



Department for
Business, Energy
& Industrial Strategy

Restoring trust in audit and corporate governance

Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems



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Ministerial Foreword

These are challenging times for the UK, but the economy is recovering well, with record job vacancies and unemployment back at pre-crisis levels. A diverse range of companies and entrepreneurs continue to identify the UK as a great place to start and grow a business. The UK continues to be Europe's most attractive location for international investment in financial services and is well positioned for continued growth¹. To help people cope with rises in the cost of living, we want to see



businesses thrive across the whole of the UK, sustaining employment and the economic health of communities.

To help drive growth further, Government is determined to solve long-term challenges facing businesses. It remains vital that investors, financial markets and all those who depend on the largest companies in the UK can continue to rely on the information they publish. The UK's Corporate Governance framework has been a deserved source of pride and a key reason why so many have been confident to invest in the UK.

However, following a series of large corporate failures that have led to job losses and uncertainty among small businesses and local communities over the last few years, the Government set out ambitious plans to further strengthen the UK's audit and corporate governance framework and empower shareholders, based on the recommendations of three independent reviews. This document summarises the responses we received concerning those plans and sets out what we will do. These decisions will maintain the UK's long-established leadership in corporate governance and reduce the risks and impacts of sudden and avoidable corporate failures.

Restoring trust in audit and corporate governance means ensuring the quality and accuracy of the information that companies are reporting. Good guidance and support from an improvement-minded regulator will play a vital role in helping companies achieve and demonstrate high standards. Alongside this, we will ensure that all of the main parties who play a role in financial reporting can be, and are, held to account if they fail to fulfil their responsibilities.

The Government therefore intends to refine the UK's audit and corporate governance framework, seizing the opportunities of the UK's departure from the EU to shape rules and processes that work for our specific circumstances. At the core of these proposals is the

¹ EY UK Attractiveness Survey for Financial Services https://www.ey.com/en_uk/financial-services/why-confidence-in-the-uk-s-financial-sector-has-hit-a-five-year-high

establishment of a strong, independent regulator, the Audit, Reporting and Governance Authority (ARGA), to implement high-quality regulation and high standards and encourage improvement by regulated entities and individuals.

Under these plans, directors will be held accountable for significant failures in their corporate reporting and audit-related duties, auditors will be held to high standards under the new regulator, and professional bodies will be subject to better oversight by ARGA as well as needing to take action on their own behalf. Large companies will report in a more comprehensible way on their resilience and on how far their reporting is independently assured, which will provide more helpful information for the benefit of investors, suppliers, customers, workers and pensioners. And for the first time large private companies' corporate reporting and audit will be subject to the same scrutiny as that of listed companies.

In a number of other areas where strong rules are required to achieve the best outcomes, including reliable corporate reporting and greater resilience and choice in the audit market, the Government will put measures in place and ensure they are enforceable.

To take full advantage of our flexibility outside the EU, and ensure that the UK remains the best place in the world to invest and grow a business, the Government will build in scope for fine-tuning of the audit and corporate governance system so we can recognise what works and improve what doesn't. In particular, we will seek opportunities to reduce regulation for smaller entities caught by requirements of retained EU law where they have proved too stringent, and use the legislation that we are developing to implement them.

For the longer term, in preference to regulation that many consultation respondents argued was unnecessary or premature, the Government is setting market participants the challenge of shaping their own future through the assurance they commission, the skills and opportunities made available to audit professionals, and the relationships forged with the new regulator. A new Audit and Assurance Policy is the practical first step to this market-led approach, intended to catalyse new demand among companies and investors for wider assurance services.

This package of measures remains a priority for me and for the Government. We have already announced our intention to prepare and publish a draft Bill. It will make the UK an even more attractive place in which to do business and to invest, keep the UK a world-leader in standards of corporate reporting and governance, and tackle the impact of sudden corporate collapses on small businesses and on hard-working people.

THE RT HON KWASI KWARTENG MP

Secretary of State for Business, Energy & Industrial Strategy

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Executive Summary

Introduction and background

This document summarises responses to the Government's consultation on its White Paper *Restoring trust in audit and corporate governance* (March 2021) and sets out the Government's plans for action in the light of over 600 comments received.

Reliable corporate reporting is vital to well-functioning financial markets, business investment and growth. It enables all interested stakeholders to make an informed assessment of a company's performance and governance and safeguards a wide range of interests – particularly those of shareholders. The UK's deserved reputation for high standards of corporate governance has been critical to attracting investment to the UK. However, successive sudden and major corporate collapses have caused serious economic and social damage in the UK, calling aspects of the corporate reporting and governance system into question.

Drawing on the work of three independent reviews, the White Paper made proposals to address this through the creation of a more effective and better-constituted regulator, the Audit, Reporting and Governance Authority (ARGA); improvements in reporting and directors' accountability at the largest companies, public and private; action to improve competition and choice in the audits of the largest publicly traded companies; and making audit a more effective tool for giving stakeholders reliable and relevant information about companies.

The Government's overall approach

The Government's objectives are to build trust and credibility in the UK's audit, corporate reporting and corporate governance system; ensure accountability for those playing key roles in that system; and to increase resilience and choice in the statutory audit market. This will further increase trust in the UK as a place to invest and to obtain investment. To do this, the Government intends to put in place a new UK approach to regulating in this area, in line with its wider approach to regulation and regulators set out in *The benefits of Brexit: How the UK is taking advantage of leaving the EU* (January 2022), that takes advantage of the UK's new freedoms outside the EU. This means:

- Setting appropriately high standards;
- Doing this in a proportionate way. The Government is looking to balance the benefits of high standards with the costs of introducing and maintaining them. In particular this means that the focus of regulation will be on the most systemically important companies and organisations, which are designated as Public Interest Entities (PIEs);
- Setting the right framework for an independent regulator, including over time amending, replacing or repealing any retained EU law that is not right for the UK;

- Creating scope to adjust the framework in line with emerging evidence; and
- Introducing reforms at a pace that balances the need for action with the time needed for those affected to prepare properly, prioritising the most immediately necessary reforms.

Proportionality was a key theme of responses to the White Paper measures, as well as being a key regulatory principle. The Government has therefore looked again at the opportunity for market-based solutions and non-regulatory options in preference to regulation. It has also reduced the overall costs of the package as a whole – for example on large private companies and on the audit market.

Implementing this approach involves a range of actors – not just government – taking forward multiple strands of reform over a period of several years. This document therefore does not seek to set out a precise timetable, but rather outlines the actions to be taken, including what the Government intends to ask of the regulator and other stakeholders. These reforms will be delivered by a variety of mechanisms, such as:

- **Market developments**, for example in the demand for assurance services beyond audit, from PIEs and other significant companies;
- **Work by professional bodies**, for example to enhance members' training and development;
- **Changes by the regulator**: to the UK Corporate Governance Code that currently applies to premium listed companies, and ongoing improvements to audit standards;
- A **Ministerial Direction** (reproduced in Annex C) that lays the foundation for the introduction of PIE auditor registration by the Financial Reporting Council (FRC) in the near future;
- **Secondary legislation** (statutory instruments) which could be used to establish new reporting requirements for PIEs (for example, a Resilience Statement and reporting on distributable profits); and
- **Primary legislation** (a Bill in Parliament), which the Government is preparing initially to publish in draft, for subsequent introduction when Parliamentary time allows, to establish a new regulator and set its powers, objectives and duties.

The Government's ongoing work to clarify the status and operation of retained EU law, and to create new powers to amend retained EU law by way of secondary legislation, is likely to provide further avenues for necessary changes.

The main measures that the Government intends to be taken forward are summarised below.

A new regulator

The White Paper set out proposals to establish a new regulator, ARGA, with the overarching objective to protect and promote the interests of investors, other users of corporate reporting and the wider public interest. ARGA's operational objectives will focus on quality, competition and, in line with the outcome of a separate consultation on local audit, acting as an effective

'system leader' for local public audit. It will also retain the FRC's statutory duty to promote economic growth.

Consultation respondents were keen for ARGA to be established, effective and well-governed.

The FRC has made a great deal of progress in transforming itself in preparation for the transition to ARGA and continues to expand its capacity and capability. The Government will empower ARGA to act decisively where needed, governed both by coherent objectives, set in legislation, and by a clear remit from government. ARGA will be accountable to government, to its stakeholders, and to Parliament.

The Government's package of reforms will give ARGA a range of statutory responsibilities and powers that the FRC does not have. These include formalised responsibility for overseeing the accounting and actuarial professions, a stronger role in auditor registration, and new powers to tackle breaches of company directors' duties relating to corporate reporting and audit.

Ministers will have flexibility as to when specific powers and reforms come into force, and will ensure that ARGA has the time and resources to establish the necessary capability.

Recognising the public interest in large private companies' reporting

The White Paper set out options for expanding the scope of regulation to large private companies, to recognise the changing nature of the UK economy and the need for high standards of corporate governance in the most significant UK companies, given their importance for employees, shareholders, and the country as a whole.

Having considered the views of consultation respondents, the Government intends to treat large private companies with both 750+ employees and an annual turnover of £750m+ as public interest entities (PIEs). Companies traded on the Alternative Investment Market (AIM) or other multilateral trading facilities will be PIEs if they meet this 750:750 test, but smaller companies on those markets will not become PIEs. Limited Liability Partnerships (LLPs) that meet the 750:750 test will also be PIEs. Public bodies such as local authorities will not become PIEs by virtue of the 750:750 test; Lloyd's syndicates will also be outside its scope. In line with the Government's commitment to proportionate regulation, the Government will not require these size-based PIEs to meet all of the same audit requirements as existing PIEs. The Government believes this approach will ensure that the companies of greatest public interest are properly scrutinised by the regulator, whilst minimising additional burdens from regulation as far as possible.

Given the UK's greater freedom outside the EU, the Government will also review the regulatory framework around existing PIEs to identify potential deregulatory measures, and will use the legislation that it is developing to enable the necessary improvements to be made.

Internal controls, fraud and dividends

To ensure directors could be held sufficiently accountable for the processes that underpin true and fair reporting, the White Paper proposed requiring directors to report on a company's internal controls and fraud-prevention measures, with auditors providing assurance on the latter. It also set out proposals for strengthening confidence that the law on dividends and capital maintenance is being respected.

In light of consultation responses, the Government believes a more incremental approach to strengthening the UK's internal control framework would be appropriate. It will therefore invite the regulator to strengthen the UK Corporate Governance Code to provide for an explicit directors' statement about the effectiveness of the company's internal controls and the basis for that assessment, and to work with companies, investors and auditors to develop appropriate guidance. It is currently only premium listed companies that are obliged to apply the Code, but its principles and provisions have an influence on governance expectations for a significantly wider range of companies. The Government intends to legislate to require directors of PIEs with 750+ employees and an annual turnover of £750m+ to report on actions they have taken to prevent and detect fraud; auditor responsibilities will be unchanged.

The Government will task ARGA with issuing guidance on what should be treated as "realised" profits and losses for the purposes of determining distributable reserves. It intends to legislate to require PIEs with 750+ employees and an annual turnover of £750m to disclose their distributable reserves and explain the board's long-term approach to the amount and timing of shareholder returns. The Government also intends to require directors of such companies to make an explicit statement confirming the legality of proposed dividends and any dividends paid in-year. The Government will give careful consideration to the appropriate lead times for the new reporting requirement for a directors' statement on fraud measures, and those relating to dividends and the disclosure of distributable reserves.

