

Department for Business, Energy and
Industrial Strategy

Restoring trust in audit and corporate
governance

JOINT RESPONSE FROM:

United Kingdom Shareholders' Association

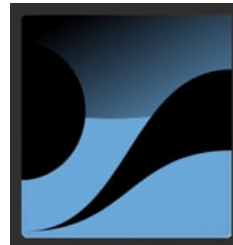
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Restoring trust in audit and corporate governance

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1. Introduction with our key points

1. As the consultation document acknowledges in its Executive Summary, “stakeholder and wider public trust in the credibility of directors’ reporting and the statutory audit has been shaken by a succession of sudden and major corporate collapses which have caused serious economic and social damage.”
2. We consider that these collapses should not simply be attributed to “a few bad actors.”
3. These collapses have highlighted major systemic failings in the current system of corporate governance, reporting and auditing; despite most good actors behaving responsibly and in good faith.
4. ShareSoc and UKSA approve of and support the thrust of the proposed changes. The proposals set out in the consultation document should improve the situation, if implemented. However, we believe that in many cases they do not go far enough and point out how they could go further.
5. While our responses to your consultation questions and the additional material in our Appendices explain our thinking in detail, we have summarised our key points in this introduction section.

Regulatory Capture

6. The FRC Board and its main committees have been dominated by accountants. This approach has not worked well for shareholders and other stakeholders.
7. ARGA and its main committees must be representative of the users of accounts, the customers. We can no longer as a society afford to have audit being run by accountants for the benefit of accountants.

The share registration system disenfranchises the beneficial owners of shares

8. British company law is predicated on the model that the registered owner of a share is the sole person who can vote that share. It was developed at a time when share ownership was always evidenced by entries on the register of shareholders and the issue of paper share certificates.
9. Following dematerialisation, large numbers of beneficial owners have found themselves being forced to use stockbrokers’ nominee companies. In most cases, they are denied the ability to vote, are unable to receive communications directly from companies whose shares they beneficially own, and have no right to attend a company’s AGM. Further, individuals acquire economic ownership

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of shares in companies through the medium of collective funds, with no legal ownership rights at all. This significantly weakens the accountability of directors to the beneficial owners.

10. We have given more details in Appendix 1.
11. Unfortunately, the consultation document has ignored this issue completely when, with the technology advances already made and being made, it would be in the government's power to restore control of director and auditor appointments and corporate reporting to beneficial owners.

Implications of the above for our response document

12. In reading our response document, please take into account that in most cases we intend the term "shareholder" to apply to the person who has the beneficial ownership, even where their shares may be legally owned by a nominee or other intermediary.

The method of appointing auditors requires radical change

13. The present vote by shareholders to appoint the audit firm is a legal fiction, and in practice nearly always a "rubber stamp" of the firm recommended by the Board of Directors.
14. While formal practice is that the Board's recommendation is based upon the decision of the Audit Committee which has no management members, in practice the Audit Committee pays overwhelming attention to the opinions of management (rather than shareholders) regarding the selection of auditors. This may be influenced by all directors relying on the appointed audit firm to keep them safe, when this is not part of any audit, and is a conflict of interest between shareholders and directors which should not exist.
15. Even more seriously, audit partners know that if they sufficiently upset the Chief Financial Officer or the Chief Executive Officer (rather than shareholders), the likelihood will be the loss of the audit engagement.
16. There have been strong calls from the FRC and investors for auditors to exercise greater 'professional scepticism' and to adopt a more challenging stance towards the opinions and claims of management. However, for as long as companies continue to appoint the auditors this desired change in audit culture is almost certain to be frustrated.
17. Accordingly, the present system of appointing and removing auditors creates a fundamental tension between the auditor's professional duty to shareholders to be challenging and the auditor's economic interest in retaining the audit.

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18. We recommend that for PIEs, the audit firm should be directly appointed by ARGA, with ARGA agreeing the audit fee. Only such radical change can ensure that auditors are motivated solely by the imperative of maximising audit quality and challenging any corporate reporting that they consider deficient. We have no objection to continuing with a confirmatory vote of shareholders, as happens at present.
19. We have mentioned this in our answer to Q 54, given more details in our answer to Q 63, and expanded on our views in Appendix 2.

Change the legal responsibility of directors

20. We welcome the proposal to give ARGA the power to regulate all directors, not just those who are members of professional bodies. However further changes beyond that are required.
21. We recommend that the law should stipulate that the legal duty of directors is to act “with utmost good faith” towards the company, towards each other, and towards auditors. “Utmost good faith” is a concept well established in the law of insurance and in the law of partnerships. Imposing this obligation upon directors should have a salutary behavioural benefit, and by “raising the bar” beyond their existing responsibilities would also make it easier to sanction directors who fall short.
22. Furthermore, ARGA and other regulators should cease fining companies for any reporting or company law failures. Although such a fine is legally paid by the company, its economic cost always falls upon the shareholders, all of whom are innocent qua shareholders. (Some shareholders may be guilty qua directors.)
23. Instead, fines for misconduct by a company should always be levied on the responsible directors or other responsible third party to whom they have delegated.

More legal protection for whistleblowers, regulators, and auditors

24. The consultation document mentions whistleblowers but does not ask any questions. We have set out our views on page 69 using your heading 11.7 Whistleblowing. We consider that a system for significant financial compensation, modelled on that used in the USA, is required to protect whistleblowers in the UK. Furthermore, whistleblowers should have legal privilege for their disclosures if made in good faith.
25. In several recent financial scandals, regulators were too slow to act, waiting in the hope of building an irrefutable legal case, because they feared litigation

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being brought against them by aggressive company directors. We consider that ARGA and its staff need stronger legal protections so that any person seeking to challenge ARGA through the courts should be required to prove actual malice on the part of ARGA or individual members of staff.

26. The present system for outgoing auditors to file a statement at Companies House when ending their audit appointment is not working. We are not aware of a single resignation statement containing meaningful information of value to shareholders. We consider that auditor resignation statements should be absolutely privileged, alongside a strengthened duty upon auditors to report fully and frankly all the circumstances leading to the cessation of the audit engagement.

Expanding the number of firms capable and willing to audit PIEs

27. We do not consider that the managed shared audit concept will achieve its goals of increasing the capability of challenger firms or their willingness to seek PIE audits.
28. We recommend applying a market share cap to the Big 4 audit firms, initially fairly loose to enable time for adaptation, but with that cap later becoming tighter. This would create a guaranteed market for challenger firms.
29. We also recommend a statutory system to cap audit firms' liability in the event of a failed audit. At present, auditors face open ended liabilities for which the Big 4 firms cannot buy adequate cover in the insurance market. The risk of such open-ended liabilities is a major impediment to challenger firms seeking to increase their PIE engagements.
30. A statutory liability cap should enable a proper market for audit insurance cover to re-emerge and increase the willingness of challenger firms to audit PIEs.

Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?

31. Actuarial regulation seems to have fallen into the FRC's remit by accident. It may not therefore get the attention that is needed to safeguard the interests of investors in insurance companies and of consumers of insurance. Accordingly, we recommend finding a different home for actuarial regulation to allow FRC/ARGA to focus on governance, reporting and audit.
32. The PRA (which employs around 80 actuaries) is a much larger repository of regulatory actuarial expertise than the FRC and would be best placed to take on all the actuarial responsibilities currently vested in the FRC.

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33. However, it will be important that FRC/ARGA, the new actuarial regulator, the PRA and the TPR (if neither of these latter two become the actuarial regulator) have a memorandum of understanding on matters where their regulatory duties overlap. This current BEIS review should also consider specifically the need for accounting and audit quality in the insurance sector.

Implementation planning, monitoring of progress and funding ARGA adequately.

34. There is little comment in the consultation document, beyond high-level comment in Section 1.2, about the timescales envisaged for the implementation of many of the proposals or even the basic procedures for monitoring progress.
35. We stress the need to set goals in terms of outputs that are relevant to end users/customers.
36. Some important changes, such as the creation of an audit profession, along with the closely related issue of driving significant change in audit culture, receive little or no discussion about who would be even responsible for them, let alone the timescales and milestones for their introduction.
37. The FRC has estimated that the implementation of much-needed reform of annual reporting is likely to be a ten-year project. This seems appropriately pragmatic and requires long-term planning. Government needs to continue to monitor progress and ensure ARGA reports on progress against its goals.
38. Added to this is the fact the environment in which many of the reforms will be taking place is one of constant change and mutation. Planning and ongoing monitoring of progress and adjustment of implementation plans is likely to be critical.
39. Responsibility for planning and oversight of many areas of reform may be delegated to ARGA. However, it is vital that ARGA has all the resources it needs in this respect. The consultation talks about the funding of ARGA by statutory levy (a system which many consider unsatisfactory), but there is no discussion of the level of resource that ARGA might require even over a five-year, let alone a ten-year, horizon.
40. The FRC's budget for 2021/22 is £52.2m. In comparison, the pure administration costs borne by the taxpayer of winding up of Carillion were £148m, while the wider economic costs to the economy were an order of magnitude greater. The additional costs to the taxpayer for the completion of the Royal Liverpool Hospital alone have been estimated by the NAO at £739m. Money spent on proper funding of ARGA in future will be money well spent.

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41. FRC CEO Sir Jon Thompson has recently spoken of the need to increase FRC/ARGA resources by 70%¹. We support an increase in resources necessary to fulfil the ARGA ambit.
42. It is vital that as we move forward with reform of audit and corporate governance BEIS sets out clear, appropriately detailed and realistic plans for the implementation and oversight of reforms. It is also vital that ARGA's resource needs as it moves forward are fully assessed and properly funded.

¹ Financial News story "Audit regulator could boost headcount 70% as boss fears FRC will be 'spread too thin'" available at <https://www.fn london.com/articles/audit-regulator-could-boost-headcount-70-as-boss-fears-frc-will-be-spread-too-thin-20210616>

2. About UKSA, ShareSoc, and the response authors

UKSA (United Kingdom Shareholders' Association)

43. UKSA is the oldest shareholder campaigning organisation in the UK. We are a not-for-profit company that represents and supports shareholders who invest in the stock market.
44. There are many agents and intermediaries active in financial markets. Unlike them, we are an organisation solely representing people who are investing their own money.
45. UKSA was formed to provide private shareholders with a voice, influence and an opportunity to meet like-minded fellow investors. It is structured as a non-profit making company with annual subscriptions. An elected Chairman and Board of Directors (all volunteers and individuals with a wide range of backgrounds and experience) monitor a regional organisation. Each region benefits from oversight by an elected regional Chairman and Committee.
46. We build relations with regulators, politicians and the media to ensure that the voice of individual shareholders is reflected in the development of law, regulation, and other forms of public policy. See www.uksa.org.uk

ShareSoc (UK Individual Shareholders Society)

47. ShareSoc is the UK's largest retail shareholder organisation, acting in all areas of the UK stock market, with more than 7,000 members. It is a not-for-profit company.
48. ShareSoc is dedicated to the support of individual investors (private shareholders as opposed to institutional investors). We inform and educate our members, through webinars and physical meetings, often where companies present to members, and also through our monthly newsletter, blogs, press releases and via social media. We also campaign for redress, retribution and better regulation when we see things have gone wrong. We do not shirk from tackling companies, the Government or other institutions if we think individual shareholders are not being treated fairly. See www.sharesoc.org

Response authors

49. This response was written by a team of seven people drawn from both organisations. Each of them has long experience of investing their own money in the shares of listed companies. More details of the authors and their wide-ranging professional expertise are set out in Appendix 3.

