Risk Report, and whether the company's section 172 statement reflects "observed reality".

#### **4.6 A new professional body for corporate auditors**

The Government proposes to put an appropriate framework in place to facilitate the establishment of **a new professional body for external auditors of all types of corporate information.**

The Government believes that **a new, distinct professional body for corporate auditors should be created** to help create a climate for wider audit and enable good audit practice to thrive across corporate audit disciplines. The rationale is that the expansion of audit to corporate auditing is a significant change and is likely to require significant change to the current professional arrangements for audit.

Auditors have to be members of, and obtain qualifications from, professional accountancy bodies formally recognised by the regulator in order to perform statutory audits of a company's accounts. It would be possible to achieve some of the benefits of reform by requiring in legislation that the regulator only 'recognise' bodies which have certain rules in place (for example, adoption of a set of audit principles with which their members must comply when carrying out corporate audits).

However, **simply enforcing compliance with the principles might not lead to bodies promoting the benefits of the 'wider audit'** discussed above or developing the training needed to underpin higher standards of audit (though the latter could potentially also be made a requirement).

**Another way** to address the issue of reliance on the accountancy professional bodies would be to require **separation as between the functions of those bodies in relation to auditors**

**and their functions relating to other members.** However, there are risks that effecting the functional separation of these bodies might not create the cultural and other separation that the Review saw as essential to delivering the intended benefits of reform. There is also a risk that professional bodies could simply opt to cease supervising and providing qualification to statutory auditors, which would not be an acceptable outcome unless there were appropriate alternative supervision and qualification arrangements.

“The establishment of a distinct professional body therefore has potential to do more.”  
(para 6.9.13 - p.120)

## 5. Quality and Competition in the audit market<sup>9</sup>

### 5.1 Operational separation:

- The Government shares the concerns raised by the CMA that the multidisciplinary structure within large firms has resulted in behavioural and financial incentives that sometimes lead to poor quality audits.
- It has therefore brought forward the CMA’s central recommendation to use **operational separation** to strengthen the oversight of audit practice.
- The Government’s central proposal is to give ARGA powers to strengthen the governance of audit practices, building on the FRC’s principles published in July 2020.

The Big4 firms have already agreed to move towards operational separation on a *voluntary* basis, but the government’s plan is to **legislate** to support that.

In line with the Principles of Operational Separation the FRC agreed with the larger firms last year, the Government proposes to require:

- **The strengthening of governance within audit practices through the creation of Independent Audit Boards within firms:** The firms already have independent non-executives who are responsible for performing the public interest oversight of the activities. This consultation aims to take this further, and allow ARGA, via legislation, to oversee this audit practice and this will take place via creation the audit boards which will comprise of a number of independent audit people, including one person at least who has no responsibility of the oversight of the wider firms.
- Audit Boards to have oversight of audit partner remuneration and ensure it is linked to audit quality
- The publication of **a separate profit and loss account for the audit practice**, accounting for cross subsidies between the audit practice and the rest of the firm through arm’s-length transfer pricing
- **Regulatory oversight of the remuneration of audit partners**, with a view to support policies and practices that reward high-quality audits

The Government envisages that the measures proposed will apply initially to audit firms who carry out statutory audits of 15% or more of the FTSE 350 by audit fees.

The Government intends to take appropriate powers to enable the regulator to deliver a full structural separation in future, subject to consultation and Parliamentary scrutiny. This is based on the CMA’s proposal to revisit the option to require a full structural split once its recommendations have been implemented and had time to take effect. i.e. **it will be evaluated**

<sup>9</sup> Chapters 7 and 8 of the BEIS consultation, Q52-60 and 61-68, respectively.

in the future, and after the implementation of the operational separation, if a structural separation is necessary or not.

## 5.2 Managed shared audits

To address the concerns that the audit of FTSE 350 companies is **highly concentrated**, and there is a great challenge to gain FTSE 350 tenders and to gain experience of auditing for FTSE350 clients, and this is detrimental to audit quality and audit market resilience.

- **The Government agrees with the CMA's conclusion that the market would benefit from increased participation from a wider range of firms.**
- It therefore **proposes that managed shared audit applies to all UK-registered FTSE 350 companies.**
- Limited exceptions apply to:
  - those who appoint a Challenger<sup>10</sup> firm as their sole audit firm
  - those that have not been a FTSE 250 company for at least half of the annual accounting period prior to the audit appointment and are not a FTSE 350 company when the audit tender process begins.

Managed shared audit would require companies to identify a *meaningful proportion* of the audits of statutory entities within the group for bids from Challenger firms only.

The Government believes that this will increase choice and support new entrants to the FTSE 350 audit market in an effective, efficient and proportionate way.