Changes to reporting requirements

To improve the available information about risks faced by significant companies and make the degree of assurance used by those companies clearer, the Government will introduce a new statutory Resilience Statement and a new statutory Audit and Assurance Policy. Both proposals have been modified in light of feedback received during consultation and will apply to PIEs with 750+ employees and an annual turnover of £750m+. Again, the Government will consider the appropriate lead times for these new reporting requirements.

Supervision of corporate reporting

The Government wants ARGA to exercise effective oversight of corporate reporting to raise standards and improve the informativeness of company reports. Having considered consultation responses, the Government intends to proceed with most of the White Paper's

proposals for strengthening the regulator's corporate reporting review powers. It intends to ensure that ARGA can direct changes to company reports and accounts, rather than having to seek a court order, along with powers to publish summary findings following a review. The Government also intends to ensure that the regulator can require or commission an expert review to support its corporate reporting review work. In addition, the Government will extend the regulator's powers to cover the entire contents of the annual report and accounts so that it can review elements such as corporate governance statements, directors' remuneration and audit committee reports, and the CEO's and chairman's reports. The Government does not now intend to give ARGA new powers to offer a pre-clearance service.

Enforcement of directors' corporate reporting and audit-related duties by ARGA

Company directors have various statutory duties in the Companies Act 2006, including in relation to the preparation of company accounts and reports, and the auditing of those accounts and reports. These duties, however, are rarely enforced. In order to promote confident investment in UK markets and in individual PIEs, the Government will give ARGA powers to investigate and, if necessary, sanction directors of PIEs for breaches of their corporate reporting and audit-related duties and responsibilities.

The Government will also invite the regulator to consult on changing the UK Corporate Governance Code to provide greater transparency about the malus and clawback arrangements that companies have in place so remuneration can be withheld or recovered from directors for misconduct, misstatements, and other serious failings.

Improving the informativeness and quality of audit

Responses to the consultation suggested that improvements to current audit standards and practice, driven by ARGA in its role as an improvement regulator, are likely to be more effective and targeted than legislative changes. The Government will therefore look to ARGA to drive improvements in audit quality, in line with its quality objective. This includes ARGA taking on responsibility for the registration of PIE auditors.

The Government supports the Brydon Review's long-term vision of expanding the future scope and purpose of audit to make it more informative. In the light of consultation responses, it believes that the first stage of this journey will be the successful introduction of the Audit and Assurance Policy and subsequent development of the market for assuring financial and non-financial information beyond that in the financial statements. The Government does not propose to create a legislative framework for this market at such an early stage in its development.

Rather than trying to create a new professional body for auditors that is independent of the existing accountancy professional bodies, the Government will ask professional bodies to

improve auditor qualifications, skills, and training in order to help create a more effective and distinctive audit profession.

Boosting resilience, competition and choice in the audit market

To support ARGA's objectives to promote high-quality audit and effective competition in the audit market, having considered consultation responses carefully, the Government has decided to proceed with a package of measures to increase choice, to improve resilience in the audit market for the largest companies and to enhance professional scepticism:

- A 'managed shared audit' regime, to be introduced on a phased basis. This will give challenger audit firms the opportunity to audit a meaningful proportion of subsidiary audits conducted for FTSE 350 companies. In recognition of the scale and complexity of certain audits, ARGA will be able to authorise exemptions from the regime.
- Powers to give ARGA the ability to operate a 'market share cap', either in the event of a significant audit firm collapse or if further intervention is required once managed shared audit is in place.
- Powers for ARGA to require 'operational separation' of the largest firms, improving governance of the audit practice with a view to promoting greater professional scepticism within multidisciplinary firms.
- Powers for ARGA to monitor the health of audit firms and to address any concerns around an audit firm's resilience.

Other legislative proposals

The Government also intends to proceed with other proposed changes to the oversight and regulation of the accountancy and actuarial professions. This includes introducing a new statutory regime for the oversight of accountancy professional bodies and powers to investigate and sanction accountants (both firms and individuals) for a breach of professional standards in cases relating to corporate reporting that give rise to a public interest concern. The Government also intends to give ARGA statutory powers to oversee and regulate the actuarial profession, by reference to actuarial activities of public interest. The Government will also propose legislation to broaden statutory supervision of financial audits for which the Comptroller & Auditor General is responsible, while transferring responsibility from the Government to Parliamentary bodies to establish these oversight arrangements.

The Government also proposes to give ARGA a range of powers and responsibilities to act as 'system leader' for local public audit in England, subject to the outcome of a separate consultation.

Recognising what works: post-legislative review of progress

In order to assess what works and evaluate progress made, the Government will carry out its Post-Implementation Review five years after its reform legislation first comes into force, as set out in the White Paper. This will assess the effectiveness both of regulation and of non-regulatory measures in tackling the issues highlighted by the White Paper.

1 The Government's approach to reform

1.1 Background

1.1.1 This document summarises responses to the Government's consultation on its White Paper *Restoring trust in audit and corporate governance*² (March 2021) and sets out how the Government plans to act in the light of comments received, including what it intends to ask of the regulator and other stakeholders. It also outlines briefly how the Government's plans take account of the outcome of a separate consultation on the establishment of ARGA as a "system leader" for local public audit³.

1.1.2 As the White Paper set out, reliable corporate reporting is vital to well-functioning financial markets, business investment and growth. It enables all interested stakeholders to make an informed assessment of a company's performance and governance and safeguards shareholder and other interests. The UK has a deserved reputation for having high standards of corporate governance, and this has been critical to the attractiveness of the UK as a destination for investment. However, successive sudden and major corporate collapses have caused serious economic and social damage in the UK, calling aspects of the corporate reporting and governance system into question.

1.1.3 The White Paper made proposals to address this, drawing on the work of three independent reviews: Sir John Kingman's Independent Review of the Financial Reporting Council (FRC)⁴, the Competition and Market Authority (CMA)'s Statutory Audit Services Market Study⁵ and Sir Donald Brydon's Independent Review of the Quality and Effectiveness of Audit⁶. The key areas for improvement included creation of a more effective and better-constituted regulator – ARGA (the Audit, Reporting and Governance Authority) – to supersede the FRC; improvements in reporting and directors' accountability at the largest companies, public and private; action to improve competition and choice in the audits of the largest publicly traded companies; and ways to make audit a more effective tool for giving stakeholders reliable and relevant information about companies.

1.2 The Government's approach to reform

1.2.1 The Government's proposals for reform were set out in the White Paper and are summarised below. Some respondents to the consultation asked about or suggested broad principles for reform, such as proportionality. This section therefore sets out the Government's

² <https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms>

³ <https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical-consultation>

⁴ <https://www.gov.uk/government/publications/financial-reporting-council-review-2018>

⁵ <https://www.gov.uk/government/consultations/statutory-audit-services-initial-consultation-on-the-competition-and-markets-authority-recommendations>

⁶ <https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review>

overall approach to reform, which both informed the White Paper proposals and underpins the measures decided on by the Government in the light of consultation responses.

1.2.2 The corporate reporting system is highly interdependent, with many different actors having parts to play in it. The Government therefore believes that a holistic approach is needed, which involves all participants in tackling the problems that have been identified.

1.2.3 The UK Government is responsible for company law across Great Britain. The Northern Ireland Executive has previously agreed that, whilst responsibility for company law in Northern Ireland is transferred, legislation regulating business entities should be made in the same terms for the whole of the United Kingdom. On that basis, most of the reforms will apply across the whole of the UK.

1.2.4 Some aspects of the proposals are devolved matters in Scotland, Wales and Northern Ireland. These include the proposals relating to the accountancy and actuarial professions. The Government is in discussion with the three devolved administrations, seeking to agree an approach to cover the whole of the UK in line with the existing cross-border functioning of these professions.

1.2.5 Since the publication of the White Paper, the Government has consulted on its proposed approach to regulators and regulation, in *Reforming the Framework for Better Regulation*⁷ (July 2021), and published its response in *The benefits of Brexit*⁸ (January 2022). This set out five principles which the Government intends will guide its approach to regulation: a sovereign approach, leading from the front, proportionality, recognising what works and setting high standards at home and globally.

1.2.6 The Government therefore intends its approach to regulating audit and corporate governance to follow its wider approach to regulation and takes advantage of the UK's new freedoms. This will ensure that the UK has a high-quality regulatory regime with rules that are tailored to its specific circumstances. When applied to the White Paper programme, this means:

- **Setting appropriately high standards.** The aim of these reforms is to tackle some areas in which the current regulator and regulatory framework, despite their strengths, have not consistently led to the best outcomes for the UK. Higher-quality regulation is needed to achieve better markets and improved outcomes. As part of this, the Government is seeking to ensure that the reforms are consistent with the central aim of the Hill Review of UK listings: to make the UK an even more attractive place to list.
- **Doing this in a proportionate way.** The Government is looking to strengthen aspects of audit and corporate governance in ways that balance the benefits of high standards with the costs of introducing and maintaining them. In this context the Government has looked sympathetically at consultation responses that propose lighter-touch ways of

⁷ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1005119/reforming-the-framework-for-better-regulation.pdf

⁸ *The benefits of Brexit: How the UK is taking advantage of leaving the EU*, January 2022, <https://www.gov.uk/government/publications/the-benefits-of-brexit>

achieving the White Paper's aims. This includes looking again at the opportunity for market-based solutions and non-regulatory options in preference to regulation.

- **Setting the right framework for an independent regulator.** In doing so the Government is seeking to set ARGA clear and achievable goals, but to give it the freedom – and the responsibility – to innovate and improve in how it meets them. This includes ensuring the regulator operates independently from government but remains accountable to Ministers and to Parliament. There will also be routes to challenge ARGA's decisions through the courts, where appropriate.
- **Creating scope to adjust the framework in line with emerging evidence.** In some cases, this means allowing for future deregulation and simplification. In others it means ensuring there are backstop powers that can be brought to bear if needed, rather than introducing them from the outset.

1.2.7 In addition, the Government remains committed to **introducing reforms at a pace that balances the need for action with the time needed for those affected to prepare properly**. This means prioritising the most immediately necessary reforms. In practice, this means a range of actors – not just government – taking forward multiple strands of reform over a period of several years.

1.3 Summary of key proposals from the White Paper

1.3.1 The Government's White Paper⁹ legislative proposals covered:

- Options for extending the definition of "Public Interest Entity" (PIE) to increase the scrutiny of large unlisted companies (Section 1.3 of the White Paper);
- The introduction of a stronger internal control framework for companies (Section 2.1);
- Improving transparency around dividends and capital maintenance (Section 2.2);
- New corporate reporting, particularly a Resilience Statement (Section 3.1) and an Audit and Assurance Policy (Section 3.2);
- Improved supervision of corporate reporting (Chapter 4);
- Making directors of PIEs accountable to the regulator for failures in carrying out their duties relating to financial and other corporate reporting (Section 5.1);
- Changes to audit's purpose and scope, including its expansion to include elements of wider assurance at the discretion of companies, measures to tackle fraud, and a new "corporate auditing" profession and professional body (Chapter 6);
- Measures to ensure companies' audit committees properly safeguard shareholders' interests (Chapter 7);
- Improving competition, choice and resilience in the audit market through a system of managed shared audit (Section 8.1), operational separation between firms' audit and

⁹ <https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms>

non-audit practices (Section 8.2), and better monitoring of the resilience of audit firms and the PIE audit market (Section 8.3);

- Improving the supervision of audit quality (Chapter 9);
- Creating, funding and governing a new independent regulator, ARGA, to replace the FRC (Chapter 10);
- More effective arrangements for the supervision of accountants and their professional bodies (Section 11.1);
- Oversight and regulation of the actuarial profession (Section 11.2);
- Powers of the regulator for use in cases of serious concern (Section 11.4); and
- Transfer of responsibility for arranging oversight of the statutory audit work performed by Auditors General from government to appropriate parliamentary bodies (Section 11.6).