3. Answers to your numbered questions

50. As you will see, in this section, as well as your numbered questions, we have also imported the structural outline of the BEIS consultation document. We have done this for two reasons:

50.1. It makes our response easier to navigate by making it clear which section of the consultation document is under consideration.

50.2. In some cases, we have made comments regarding material covered in one of the BEIS subsections where no numbered question was asked. To ensure those comments are not overlooked, we have enumerated them below:

- Subsection 1.1 The Government's approach immediately below on this current page.
- Subsection 2.2 Dividends and capital maintenance on page 27
- Subsection 6.5 Auditor Reporting on page 42
- Subsection 11.7 Whistleblowing on page 69

1 The Government's approach to reform

1.1 The Government's approach

51. In paragraph 1.1.9 you say: "the Government will look for opportunities to simplify or consolidate requirements on business." It will be important that Government prioritise those opportunities which are in the interests of investors. The Government should not reduce companies' transparency or obligations to their investors.

1.2 The timetable for change

1.3 Resetting the scope of regulation

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

52. Yes. For the reasons explained below, we consider that large private companies should be included.

53. Large private companies, even where they are not credit institutions or insurance undertakings, will be just as much public interest entities as those

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admitted to a regulated market or a credit institution or an insurance undertaking because of their impact on and relevance to their investors, employees, customers, suppliers, other key stakeholders and the country's economy. There should be no difference in the audit and corporate governance regime for large companies whose failure could have a material impact on the public, whether they are publicly listed or privately owned.

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

54. Your consultation document suggests there are 1,945 existing PIEs. Doubling this number under Option 1 appears to us to be impractical because of the additional need for PIE auditors and staffing at ARGAs that may become required. Even increasing the number by a third under Option 2 seems ambitious.
55. Therefore, Option 2 would be our choice; recognising that smaller entities using a regulated securities market for its financing would be automatically captured as a PIE. However, the capacity of the audit world to fulfil the demands required of a larger pool may limit what is possible regardless of either option.

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

56. Yes. Even though AIM is not a regulated securities market, we would see no difference in public interest between AIM market companies and those companies listed on regulated securities markets.

Q 4. Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?

57. No. The whole point of the proposed reforms is to restore trust in audit and corporate governance. Such reforms or even the existing good practice of PIEs and their audits should apply to both newly listed companies and to any additional PIEs captured by the new definition of PIE.
58. Exemption differentiations could be used as loopholes to game the system and would reduce trust rather than restore it.

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

59. We are not sufficiently knowledgeable of Lloyd's Syndicates to answer this question.
60. However, from a lay person's point of view, it seems odd that they are not already classed as insurance undertakings requiring them to be PIEs. There is potential here for damage in public trust of regulation if syndicates have exemptions which conflict with public expectations.

Q 6. Should the Government seek to include large third sector entities as PIEs beyond those that would already be included in the definitions proposed for large companies? If so, what types of third sector entities do you believe should be included and why?

61. No. We think that the new definitions proposed for large companies should already capture and include those large third sector entities which should be treated as PIEs.

Q 7. What threshold for 'incoming resources' would you propose for the definition of 'large' for third sector entities? Is exceeding £100m too high, too low or just right?

62. We are not sufficiently knowledgeable of third sector entities to advise on such a threshold.

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

63. No.

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

64. We cannot answer this question but would hope that the increase in the number of PIEs would increase the number of PIE auditors and therefore the choice available to PIEs between auditors. It should be remembered that the number of PIEs will not remain static, and this perpetual dynamism should underpin some resilience and a widening of choice in the PIE audit market.
65. We would expect that those companies which are newly treated as PIEs under an expanded definition will be less international and less complex than existing PIEs. That may result in second tier firms being more willing to become

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auditors of such “New PIEs” and having gained experience at PIE auditing seek to move up the complexity chain.

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

66. No. A new definition of PIE should be introduced as soon as the Government has decided what this should be. The implications for new PIEs, their existing or prospective directors, their auditors and relevant regulators should then be managed through transition periods for meeting any specific new requirements that these new PIEs will have to meet.
67. We would hope that most if not all UK businesses would emulate PIE good practice, proportional to its relevance for them, as they will see the benefits of such good practice in obtaining or retaining public trust.

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

68. No. See our comments above to Q 10.

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

2.1 Stronger internal company controls

Q 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?

69. Strengthening the internal control framework improves overall governance. Improvements in governance improve risk management.
70. The benefits are:
- 70.1. True accountability from the board resulting from improved boardroom discussions on the level of residual risk remaining when considering the quality and application of controls.
 - 70.2. Improved individual and collective understanding, making it easier to define risk appetite and tolerances.
 - 70.3. Clarification over the level of strategic, operational and financial resilience that helps define the scope of business continuity planning,

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thereby reducing the likelihood of crises, whilst responding better to them.

71. The benefits create a virtuous circle that also supports other aspects of this consultation on resilience and better planning for reverse stress testing.
72. In our view the benefits outweigh the downsides, but there are some downsides of a practical nature. More boardroom time will be needed to put the review process on a formal footing, including adapting governance structures and information channels to cover broader and more precise risk and control reporting.
73. In this context, corporate risk management may need reviewing and changing. Risk is a loaded term that focuses on the negative. Risk management should be balancing between probable benefits and probable harms. Too much focus on the negatives and mitigating them will result in limitations of, or constraints on, the positives.

Q 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?

74. We do not support the totality of Table 2.
75. While we broadly agree with Table 2's contents regarding directors, we would like to see the following changes:
 - 75.1. Directors should first be required to review the effectiveness of all the company's internal controls. This is because all activity and related risk and controls influence the financial, viability and resilience positions. They can then assess the controls relating to financial accounting.
 - 75.2. Reporting on any deficiencies found and remedial actions taken should be expanded to include all internal controls.
 - 75.3. When we say 'all internal controls', these should be determined proportionately. The principles and guidance of the benchmark system should provide guidance for materiality assessment.
76. With regard to external audit and assurance, our preferred option is Option C (requires auditors to express a formal opinion).

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77. Option A (requires a specific directors' statement) only makes sense if we can believe that all directors have sufficient skills and aptitude in risk management and internal controls.
78. We regard Option B (requires auditors to 'report more') as an undesirable "half-way house." Once auditors are going to say anything publicly about their view on controls, they will consider it necessary to do an extensive amount of reviewing of the controls. Hence we prefer moving to the logical endpoint, which is Option C.
79. Option C has the added advantage that the auditor, as part of the work needed to express a formal opinion on the directors' assessment of the effectiveness of the internal control systems, will simultaneously obtain assurance for their own audit purposes of the quality of controls they will be basing their audit work on.
80. That will help the auditor with improved challenge and judgement. As mentioned in Section 7 "Professional scepticism and the ability to exercise constructive challenge are both key in delivering quality audits".

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

81. All PIEs.

2.2 Dividends and capital maintenance

82. We begin with some general remarks on dividends and capital maintenance.
83. Taking into account the history of English company law, we understand "capital maintenance" to be short-hand for maintaining original levels of equity capital by ensuring it is not eroded by unlawful distributions in contravention of Companies Act 2006 s830 and subsequent sections. Historically this can be seen as protecting two categories of persons:
 - 83.1. Shareholders were protected against directors paying dividends to them out of subscribed capital while maintaining an illusion that the company is prospering.
 - 83.2. Creditors, especially holders of long-term debt instruments, were protected against the company reducing its ability to pay them by reducing its capital below the amount shown when the company incurred the liabilities to the creditors.

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84. The case law in this area is relatively old. While Companies Act 2006 is a recent statute, it primarily repeats legal provisions originally legislated many decades ago.
85. In broad terms, we consider that a “first principles” reconsideration is required to set out the rules that should apply to companies’ ability to distribute cash or other assets to shareholders as dividends or purchases of own shares.
86. Some of the recent accounting scandals show the importance of taking into account the extent to which dividends can reduce the viability of a company even where they are paid from what appear to be realised profits, particularly where the firms have large debt overhangs. (Carillion and Greensill Capital come to mind).
87. Accordingly, we welcome those sections of the consultation document that bring some fresh thinking to these issues, beyond simply tightening the rules around historic concepts such as “realised profits”, by introducing forward looking requirements.
88. When considering whether a distribution is permitted, these new requirements should take into account the riskiness of the company’s assets, ranging from non-risky assets such as cash, less risky assets such as short-dated government bonds, and very risky assets such as derivatives which have to be valued using models where there is no readily available traded market value.
89. Auditors should therefore be encouraged to ensure, as far as possible, that shareholders have the information they need to determine the adequacy of capital. Firms should be required to report all the major risk factors that might impede the quality of capital. Some firms already do so, but it is doubtful that they capture the whole truth. In our experience firms will often choose to ignore or to understate the most material risks. Auditors should determine whether any material risk to capital has been omitted from the financial statements. This task should not be difficult, given that it is easy to identify books or businesses with excess or unusual returns, and as a consequence to check whether the risk resulting from these has been communicated clearly in financial statements.

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

90. Although it is an old concept, we accept that the concept of “realised profit” does retain some merit. For example, in certain cases International Financial Reporting Standards allow revenue (and therefore profits) to be recognised in advance of either the receipt of cash from the customer or even an immediate obligation to pay cash. In such circumstances we accept that a prohibition of paying dividends out of unrealised profits protects creditors.
91. We support the approach of giving ARGA delegated legal power to make rules regarding when a profit is realised, as the investor community appears to no longer have confidence in the accountancy bodies specifying such rules.
92. Your paragraph 2.2.8 sets out two alternative approaches. Of these:
- 92.1. Option 2, ARGA publishing binding rules regarding the determination of realisation, would be inconsistent with the principles-based approach to accounting questions generally adopted in the UK. The example of the USA shows that “bright-line” tests tend to be “gamed” by companies.
- 92.2. Accordingly, we favour option 1, ARGA publishing guidance which 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 ARGA.
93. Regarding ‘other options to be considered’, see our remarks above on capital adequacy, and the need for auditors to determine whether material risk to capital has been omitted from the financial statements.

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

94. Disclosure of the distributable reserves in the financial statements should not be onerous. It should ensure that listed companies do not pay unlawful

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dividends which happens from time to time. Accordingly, while company law contains its present limitations on distributions by reference to distributable reserves, such a disclosure requirement should apply.

95. We are less convinced about the merits of disclosure of estimates of a group's dividend-paying capacity. We consider that the main constraint on most listed groups' ability to pay dividends is the need to avoid becoming over-leveraged, and the need to balance the retention of funds for investment against the desire to distribute funds to shareholders. These are all issues relating to cash, rather than accounting distributable reserves.
96. With that background, companies publishing figures for the maximum dividend that they could pay based upon group distributable reserves, ignoring the real constraints mentioned above, appears to have little merit. Disclosing distributable reserves, against which any distribution can be compared for affordability, is sufficient.

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

97. The fact that a company paying a distribution is doing so lawfully by having legally distributable reserves should be taken as read. Requiring publication of that statement appears to have little more merit than requiring directors to confirm that they have not breached any of an almost endless list of laws they are required to comply with.
98. However, we regard the future solvency statement in the second bullet of paragraph 2.2.21 as very desirable. We consider that two years is, if anything, too short, and recommend making it three years.