**This is instead of the CMA's proposed joint audit regime, with which the Government had a number of concerns, including the joint and several liability which results from joint audits.**

Detailed and binding requirements would be issued; it is currently proposed that these would include:

- A Challenger firm to be appointed to carry out a *meaningful proportion* of the group's statutory audits: **The Government suggests that this could be determined and calculated with reference to the total amount of the audit fee in the prior year, Revenues**
- The company's audit committee identifying through its audit tender planning subsidiaries that could be audited by a Challenger
- The Challenger being liable for its audit of the relevant subsidiaries (but not for the group audit)
- The Challenger firm having access to and engagement with the FTSE 350 company's main (group) audit committee

Indicative modelling by BEIS, summarised in the accompanying Impact Assessment, indicates that Challengers could achieve 9.1% to 12% share of the FTSE 350 audit market by share of fees after ten years, in line with the CMA's modelling for joint audit.

The Government also suggests that there could be merit in the Challenger subsidiaries being rotated during the term of the audit contract to provide the Challengers with greater exposure to the company. The Government suggests that this creates greater flexibility between the two firms. After a period of time, expected to be between five and nine years, there would be a review of its effectiveness in increasing choice and supporting new entrants to the FTSE 350

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<sup>10</sup> By Challenger, it means a firm that provides statutory audits to PIEs and whose audit revenue did not represent more than 15% of the FTSE 350 statutory audit market by fees in either of the previous two years).

audit market. If the review concluded that managed shared audit was making sufficient progress it would be expected to be retained for a further period.

### ***Regulation and phasing***

This requirement would be phased in by **requiring companies, acting through their audit committees, to adopt Managed Shared Audit when their audit contract is re-tendered, rather than at an actual reappointment.**

The expectation is that the regulator would monitor companies' compliance with the managed shared audit requirements, and would therefore have powers to request information from, and engagement with, FTSE 350 companies and audit firms. The regulator would also have enforcement and sanctioning powers against companies that do not comply with the requirements.

The Government also proposes a **reserve power for the Secretary of State** to allow the regulator to introduce a market share cap. This would be operated following joint review by BEIS and the regulator, should mandatory shared audits not bring about the desired change to the FTSE 350 audit market in a reasonable time frame.

### **5.3 Audit Committee oversight**

Both the CMA and Kingman Reviews noted that the commercial relationship between a company's audit committee and its chosen auditor could result in a **lack of professional scepticism** being exercised by both parties.

The Government therefore proposes **to give ARGA powers to set additional requirements** as to the audit committee's role in the appointment and oversight of auditors.

ARGA's proposed powers will ensure that the audit committee acts effectively as an independent body responsible for safeguarding the interests of shareholders and other users of accountants.

#### **What are the Government's proposals?**

- Require ARGA to impose additional requirements on audit committees in relation to the **appointment and oversight of audits**. These requirements will cover the need for audit committees to continuously monitor audit quality, and consistently demand challenge and scepticism from auditors.
- Regulatory powers for ARGA where problems exist, such as when an auditor resigns, when a PIE is unable to find an auditor, or when a persistent issue with audit quality identified.
- ARGA will consider how the new requirements it develops will fit alongside the existing obligations which apply to audit committees, and it would also continue to issue guidance to assist companies and those serving on audit committees.
- Any new requirements imposed by ARGA should allow for audit committees to exercise discretion and professional judgement and for innovative best practice to develop.
- Impose a duty on ARGA to monitor compliance with the new audit committee requirements, including through a power to require information and/or reports from audit committees, and a power to place an observer on audit committees if necessary.
- Give ARGA the ability to take action against company directors and/or the audit committee for breaching the new audit committee requirements, with the regulator taking action in proportionate stages and giving the audit committee the opportunity to address any issues of regulatory concern before taking remedial steps publicly.



## 6. Supervision<sup>11</sup>

### 6.1 Scope of Corporate Reporting Review

**The Government will give the regulator powers allowing it to publish correspondence entered into during the course of a CRR, as well as summary findings.**

The regulator's current CRR powers currently only extend to certain parts of the annual report and accounts, namely the strategic report, the accounts themselves and the directors' report.

This means that important – required – aspects of the annual report relating to corporate governance are not subject to formal FRC oversight. This includes the corporate governance statement (unless this is included in the directors' report) and the directors' remuneration and audit committee reports.

The Government will accordingly legislate to extend both the existing power to request information from companies and the new power to direct changes to accounts to cover the entire content of the annual report.

The FRC Review recommended that the regulator should be able to offer companies a pre-clearance service for novel and contentious matters connected with the interpretation of accounting standards in advance of the publication of the annual reports.

### 6.2 Scope of Audit Quality Review

#### *Government proposals and intended outcomes*

The Government intends to provide the regulator with its own powers to require a UK group auditor to provide it with access to overseas component working papers, instead of relying on the RSB<sup>12</sup> rules, in order to enable the regulator to assess more thoroughly how well the UK group auditor has discharged its responsibilities.

Under the proposed power for the regulator to access overseas component working papers, where those papers are accessed and examined as part of an AQR inspection, the regulator might have concerns about the UK group auditor's engagement with the overseas component auditors or could identify a potential breach by the UK group auditor of a relevant audit requirement.