1.4 Broad themes in consultation responses

1.4.1 The great majority of the 600-plus responses to the White Paper accepted the need for reform set out by the White Paper and by the three independent reviews it drew on. This included a significant degree of support for the establishment of the new regulator ARGA and for the aims of improving audit quality, tackling fraud and improving the usefulness of corporate reporting. There was support too for the intended outcomes of greater trust in reporting and greater resilience of companies.

1.4.2 Taken as a whole, responses across the range of stakeholders supported taking forward a high-quality package of reforms at a pace that could be met by investment markets, by companies and other organisations preparing financial reports, and by audit firms, with costs kept proportionate to the benefits.

1.4.3 Given the high volume of responses, there was inevitably a wide range of views on individual proposals. Some responses (notably from academics) argued that the Government should go further than proposed in some instances, or adopt additional measures. Others sought reductions in scope or proposed alternative means of implementation, both (i) from a broad perspective that it was a very large and significant set of changes to introduce at one time, and (ii) by proposing that particular measures were better delivered by other means than primary legislation.

1.4.4 Where respondents wanted to see changes it was possible to draw out some specific themes:

- from *business*, concerns over cost, over whether measures would be effective and over the timing of reforms being introduced, particularly in the wake of COVID-19;

- from *auditors* and their representatives, concern that the scale of reforms could put excessive strain on the pool of trained auditors. Many said that existing standards and systems were largely adequate and could be improved without legislation; and
- from *investors*, a mixed range of views, with many keen to get better information about companies from improved reporting but others uncertain as to whether this would happen in practice. Some were concerned about potential impacts on company listings in the UK.

1.4.5 These were by no means the only voices. For example, some respondents expressed concerns about how much power was being given to the regulator, whether the functions of the regulator were adequately supervised, and the availability of ways to challenge the regulator's decisions.

1.4.6 Later parts of this document set out details of how the Government proposes to handle these points in respect of particular proposals from the White Paper. What follows is an overview of how the Government is approaching these issues in the round.

1.5 The Government's response to points made

Overview

1.5.1 The Government is grateful for the time and effort that has gone into preparing responses to the White Paper, and – in consequence – for the generally high quality of what it received.

1.5.2 The overall positive response to the case for reform set out in the White Paper confirms the Government in its view that reform is necessary. The reviews and the corporate failures that have inspired them highlight that action is needed to rebuild trust in audit and corporate reporting, ensure the UK reputation for high standards of corporate governance is maintained, and lay the foundations for a stronger, healthier audit market. The Government continues to believe that regulatory changes are needed to deliver this. In delivering those changes, it seeks to ensure the UK remains a competitive and attractive economy to investors and businesses, to protect the public and the state from the effects of fraud and malpractice, and to improve the prospects for long term growth across the whole of the UK.

1.5.3 In line with the principles outlined above, the Government intends to involve all market participants in tackling the problems that have been identified. Successful outcomes can only be achieved if all those involved play their role fully. Thus, investors are already subject to new rules on disclosure of their long-term investment strategies¹⁰, company directors will be held accountable for significant failures in reporting, auditors will be held to updated standards set by the new regulator ARGA, and professional bodies subject to better oversight by ARGA as well as needing to take action on their own behalf. Companies will report in a more comprehensible way on their resilience and on how far their reporting is

¹⁰ White Paper, section 11.3.

assured, which will provide more helpful information for the benefit of investors, suppliers, customers, workers and pensioners.

1.5.4 Feedback from consultation has helped the Government to fine-tune the package of measures that it will bring forward to address the immediate challenges, from the lack of resilience and choice in the audit market for the largest companies and the imperfect state of the current regulator to shortcomings in the informativeness of and confidence in audit reports. The Government intends the resulting package of measures to be targeted and proportionate, recognising the complexity of the system, and seeks to make the necessary changes in a way that both best delivers the outcomes and minimises the costs.

1.5.5 Proportionality was a key theme of responses to the White Paper measures more generally, as well as being a key regulatory principle. In the light of those comments, the Government has looked again at the opportunity for market-based solutions and non-regulatory options in preference to regulation. The Government has also considered and reduced the overall costs of the package as a whole – for example on large private companies and on the audit market.

1.5.6 In response to some concerns that the White Paper proposals were too ambitious, too broad in scope or too likely to stretch rather than build audit market capacity in the short term, the Government will focus on the most immediately necessary reforms in developing proposals for legislation, reducing the cost and complexity of legislative measures. This will also help to ensure that the reforms are consistent with the central aim of the Hill Review of UK listings: to make the UK an even more attractive place to list. It also means that the total estimated cost to business of implementing the reform package is significantly lower than it would have been under the White Paper proposals.

1.5.7 Further details of consultation responses and how the Government has taken account of them are given topic-by-topic in the chapters and sections below.

Timescale for reform

1.5.8 Where regulation is needed, it will be implemented on timescales that give market participants time to plan and prepare for it, and to boost their capacity and capability where needed. This document therefore does not seek to set out a precise timetable, but rather outlines the actions the Government intends to take, including what it intends to ask of the regulator and other stakeholders. In particular, it remains the Government's intention to develop legislation along the lines set out in this document and to legislate when Parliamentary time allows.

1.5.9 In carrying out its work, the Government will take account of:

- the benefits of the earliest possible commencement, for example because a policy will take a long time to have its full effect and/or has a built-in lead time;
- the capacity of the statutory audit market to audit PIEs, and of the local public sector audit market;

- the time and preparation needed by businesses and others to achieve compliance with new requirements;
- the regulator's plans to grow its capacity and capability;
- the time needed for the preparation of guidance, the passage of any secondary legislation (subject to Parliament's approval), and other work to implement the regulatory regime; and
- any further consultation needed as part of this implementation.

1.5.10 The intention is to create ARGA and equip it with its powers at the earliest possible juncture, since many of these factors represent work that ARGA will need to do. The timescale for this and for other legislative measures will depend on the availability of Parliamentary time and on Parliament's agreement to the Government's proposals.

1.5.11 The timescale for implementation is expected to stretch over several years in the case of some measures. The detail will depend not only on Parliament but also on Ministers' assessment of the economic circumstances at the time. The Government will give careful consideration to the appropriate minimum lead times to apply, so that market participants can be assured that the pace of change will be measured and manageable.

Post-publication developments

1.5.12 This section notes three developments since the White Paper's publication in March 2021 that are significant for the Government's proposals.

1.5.13 The Government's January 2022 paper on *The benefits of Brexit* highlighted that these reforms to audit and corporate governance are part of the Government's plan to maintain the UK's lead in professional business services and ensure that the sector remains a national success story. The paper also set out details of the Government's approach to regulation and regulators, including the principles set out in section 1.2 above, and its plans to enable the repeal or replacement of any retained EU legislation that does not work in the interest of the UK or could be made to better align with the UK's priorities.

1.5.14 In November 2021, the BEIS Select Committee published its report on Liberty Steel. The Committee recommended, in the light of concerns about the corporate structure and governance of the companies involved, that "Ministers reflect on the systemic risks to UK industry posed by such unusual corporate structures and, if deemed necessary, bring forward amendments to the Companies Act."¹¹ The Government responded to this recommendation as follows:¹²

Complex corporate structures exist for a variety of reasons, and the government does not wish to restrict the ability of businesses to structure themselves

¹¹ *Liberty Steel and the Future of the UK Steel Industry*, BEIS Select Committee, November 2021, paragraphs 28-29.

¹² *Eighth Special Report - Liberty Steel and the Future of the UK Steel Industry: Government Response to the Committee's Fourth Report*, published by BEIS Select Committee, 20 January 2022, paragraphs 3 and 4.

appropriately. However, the government agrees that those structures should not be a legal barrier to proper scrutiny of companies such as the GFG Alliance.

As part of its planned reform of audit and corporate governance, the government is considering whether to enable the new audit, reporting and corporate governance regulator, the Audit, Reporting and Governance Authority (ARGA), to investigate and take action in cases of exceptional public interest, even if the company concerned is not a Public Interest Entity and would be outside ARGA's normal sphere of action.

This response is reflected in the reform measures set out in this document.

1.5.15 There has also been ongoing action to tackle problems in the local public audit market in England, led by the Department for Levelling Up, Housing and Communities (DLUHC). A key aspect of proposals to improve local audit is the establishment of a 'system leader' to coordinate improvement efforts between the range of actors in the local audit space. The Government intends to give ARGA the role of system leader and to reflect this in its objectives, as it previously set out in a technical consultation led by DLUHC. Further detail on these local audit developments is given in section 11.5 below.

1.5.16 Chapter 10 outlines how ARGA would accommodate the local audit proposals.

Next steps

1.5.17 The Government will legislate, when Parliamentary time allows, to create ARGA and provide for the measures set out in this document that require changes in primary legislation. The Government has announced¹³ that it is preparing this legislation for publication in draft. Primary legislation will set out the objectives, powers and duties of the new regulator and new legal obligations on other parties, and set a solid basis for other reforms. Reform in some other areas can and will be taken forward without the need for primary legislation – for example through changes to the UK Corporate Governance Code, through regulations (secondary legislation), in codes of practice and in guidance. There is likely to be additional consultation on details of those regulations and guidance.

1.5.18 Some of these measures may lead to complementary changes to rules set by the Financial Conduct Authority (FCA) such as the Listing Rules. Any changes to FCA rules would be for the FCA to determine and subject to a separate FCA consultation.

1.5.19 In addition, the Government will review the requirements on existing PIEs (such as listed companies, credit institutions and insurers) to identify potential deregulatory measures that could reduce costs, and will use the legislation it is developing to put them in place.

¹³ <https://www.gov.uk/government/news/beis-in-the-2022-queens-speech>

1.6 Resetting the scope of regulation

The Government believes it is important to restore public trust in the way that the UK's largest companies are run and scrutinised, by ensuring high standards of corporate governance amongst the most economically and systemically important companies; empowering investors, creditors, workers, and other stakeholders by giving them access to reliable and meaningful information on a company's performance; and keeping the UK's legal framework for major businesses at the forefront of international best practice.

The Government will therefore expand the definition of a Public Interest Entity (PIE) to include the most economically and systemically important companies and entities: those with 750 employees or more and an annual turnover of at least £750 million.

To minimise burdens as far as possible, the Government will not require these size-based PIEs to meet all of the same requirements as existing PIEs, and will allow a generous lead-in time when including new PIEs in ARGA's regulatory remit, in line with paragraph 1.5.11.

Taking advantage of the UK's freedom outside the EU, the Government will also legislate to enable further deregulatory measures for current PIEs in due course.