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

99. See our reply to question 17. Any new reporting requirement should be about the degree to which creditors and shareholders are exposed due to the

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company's balance sheet leverage, the riskiness of its assets as mentioned above, and the variability of its profits and cash flow.

3 New corporate reporting

3.1 Resilience Statement

Q 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?

100. Yes, we support all six items listed in the bullet points in paragraph 3.1.13 being included in the Resilience Statement by all companies.
101. They should be addressed in the short-term section as their probabilities of impact or crystallisation will be more ascertainable in the short term of one to two years. As all futures are uncertain and unpredictable, such detailed matters are not appropriate for the medium (three to five years) and long term (over five years) sections.
102. Another matter that should be included in the short-term section of the Resilience Statement is the existence, security and realisability of cash held at the balance sheet date and the certainty or not of cash flow forecasts for the subsequent short term (two year) period.

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

103. No. Reporting on climate change and environmental issues is a matter of significant and rapidly growing interest to investors. TCFD reporting is too important simply to be treated as part of the Resilience Statement. TCFD issues require either a dedicated section within the annual report or a separate TCFD report which is referenced in the annual report (AR). Either way, relevant TCFD issues should be cross-referenced in the Resilience Statement. At its most basic TCFD reporting needs to consider:
- 103.1. The impact that the company's activities have on the environment and climate change.
- 103.2. The impact that climate-change and measures to mitigate climate-change are having or are likely to have on the company and its sustainability.

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104. It is the second of the two components above which is most relevant in the context of the Resilience Statement. However, the first component cannot simply be ignored just because it is not particularly relevant to the Resilience Statement.

105. This being the case it is much more appropriate for the Environmental/TCFD report to be presented as a self-contained element of the annual report but with cross-references to other parts of the AR (such as the Business Model, the Risk Report and the Resilience Statement) wherever relevant.

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

106. Yes, we agree with the proposed company coverage and the delay for non-premium listed PIEs for two years.

107. For the reasons mentioned in our reply to Q 10 above, recently listed companies should be in scope.

3.2 Audit and Assurance Policy

Q 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?

108. Yes, we agree with the proposed minimum content suggested in the consultation document's paragraph 3.2.9:

108.1. 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 that required by statutory audit.

108.2. A description of the company's internal auditing and assurance processes. We consider this should especially address areas that impact the supply chain and which impact consumers such as data protection and privacy measures, with supporting commentary. The supporting commentary is especially necessary if any recommendations were rejected, or if any relevant actions were delayed. This commentary should cover all recommendations whether from internal or external auditors, or from other assurance providers.

108.3. A description of what policies the company may have in relation to the tendering of external audit services, and

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108.4. An explanation of whether, and if so how, shareholder and employee views have been considered in the formulation of the Audit and Assurance Policy.

109. The other matters that should be addressed are:

109.1. An overview or summary of the company's policy, including its purpose, objectives, and structures and processes. This should also refer to the statutory audit, including a clear explanation of materiality and how it is used, as it should not be assumed that key stakeholders will understand this.

109.2. Who is responsible for what, and

109.3. Any other key policy matter suggested by key stakeholders and agreed to by the Audit Committee or owner of the policy.

110. The other matters suggested immediately above are mentioned for the avoidance of doubt because they risk being forgotten under the assumption that they are so well known that they do not need a mention. We believe that any matters other than the minimum content should be decided by the Audit Committee (or whoever within the company "owns" the policy) with input from the board, audit committee, shareholders and employees.

Q 23. Should the Audit and Assurance Policy be published annually and subject to an annual advisory shareholder vote, or should it be published and voted on at least once every three years?

111. The Audit and Assurance Policy should be published and voted on at least once every three years. For what are checks and balance processes rather than key responsibilities of companies and directors to shareholders and other key stakeholders, significant changes should not in normal or usual circumstances occur annually.

112. Audit and assurance will be more important than remuneration for shareholders to engage on. The policy and it being voted on will be a catalyst for improved shareholder engagement on company reporting. A three-year cycle should not prevent more regular shareholder engagement, especially where shareholders have reporting concerns in the interim. It will be for companies and audit committees to proactively seek these out.

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

113. Yes, we agree with the scope. We have comments below on the method.

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114. We suggest that a lot of unlisted PIEs will have shareholders (or equivalent) and it will be important that listed and unlisted PIEs with shareholders are not treated differently. Therefore, such unlisted PIEs should also have requirements for a shareholders' vote and a minimum content statement of how shareholder views have been considered.
115. We cannot see why other listed and unlisted PIEs should have a further two years to prepare and publish their Audit and Assurance Policy as proposed in paragraph 3.2.15. The entry into force of the reporting requirement is uncertain and it would be reasonable to assume the earliest would be for years ending 31st December 2022, which would mean years ending 31st December 2024 for other listed and unlisted PIEs.
116. On the basis that companies will already be thinking about this and putting in place policies as good practice, we therefore suggest that a one-year delay will be better for shareholders rather than the two years proposed in the consultation document.

3.3 Reporting on Payment Practices

Q 25. In order to improve reporting on supplier payments, should larger companies be required to summarise their record on supplier payments over the previous 12 months as part of their annual Strategic Report (applying at a group level in the case of parent companies)? If so, what should the reporting summary include at a minimum? Do you have alternative suggestions on how to improve supplier payments reporting?

117. Late payment of suppliers is an important issue and one which needs to be addressed. However, we are doubtful whether requiring companies to report on their supplier payment record over the previous twelve months is likely to be helpful. This is because:
- 117.1. There may be a variety of different terms agreed for different suppliers, particularly those for large and/or complex supply contracts for which there may be bespoke terms.
- 117.2. In some cases payment delays may result from invoice queries or disputes.
- 117.3. In most cases we suspect that there will be insufficient information provided for shareholders to be able to hold management to account and force management to change its practices if needed.

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118. We believe that it would be better if companies explicitly stated their payment policy aims and payment time period and that the auditor then commented on whether the company has complied with that policy in the audit report, perhaps as part of the 'graduated audit findings'.

119. Given our earlier comments, this may require summary disclosures of supplier payment practices in relevant notes to the financial statements such as those relating to profit or loss account costs and/or trade creditors. This would then need to be audited and any resultant graduated audit findings reported would provide shareholders with a more concise and readily understandable assessment of whether there was reason to be concerned about the company's payment practices. Armed with this information they would be in a strong position to challenge the company's management more effectively.

Q 26. To which companies should improvements in supplier payments reporting apply: companies which are PIEs and already report under the Payment Practices Reporting Duty, or PIEs with more than 500 employees?

120. As suggested above in the response to Q 25, a comment on payment practices should be contained in the audit report. We see no reason to limit it to PIEs with more than 500 employees.

3.4 Public Interest Statement

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

121. Yes. For the time being this is adequately covered by Section 172 requirements.

4 Supervision of corporate reporting

4.1 Background

4.2 Stronger powers for the regulator

4.3 Measures to strengthen corporate reporting review activity

4.4 Influencing the corporate reporting framework

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

122. We believe that the proposals that are being made are entirely appropriate.

123. The FRC has already started a major review of corporate reporting (A Matter of Principles - the future of corporate reporting). We very much welcome this. However, improving the clarity, brevity, comprehensibility and usefulness of corporate reporting is going to be a long and difficult exercise. Guidance can be given on good practice, but it is going to be much more difficult to eradicate the boilerplate, jargon, hype and obfuscation that currently pervades much corporate reporting.

124. If much is to change, the FRC/ARGA will need stronger powers than just the ability to issue guidance. We suggest that the new regulator's principle relating to promoting brevity, comprehensibility and usefulness in corporate reporting is linked to their new power to direct changes to the entire annual report.

125. While a significant number of companies work with the Plain English Campaign on their consumer-related communications, it seems that very few seek any input from the Plain English Campaign on the drafting of their narrative reporting to shareholders. Companies should be encouraged to ensure that their narrative reporting meets basic Plain English standards.

126. The ARGA should be given the powers and sanctions to make this happen.

5 Company directors

5.1 Enforcement against company directors

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

127. We have no comments on other possible arrangements that might be put in place right now to ensure that overlapping powers are managed effectively. However, we strongly recommend that this issue is kept under close review over the next three to five years and that appropriate mechanisms are in place for prompt action to be taken if problems arise with the overlap and coherence of existing powers.

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

128. The powers outlined appear to relate essentially to the financial statements. However, the Brydon review and this consultation document recommend that the scope of the audit should go beyond simply verifying the financial statements and should cover wider information contained in the annual report.

129. This being the case, we believe that the regulator should have the power to sanction directors who make misleading or overly optimistic statements in the narrative sections of a company's reporting. The report by the BEIS and Work and Pensions Committee (May 2018) into the collapse of Carillion commenting on the role of the Chairman, Philip Green, in Carillion's demise noted:

"Mr Green appears to have interpreted his role as Chairman as that of cheerleader-in-chief. His statement in the 2016 Annual Report and Accounts, signed on 1 March 2017, just four months before the profit warning, concluded:

'Given the size and quality of our order book and pipeline of contract opportunities, our customer-focused culture and integrated business model, we have a good platform from which to develop the business in 2017'.

Even more remarkably, on Wednesday 5 July 2017, a few days before the Monday 10 July profit warning, Carillion board minutes recorded:

In conclusion, the Chairman noted that work continued toward a positive and upbeat announcement for Monday, focusing on the strength of the business as a compelling and attractive proposition [...]"

130. Discussion with the FRC leads us to believe that it is not uncommon for the financial statements in the annual report to appear to be giving a different account of a company's performance and prospects in comparison to the pronouncements made in the narrative sections. Not all may be as egregious as the case of Carillion shown above. However, it is clear that too often narrative reporting seeks to give an up-beat view of performance, prospects and outlook while playing down risks, threats and areas of underperformance.

131. It is important that the regulator has the power to take action against directors who make or approve actual or potentially misleading statements in the narrative sections of any company reporting or in any update on the company's performance, prospects, viability as a going concern or longer-term sustainability.

Q 31. Are there any existing or proposed directors' duties relating to corporate reporting and audit that you think should be specifically included or excluded from further elaboration for the purposes of the directors' enforcement regime?

132. No; there are none that we can identify.

Q 32. Should directors of public interest entities be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audits? Should those standards be set by the regulator? What standards should directors have to meet in this context?

133. Yes. The contract that a director has with the company that employs him or her should, as is required by the law of insurance contracts and the law of partnerships, include the requirement to act with 'utmost good faith'. It should not be possible for a director to:

133.1. act dishonestly by, for example, seeking in any way to deceive the auditor,

133.2. make any sort of false or dishonest public statement about the company, or

133.3. knowingly do or say anything that would bring the company into disrepute or damage its reputation

133.4. and be able to do so without any fear of sanction or retribution.

134. A good example is the recent case at Rio Tinto which deliberately destroyed the Juukan Gorge caves in Australia despite clear advice that the site was highly sensitive and of great historic significance. The Company and its directors were ultimately held to account for this. However, this was of little consolation to shareholders who ultimately had to bear the costs of repairing the environmental damage (in so far as it could even be 'repaired' or 'restored') and the damage done to the Company's reputation.

135. With regard to setting specific standards, we believe that the regulator should define and agree these with the investing community and other stakeholders.