In these cases, it is intended the regulator could investigate and, if appropriate, take enforcement action against the UK group auditor under existing audit enforcement procedures. The Government considers enforcement action against the UK group auditor is appropriate, and there are sufficient powers to enable this.

### 6.3 PIE auditor Registration

#### Responsibility for appointment decisions

The Government has concluded that the regulator should carry out the task of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs, rather than continuing the present delegation of this task to the RSBs.

The RSBs would continue to carry out the delegated task of determining whether individuals and firms are eligible to be appointed as statutory auditors of non-PIE entities.

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<sup>11</sup> This theme covers chapters 9 and 11 and questions

<sup>12</sup> The Association of Chartered Certified Accountants (ACCA) and the three Institutes of Chartered Accountants (ICAEW, ICAS and CAI) are Recognised Supervisory Bodies (RSBs).



The Government considers that the task of entering ARGA-approved individuals and firms onto the register of statutory auditors should fall to the RSBs, which are better placed to carry it out.

## **7. Enforcement<sup>13</sup>**

### **7.1 Enforcement in relation to company directors**

The Government intends to legislate to provide ARGA with the necessary powers to investigate and sanction breaches of corporate reporting and audit-related responsibilities by all PIE directors.

#### *Sanctions*

The consultation considers new investigation and enforcement powers, giving the regulator powers to gather information and carry out investigations to establish whether a director has breached a relevant requirement, and to impose sanctions in cases where a breach is found to have occurred.

- The regime would provide a graduated range of civil sanctions that could be applied by the regulator where a breach was proven.
- The civil standard of proof 'on the balance of probabilities' would apply when deciding disputed facts.
- The regulator would be required to apply sanctions in a proportionate manner according to the seriousness of the breach and risk posed by the director's conduct.

### **7.2 Enforcement in relation to accountants & professional bodies**

#### *Code of ethics*

The Government proposes to give the regulator the power to establish a standardised code of ethics with which members of the chartered bodies (either individuals or firms) would be required to comply and which would be enforceable by the regulator using its new powers.

- Chartered bodies would be able to add additional ethical requirements specific to their membership which would be enforceable by them.
- The new code of ethics would aim to standardise the variations between the core elements of each ethical standard, based on the International Code of Ethics for Professional Accountants so that consistent standards apply across the profession.

#### *Sanctions- Accountants*

The Government proposes to give the regulator powers to gather information and carry out investigations to establish whether an individual or firm has breached the required standards, and to impose sanctions in cases where a breach is found to have occurred.

#### *Supervision: Accountants and their professional bodies*

At the moment, participation in the regulator's oversight arrangements by the chartered professional accountancy bodies is voluntary. The regulator's proposed new power in respect of participating professional bodies will be significantly undermined if bodies are free to opt out of them. The Government instead proposes to legislate to require the chartered bodies to comply with oversight arrangements set by the regulator (para 11.1.22).

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<sup>13</sup> This theme covers Chapters 5, 9, 10 and 11 of the BEIS consultation, and questions 29-34, 69-73, 74-75 and 76-98 respectively.

### *Power to direct the professional accountancy bodies to take action*

“The Government accepts the FRC Review’s recommendation that the regulator should be given a power to direct the relevant accountancy bodies to take action in relation to the areas within scope of its oversight activities and intends to legislate to that effect [...] However, the expectation is that the power would be used rarely and only where a professional body had failed to take action to address the regulator’s concerns within a reasonable period set by the regulator” (para 11.1.29).

### **7.3 Oversight and regulation of the actuarial profession**

The Government thinks that responsibility for the oversight and regulation of the actuarial profession sits more appropriately with ARGA than the PRA and proposes that ARGA should be responsible for the oversight and regulation of the actuarial profession.

The Government therefore proposes to introduce a strengthened, statutory basis for the regulation of the actuarial profession with clear and defined roles and responsibilities.

The Government sees merit in the case for regulating actuarial work undertaken by entities in addition to the regulation of individual professionals that undertake actuarial work. The Government proposes that this regulation should be placed on the same statutory basis as for individual professionals.

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## 8. Appendix

### Key BEIS Questions<sup>14</sup> for our stakeholders to consider

#### Regulatory Framework

12. Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?

13. If the control framework were to be strengthened, would you support the Government's initial preferred option (Table 2)? Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?

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

#### Corporate Reporting and Governance

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?

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?

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

#### Audit Scope

35. Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?

36. In addition to any new statutory requirement on auditors to consider wider information, should a new purpose of audit be adopted by the regulator, or otherwise? How would you expect this to work?

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?

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?

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

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<sup>14</sup> Please note that the question numbers follow the BEIS consultation ones and are NOT sequential.

49. What would be the best way of establishing a new professional body for corporate auditors that helps deliver the Government's objectives for audit? What transitional arrangements would be needed for the new professional body to be successful?

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

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

#### **Quality & Competition in the Audit Market**

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?

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?

#### **Supervision & Enforcement**

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?

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?