What the White Paper proposed

1.6.1 Responding to concerns in the FRC Review that “the UK's current PIE definition may be somewhat too narrowly drawn and may exclude entities whose audit arrangements are a matter of public interest”, section 1.3 of the White Paper set out proposals to widen the definition of PIEs to ensure that large businesses which are of public importance are subject to appropriate regulation.

1.6.2 In examining options for expanding the definition, the White Paper set out three principles to be considered when making decisions on setting the threshold:

- a clear articulation of public interest;
- ensuring the impact is proportionate; and,
- so far as possible, aligning with existing thresholds.

1.6.3 The White Paper set out two size-based options for large private companies, widening the existing definition of public interest entities¹⁴. Option 1 was based on the scope of the large private company corporate governance reporting requirement in the Companies

¹⁴ Public interest entities are currently defined by s494A of the Companies Act 2006, as: “public interest entity” means—

(a) an issuer whose transferable securities are admitted to trading on a UK regulated market;
(b) a credit institution within the meaning given by Article 4(1)(1) of Regulation (EU) No. 575/2013 of the European Parliament and of the Council, which is a CRR firm within the meaning of Article 4(1)(2A) of that Regulation;
(c) a person who would be an insurance undertaking as defined in Article 2(1) of Council Directive [91/674/EEC](#) of 19 December 1991 of the European Parliament and of the Council on the annual accounts and consolidated accounts of insurance undertakings as that Article had effect immediately before IP completion day, were the United Kingdom a member State.

(Miscellaneous Reporting) Regulations 2018¹⁵ (sometimes referred to as the ‘Wates Option’)¹⁶ and Option 2 was based on a narrower test which incorporates the threshold for additional non-financial reporting requirements for existing PIEs¹⁷.

1.6.4 The White Paper set out that the threshold would apply to companies in their own right, and additionally to parent companies, if the threshold was met when applied to the accounts of the group headed by that company (that is, its consolidated financial statements), where the parent company was required to file group accounts in the UK. The White Paper recognised that there needed to be further consideration of how requirements should apply to PIEs which are part of a group.

1.6.5 The White Paper also asked questions on whether:

- a lower threshold should be used for including companies traded on the Alternative Investment Market (AIM), based on the current threshold of market capitalisation exceeding €200m used by the regulator for monitoring these companies’ audits¹⁸;
- Lloyd's syndicates should be included, though the White Paper recognised this might be disproportionate given their structure;
- large third sector entities (for example, universities, charities and housing associations) should be included as PIEs, and if so whether they should have a different threshold to private companies. The White Paper recognised that a number of these entities were subject to sectoral regulation but was concerned that a gap in regulation could be opened up;
- there should be a temporary exemption for newly listed companies from some of the requirements on PIEs, to ease the potential burden of listing; and
- there should be a lead time and phased introduction to allow entities time to prepare for the additional requirements being introduced.

1.6.6 The White Paper also asked what impact an increase in the number of PIEs would have on the number of auditors operating in the audit market and identified the need for a mechanism for smoothing population changes in reporting companies due to variation in turnover and employee numbers.

¹⁵ <https://www.legislation.gov.uk/uksi/2018/860/regulation/2/made>

¹⁶ The test used to identify those large companies which are already required to include a corporate governance statement in their directors’ report. That provision covers all companies with either:

- more than 2,000 employees; or
- a turnover of more than £200 million and a balance sheet of more than £2 billion.

¹⁷ a narrower test which incorporates the threshold for additional non-financial reporting requirements for existing PIEs, and would mean the definition of a PIE was only extended to large companies with both:

- over 500 employees, and
- an annual turnover of more than £500 million.

¹⁸ Under the current PIE definition, AIM and other Multilateral Trading Facilities are not ‘regulated markets’, and so are not included in the current PIE definition even though their shares are publicly traded. They do, however fall within the FRC’s purview under Audit Quality Reviews (AQR) and Corporate Reporting Reviews (CRR).

Issues arising from consultation

1.6.7 324 responses commented on the Chapter 1 proposals for PIEs.

Large private companies threshold

1.6.8 Of the 250 responses that provided a view on whether large private companies should be included within the PIE definition, a large majority – just under 75% (187) – supported extending the PIE definition to include large private companies. Most pointed to the risk such companies posed as being equivalent to similar sized public companies. Of those not in favour, most responses (which came from across different sectors) were concerned about additional, disproportionate burdens which could act as a barrier to growth. A number of responses from family-owned businesses questioned whether family businesses should be included in the PIE definition, given that their shareholders are members of the family and as such were often closely involved in decision making, suggesting this made additional transparency requirements nugatory.

1.6.9 Amongst the 190 respondents who gave a view on the options for the PIE definition threshold, a wide variety of views were expressed and there was no clear consensus nor a particular sectoral position. Just over 40% (79) favoured Option 1, with just under 15% (27) favouring Option 2, with just under 45% (84) opting for “other”. However, further analysis of the responses and the reasons provided for the choices expressed suggested that the majority of respondents favoured either Option 2 or a variant of it. A number of those supporting Option 1 were concerned about the large number of companies included due to the use of an either/or test, and suggested that the test should be altered to include companies within scope only where they met both limbs of the test, reducing the number of companies.

1.6.10 The large majority of those who supported another option than those set out in the White Paper suggested an amended version of Option 2 would be more appropriate. There were various suggestions aimed at reducing the number of companies in scope: a large minority suggested that the level of the proposed Option 2 threshold be raised as they felt it was too low as proposed.

1.6.11 A vocal minority called for a clearer link to what constitutes ‘public interest’, suggesting this should include systemic risk or size; and a number suggested that the employee number should be based on number of employees in the UK, rather than globally, or on a broader definition of workforce.

Excluding entities from the PIE definition

1.6.12 A significant minority of those responding to the question of scope raised the potential for deregulation in this space, following the UK's exit from the EU. Whilst the White Paper had not proposed any deregulation from the current PIE definition, some respondents (including bodies representing smaller credit institutions and insurance companies) recommended that the Government should consider removing some existing PIEs from the current definition. A number of smaller listed companies and investment companies also supported further consideration of deregulatory opportunities. A number of the respondents raised the point that

a number of sectors are already heavily regulated by other bodies, such as the Prudential Regulation Authority (PRA), suggesting this represented an unnecessary duplication.

Treatment of groups and subsidiaries

1.6.13 A large number of respondents from all categories raised concerns about the treatment of large subsidiaries in a group, and the potential for duplicative and/or disproportionate burdens when the parent company was already a PIE. This was often linked to internal controls reporting, where the internal control framework was set at group level, and concerns were raised that the directors of the subsidiary might be held accountable for something over which they had very little control. Concerns were also raised that there would be unnecessary duplication if subsidiaries that met the PIE threshold *and* the parent company were required to report on the internal controls.

Threshold for inclusion of AIM companies in PIE definition

1.6.14 136 responses were received on whether AIM companies should be included in the PIE definition, and whether the threshold should be based on those with market capitalisations above €200m. The vast majority of responses from across all sectors – though there was significant representation from AIM companies – were in favour of including a smaller number of AIM companies than the proposed threshold would bring into the definition, with just over half saying the market capitalisation figure should be higher or that the size threshold should be aligned with the large private company threshold. These responses argued that entities traded on AIM or other Multilateral Trading Facilities (MTFs) were deliberately subject to a lighter regulatory regime than for listed companies, as their objective was to act as an incubator to innovative companies, and this was recognised by those investing in them who were prepared to accept a higher level of risk.

1.6.15 Arguments from individuals (often academics) and listed companies against raising the threshold – and in a few cases lowering the threshold further – pointed to the higher risk of AIM and other MTFs due to their lower regulation and called for greater transparency. A few of these responses suggested that some large AIM companies were using AIM to avoid the main listed market regime, and should be encouraged to move onto the senior market by aligning the reporting requirements.

Temporary exemption for newly listed companies from the PIE requirements

1.6.16 113 responses were received on this issue. Nearly 40% of responses – with representation from all sectors – supported providing an exemption for a short time but a small majority – including a number of existing listed companies – made the case against allowing an exemption. They argued that the newly listed companies were more likely to be the riskiest propositions for investors, and as such there would be benefit from them providing the information. A number also argued that newly listed companies should also have this information available as it was an important part of the process of listing and being admitted to the Main Market.

Inclusion of Lloyd's syndicates in the PIE definition

1.6.17 79 respondents answered this question. Responses were split quite evenly for and against; a number of responses (including from individuals) argued for Lloyd's syndicates to be included on the basis that there were risks attached to possible failure or collapse of syndicates, and that the threshold should be consistent across different types of entity and sector. A significant proportion of those against were companies associated with Lloyd's syndicates, as well as a professional accounting body and a number of the larger audit firms. Many agreed with the concern raised in the White Paper that complying with the additional scrutiny and regulation which is associated with being a PIE would be disproportionate. The chief reasons cited were that the structure of the Lloyd's syndicates did not lend itself to reporting against the requirements and that the current regulatory regime provided adequate protection.

Inclusion of third sector entities and threshold

1.6.18 130 respondents responded to questions about these entities. Just over half of those responding, including most of the large audit firms and a number of charities, were against inclusion of any third sector entities. In relation to charities in particular, respondents argued that regulation by the Charity Commission and the equivalent bodies in Scotland and Northern Ireland meant it was unnecessary for these entities to be PIEs.

1.6.19 However, a significant number of all respondents to these questions – both those for and against inclusion of the third sector entities – suggested that the threshold for inclusion should be aligned with the threshold for large private companies, rather than with the proposed 'incoming resources' threshold of £100m. The main reasons given for including these entities were that a number were large employers, and that some charities carried out business which was relatively indistinguishable from businesses in other sectors which would be within scope.

Inclusion of other entities in the PIE definition

1.6.20 81 respondents commented on this, and of the responses received there was a relatively equal split for and against including new entities. A significant proportion of those wishing to include other entities identified Limited Liability Partnerships (LLPs) as currently missing and needing to be included. They argued that a number of large LLPs were significant players in the wider economy with significant employee numbers and they should be subject to increased transparency and scrutiny.

1.6.21 A few stakeholders raised that it would be disproportionate for public bodies such as local authorities to be included within scope, since these bodies were already subject to stringent audit and transparency requirements. Whilst the White Paper did not propose to include any additional public bodies as PIEs via the size-based threshold, some are already PIEs under the existing definition, for example because they have issued bonds listed on the London Stock Exchange.

Impact of extending PIE scope on audit market

1.6.22 132 respondents commented on this question. There were a range of views on whether the audit market would be able to meet the challenge of a major increase in the

number of PIEs. A majority of the large audit firms and their professional bodies were concerned that the impact would be negative and were concerned that too large an expansion would overwhelm PIE auditors, the supply of which would be outstripped by the increased demand. Of the others responding to this question a number of professional bodies, business representative groups and listed companies expressed concerns that supply constraints would lead to increased fees. These concerns were strongly linked to the number of audit companies in competition for market share, and it was acknowledged that increases in the capacity and capability of the audit market would assuage some of the concerns.

Providing time to prepare and phasing introduction of a new PIE definition

1.6.23 170 respondents commented on this issue. All but a few responses responding to these two questions strongly favoured giving industry time to prepare and introducing requirements with a phased approach. Where reasons were given, this was due to the perceived burden of the requirements, with some respondents identifying the need for audit companies to both expand their staff numbers and upskill to meet the additional demand. Concerns were raised that skilled staff able to run PIE audits were not available and capacity and capability needed to be grown.