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

136. Yes.

5.2 Strengthening clawback and malus provisions in directors' remuneration arrangements

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

137. We support the proposed minimum list of malus and clawback provisions. We are unable to comment on legal and other considerations for enforcing the minimum provisions.
138. We would add a further condition to the minimum list and that is “unreasonable failure to protect the interests of shareholders.”
139. It seems to us that directors, especially in companies in difficulties, forget about protecting the potential residual value of companies for shareholders.
- 139.1. As a result, they do not precipitate any insolvency or administration or similar closing down in a managed way with the above objective in mind.
- 139.2. There will also be situations where companies and their directors can see that any viability of or resilience in their business model is finite and without remedy and where they should be prioritising the protection of residual value for key stakeholders including shareholders.

6 Audit purpose and scope

6.1 The purpose of audit

Q 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?

140. Yes.
141. At present the legal duty of an auditor is limited to expressing an opinion on the accounts, along with some historic additional legal responsibilities (without meaning to diminish their importance) such as reporting if proper books of account have not been kept.

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142. However, many shareholders expect an auditor to do more, for example if the auditor becomes aware of unlawful conduct.

143. Accordingly, a new statutory requirement as proposed in paragraph 6.1.12 should help in making auditing more trusted.

Q 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?

144. Yes. We support the proposal in paragraph 6.1.19 for the regulator to publish and adopt a non-binding statement of the purpose of auditing.

145. The regulator should consult widely with stakeholders, especially investors as the key consumer of audits, before finalising such a purpose statement.

6.2 Scope of audit

Q 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?

146. Yes, generally we agree with the Government's approach. This is because, if we understand the approach correctly, the definition of wider auditing services will be driven by what is declared in Audit and Assurance Policies ("AAPs") and, as a result, will be led by shareholders, as consumers of corporate audits, input to those AAPs.

Q 38. Should the regulator's quality inspection regime for PIE audits be extended to corporate auditing? If not, how else should compliance with rules for wider audit services be assessed?

147. In principle the answer must be yes.

148. However, ARGAs will have a major task just restoring the credibility of financial auditing given the problems of recent years. Adding to that the responsibility of regulating and inspecting culture auditing, cyber-security auditing (beyond its financial statement implications), ESG auditing, and the other matters illustrated in paragraph 6.2.2 risks severe overstretch.

149. It would be very damaging if ARGAs failed to achieve its goals regarding financial statement auditing due to loading it up immediately with such additional responsibilities.

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150. Accordingly, while we see ARGAs as a reasonable choice to be the eventual regulator for such wider corporate auditing as illustrated in paragraph 6.2.2, that should be left to one side for several years until ARGAs have succeeded in restoring the credibility of financial statement auditing.

151. All our comments about corporate auditing below are made subject to the above concerns.

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

152. The role should be the same as regulating statutory auditing, bearing in mind that wider auditing services standards may have to be developed.

153. We cannot see any need to extend the role beyond setting, supervising and enforcing wider auditing standards.

6.3 Principles of corporate auditing

Q 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?

154. Yes and yes.

Q 41. Do you agree that new principles for all corporate auditors should be set by the regulator and that other applicable standards or requirements should be subject to those principles? What alternatives, mitigations or downsides should the Government consider?

155. Yes. Prioritising principles over rules, substance over form, and the spirit over the letter, is always preferable in a good regulatory regime. In a way it is what differentiates UK regimes compared to those of the USA and the EU, which tend to prefer rules or codified legal requirements. It also allows for judgements to be made on the basis of what is right or wrong and reduces the risk of using the excuse of following the rules as an acceptable defence where the outcomes have been more wrong than right.

156. Alternatives and mitigations should not be needed. We cannot envisage any serious downsides as we noted when we accepted the Brydon review conclusion that its recommendations should be seen as a holistic package.

6.4 Tackling fraud

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

157. Yes, as the reforms should:

- 157.1. Make it clearer that directors are responsible for preventing fraud, usually through implementing adequate operational and financial controls, and detecting it;
- 157.2. Make it clearer what auditors are responsible for in respect of fraud, mainly identifying any that will cause a material misstatement in a company's financial statements;
- 157.3. Provide appropriate standards, guidance, training and other relevant support to directors and auditors in preventing and detecting fraud;
- 157.4. Clarify or simplify the complexities, which arise mainly out of the misunderstandings of, or the propensities to misinterpret, the requirements of the regime; and
- 157.5. As a result, reduce the expectations gap noted in the Brydon review.

6.5 Auditor reporting

158. In your paragraphs 6.5.7 to 6.5.12, you discuss auditors reporting new information materially useful to users. As a general point, we are sceptical about how frequently auditors' new information materially useful to users will be inside information too sensitive to disclose. However, we do support the FRC deciding to take the Brydon review proposal of auditors reporting new information forward and resolving with the FCA the complex interaction of the proposal and the current law on market abuse.

Q 43. Will the proposed duty to consider wider information be sufficient to encourage the more detailed consideration of i) risks and ii) director conduct, as set out in the section 172 statement? Please explain your answer.

159. Further to and in the context of our response to Q 35, the proposed duty to consider wider information should be sufficient to encourage a more detailed consideration of section 172 statement risks and director conduct.

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160. We believe this because the proposed duty recognises that wider information will be available to an auditor beyond the company and its financial statements being audited, including their experience of director conduct during their audits.
161. In respect of this question and Q 35, we note that the proposed Audit Principles suggested by the Brydon review do not contain principles:
- 161.1. for considering wider information or
 - 161.2. for having a more holistic approach to audits or
 - 161.3. for standing back and considering how the evidence obtained supports an audit opinion or
 - 161.4. for considering not just confirmatory information but also contradictory information.
162. Any development of proposed Audit Principles should include these.

6.6 True and fair view requirement

Q 44. Do you agree that auditors' judgements regarding the appropriateness of any departure from the financial reporting framework proposed by the directors should be informed by the proposed Principles of Corporate Auditing? What impact might this have on how both directors and auditors assess whether financial statements give a true and fair view?

163. Yes, we agree.
164. We are supportive of the "true and fair override" as there will always be some situations when following the financial reporting framework will give the wrong answer and where there will be a need for this valuable safety valve as described in the Brydon review. We consider that full disclosure should be made where the "true and fair override" has been used.
165. We cannot predict what the impact this will have on directors' and auditors' assessments of financial statements giving a true and fair view.
166. However, we do hope that directors and auditors will stop contending that following the financial reporting framework automatically results in financial statements giving a true and fair view. Instead, they should acknowledge, as you point out in your consultation, that IFRS and FRC guidance both indicate that there will be a minority of cases where complying with the requirements of the accounting standards will not be consistent with giving a true and fair view.

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

Q 45. Do you agree that the need for specific assurance on APMs or KPIs, beyond the scope of the statutory audit, should be decided by companies and shareholders through the Audit and Assurance Policy process?

167. Yes.

6.8 Auditor liability

Q 46. Why have companies generally not agreed LLAs with their statutory auditor? Have directors been concerned about being judged to be in breach of their duties by recommending an LLA? Or have other factors been more significant considerations for directors?

168. We have no answers to your questions on why companies generally have not agreed LLAs with their statutory auditors and on directors being concerned about being judged to be in breach of their duties by recommending LLAs. As shareholders, we have no recollections of even actually being asked about LLAs.

169. However, we can imagine that companies and their directors and management have been influenced by self-preservation in not agreeing LLAs with their statutory auditors. We are aware that companies and directors sometimes rely on their statutory auditors to keep them safe in the realm of corporate reporting and financial statements and therefore would also feel that if they agreed any LLA their auditors would not be incentivised to keep them safe to the maximum level possible.

170. If we are right that this is a significant consideration in deciding whether to agree an LLA with a statutory auditor, this will need to be addressed so that directors have to rely on themselves individually and collectively when financially reporting and not rely on statutory auditors. If they have so relied on auditors to keep them safe and auditors have colluded with this reliance, then it could be argued that auditors will have been conflicted and not independent or objective in their audits and responsibilities to shareholders for those audits.

171. We hope that such situations will be resolved by the overall reforms being recommended and especially through engagement and dialogue between shareholders and their audit committees and auditors, principally in respect of Audit and Assurance Policies.

Q 47. Are auditors' concerns about their exposure to litigation likely to constrain audit innovation, such as more informative auditor reporting, the level of competition in the audit market (including new entrants) or auditors' willingness to embrace other proposals discussed in this consultation? If so, in what way and how might such obstacles be overcome?

172. Yes. Litigation risk is always the preponderant concern of auditors, given the ability of major lawsuits to destroy an audit firm.
173. If the Government wants auditors to become more informative and to embrace new responsibilities, and wants to encourage more firms to become PIE auditors, then the single most important thing it could do is to introduce automatic statutory audit liability caps, which varied with the size of PIE being audited.
174. Absent that, the Government will find itself severely disappointed by the willingness of smaller firms to become new entrants to the PIE audit market, and auditors will continue to report as defensively as possible.
175. We agree that auditors' legal liability should not be extended beyond that owed to shareholders as a body. The real shareholders or beneficial owners of companies have been intermediated enough from ownership of their companies and do not need auditors to have their legal liability extended to anyone else, including directors who supposedly are agents representing shareholders as a body except in respect of their shareholdings as part of this body, and other third parties.

6.9 A new professional body for corporate auditors

Q 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.

176. Yes, we agree that a new, distinct professional body for corporate auditors, such as a Chartered Institute of Corporate Auditors, would help drive better audit. We agree with reasons set out in the Brydon review and your consultation document.
177. We would add that we could see a separation between professional accountants and professional auditors resulting in a natural tension between the two, which would improve the development and quality of financial reporting and audit.

Q 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?

178. As indicated in our answer to Q 48, we believe a new, distinct professional body for corporate auditors should be established and the best way to establish it and its public interest would be to grant it a royal charter.

179. The transitional arrangements should be left to the regulator, FRC and then ARGA depending on timing, in consultation with relevant interested parties, including the Institutes of Chartered Accountants, providers of statutory audits, those who provide wider assurance services and therefore could become corporate auditors, and shareholders.

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

180. In principle the answer is yes. However, it should be recognised that the skills required to be a cyber-security auditor are completely different from those required to be a culture auditor, and so on for the other types of corporate auditing illustrated in paragraph 6.2.2.

181. Accordingly, the professional qualifications will need to be segmented appropriately. The qualification names should not be allowed to lead anyone to assume that a culture auditor is competent to audit cyber security, or vice versa.

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

182. Yes.

7 Audit Committee Oversight and Engagement with Shareholders

7.1 Audit Committees – role and oversight

Q 52. Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

183. Yes, we agree. We would also like to see the application of these additional requirements extended beyond FTSE 350 audit committees to all PIEs.

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184. We are neither for nor against an appointment of an observer as there are governance issues surrounding such an appointment but not for the arguments stated.

Q 53. Would the proposed powers for ARGA go far enough to ensure effective compliance with these requirements? Is there anything further the Government would need to consider in taking forward this proposal?

185. It seems to us that the proposed powers set out in paragraphs 7.1.17 and 7.1.18 should be sufficient, especially if they are subject to the subsequent post implementation review after five years mentioned in the consultation document's paragraph 1.1.7.

186. We also consider that more can be done to improve the quality of the individuals appointed to relevant audit committees regarding a willingness to listen, learn and apply, and to engage in proactive, sound challenge as well as reasoned, objective defence with shareholders and auditors. An emphasis on audit committee training, equivalent to the scope potentially applying to auditors, should be introduced. The present requirement for financial acumen, often seen as fulfilled by having a professional accounting qualification, is insufficient given the complex interplay between risks, controls, costs, benefits and performance that audit committee members need to take into account.