Government response

Large private companies threshold

1.6.24 The public interest in audit, corporate reporting and corporate governance is in pursuing the objectives set out in the White Paper: to promote good economic health through well-functioning markets by ensuring provision of trustworthy information for investors and other stakeholders with an interest in companies, and to help mitigate risks arising from possible economic and social shocks by enabling early action to avoid or manage significant company failures. The Government believes that to seek to define public interest more tightly, as some respondents argued for, could risk the achievement of these objectives.

1.6.25 However, the Government agrees that a clear definition of public interest entities (PIEs) is called for, to ensure the right level of predictability and clarity for those companies in scope. Its starting point for a definition is the identified, systematic public interest in the following:

- significant economic actors, large employers and/or those with extensive supply chains;
- those whose investors and other stakeholders rely on published information about the company's prospects, typically where the company's shares are publicly traded; and
- systemically important companies whose collapse would have wider ramifications, e.g. financial institutions, energy providers, water utilities and transport infrastructure.

1.6.26 For the purpose of assessing the public interest in large private companies, the Government has focussed on the first and third of these and sought to establish the best means of identifying such companies.

1.6.27 The Government considers that introducing a size-based threshold offers the simplest and clearest set of criteria, providing clarity around which companies are in scope.

1.6.28 In assessing the size options proposed in the White Paper and responding to concerns that too many companies might be brought within scope of the threshold, the Government has sought to identify an option that delivers coverage of those companies that meet the criteria above and that does this in a way that is as targeted and proportionate as possible, in line with the Government's key objective of minimising burdens on business.

1.6.29 The Government has concluded that a variant of Option 2 – a size-based threshold based on turnover and employees – strikes the best balance for the widening of the PIE definition, being proportionate whilst ensuring those companies which are economically important and systemically important are within scope. Therefore, **the Government intends to extend the PIE definition to large companies with both:**

- **750 or more employees, and**
- **an annual turnover of £750 million or more.**

1.6.30 This recognises the arguments advanced in responses, where the majority wanted a more tightly focused threshold that targeted those companies or entities which were of most public interest. The Government considers that this 750:750 threshold captures the entities of most public interest, whilst also being more proportionate than the 500:500 threshold on which the Government consulted.

1.6.31 The Government considered arguments to change the employee measure to take account of only UK employees or workforce. The Government intends to continue to use the global employee figure, for three key reasons:

- Employee figures (unlike workforce numbers) are routinely disclosed on a comparable basis;
- It is important that the corporate governance of major UK headquartered companies is robust, regardless of where in the world their activities take place; and
- Some companies might move their workforce offshore to avoid the need to comply with a UK-only requirement.

Companies quoted on Multilateral Trading Facilities such as AIM

1.6.32 The White Paper asked a question about AIM companies specifically, reflecting current practice, but the Government believes it is appropriate to treat all companies traded on Multilateral Trading Facilities (MTFs) in the same way. In light of consultation responses, **the Government will include companies traded on MTFs such as AIM in the PIE definition only where they meet the same size threshold as for large private companies.** This recognises the role of MTFs such as AIM as incubators for innovative companies and the fact that these facilities have deliberately been developed as a less regulated marketplace.

1.6.33 The Government's intention, following the thinking of the FRC Review, has been that the PIE definition should largely set the focus of ARGAs work. Since only the very largest MTF-quoted companies will become PIEs in future, that would suggest that ARGAs activity

would potentially reduce compared to the FRC's current approach, under which all AIM companies are within scope of its Corporate Reporting Review function and those with market capitalisation over €200m are within scope of its Audit Quality Review. **The Government will undertake further work with the FCA, the FRC and the London Stock Exchange to explore whether there is good justification for ARGA to continue certain aspects of FRC scrutiny of all or some companies traded on MTFs even though they will not become PIEs and, if so, on what basis.**

Lloyd's syndicates

1.6.34 The Government has considered the arguments presented and concludes that Lloyd's syndicates should not be included as PIEs. The Government acknowledges that the current existing regulation in place is effective and does not believe that duplication would add value. The Government also notes concerns that the managing agent structure does not readily lend itself to reporting in the same way as existing PIEs. The Government does not therefore intend to include Lloyd's syndicates in scope of the new size threshold.

Third sector entities

1.6.35 The Government has considered the responses received, in particular those questioning the proportionality of introducing a lower threshold than for large private companies and agrees that aligning the threshold makes sense. It has also noted the extensive regulatory regime operated by the Charity Commission and its equivalents in Scotland and Northern Ireland. The Government therefore intends to include only third sector entities that meet the new 750:750 size threshold.

Other entities

1.6.36 The Government has noted the concerns raised by a number of respondents who identified LLPs (Limited Liability Partnerships) as being a key group currently missing from the proposals. Seeking to adopt a consistent approach across the different entities, the Government intends therefore to align the approach for LLPs by including all of those that meet the new 750:750 size threshold.

1.6.37 Noting concerns raised by stakeholders, the Government does not intend to include local authorities that are not already included as PIEs (for example, because they have listed debt) if they only meet the 750:750 threshold. The Government also intends to exclude other public sector bodies from the 750:750 threshold, as appropriate (for example, because they are already subject to similar requirements).

Newly listed companies exemption

1.6.38 The Government agrees with the view expressed by the majority of consultation responses that newly listed companies should have complied with the vast majority of the requirements when preparing for listing, and need to be subject to PIE requirements since they may pose a greater risk than established listed companies. On that basis, the Government does not intend to provide temporary exemptions from PIE requirements for newly listed companies.

Time to prepare and phased introduction

1.6.39 To ensure that businesses and their auditors have sufficient time to prepare for complying with PIE requirements (for example, businesses ensuring their auditor does not provide excessive or prohibited non-audit services), the Government will allow an adequate period between an entity exceeding the new 750:750 threshold and being subject to any new requirements. The Government will set out the detail in legislation, but it will be a full annual reporting period as a minimum.

Qualifying and ceasing to qualify as a PIE

1.6.40 In order to ensure certainty for businesses and the regulator about which entities are PIEs at any given time, and to prevent volatility in reporting (particularly for those on the border of the 750:750 threshold), the Government intends to introduce a smoothing mechanism which will mean that entities will have to continue meeting requirements for a set period after they qualify as a PIE, even if they drop below the 750:750 threshold. Details of the mechanism will be included in legislation.

Group and subsidiaries

1.6.41 The Government confirms its intention that where a UK parent company prepares consolidated accounts for a group, and that group when aggregated meets the size threshold, then the parent company of that group will become a PIE. This should help to address concerns that companies may restructure themselves in order to drop below the threshold and so avoid the PIE requirements, as well as better reflecting the commercial reality of global groups.

1.6.42 The Government also confirms its intention that where an entity that is a PIE by virtue of the new size threshold is a subsidiary of a UK-incorporated parent, the parent will also qualify as a PIE.

1.6.43 The Government recognises that this presents a risk in terms of duplication of reporting within a group structure. The Government will consider a mechanism to remove or reduce this risk ahead of introducing primary legislation. For example, there could be an option of either reporting at subsidiary level or reporting on a consolidated group basis.

Establishing a tiered approach

1.6.44 The Government is keen to ensure that the additional regulation businesses will face as PIEs is proportionate. Including large private companies and other large entities in the definition of PIE is a significant step for businesses, auditors, and the regulator. To minimise additional burdens, **the Government does not intend to apply requirements to have an audit committee, to retender the audit every 10 years and to rotate auditor every 20 years to entities that are PIEs because of the new size-based threshold.**

1.6.45 These are useful requirements that promote auditor independence and, in the case of audit committees, provide a mechanism of greater oversight and accountability in companies for audit. However, they are also the costliest requirements for PIEs, and so to reduce burdens

as far as possible, the Government does not intend to extend these requirements at this stage to size-based PIEs.

1.6.46 In response to consultation feedback, the Government has also considered the case for taking a more proportionate approach to regulation in regard to the new corporate reporting requirements: that is the Resilience Statement, the Audit and Assurance Policy, the directors' statement on fraud measures and the requirements relating to dividends and the disclosure of distributable reserves.

1.6.47 While in general ARGAs remit will extend to all PIEs in view of their substantial public interest, the Government believes smaller PIEs should not be subject to the new corporate reporting requirements, in order to minimise burdens and ensure a proportionate approach. This is in line with the Government's determination to make the UK listings market even more attractive, both to UK companies considering an IPO and to overseas companies considering where to list.

1.6.48 Therefore, **the Government therefore intends to introduce a tiered approach to reporting: to apply the new corporate reporting requirements set out in Chapters 2, 3 and 6 of this document (Resilience Statement, Audit and Assurance Policy, directors' statement on fraud measures and the new disclosures about dividends and distributable reserves) only to PIE companies with 750 or more employees and £750m or more in annual turnover.**

1.6.49 The greatest value in the new reporting requirements will be for companies whose scale is such that poor practice or potential for collapse would be likely to have widespread consequences for many stakeholders. It is less clear that they would add significant value in respect of PIEs that do not exceed the 750:750 threshold. While a number of listed PIEs below this threshold may have significant market capitalisations, the central aim of the new reporting is to provide greater assurance over the management of large, complex businesses with a significant economic and social footprint. UK listed companies below the threshold would still be subject to the FCA's Listing Rules (including the need to have adequate systems, controls and processes in place) and to Companies Act requirements on risk reporting. Likewise, credit and insurance companies not meeting the threshold would still be subject to regulation by the FCA and the Prudential Regulatory Authority (PRA). The Government therefore believes that adding additional reporting requirements would be of less value. There is precedent for excluding smaller PIEs from reporting requirements: for example, the requirement for a non-financial information statement, introduced in 2017, applies to PIEs with more than 500 employees.

Creating scope for deregulation and fine-tuning of PIE audit requirements

1.6.50 Given the significant number of respondents who suggested excluding some smaller entities from the PIE definition altogether, the Government intends to consider this further. The UK is no longer legally required to follow the EU's PIE definition, and this provides an opportunity to review the PIE framework to remove any undue burdens. For example, since current PIEs are generally either subject to the FCA's Listings Rules or regulated by the PRA and FCA, there may be some scope for removing duplication between some of these

regulatory regimes and the additional requirements applied to PIEs, particularly to smaller PIEs under the current definition. There may be other examples where the Government could choose to reduce burdens for PIEs.

1.6.51 In line with the approach set out in *The benefits of Brexit*¹⁹ (January 2022), the **Government will review the existing regulatory framework for PIEs to identify further deregulatory opportunities.**

1.6.52 On this basis, **the Government intends to legislate so that Ministers can disapply PIE requirements from particular entities or categories of entities in secondary legislation**, according to further consideration of the potential benefits and disadvantages of a more targeted approach.

1.6.53 The Government recognises that ‘public interest’ may evolve over time, and that the PIE definition may need to evolve with it. Therefore, **the Government intends to legislate so that Ministers can amend the size threshold by secondary legislation in future, as well as including or excluding groups with specific characteristics such as sector or company type**, if it proves necessary to change the scope in the light of changes in circumstances.