187. Also, in our view, the proposals will not discourage high quality individuals from seeking appointment to audit committees. They hopefully will discourage those seeking an easy life on audit committees.

7.2 Independent auditor appointment

Q 54. Do you agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors in specific, limited circumstances (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?

188. Yes.

189. However, as explained in our answer to Q 63 below, and in Appendix 2, we believe more drastic action is needed than the above very limited proposal.

Q 55. To work in practice, ARGA's power to appoint an auditor may need to be accompanied by a further power to require an auditor to take on an audit. What do you think the impact of this would be?

190. As far as we are aware, to date no listed company has completely failed to find a firm willing to act as auditor. If no firm is willing to take on the audit, it suggests something very serious is going wrong at the company, which may merit stronger action than simply having ARGA appoint an auditor. It may merit something equivalent to appointing an administrator.
191. Having ARGA mandate that an audit firm takes the auditor appointment for a particular company may be capable of working in practice if is very occasional. However, given the risks such an assignment presents to the audit firm appointed, special measures may be needed to limit its liability and to ensure that the audit concerned is commercially viable for the audit firm concerned.
192. If the need for mandatory audit appointments is large, as may be suggested by recent experience of auditors resigning high risk audits or refusing to be considered for appointment, we doubt this would work in practice with such limited choice at the moment between the Big 4 or even the Big 6. The power would have to be developed hand-in-hand with achieved increases in the number of capable challenger firms.

Q 56. What processes should be put in place to ensure that ARGA can continue to undertake its normal regulatory oversight of an audit firm, when ARGA has appointed the auditor?

193. The issue of managing the conflict of interest between ARGA monitoring the ARGA appointed audit firm and ARGA as the appointer of this audit firm should be addressed by a strong "Chinese Wall" between the personnel at ARGA who monitor audit firms, and those who have the power to appoint auditors.

Q 57. What other regulatory tools might be useful when a company has failed to find an auditor or in the circumstances described by Sir John Kingman (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?

194. See our response to Q 55.

7.3 Shareholder engagement with audit

Q 58. Do you agree with the proposals and implementation method for giving shareholders a formal opportunity to engage with risk and audit planning? Are there further practical issues connected with the implementation of these proposals which should be considered?

195. Yes.

196. But we need to understand which shareholders are meant. We would expect all retail shareholders, including nominee account shareholders, to be in scope. We are concerned that Brydon's suggestion of relating this to "size of shareholdings" (in 7.3.6, 4th bullet) will disenfranchise the individual shareholder.

Q 59. Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?

197. Yes, but with some modifications.

198. We would like to see implemented Brydon's recommendation on having a standing item on the AGM agenda for questions to the audit committee chair and the auditor. The reasons are various and stated throughout the review: the state of internal controls, the audit policy and process, the ability for shareholders to suggest topics for audit, and the appropriateness of the relationship between the auditor and the company as summarised in the bulleted list in 7.3.14. A standing item brings together the individual parts into a cohesive whole.

199. Whilst the Companies Act 2006 does appear to address the concerns, it is at such a high level that makes it difficult to apply in practice. Something much more substantial is needed. See also our answer to Q 60.

Q 60. Do you believe that the existing Companies Act provisions covering the departure of an auditor from a PIE ensure adequate information is provided to shareholders about an auditor's departure? If you believe those provisions are inadequate, do you think that the Brydon Review recommendations will address concerns in this area? What else could be done to keep shareholders informed?

200. We believe the provisions are inadequate.

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201. Yes, we believe the Brydon recommendations, in the main, will address these issues so long as our concerns in our response to Q 58 are addressed.
202. The real issue is not whether the Companies Act provisions are adequate but why they are not used. Lack of use is, in itself, proof that the provisions are inadequate.
203. This is all part of the bigger picture of shareholder disengagement from the audit process, which is partly structural and partly procedural. Because the audit committee chair and the auditor are not apparent at AGMs, it has become a de facto expectation to not scrutinise the audit.
204. Two parts of the existing Companies Act provisions concern us.
205. The first is that all discretion rests with the auditor to raise issues: “The statement must include details of any matters which the auditor considers need to be brought to the attention of the shareholders or creditors of the company in connection with them ceasing to hold office”. However, the law gives auditors no protection against claims of defamation or disclosure of confidential information in such resignation statements.
206. We consider that auditors should be required to inform the world, by filing a public statement at Companies House and which the company is required to send to all shareholders, regarding the circumstances leading up to the cessation of the audit appointment. This statement should be absolutely privileged against all claims for defamation or disclosure of confidential information.
207. The second relates to shareholders. If shareholders have concerns, they can call for a general meeting but only if those raising concerns hold at least 5% of the shares. This disenfranchises retail shareholders. It also disenfranchises those using nominee accounts and who therefore do not have their name on the company register, which is the wider problem we have mentioned earlier.

8 Competition, choice and resilience in the audit market

8.1 Market opening measures

Q 61. Should the ‘meaningful proportion’ envisaged to be carried out by a Challenger be based on legal subsidiaries? How should the proportion be measured and what minimum percentage should be chosen under managed shared audit to encourage the most effective participation of Challenger firms and best increase choice?

208. We consider that several factors need much more detailed consideration before the Government’s proposal of “managed shared audit” could be successfully implemented.

209. There are very good reasons why it has become increasingly common, almost standard, for a PIE to appoint a single audit firm network to audit all, or almost all, of the group, with the network’s UK member firm being the auditor of the parent PIE and of UK registered subsidiaries, and international members of the same network being appointed to audit overseas locations.

209.1. Sometimes independent non-network firms are appointed as statutory auditors of some of the overseas subsidiaries, either for cost or local legal reasons. However even in such cases the norm is for the overseas audit work that is relied upon by the group auditors to be performed by overseas network member firms.

209.2. The key reason why the overseas audit work relied upon for the group audit is performed by firms in the same network is that those firms will have a common (and known to all in the firm) audit process and it is problematical for the group auditors to rely upon the work of non-network firms where the group auditor may not have confidence in the quality or know the audit process of the non-network firms.

209.3. The issues are well explained in chapter 2 “Evaluating component auditor competence and independence and the standards they apply” of the publication “Auditing groups: a practical guide” published by the ICAEW Audit & Assurance Faculty in 2014.²

² Available from <https://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/audit-and-assurance-faculty/publications/others/auditing-groups-a-practical-guide-including-supplementary-material.ashx?la=en>

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210. At present, the group auditor is legally, and even more importantly, reputationally responsible for the opinion given on the group audit. That is why the ICAEW document mentioned above puts so much emphasis on reviewing the work of component auditors. In the absence of changes to the legal liability framework, where non-network firms become auditors of significant components of the PIE, one can expect the group auditors to significantly increase the amount of time they spend assuring themselves of the quality of the audit work performed by the Challenger firm on subsidiaries.
211. Consequently, Government needs to accept that the first consequence of imposing managed shared audits will be a significant increase in audit fees.
212. To some extent, this increase in audit fees could be mitigated by legal reforms which protected the group auditor from any liability arising from reliance upon the audit work of a Challenger firm as part of mandatory shared audits.
213. However even with legal liability changes, Government would not be able to insulate group auditors from the reputational damage if a PIE fails as a result of deficient audit work in a subsidiary audited by a Challenger firm, since “mud sticks.”
214. Accordingly, we would expect group auditors to still expend significant effort reviewing the work of Challenger firm component auditors, even if changes were made to relieve group auditors from legal jeopardy arising from relying upon the audit work of Challenger firm component auditors.
215. In any event it would seem counter-intuitive when making reforms to improve trust in audit to begin by protecting a group auditor from any liability arising from reliance on Challenger firm work.
216. To summarise, we consider that while the proposal may help Challenger firms to expand their size and capability, it will come at the cost of a significant increase in audit fees to allow the group auditor to sufficiently review the work of relevant Challenger firms to place reliance on it.
217. The “meaningful proportion” should be determined as follows:
- 217.1. The requirement can only apply subsidiary by subsidiary in practice.
 - 217.2. The key measure is the number of person hours of audit time required by each subsidiary.
 - 217.3. As a starting point, in the first year of application, the minimum percentage should be relatively low, e.g., 5% of total group audit hours. This can easily be increased in later years.

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217.4. One may need to consider overseas subsidiaries separately, as Challenger firms typically have much weaker international networks.

217.5. Indeed, if they are to become credible bidders for the audit of PIE group accounts, Challenger firms need measures which will assist them to expand their international networks and to deepen the integration of their network's member firms.

Q 62. How could managed shared audit be designed to incentivise Challenger firms to invest in building their capability and capacity? What, if any, other measures, would be needed?

218. We would expect managed shared audit, if introduced, to encourage Challenger firms to build their capacity as long as there was a growing availability of relatively low-risk UK subsidiaries of PIEs for them to audit.

219. The biggest deterrent for Challenger firms when bidding for PIE group audits is the litigation risk and the potential for unlimited claims against them. Accordingly meaningful reform to reduce auditors' legal liability would be the strongest measure Government could take to encourage Challenger firms to expand their interest in the audit market.

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

220. A market share cap that was introduced in stages would have the potential of facilitating the growth of Challenger firms. For example, if after a transition period no firm was allowed to audit more than 20% of the FTSE 350, that would mean that the Big 4 audit firms could only audit 80%, meaning that 70 FTSE 350 companies would have to choose an auditor outside the Big 4, selecting from the Challenger firms.

221. In our opinion, the proposals regarding auditor appointment in the consultation document fail to adequately address the serious issues that lead to a lack of confidence in auditing.

222. Your paragraphs 7.2.1 and following discuss Sir John Kingman' letter of December 2018 to The Rt Hon Greg Clark MP, Secretary of State for Business, Energy and Industrial Strategy. In that letter, Sir John considered a different auditor appointment model where an independent regulator would appoint auditors and set audit fees but concluded by drawing back from this proposal.

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223. Subsequently our organisations sent a joint letter³ on 19 February 2019 to the Secretary of State. (In passing, we never received any response to the letter whose final paragraph asked for a meeting to discuss the issue further.)

224. In our letter, we gave strong support to the introduction of this new model of auditor appointment. To quote briefly:

We believe that Sir John's proposals for the appointment of auditors make eminently good sense. The current system for appointing auditors has failed miserably. It is riddled with conflicts of interest and effectively creates an unhealthy and inappropriate dependency between the auditors and the executive directors of the client companies. It creates a situation in which there is every incentive for auditors to acquiesce to the blandishments of the executive directors over the presentation of the financial statements and to suspend professional scepticism.

225. In our penultimate paragraph, we concluded as follows:

***Appointment of auditors by a third party with the relevant skills and expertise would, once and for all, break the current link of excessive dependency between auditors and those they audit.** It is a change that should not be difficult or costly to implement and would be effective in achieving much greater auditor independence than at present. Auditors are currently appointed for a maximum term of ten years. If, on a trial basis, the Regulator started by managing the appointment of auditors for FTSE 100 companies this would mean an average of ten appointments a year. This should not be a particularly onerous workload for a team of experts. It is low-risk and requires relatively little investment.*

226. The emphasis in bold above was present in our original letter.

227. Sir John Kingman stated in his letter “*Notwithstanding these considerations, almost all respondents (with the notable exception of one accounting firm, Grant Thornton) are currently opposed to change.*”

228. UKSA and ShareSoc are the only two bodies in the UK representing individuals who are investing their own money. It logically follows that all of the respondents Sir John refers to must have been either institutional investors investing other people's money, company directors, audit firms, and others who are not representatives of individuals investing their own money.

³ Available at <https://www.uksa.org.uk/news/2019/02/19/letter-rt-hon-greg-clark-mp>

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229. We continue to believe that giving ARGA the power to appoint all PIE auditors remains the single most important change that should be made if the Government is serious about restoring trust in auditing.

230. One of our team, Mohammed Amin, who is a retired PricewaterhouseCoopers tax partner and a former member of that firm's Supervisory Board, writing in a personal capacity, explained in an article "How to make auditors completely independent" first published in UKSA's magazine "The Private Investor" why he considers this would result in a dramatic increase in audit quality. His article can be accessed most easily via his personal website.⁴

231. We have also expanded upon our views in Appendix 2

8.2 Operational separation between audit and non-audit practices

Q 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?

232. Broadly, we think these proposals are satisfactory.

233. We agree with the point in para 8.2.1 of the consultation document that "there is a 'one firm' culture in multidisciplinary firms, diluting the culture of objectivity and challenge required by auditors", and that this needs to change. The operational separation proposals should be designed to ensure that auditors' first duty is to shareholders in respect of the quality of the audit.

Q 65. The Government proposes to require that all audit firms provide annual reports on their partner remuneration to the regulator. This will include pay, split of profits, and which audited entities they worked on. Do you have any comments on this approach?

234. The report to the regulator should include the fees and hours charged by the audit partner to each client and the firms' audit fee and any other non-audit fees the firms have charged to each audit client. This degree of detail is needed to evaluate what work has been done.

⁴ Available at <https://www.mohammedamin.com/Finance/Making-auditors-completely-independent.html>

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235. Without this detail, the summary data mentioned in Q 65 may be of limited use. The extra data, we have proposed, would have helped to highlight the concerns about for example Carillion.
236. The proposals for independent Audit Boards within firms appear a good idea to us.
237. These Audit Boards will be responsible for remuneration and reward systems through the Audit part of the firm. They will set out performance targets and ensure that the right competences and behaviours are rewarded - and hence encouraged and incentivised. Para 8.2.11 refers to this, but does not explain the detail. It is difficult for us to comment further without a worked example, but the concept is, we believe, possible in theory.
238. The publication of separate financial profit and loss statements for audit practices (para 8.2.10) is welcomed. This will highlight the relative profitability of the different parts of audit firms, cross subsidies if they exist and the need for separate Audit Boards.

Q 66. In the event that the Government wishes to go further than the existing operational split proposals in future and implement split profit pools in line with the CMA recommendation, do you have any comments on how these can be made to work effectively?

239. It is difficult for us to comment on the impact of split profit pools, without a detailed knowledge of the size and scope of central costs and how these might be charged to the audit and non-audit parts of the firm.
240. Allocation of central costs to different parts of the multi-disciplinary firm is a complex task and can be done in many ways. At present, audit is about 25-30% of the total revenue of Big 4 firms. One could argue that audit needs much investment so should bear only a small part of the central costs. Alternatively, one could argue that the future growth of the business is from fast growth non-Audit areas and investment should be focussed there and these parts of the business should not be saddled with large central costs.
241. The simplest approach would be to mandate that central costs be charged pro-rata to revenues. This would ensure consistency and aid comparability between Big 4 firms' audit profits.
242. We note that audit practices tend to have proportionately more staff than non-audit parts of Big 4 firms, and that they have lower average remuneration. This may reflect their staff being more junior and being less experienced and less competent than staff in other areas. If true, this needs to be addressed to ensure audit teams have high quality auditors to conduct high quality audits.

Q 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?

243. In our previous submissions to Brydon, Kingman and CMA, we highlighted the attractions of audit being mandated to be a separate firm (for the Big 4 in the UK). The ARGA cannot have powers over firms based overseas, so any separation plan needs to recognise this. It may take some time for other countries to follow the leadership of the UK, if and when we choose to go down this route.

244. The Government, and all parties, will need patience to make this work effectively and all will need to work constructively together to achieve the common objectives.

8.3 Resilience of audit firms and the audit market

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

245. The fundamental problem with auditing as a profession is that it is very dangerous. Management often wishes to paint a particular picture of the company's results, and in practice shareholders and the directors they appoint almost always follow management's wishes when it comes to changes of auditor. Accordingly, the auditor is always in danger of being presented with deceptive accounts to audit, with enormous liability risks and reputational costs in the event of audit failure.

246. It would help if corporate failures were not automatically nearly always also called audit failures. Making all directors accountable for financial and governance reporting and no longer reliant on external auditors for this will go some way to addressing this. It may help if the same directors were made responsible for unreasonable corporate failures and auditors given a safe harbour unless grossly negligent or wilfully fraudulent in an unreasonable corporate failure situation.

247. While the law allows companies to agree a liability cap with their auditors, this has been little used.

248. If the Government is seriously concerned about avoiding the failure of a Big 4 audit firm, as we have recommended earlier it should introduce a statutory

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liability cap for auditors in the UK, and work with its international trading partners for the introduction of similar caps in other jurisdictions which have significant capital markets.

8.4 Additional competition proposals from the CMA

9 Supervision of audit quality

9.1 Approval and registration of statutory auditors of PIEs

Q 69. Do you agree with the Government's approach of allowing the FRC to reclaim the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs?

249. Yes.

250. We would also point out that we hope the Government and the regulator agree that the Recognised Supervisory Body ("RSB") for the appointment of non-PIE auditors should be the new professional body for corporate auditors described in section 6.9 of the consultation document when it has been set up and is fully functioning.

9.2 Monitoring of audit quality

251. We believe that more work needs to be done in developing the definition of audit quality, i.e., what does a "quality audit" mean, and indicators of audit quality ("AQIs"), especially at an individual engagement level. This should be led by the regulator but also driven by the key stakeholders, especially shareholders as the consumers of audit services.

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

252. We are sceptical that any types of sensitive information are included in AQR reports beyond information embarrassing for individual directors which arguably should be published. Therefore, we are dubious about any need to provide exemptions from disclosure.

253. AQRs by their nature contain historic audit file information and therefore unlikely to contain fresh, up to date granular and potentially sensitive information of the group being audited. Even the auditors being reviewed will be accessing and recording mainly historic information.

254. By the time AQR reports are published, any information, even if it was originally sensitive, will most probably have lost its sensitivity. If it has not, that would

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raise all sorts of questions on why it had not been published sooner under the requirements of MAR relating to inside information.

255. One of our team, Charles Henderson, is a former member of the FRC's Audit Quality Review Committee and we understand from him that in the four years, from 2017 to 2020, he cannot recollect any AQR reports seen by the committee that had any sensitive information requiring a consideration of exemption from disclosure.

256. Again, we repeat our view, mentioned earlier in our response, that we are sceptical of there ever being any sensitive information in AQR reports concerning the audit of public interest entities as most, if not all, cases would require earlier public disclosure under the relevant requirements for any public securities market.

71. In addition to redacting sensitive information within AQR reports on individual audits, what other safeguards would be required to offer adequate protection to the entity being audited whilst maintaining co-operation with their auditors?

257. As audits are for shareholders as a body, we see no obvious reasons for redacting sensitive information (see response to Q 70), or for providing other safeguards to protect the entity being audited. Auditors should be reporting any non-cooperation from the entity being audited to its shareholders.

9.3 Regulating component audit work done outside the UK

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

258. We have no reasons not to agree with the Government's approach and we are not sufficiently knowledgeable enough to suggest any improvements.

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

Q 73. Do you agree that it is problematic if documents that the auditor reviewed as part of the audit are unavailable to the regulator because of the audited entity's legal professional privilege? If so, what could be done to solve or mitigate this issue while respecting the overall principle of legal professional privilege?

259. Yes, we agree but, not being lawyers, have difficulty in suggesting solutions or mitigation.

10 A strengthened regulator

10.1 Establishing the regulator

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

260. We broadly agree with the general objective.

261. However, we disagree with the text “*by holding to account the companies...*”. This should be revised to read “*by holding to account directors of companies...*”.

262. A company belongs to its members, and when companies are fined, it is the shareholders who bear that fine. Where a company has committed misconduct, it has always done so under the command of its directors, and it is those directors who should face sanctions.

263. The shareholders rely on the honesty and integrity of directors (and auditors) to present a true and fair picture of the accounts and the shareholders should not therefore become the ones who bear the economic cost of ARGA’s sanctions.

Q 75. Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?

264. We agree.

265. We suggest two other principles should be considered:

265.1. Promoting quality in statutory audit work, corporate reporting and corporate governance.

265.2. Anticipating emerging corporate governance, reporting or audit benefits.

266. The latter is so the regulator does not focus on just the negatively inclined risks but also on potential benefits.

10.2 Governance

10.3 Funding: a statutory levy

11 Additional changes in the regulator’s responsibilities

11.1 Supervision: Accountants and their professional bodies

Q 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?

267. The scope of oversight and supervision in the context of accountancy work should be limited to the chartered bodies of accountants.

268. Otherwise ARGAs face the risk of becoming ineffective due to broadening its reach too widely too rapidly.

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

269. Judicial review is the safeguard that protects the public against overreach by the PRA and FCA, possibly other regulators. That should be equally appropriate in the case of ARGAs.

Q 78. Should the regulator's enforcement powers initially be restricted to members of the professional accountancy bodies? Should the Government have the flexibility to extend the scope of these powers to other accountants, if evidence of an enforcement gap emerges in the future? What are your views on the suggested mechanisms for extending the scope of the enforcement powers to other accountants if it is appropriate at a later stage?

270. We do not think that, apart from enforcing compliance with technical standards, any other enforcement framework is necessary.

Q 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?

271. As paragraph 11.1.48 states, the chartered bodies of accountants already have codes of ethics.

272. While the consultation document does not set out any failings or inadequacies in the existing codes of ethics, in principle we have no objection to the regulator specifying a code of ethics applicable to those undertaking activities which fall within the regulator's area of oversight.

11.2 Oversight and regulation of the actuarial profession

273. We begin with some general remarks on oversight and regulation of the actuarial profession.
274. Any answer to any of the questions below should be set in the context of the findings of the Morris Review of the Actuarial Profession, March 2005. The purpose of that review was to address the failings that led to the Equitable Life disaster that culminated in the early 2000s.
275. The relevant key findings of the Review were that the actuarial profession
- 275.1. had failed to take full account of relevant developments in actuarial and non-actuarial theory or in non-traditional areas of actuarial employment;
 - 275.2. had failed to address the role played by entrenched commercial interests in the development of the Profession's education policy;
 - 275.3. was insular in its methods and approach; and
 - 275.4. had reserved certain roles to actuaries even when input from other technical and professional practitioners would have been appropriate.
276. The Morris Review prompted attempts at reform, including some form of regulation by the FRC. However, the problems identified by the Review are still with us. For example, actuaries have had difficulty with the pricing of options, e.g. equity release mortgages, which embed a form of option in the No Negative Equity Guarantee (NNEG) which firms are arguably still failing to price correctly, as evidenced by a series of papers published by the PRA, starting in 2016 and continuing. Another example is longevity estimates not reflecting changes in morbidity data which contributed to the Defined Benefit Pension demise.
277. Actuaries continue to hold certain roles that would be more appropriately held by practitioners in market risk, credit risk and derivatives. For example, the PRA's life insurance department continues to employ actuaries only, even for projects that require credit and derivatives expertise. Any non-actuary in an insurance firm is likely to be reporting to an actuary as the main function holder. The role of the Independent Expert required for Part VII transfers is mandated by regulation to be an actuary.
278. Entrenched commercial interests continue to play a role in actuarial research. For example, the Institute's Equity Release Working Group consists almost entirely of members from firms which are exposed to equity release products.