1.6.54 Ministers’ use of these delegated legislative powers would be subject to Parliamentary scrutiny.

¹⁹ *The benefits of Brexit: How the UK is taking advantage of leaving the EU*, January 2022, <https://www.gov.uk/government/publications/the-benefits-of-brexit>

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

The Government considers that there would be benefits in strengthening the UK's internal control framework. It will proceed by inviting the regulator to strengthen the UK Corporate Governance Code to provide for an explicit directors' statement about the effectiveness of the company's internal controls and the basis for that assessment. Alongside new Code provisions, the Government will ask the regulator to work with companies, investors and auditors on guidance covering the identification of acceptable standards or benchmarks, definitional issues, and the circumstances where external assurance would be appropriate. Currently²⁰ only premium listed companies are obliged to apply the Code, but its principles and provisions have an influence on governance expectations for a significantly wider range of companies. The Government also intends to require Public Interest Entities (PIEs) above the size thresholds set out in Chapter 1 to state, as part of the proposed "minimum content" for the new Audit and Assurance Policy, whether or not they plan to seek external assurance of any reporting on their internal control arrangements.

The Government also plans to proceed with proposals for strengthening confidence that the law on dividends and capital maintenance is being respected. It intends to give ARGAs a new responsibility for issuing guidance on what should be treated as "realised" profits and losses and to require PIEs above the size thresholds set out in Chapter 1 to disclose their distributable reserves. This will be set in a broader context by requiring companies to provide a narrative explaining the board's long term approach to the amount and timing of returns to shareholders. The Government also intends to require directors of such companies to make an explicit statement in the annual report confirming the legality of proposed dividends and any dividends paid in year.

2.1 Stronger internal company controls

What the White Paper proposed

2.1.1 Confidence in risk management and company reporting is based on the effectiveness of a company's internal control and risk management processes and the quality of reporting on it. The regulatory and other requirements applying to internal control arrangements in UK companies are well-established and were summarised in the White Paper. However, the FRC Review recommended that the Government should consider how this framework could be strengthened, learning lessons from the Sarbanes-Oxley regime in the US and giving special consideration to the importance of proportionality in relation to the size of the company. The

²⁰ As part of its current Primary Market Effectiveness Review, the Financial Conduct Authority has published a [discussion paper](https://www.fca.org.uk/publications/discussion-papers/dp22-2-primary-markets-effectiveness-review) (https://www.fca.org.uk/publications/discussion-papers/dp22-2-primary-markets-effectiveness-review) seeking views on a proposal to replace the existing premium and standard listing segments for shares in commercial companies with a single segment.

Brydon Review also made recommendations to improve directors' accountability for effective internal controls.

2.1.2 The White Paper discussed a range of options for strengthening the UK's internal controls, including:

- Option A: requiring an explicit statement from directors about whether they regard their internal controls to be effective and the basis for that assessment;
- Option B: requiring the external auditors to say more about the work they already undertake to understand the company's internal control systems and how that work has influenced the approach taken to the audit – but without requiring a formal attestation of their effectiveness; and
- Option C: requiring auditors to provide a formal assurance of the directors' statement about control effectiveness.

2.1.3 The White Paper outlined an "initial preferred option" based on an explicit statement from the directors, leaving the question of whether external assurance should be sought as a voluntary matter for the company (and its shareholders) to determine based on its own circumstances, other than in certain exceptional circumstances. The White Paper stressed that the initial preferred option was not intended to close down consideration of alternatives.

2.1.4 The White Paper asked specific questions about whether there was a case for strengthening the internal control framework for UK companies and for views on options for achieving this. It also asked which companies should be in scope of any stronger framework.

Issues arising from consultation

Overview of responses

2.1.5 More than 260 respondents expressed views on whether there was a case for strengthening the internal control framework. Whilst a big majority of respondents (more than 70%) agreed that there was a case for doing so, views on how this should be achieved, and the degree of reform needed, differed significantly.

2.1.6 The benefits of a stronger internal control framework were typically perceived to be improved corporate discipline, higher quality reporting and audit, fewer accounting restatements, fewer opportunities for material fraud, better corporate governance and enhanced investor confidence in the reporting and resilience of companies, leading to a lower cost of capital.

2.1.7 The disadvantages cited typically related to the potential costs of some of the measures proposed in the White Paper, particularly if external assurance of the directors' statement about the effectiveness of the controls was made mandatory or became so in practice. Several respondents thought that the Impact Assessment accompanying the White Paper had significantly underestimated the likely cost. These costs were expected to arise from transitional arrangements – for example, the establishment of compliant internal control systems, upgrading existing IT and documentation – and from the ongoing costs of reporting

and attestation. Concerns were also raised about audit capacity constraints that could arise as a result of potential increases in the volume of audit work from strengthened internal controls requirements.

Directors' statement about internal control effectiveness

2.1.8 More than 200 respondents had views on whether the proposed directors' statement about internal control effectiveness should be subject to mandatory external audit or assurance. Of these, about 80% were opposed to making assurance mandatory.

2.1.9 Listed, private and AIM companies generally supported a stronger directors' statement but were almost unanimously opposed to mandatory assurance. Views typically expressed were that audit committees should be able to decide whether external assurance was needed; that companies should be able to place reliance, where justified, on the work of internal auditors and challenge from non-executive directors on the board; and that companies should be able to tailor their approach to the risk appetite of investors and the budget available.

2.1.10 A group of audit committee chairs agreed that there was a need for the reporting about internal controls to be improved to help build investor confidence and sharpen directors' accountability. However, they questioned the implication that there was a general need to strengthen the systems themselves in large UK companies. A number of respondents questioned how many corporate failures had been attributable to internal control weaknesses. They thought that the reasons for failure were far more often attributable to non-viable business models and poor judgement and decision-making.

2.1.11 Several respondents, particularly companies, thought that an approach based on the US model, involving compliance with the detailed Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework²¹ and mandatory external assurance, would be disproportionate for many companies. One suggested that it would only be suitable for companies with the size and scale of the FTSE 100. There was concern, however, that an attempt to introduce a lighter, more flexible UK version might not work as intended because peer pressure and the stronger enforcement of directors' duties proposed elsewhere in the White Paper would lead directors to seek external assurance in practice.

2.1.12 A small number of companies, particularly those with a dual listing in the US and therefore already subject to the Sarbanes-Oxley Act requirements, were content for external assurance to be mandatory, provided that compliance with US standards was recognised as equivalent in the UK. Amongst this group, however, several pointed to the cost and effort which had been needed to meet and evidence the required US standards.

2.1.13 A number of respondents thought that the introduction of US-style internal control regulation would adversely affect the UK's attractiveness as a prime location for business because it would increase costs for preparers. They feared that, if the reforms were not proportionate, there would be a reduction in the number of companies seeking a listing.

²¹ <https://www.coso.org/Documents/990025P-Executive-Summary-final-may20.pdf>

2.1.14 A number of companies expressed concerns that mandatory assurance would run up against capacity constraints in the audit sector. In the short term, at least, there might not be enough auditors with skills in internal control methodologies, leading to price increases and potential delays in accounts being approved. It might also give the largest audit firms an advantage over challenger firms when tendering because they would be able to draw on their US experience.

2.1.15 The largest accountancy firms were all in favour of mandatory assurance, whilst views amongst challenger and smaller audit firms were more mixed. Accountancy firms tended to support mandatory assurance as the best way in their view to ensure a meaningful shift in the seriousness with which boardrooms considered internal controls. They also thought that UK capital markets would not benefit as fully as the US markets without mandated external auditor assurance.

2.1.16 Several audit firms pointed out that if external assurance was a voluntary matter rather than a legal requirement, then the fees involved would count towards the cap on non-audit fees. This could be a disincentive to companies who voluntarily wanted to commission such work because they would potentially need to contract an alternative provider to their external auditor. In the auditors' view this could be addressed by treating assurance work on internal controls as part of the audit or by adjusting the audit fee cap to include this work.

2.1.17 A representative body for institutional investors said that current company reporting about internal controls tended to be "boilerplate" and uninformative, and that existing UK Corporate Governance Code provisions²² did not go far enough. It supported the proposal for a stronger directors' statement about internal control effectiveness and wanted to see the statement made in respect of all the internal controls – financial, operational and compliance related – not just those concerned with the reliability of financial reporting. It expressed the view that more transparency and accountability would increase investor confidence in the reliability of corporate reporting and risk management. Most individual institutional investors also agreed that there should be a stronger directors' statement.

2.1.18 There was less consensus amongst investors on whether the directors' statement should be subject to mandatory external assurance. A representative body for institutional investors and the representative bodies for retail investors thought that the controls over financial reporting should be subject to external assurance. A number of leading individual institutional investors, however, opposed mandatory assurance, although thought that this should be revisited if standards of disclosure did not improve.

2.1.19 A number of respondents, particularly accountancy firms, thought that the Impact Assessment published alongside the White Paper underestimated the costs to companies of implementing a stronger control framework, particularly if external assurance was made mandatory or became so in practice. One large audit firm, for example, thought that the likely range for increases in the annual audit fee would be more likely to start from 15%, rather than

²² <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF> - in particular, provision 29.

the 5%-35% range cited in the Impact Assessment. That firm was confident nonetheless that the net benefit over time would outweigh the costs.

More informative audit report disclosures

2.1.20 There was a strong degree of interest in the possibility of external auditors saying more about the work they already undertake – as part of the statutory audit – to understand a company’s internal control system and how that work has influenced the approach taken to the audit. Several large companies suggested this, as did two of the big audit firms.

2.1.21 One representative body for large companies said that it favoured “increasing audit report disclosure to include details of the work performed and the extent to which auditors have placed reliance on the controls”. Several audit committee chairs thought that a material weakness in the internal controls over financial reporting ought to be detected already by an effective audit of the financial statements.

Internal control standard

2.1.22 There was a range of views on the nature of the internal control standard that should be adopted against which companies and their auditors (to the extent that auditors were to be involved) would be expected to assess their control effectiveness. Some thought that a prescriptive standard was required to avoid a plethora of differing principles and approaches being adopted, which would make comparisons between companies very difficult and create problems for external auditors in making an objective assessment. There needed to be clarity about the rigour and diligence required.

2.1.23 Others were looking for a balance between prescription and scope for companies to adopt an approach based on their own circumstances, provided there was an adequate explanation of why the standard adopted was appropriate. The COSO framework was pointed to as a possible model. This was principles-based, but there was a widespread perception that the way it had been interpreted and applied in the US had been too detailed and prescriptive for the UK business environment. Several respondents thought that a lighter framework could be developed which took account of strengths of the existing UK provisions relating to internal controls. It was suggested that it would be possible to build on early work undertaken by a group of audit committee chairs. It might also be possible to elaborate on the existing Listing Rules provisions which require an IPO sponsor to be satisfied that the directors have established procedures which provide a reasonable basis for them to make proper judgements on an ongoing basis as to the financial position and prospects of the applicant and its group.

2.1.24 Many respondents pointed to the importance of defining key terms properly. For example, if these were to be reportable matters, there should be a clear understanding of what was meant by the term “material control weakness” or a “demonstrable control failure”.

Scope

2.1.25 Investors and companies generally considered that a stronger internal control regime should extend to all PIEs (although some thought that investment trusts should be excluded because of their simpler structure and different corporate governance arrangements). There

was general agreement, however, that any new requirements should be phased in, starting with premium listed companies or – some suggested – the FTSE 350. Auditors in particular warned that lengthy lead-in times would be needed, particularly to bring non-listed PIEs into the new regime. They reported that it took time to upgrade internal control systems, document them and then test them: so up to three years could be required.

Government response

2.1.26 Consultation has demonstrated strong support for strengthening the UK's internal control framework based around a more explicit statement by directors about whether they regard their company's internal control framework to be effective and operating effectively. The Government agrees that directors should be more open and accountable for operating an effective internal control system, not only for financial reporting but also for wider operational and compliance risks. Improving controls has the potential to improve the quality and reliability of corporate reporting and – indirectly – of audit. The FRC's recent guidance note, 'What makes a good audit'²³, points to the importance of effective internal controls in underpinning a high-quality audit. In addition, improving the reporting on these matters, as well as the underlying substance, can help build investor confidence.

2.1.27 The Government believes, however, that there are risks in moving directly to putting a directors' statement on a legislative footing. It has noted the views of a number of respondents, including audit committee chairs, that a legally required directors' statement might, in practice, lead companies to default to seeking external assurance from their auditors as the safest way of avoiding challenge. There would be a risk that the UK might unintentionally default to an approach very similar to the one in the US where mandatory external assurance is a requirement and combined audit and assurance costs are significantly higher. This would affect the attractiveness of the UK's public markets as a place to list.

2.1.28 The White Paper represented the first time that there has been substantive recent consultation on options for a stronger control framework. The consultation has revealed a range of views and underlined that there are important issues that need further deliberation and resolution. For example, if there is to be a statement about internal controls, what benchmark or standard should be used? There was a widespread view that it would be preferable to have a proportionate standard tailored to the UK's existing business framework, building on current requirements, rather than simply adopting the COSO framework, but this would require time to develop.

2.1.29 Further work is also needed to build a consensus about the minimum steps that directors should be expected to take to demonstrate that their statement is soundly based. There is also the important question of whether the statement should only relate to the internal controls over financial reporting or extend to the effectiveness of controls over operational and compliance risks as many investors want.

²³ <https://www.frc.org.uk/document-library/audit-quality-review/2021/what-makes-a-good-audit#:~:text=Good%20audits%20will%20demonstrate%20how,provide%20an%20effective%20audit%20approach> (page 5).

2.1.30 The tried-and-tested UK approach to strengthening aspects of corporate governance – particularly complex ones such as this – is to proceed through changes to the UK Corporate Governance Code²⁴ rather than through legislation. The Code provides a way of testing and refining an approach before making it a stronger legal requirement at a future point if required, and potentially extending it to a wider range of companies. The ‘comply or explain’ basis provides for improved transparency and accountability to investors. The Code provides the opportunity for companies to tailor their approach to their particular circumstances. Whilst it currently applies only to premium listed companies, it has a wider influence on other codes and best practice principles developed for different types of companies. These include the QCA Corporate Governance Code²⁵ which is tailored for small and mid-size quoted companies and the Wates Principles²⁶, aimed at improving corporate governance in large private companies.

2.1.31 **The Government intends to take a Code-based approach as the most practical and proportionate way of strengthening boardroom focus on internal control matters.** It will be particularly effective if investors in their stewardship role are ready to apply pressure on boardrooms where internal controls seem to be weak, or where the statements by directors are “boilerplate” or inadequate.

2.1.32 There are additional supporting steps that the Government proposes to take (set out below) to ensure that investors are equipped with the information and tools needed to challenge companies where necessary. For example, the new Audit and Assurance Policy (addressed in the next chapter) will require companies to state whether or not they plan to seek external assurance of the company’s reporting on internal controls. This will provide transparency to investors and other stakeholders and an opportunity, in practice, to raise the issue and press for more assurance if warranted. So too will the provision of more information from the external auditor about the work they undertake to understand and assess the internal controls. The regulator’s stronger corporate reporting review powers to monitor the entire annual report should also help address and deter cases of inadequate reporting.

2.1.33 The Government also intends to proceed with implementation of the White Paper proposal that directors of Public Interest Entities above the size thresholds set out in Chapter 1 (see paragraph 1.6.48) should be required to report on the steps they have taken to prevent and detect fraud. This reporting could provide more transparency about internal controls more generally since, whilst the fraud statement would not require them to say anything about the wider internal control system, it would be an obvious opportunity to do so, since an effective system is the best defence against fraud. The fraud statement is addressed in more detail in section 6.2 of this document.

2.1.34 The Government therefore intends to:

- **Invite the FRC to consult on strengthening the internal control provisions in the UK Corporate Governance Code to provide for an explicit statement from the**

²⁴ <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code>

²⁵ <https://www.theqca.com/shop/guides/208266/corporate-governance-code-2018.html>

²⁶ <https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf>

board about their view of the effectiveness of the internal control systems (financial, operational and compliance systems) and the basis for that assessment. The Government expects that this would be underpinned with guidance on how boards should approach the preparation of the statement, which would be developed following a review of the FRC's existing *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting*²⁷. This guidance would cover the identification of acceptable standards, benchmarks or principles and address definitional issues and the circumstances in which external assurance might be considered appropriate;

- **Require Public Interest Entities above the size thresholds set out in Chapter 1 to state, as part of the proposed “minimum content” for the new Audit and Assurance Policy, whether or not they plan to seek external assurance of the company’s reporting on internal controls**²⁸. This would not require directors to seek such assurance but would help ensure that they had at least considered the possibility. It would also provide external shareholders with a clear opportunity to raise the matter and press for more assurance if they had concerns; and
- **Ask the FRC to explore with investors and other stakeholders whether and how the content of the auditors’ report could be improved to provide more information about the work auditors have undertaken on the internal controls over financial reporting.** This would be limited to observations based on work carried out as part of the statutory audit and would not amount to assurance of the control system. The FRC has agreed to take this forward as part of a consultation on the content of audit reports.

2.1.35 The Government and the regulator will review the effectiveness of the envisaged Code changes in driving improved standards of internal control and more informative reporting as part of the Post-Implementation Review of the reform package. They will also consider the extent to which the provisions have been reflected in other codes and best practice principles. The Government will consider at that point whether further measures are needed, and if there would be value in extending the measures to other Public Interest Entities. **If necessary, new statutory reporting requirements relating to internal controls could be introduced using existing powers in the Companies Act 2006**²⁹.

2.2 Dividends and capital maintenance

What the White Paper proposed

2.2.1 Paying a dividend leaves a company with fewer assets with which to meet its liabilities to creditors and meet other demands for capital. For this reason, there are legal constraints on the amount a company can distribute in dividends. In particular, capital maintenance rules mean that dividends cannot be paid out of capital, but only paid from a

²⁷ <https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf>

²⁸ See 3.2.11.

²⁹ In particular the powers in sections 416 and 468 of the Companies Act 2006.

company's accumulated realised profits less its accumulated realised losses. Even if realised profits are available, other legal considerations such as the law on directors' duties, sector regulation and common law duties may mean that no dividend ought to be paid. This framework is well established, but high-profile examples of companies paying out significant dividends shortly before profit warnings and insolvency have put the spotlight on these rules and the extent to which they are being respected and enforced.

2.2.2 The White Paper sought views on the following proposals for strengthening the law on dividends and capital maintenance:

- giving ARGAs responsibility for defining what should be treated as “realised” profits and losses for the purposes of complying with the Companies Act 2006 through either: (a) a power to make binding rules; or (b) a power to issue statutory guidance. (Guidance on these matters is currently published by ICAEW and ICAS on a voluntary basis);
- requiring companies (or, in the case of a group, the parent company only) to disclose their distributable reserves and potentially making this figure subject to audit. In the case of a parent company with several companies in its group, the White Paper also proposed that the parent should disclose an estimate of the dividend-paying capacity of the group as a whole; and
- requiring directors to make an explicit statement confirming that a dividend is legal and that paying it would not be expected to jeopardise the solvency of the business over the next two years.

2.2.3 The White Paper asked whether the new disclosures and statement should apply to listed and AIM companies only or be extended to all Public Interest Entities.

2.2.4 The White Paper also asked whether companies should be required to disclose more about their overall distribution and capital allocation policies to set dividends in a wider context, but suggested that recently introduced reporting requirements and pressure from the investment community might be sufficient to ensure that this happened without further legislation.

Issues arising from consultation

New role for ARGAs in clarifying “realised profits and losses”

2.2.5 There was strong support from companies, investors and auditors and their representative bodies for the proposal for ARGAs to take on responsibility for defining realised profits in line with prevailing, generally accepted principles. A power for ARGAs to issue statutory guidance was strongly preferred over a rule-making power.

2.2.6 The reasons given for this preference were that in such a complex area it would be difficult to devise hard rules to cover every scenario. Further, a power to make binding rules would involve a much bigger change to the relevant Companies Act provisions. Section 853 defines the terms ‘realised profits’ and ‘realised losses’ as those that “...fall to be treated as realised in accordance with principles generally accepted at the time when the accounts are

prepared...” If ARGA had a rule-making power, it would be defining the term rather than distilling prevailing principles.

2.2.7 Companies suggested that any change to the existing guidance published by the ICAEW and ICAS should be incremental and should not apply retrospectively. Some auditors, however, took a different view suggesting that ARGA should draft the guidance from first principles rather than adopting and amending guidance that has evolved over many years and, in their view, become very complex in the process.

2.2.8 Some other respondents, including some investors and companies, suggested that the guidance should be published with an explicit statement that it had been prepared to comply with section 853 of the Companies Act 2006 or reviewed by an independent lawyer for consistency with the capital maintenance regime. Several respondents pointed out that ARGA would need resources and to develop expertise to deliver the proposed new responsibility effectively.

Disclosure of distributable reserves

2.2.9 Companies supported the requirement for companies (or the parent company only in the case of a group) to disclose their distributable reserves. They thought that these were figures that directors should already have available and would not amount to a new burden. However, there was strong opposition to the second proposal that parent companies should provide an estimate of the group’s dividend-paying capacity. This was regarded as costly, difficult for the auditors to audit and potentially misleading for investors. It was suggested that significant additional narrative would be needed to explain the limitations on the extent to which subsidiaries in different jurisdictions would be able to pay a dividend in practice (for example because of local solvency or prudential rules or because reserves needed to be held for investment or other purposes), making comparisons between companies difficult. One respondent thought that it might even increase pressure from investors to pay dividends because of the increased visibility of reserves within the group.

2.2.10 Auditors and their representative bodies expressed strong support for companies disclosing a distributable reserves figure at the parent company level, but, like companies, thought there was no easy way for companies to disclose figures relating to the dividend-paying capacity of the group as a whole. They suggested that group estimates should be encouraged rather than mandated. Several auditors, however, thought that the distributable reserves figure should be set in the context of a wider package of information about a company’s capital maintenance policy, including its dividend policy and how it had been implemented.

2.2.11 Investors supported the proposal for companies to disclose a distributable reserves figure. They also wanted to see a narrative alongside the figures providing context, to ensure that investors had a better sense of dividend availability and constraints within the group and a better idea of dividend headroom and the sustainability of the dividend policy.

2.2.12 Most respondents thought that the new reporting should extend to all PIEs rather than being limited to listed companies and AIM companies, on the grounds that a company’s

reserves and dividend headroom were of interest to suppliers, creditors and lenders as much as to external shareholders. Private companies, however, were opposed to extending new reporting beyond listed and AIM companies. A small number of respondents who supported the introduction of new disclosures suggested that a phased implementation approach should be adopted to allow expectations to be established and to build capacity for any analysis required. For example, the requirement could apply initially to premium listed companies followed by other main market and AIM companies. It could then be extended to privately owned PIEs if the disclosures had proved useful.