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279. A separate problem, implied by the ‘insularity’ finding, is that actuaries often price the same assets and liabilities differently from specialists in other disciplines. This inevitably leads to the problem of regulatory or capital arbitrage, where assets or liabilities which are valued prudently by non-insurance firms are priced less prudently (or wholly imprudently) by insurance firms, and leads to problem assets finding their way onto insurance books.

Q 80. Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?

280. It is not.

281. In October 2020 UKSA & ShareSoc made a joint response⁵ to the House of Commons BEIS Committee’s enquiry on audit reform. We reproduce below the relevant parts of our response:

2.6.4. [BEIS Committee] Recommendation 74: The Government, working with the PRA and TPR, should review what powers are required effectively to oversee regulation of the actuarial profession.

2.6.4.1. [UKSA & ShareSoc] We recognise that actuarial regulation seems to have fallen into the FRC’s remit by accident and that it may not therefore get the attention needed in the interests of investors in and consumers of insurance that it should. Therefore, we welcome this recommendation to find a home for actuarial regulation to allow FRC/ARGA to focus on governance, reporting and audit. However, it will be important that FRC/ARGA, the new actuarial regulator, the PRA and the TPR (if neither of these latter two become the actuarial regulator) have a memorandum of understanding on matters where their regulatory duties overlap. This review should also consider the need for accounting and audit quality in the insurance sector.

2.6.5. [BEIS Committee] Recommendation 75: The Review recommends that neither the FRC, nor its successor body, is best-placed to be the oversight body. The PRA (which employs around 80 actuaries) is a much larger repository of regulatory actuarial expertise than the FRC and would be best placed to take on all the actuarial responsibilities currently vested in the FRC.

2.6.5.1. [UKSA & ShareSoc] See our comments on recommendation 74 at 2.6.4.1 above.

⁵ Available on the Parliament website at <https://committees.parliament.uk/writtenevidence/9557/html/>

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282. If our recommendation is accepted, ARGA and the new regulator of the actuarial profession should enter into a memorandum of understanding regarding those matters where the work of actuaries results in numbers that are included in published financial statements.

283. The consultation document notes (11.2.6) that ‘the FRC’s actuarial team is under-resourced’, which is true, although we question why the team should be an actuarial team when the problem is that actuaries do not necessarily have expertise in the areas of credit risk, market risk, and derivatives pricing.

284. If, notwithstanding our recommendation against this, ARGA undertakes oversight, it should employ experts in the areas of credit risk, market risk and derivatives pricing, and preferably avoid using actuaries except for the traditional role of managing and pricing longevity exposure.

Q 81. Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?

285. We do not believe that regulation is the right solution in the long term, however a root and branch reform of the profession can only be achieved on a strong statutory basis.

286. Accordingly, we recommend a separate review of the actuarial profession similar to those carried out recently of the auditing profession.

Q 82. Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.

287. We are sceptical about the need for confidentiality in most cases. The pricing of longevity or credit risk does not seem to be a confidential matter.

288. Astonishingly, the five principles nowhere refer to the importance of a sound technical basis for actuarial work, and the importance of avoiding regulatory (or other forms of) arbitrage. There should be a principle of technical consistency, or adherence to commonly accepted valuation principles, that underpins all insurance work, and which should be the main focus of any future regulator.

Q 83. Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?

289. We think that the third role (providing an independent investigation and discipline regime) should be considerably strengthened. Our experience is that the FRC has avoided such investigations in the past.

Q 84. Should the regulator continue to be responsible for setting technical standards? Should these standards be legally binding? Should the regulator be responsible for setting technical standards only?

290. We believe that setting technical standards, by specialists with appropriate expertise (i.e. not just actuaries) should be the main, perhaps the sole focus of the regulator. A majority of those on the Board of the regulator and its main committees should not be actuaries, so as to avoid regulatory capture as appears to have occurred currently and in the past.

291. For that reason, the technical standards should *not* be developed by giving preponderant weight to input from the IFoA, an organisation which is insufficiently independent of, and indeed dominated by, the insurance industry. We are uncertain whether the PRA (whose insurance department is wholly staffed by actuaries) or the TPR (likewise) would provide sufficiently independent input. Appropriate expertise here means expertise in the pricing of market and credit derivatives, and the management of market and credit risk, which forms half of the exposure of the life insurance and general insurance industry.

292. Consultation with key stakeholders, including shareholders and policyholders, should also form part of the standard setting process.

Q 85. Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?

293. Good technical standards (e.g., setting a fair value on insurance products) imply good ethical standards. Again, good technical standards, particularly in the areas of credit risk, market risk and derivatives, should be the main focus of any regulator of the actuarial profession.

294. However, the regulator should also consider compliance with ethical standards.

Q 86. Should the regulator have the power to request that individuals provide their work in response to a formal request - and to compel them to do so if necessary?

295. The regulator should have the power to request the provision of work both by entities and by individuals.

Q 87. Should the regulator have the power to take appropriate action if work falls below the requirements of the technical standards? What powers should be available to the regulator in these instances?

296. The regulator should first deal with the task of setting firm and technically sound standards (the current TAS framework falls somewhat short in this regard).

297. When that objective is achieved, the regulator can then address the task of monitoring compliance to those standards. Disciplinary action (or the perceived implication of it) should be a core part of the process. Replicating for actuaries, the current FRC sanctions regime for corporate reporting and audits, would be a good place to start.

88. Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?

298. Any independent oversight should include a role for whistleblowers. See our remarks about whistleblowers on page 69.

Q 89. Should the regulator's oversight of the IFoA be placed on a statutory basis? What, if any, powers does the regulator require to effectively fulfil this role?

299. We have no strong views on the method of oversight, except that oversight should be effective, and wholly unconflicted.

Q 90. Does the current investigation and discipline regime remain appropriate? Should it be placed on a statutory basis? What, if any, additional powers does the regulator require to fulfil this role?

300. We question the term 'remain', which implies that the regime has ever been effective.

301. All serious complaints, to our knowledge, have been ignored by the current regulator (the FRC, also the PRA). As stated above, we suggest a different regulator to the FRC/ARGA, with that new regulator being tasked on creation with introducing an appropriate investigation and discipline regime.

Q 91. Do respondents think that the regulator's remit should be extended to actuarial work undertaken by entities? What would be the appropriate features of such a regime, including the appropriate enforcement powers for the regulator?

302. See our reply to question 86 above. Currently the PRA insurance department is responsible for the regulatory balance sheet and capital requirements, not the statutory balance sheet, i.e., the true balance sheet. The PRA has always said that the latter is the responsibility of the FRC.

303. The new actuarial regulator should take this responsibility seriously, with appropriate statutory powers, and with a clear MOU with ARGAs regarding overlapping responsibilities.

Q 92. Should the regulator's independent investigation and discipline regime for matters that affect the public interest also apply to entities that undertake actuarial work? Should the features of the regime differ for Public Interest Entities?

304. We have no firm view.

Q 93. Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?

305. We have no firm view.

11.3 Investor stewardship and relations

11.4 Powers of the regulator in cases of serious concern

Q 94. Are there others matters which PIE auditors should have to report to the regulator? Could this duty otherwise be improved to ensure that viability and other serious concerns are disclosed to the regulator in a timely way?

306. Auditors should be required to report to the regulator on every occasion when they become suspicious that what they are being told by a PIE director or senior member of PIE management cannot be relied upon. They should be required to report at the point where suspicion arises, with a follow up report to confirm whether the suspicion was erroneous or well founded.

307. Such communications should receive blanket legal privilege, so that the auditor is immune (has a safe harbour) from any claim by the company or the individual of breach of trust, defamation, or any other cause of action.

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308. This would make PIE directors and management much more aware of their duty to disclose fully and honestly to auditors at all times.

Q 95. Should auditors receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator? Would this encourage auditors to report viability and other concerns to the regulator?

309. Yes.

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

310. A standard maximum of 30 days is probably appropriate. However, the regulator should be able to specify a shorter time period if the regulator considers that to be appropriate.

311. For example, in extreme circumstances a 24-hour notice period would be reasonable if the PIE's management are simply being asked to report to the regulator what they know, or to supply existing documents in their possession, rather than being asked to assemble new information. This is the same period we believe currently used for financial services firms regulated by the FCA and/or PRA.

Q 97. Should the regulator be able to publish a summary of the expert reviewer's report where it considers it to be in the public interest?

312. The regulator should have this power.

313. However, the PIE should be able to see in advance what is to be published, with a rapid appeal mechanism if the regulator and the PIE cannot agree on the precise wording of what is to be published.

Q 98. Are there any additional powers that you think the regulator should have available where an expert review identifies significant non-compliance by a company in relation to its corporate reporting and audits?

314. Nothing beyond what is proposed elsewhere in the consultation document comes to mind.

11.5 Local audit

11.6 Independent supervision of the Auditors General

11.7 Whistleblowing

315. Our experience of the FRC response to whistleblowing is wholly consistent with Baroness Kramer's observations, which we reproduce below without comment.⁶

"We've had scandal after scandal after scandal and you would think that the regulator learned that it needed to go on the front foot, needed to be far more aggressive, pick up any signal that wrongful behaviour is taking place, and come down hard on those who are involved. It's got the tools of the senior managers regime, we know that it doesn't use that, [albeit] once and that very gently, with the chief executive of Barclays, Jes Staley, who hired private investigators to try and uncover the identity of a whistleblower. It is very gentle in the way that it's been used and frankly institutions and senior managers are no longer afraid of it, and that is a very bad position to be in.

"But look, things that we are trying to do because we have to see where can we act now to try and make change, I'm involved at the moment with the Financial Services Bill, we are trying to get something called the Duty of Care introduced, that will require every financial services provide to have a duty of care to its customers. Now that's much stronger than treating customers fairly, which is the current standard, and which is always offset by a caveat emptor, which is 'but the customer has to be responsible for the choices they make'. We actually think there needs to be a proper duty of care, and we may eventually get some version of it, once this bill has bounced between the House of Lords and the House of Commons, but I think that would change the ground rules in an important way.

"The Office of the Whistleblower is absolutely critical. I was talking with several prosecutors in the United States not very long ago, who basically said whistleblowers are a citizens' army. There is no way that we could police an industry as complex as this, but whistleblowers can bring the issues to our attention, and that makes all the difference, and they are a deterrent. But we don't back up our whistleblowers. The experiences they go through, and I'm the vice chair of the APPG on whistleblowing, are frankly shocking. I have a private members bill down at present, to create an Office of the Whistleblower. It will die with the end of this session, but I will go back into ballot to try and get it back again, and it is a general and much broader campaign than anything you can do, working with members of Parliament, anybody else that you come into contact with. We really do need something overarching that will be able to take on those crucially

⁶ <https://youtu.be/jhLnjirfUZQ?t=1692>

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important issues, and provide that respect, the respect you give a citizens' army, because at present, we often require our whistleblowers to be sort of martyrs and heroes, which is just entirely inappropriate. People doing their jobs, speaking out with courage, should be protected, not the victims of retaliation. And it would make a very fundamental difference.

“And I found sadly one of the most fascinating part of this is the Gloster report on LCF, where her descriptions of the way in which the whistleblowing channel worked at the FCA, basically that, in the United States, the equivalent whistleblowing channel, the first contact the whistleblower has, or their legal representative has in the United States, is with an investigator with a minimum of five years experience in finance and investigation. In the UK, the whistleblower finds themselves talking to a call centre trained in complaints handling. And the Elizabeth Gloster report makes it clear that very little of that information ever gets triaged up to any enforcement group, because the people that are taking the call are focused on calming folks down, are encouraging them to go away, taking a few notes, no notion of the consequences of what they are listening to or the importance of it, and that to me is a problem right at the beginning of that chain of information. So strengthen the responsibility that falls upon every single financial services company and give it real teeth, have something like the office of the whistleblower, I don't care what you call it, but somewhere make sure that whistleblowers get the support and protection, and the compensation that they need.”

316. A move to the US model of whistleblowing is long overdue. I.e., whistleblowing to be handled by specialists in the subject, and financial compensation for those who have suffered as whistleblowers.

4. Appendix 1 – The nominee system and beneficial owners

317. The unintended consequences of Government policies combined with the vested interests of the financial sector have driven a wedge between companies and their beneficial owners. This is both an injustice and a lost opportunity.
318. In all the consultation documents that we can recall coming out of Government, or out of official bodies, there seems to be minimal interest in the problems facing individual investors. The nominee system has effectively disenfranchised most individual investors, even if they actively select holdings in specific companies.
319. As a consequence, what Lord Myners in his lecture⁷ called the “ownerless corporation” is still with us, and shareholder democracy currently seems a forlorn hope.
320. We suggest that individual shareholders, who are sometimes prepared to attend and speak at company meetings including AGMs, represent an essential resource to the corporate governance system, particularly now that ownership responsibility has been rightly extended to matters of importance to society generally. We know from our collective experience that constructive, well-informed, comment and questions from private investors can have an impact on boards of companies quite unconnected with the size of shareholding. If it were possible for shareholders to speak in AGMs to the audit, and to ask questions of auditors, this would also have an impact, in the interest of stakeholders as a whole.
321. Giving back control of appointing directors and auditors to beneficial owners should also have a positive impact on audits and corporate governance.

⁷ Lord Myners’s 2018 Autumn address to the Institute and Faculty of Actuaries can be seen at [Autumn Lecture 2018 - YouTube](#) or <https://www.youtube.com/watch?v=9nYJExU9Tn4> The title of the address was “in investment how do we define long term”. Among other things, Lord Myners explains how, when running Gartmore, a major investment house, he concluded that corporations were essentially “ownerless” as a result of the dominant shareholdings in UK PLCs of investing institutions and their business models.

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Pooled investment vehicles

322. As well as the failure in corporate governance represented by the nominee system⁸ in relation to investors who select individual companies, we detect little concern that the wishes of the underlying beneficiaries of pooled investment vehicles – which includes all “funds” promoted by the financial sector – in relation to the principles of corporate behaviour are considered.
323. Such wishes deserve careful consideration in the voting policies of institutional fund managers. Those underlying beneficiaries have the same economic interests as direct shareholders, and more engagement throughout society with questions of corporate behaviour would be a healthy development.
324. It will be interesting to see whether the FRC acknowledges this in their assessments of signatories to their new Stewardship Code and in particular of institutional fund managers applying this Code’s Principle 6, Signatories take account of client and beneficiary needs and communicate the activities and outcomes of their stewardship and investment to them.

⁸ The nominee system removes shareholder rights from beneficial owners, ensures that those beneficial owners do not appear on company registers, and exposes them to security and fraud risks that would not otherwise be present. We have argued for a system whereby both the name of the nominee and the name of the beneficial owner are automatically held on company registers, which would permit direct communication between companies and those beneficial owners.

5. Appendix 2 – How auditors should be appointed

325. In November 2018 at the request of the then Secretary of State, Rt Hon Greg Clark MP, Sir John Kingman produced a supplementary report on the selection and appointment of auditors. This considered the possibility of the regulator playing a much greater role in the procurement of audit services for FTSE100 companies.
326. We believe that the benefits that this approach offers were dismissed too readily.
327. One of the main prompts for considering greater input from the regulator seems to have been the CMA's concern that this would be a more certain way of achieving reform of the audit market in which the Big Four audit firms currently audit all FTSE 100 companies and the vast majority of FTSE 350 companies.
328. We agree that this concentration is not satisfactory in that it creates an over-dependence on a few large firms. Specific concerns are:
- 328.1. The current system would become unsustainable if one of the Big Four ceased to exist;
 - 328.2. Potential challenger firms are already withdrawing from bidding in this market because their chances of winning audit instructions are so low.
329. There are other good reasons why we believe that it would be much better if the regulator were to take a much more active role in the appointment of auditors to PIEs. These include:
- 329.1. Current proposals to stimulate involvement of Challenger firms by adopting a system of managed shared audits are not satisfactory. There is no guarantee that this will improve audit quality and it could, in fact, have adverse consequences;
 - 329.2. There is little evidence that Challenger firms, most of which have a strong UK orientation, have any desire to tie up their resource sending key staff around the world, possibly for extended periods of time, to carry out part of an audit with a larger rival;
 - 329.3. The current system whereby companies and, to some degree, the shareholders appoint the auditors involves serious conflicts of interest and has been shown to be unsatisfactory in terms of the culture and outcomes it encourages.

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330. There is good reason to believe that in, say five years' time, the current proposals will have resulted in little change and the government will be forced to consider introducing a market cap system to force change. As the consultation document makes clear, this in itself will require significant intervention from the regulator.
331. If the government is serious about reforming the audit market it would be much better to take firm and decisive steps now by involving ARGA directly in the audit procurement and selection process.
332. Other benefits of much greater involvement from ARGAs in the appointment of auditors to PIEs would be:
- 332.1. It would change the current unsatisfactory and conflicted relationship whereby the company chooses and appoints the auditor; this arrangement and the dependent relationships it engenders between the company and the auditor will always compromise auditor independence;
 - 332.2. It would help to ensure that auditors were both encouraged to use their 'professional scepticism' and adopt a greater element of constructive challenge towards companies when carrying out the audit. Expecting companies to select the auditors most likely to apply these principles is akin to asking turkeys to vote for Christmas;
 - 332.3. There should be ample opportunity for the regulator to work collaboratively with shareholders to apply a more interventionist and more direct approach towards auditor appointment. The FRC has worked hard to introduce an excellent programme of investor outreach and engagement. This already works well and should be built upon to help achieve better strategic outcomes in the audit market;
 - 332.4. The closer involvement of shareholders (and possibly other stakeholders) working closely with the FRC/ARGA on auditor appointment for PIEs would provide a helpful counterbalance to undue influence from those who the regulator is supposed to regulate. It should therefore help to reduce the risk of 'regulatory capture';
 - 332.5. It would make it much easier for the regulator to identify and gather information on examples of good practice in audit and ensure that these are promoted across the board. This is particularly important in the light of proposals from Sir Donald Brydon for a proper audit profession. This has implications not only in terms of reformed audit culture but also in terms of the proposed changes to the scope of audit;

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- 332.6. It would allow reform of the current ineffective and wasteful way in which audit is procured. At present, whenever a FTSE 100 firm retenders its audit, there are likely to be four bidders – or three if the audit is being rotated. Only one of those can win the contract. For the others, the bid costs are wasted and have to be absorbed within fees charged for the contracts that are won. There are also doubts as to how rigorous the selection process is;
- 332.7. It would be much better if auditors for PIEs were to bid once every, say, five years to gain a place on framework agreement with the regulator. This would be similar to the current framework agreements used in public procurement. Companies would then ‘call-off’ from the framework as instructed by the regulator. This would be the point at which the ‘contract’ with the company would come into being.

6. Appendix 3 – Members of the consultation response team

333. As mentioned earlier in the document, all of the members of the consultation response team are long-standing individual investors, in addition to the current and past roles described below.

334. The authors are listed in alphabetical order.

Mohammed Amin MBE FRSA MA FCA AMCT CTA(Fellow)

335. For over 19 years Mohammed Amin was a corporate tax partner in PricewaterhouseCoopers responsible for advising audit partners on the audit of tax provisions, and often attending client audit committee meetings.

336. For over six years he served on the firm's Supervisory Board where he was a member of the firm's Audit and Risk Committee since as an LLP the firm is required to publish audited accounts. He has also served on the Board of Manchester Training & Enterprise Council and the Governing Body of Salford University including serving on the audit committee of both organisations.

Dean Buckner PhD MSc

337. Dean Buckner recently retired after working at the Financial Services Authority (FSA, the predecessor to the current regulator, the FCA) and then the Prudential Regulation Authority (PRA) and Bank of England for nearly 20 years. He specialised in derivative and asset valuation and capital modelling in both the banking and life insurance sectors.

338. Most recently, working with Professor Dowd of Durham University Business School, he has been instrumental in strengthening the capital adequacy rules applying to institutions holding equity release mortgages

Charles Henderson BA FCA

339. Charles Henderson is a chartered accountant who takes an active interest in corporate reporting, including auditing, corporate governance and ESG from an investor perspective.

340. He is a member of the FRC's Advisory Panel, a participant of the Corporate Reporting Users' Forum (CRUF), a member of the BEIS Audit Contact Group and co-chair of the CRUF ESG subgroup.

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John Hunter MA FCCA

341. John Hunter is retired after a career with a FTSE100 company that included seven years in the US as VP (Finance) of a major acquisition and five years as Group Company Secretary with some responsibility for investor relations.
342. He has been a trustee director of the corporate pension fund for 15 years, including five years as Chairman of the Investment Committee.

Sue Milton BA, CISA, CGEIT

343. Sue Milton is an expert in increasing corporate resilience globally, including our ever-increasing dependence on information technology.
344. Her experience comes from working with governments and central banks, including the Bank of England, as an adviser on governance and assurance, guiding both types of institution to manage the fine balance between mandated policy and free market behaviour. Sue has also worked with the financial sector globally, on a range of governance specifics such as organisational behaviour, anti-money laundering processes, technical innovation and security. Sue also holds the FT's Non Executive Director diploma.

Peter Parry BA, MBA, Dip Inst M, MCIPS

345. Peter Parry started his career in manufacturing industry working in South America and Europe. On returning to the UK, he spent a number of years working in logistics with the National Freight Consortium (NFC) shortly after the business was bought by the employees from the government.
346. Over the last twenty years he has worked in management consultancy, specialising in purchasing and supply chain management. He spent five years with a large international consultancy and for the last twelve years has run his own business.

Cliff Weight, MA

347. Cliff Weight led the ShareSoc campaigns for better governance at RBS, and leads the campaigns for redress regulation and retribution at Woodford and Sirius Minerals
348. Cliff Weight was a director MM&K Limited, the leading independent remuneration consultant, and has 30 years' experience as a remuneration consultant, advising many FTSE 350, Small Cap and AIM companies. He is a member of the Editorial Board of Executive Compensation Briefing. He is also the author of the Directors' Remuneration Handbook.