New directors' statement about the legality of dividends and that the dividend will not threaten the solvency of the company over the ensuing two years

2.2.13 Most companies did not oppose the proposal for a directors' statement confirming the legality of a dividend, saying that it would not entail any significant new burden. It was something that directors should already be considering. Some questioned whether it was necessary if that was the case. Others, however, thought it could focus the board's mind on the level of the dividend.

2.2.14 Investors and auditors expressed stronger support for a directors' statement about the *legality* of dividends. Several auditors suggested that this statement should be made every time a dividend is proposed or declared, including in relation to interim dividends. Investors pointed to regular examples of shareholders being asked to approve dividends retrospectively because the company had paid out dividends without the distributable profits being available at the group level. Respondents said that this was usually a technical oversight, but nonetheless indicative of a loose approach to complying with the law which needed tightening. One auditor suggested that the legality statement should include confirmation that the directors had determined the distributable reserves by reference to ARGA's guidance.

2.2.15 Investors were "minded to support" the extension of the directors' statement to privately owned PIEs, given the experience of BHS and other large private companies, including companies owned by private equity firms.

2.2.16 Views about the proposal for a statement confirming that a dividend would not jeopardise the future solvency of a company were generally less positive. A representative body for institutional investors favoured it (although stressed the need to link a solvency statement with the Resilience Statement: see section 3.1). Companies, auditors and responses from the legal profession were generally opposed to the proposal. The grounds for opposition included that:

- it would amount to a duplication with the proposed Resilience Statement and ought to be covered there;
- there would be an evidential burden, particularly if a solvency statement was required every time a dividend was declared;
- the proposed two-year period did not align with the 12-month going concern period, nor with the longer period covered by the Resilience Statement, and it was at odds with the

existing provision in the Companies Act for capital reductions, which required a 12-month declaration of solvency; and

- it could clash with the rules around similar forward-looking solvency statements required in some other jurisdictions.

2.2.17 A specialist lawyers' group argued that it would sit uncomfortably with common law duties on directors to act prudently and to ensure that companies can meet their obligations as they fall due. The two-year solvency statement that was envisaged might be more or less demanding than required under common law. They suggested, therefore, that it would amount to a confusing extra layer being added to an already complicated dividend framework.

2.2.18 There was some support for the principle that the dividend rules should be more forward looking and attach more weight to the impact of dividends on future solvency, but the view was that this required a much more detailed and specific review of the capital maintenance rules. The White Paper had not provided such an opportunity.

Company disclosure of distribution and capital allocation policies

2.2.19 Many investors disagreed with the White Paper suggestion that there was no need to introduce new reporting requirements about dividends and capital allocation policies. They strongly favoured a requirement for companies to disclose a distribution policy which would set out the board's long-term approach to making decisions on the amount and timing of returns to shareholders – including dividends, share buybacks and other capital distributions – within the context of any relevant legal or financial constraints. They thought a requirement would ensure a consistent level of disclosure on these important matters and it was not enough to rely on best practice.

2.2.20 Several large audit firms also thought that a requirement to report a distributable reserves figure on the balance sheet date was insufficient, and that supplementary narrative should be required to set it in the context of a company's wider distribution policy. One audit firm suggested that any new narrative reporting requirement on distributions could be underpinned with guidance from the regulator. Most companies were less enthusiastic about introducing formal new reporting requirements, suggesting that investor pressure and wider adoption of best practice in relation to reporting on section 172 matters ought to be sufficient to achieve the improvements being sought by investors.

2.2.21 Most auditors prefaced their comments with the observation that the current law on capital maintenance and dividends was too complex and paid insufficient heed to a company's ability to pay dividends and meet debts in the future. One auditor suggested that the existing regime had become steadily more disconnected from current accounting concepts and the methods of modern business. Many respondents wanted to see a fundamental and expert review of the law to see whether the UK should adopt the "future solvency" approach to dividends adopted in some other countries, which dispenses with complex capital maintenance rules based on historical profits. However, they accepted that this was not within the scope of the Government's White Paper.

Government response

ARGA responsibility for issuing guidance on “realised profits and losses”

2.2.22 Responses demonstrated strong support across all the main stakeholder groups for giving ARGA formal responsibility for publishing guidance on realised and distributable profits. Guidance is currently published by the professional accountancy bodies on an entirely voluntary basis. Giving ARGA formal responsibility for issuing guidance would therefore enhance the status of the guidance and help avoid any perception that the accountancy profession is setting its own rules. It would also give preparers greater confidence that in following the guidance they are complying with the relevant Companies Act requirements. **The Government therefore intends to give ARGA formal responsibility for issuing guidance on what should be treated as “realised” profits and losses for the purposes of section 853 of the Companies Act 2006.** The guidance would be subject to full prior consultation.

Disclosure of distributable reserves

2.2.23 There was strong support across different stakeholder groups for disclosure of the distributable reserves figure at the parent company level. Investors have asked for it, and companies say that they have this information so it will not amount to a significant extra burden to publish it. **The Government therefore intends to require qualifying companies or, in the case of a UK group, the parent company only, to disclose their distributable reserves, or a “not less than” figure if determining an exact figure would be impracticable or involve disproportionate effort.** The Government is confident that this disclosure will provide useful information for investors about dividend headroom and help reassure shareholders and other external stakeholders about the legality of proposed dividends. Further, the Government intends to make the distributable reserves figure at the balance sheet date subject to audit³⁰. This will help to address criticism that compliance with the capital maintenance rules is not properly enforced.

2.2.24 On its own, the distributable reserves figure will have limitations in terms of its value to the users of financial reporting. A parent company can only distribute earnings made by subsidiaries to the extent that subsidiaries have passed up dividends to the parent. This means that the parent company position is incomplete. It will not say anything about the potential dividend-paying capacity of the group as a whole. The White Paper suggested that parent companies could provide an “estimate” of this capacity. Companies, however, have opposed this strongly on the grounds of cost, complexity, audit difficulties and the risk of misleading investors without extensive explanations of the barriers to paying dividends. In the light of these responses, the Government agrees that it does not lend itself to a legislative requirement and that **disclosing an estimate of the dividend-paying capacity of the group as a whole should be encouraged rather than a required element of reporting.** Guidance issued by the regulator and by institutional investors (where they would value the information) should be used to improve transparency about the group’s overall dividend position.

³⁰ Some companies already disclose their distributable reserves figure on a voluntary basis. Under current standards, where they do so, that figure is subject to audit.

Setting the distributable reserves figure in a narrative context

2.2.25 Investors and auditors have argued strongly that the distributable reserve figure requires a narrative context to increase its usefulness. Respondents have pointed to some improvements in company reporting on distributions and capital allocation policies following the recent introduction of a requirement for directors to report on how they have met their duties under section 172(1) of the Companies Act. There is not, however, any explicit reference to dividend policies or capital allocation in the current reporting requirements and not all companies have improved their reporting on these matters.

2.2.26 **The Government therefore intends to require companies to provide a narrative explaining the board's long-term approach to the amount and timing of returns to shareholders (including dividends, share buybacks and other capital distributions) and how this distribution policy has been applied in the reporting year.** As part of this narrative, companies will also be expected to explain any relevant legal and financial constraints and risks to the policy, including the availability of distributable reserves and cash within the wider group, any significant barriers to subsidiary companies paying up dividends to the parent and any competing demands for capital such as investment. This narrative will give investors and other users of the annual report and accounts a better understanding of the company's overall approach to dividends and other uses of capital and allow them to consider the distributable reserves figure in this wider context. The Government will expect the regulator to issue guidance to underpin the new narrative reporting requirement reflecting best practice and investor needs.

Directors' statement about legality of proposed dividends and assurances that the dividend will not threaten the solvency of the company

2.2.27 Responses to the White Paper show that the arguments for requiring a directors' statement about the legality of any proposed dividend are finely balanced. On the one hand, it is implicit that directors should be complying with the law: in other words, that they are paying dividends from distributable profits and have had regard to their wider duties to the long-term success of the company and other matters. On the other hand, there are examples of companies making mistakes and paying dividends without having the necessary reserves (often because a dividend has not been formally transferred from a subsidiary to the parent or because the necessary interim accounts have not been filed). Making this a positive attestation required from the board as a whole should improve focus and help answer suggestions that directors sometimes pay insufficient heed to the capital maintenance rules and their wider duties with respect to dividends. Investors have called for it, and companies do not think it would represent a sizeable new burden. **The Government therefore intends to take forward a requirement for directors to make explicit statements confirming the legality of proposed dividends and any dividends paid in year.**

2.2.28 Consultation responses have pointed to significant difficulties with proceeding with the solvency statement proposal. It would introduce a further layer of complexity into an already complicated framework. The proposed two-year coverage would need to be reconciled with different periods covered by the going concern statement and the proposed Resilience Statement and with the common law duty to act prudently, which does not have a fixed time

period. Some other jurisdictions have adopted a solvency-based approach to the payment of dividends. These would need further exploration to ensure that the UK's approach was sufficiently consistent with them to avoid creating difficulties for multinational companies.

2.2.29 The White Paper proposal was aimed at introducing a more forward-looking element to the dividend rules to complement capital maintenance rules, but it is clear that this would require further detailed consideration beyond the White Paper consultation. **The Government has therefore decided not to proceed with the proposal for a directors' assurance that a dividend would not be expected to jeopardise the future solvency of the company over a period of two years.** The Government does, however, expect the proposed Resilience Statement (discussed in Chapter 3.1) to take into account the company's dividend policy.

Scope of the new disclosures

2.2.30 The rules on capital maintenance and dividends apply to all companies irrespective of their size or source of capital. External investors have an interest in whether a dividend is legal and affordable, but the rules are there primarily to protect the interests of others, including creditors and employees. Respondents have pointed to examples of private as well as listed companies paying dividends that potentially put the long-term viability of a company in question. **The Government therefore considers that it would be appropriate to apply the new disclosures and the legality statement to companies that are Public Interest Entities above the size thresholds set out in Chapter 1** (that is, to both listed and unlisted companies with 750 employees or more and an annual turnover of at least £750m).

3 New corporate reporting

The Government confirms that it will continue with its proposals to introduce a new statutory Resilience Statement and a new statutory Audit and Assurance Policy. Both proposals have been modified in light of feedback received during consultation and will apply to Public Interest Entities above the size threshold set out in Chapter 1 of this document. On payment practice reporting, the Government has recently carried out a Post-Implementation Review of existing regulations in this area and is now planning to consult on whether those regulations should be amended to enhance further transparency and accountability in supplier payment reporting. That consultation will take account of responses to the White Paper proposal.

3.1 Resilience Statement

What the White Paper proposed

3.1.1 The White Paper proposed that companies within scope of the new Public Interest Entity definition should produce an annual Resilience Statement, which sets out their approach to managing risk and developing resilience over the short, medium and long term. The proposal responded to a recommendation in the Brydon Review and to concerns expressed in both that Review and the FRC Review that existing risk and viability reporting by many companies – including the viability statement produced under the UK Corporate Governance Code – lacked sufficient detail and specificity, and was not long-term enough in outlook.

3.1.2 The White Paper proposal consisted primarily of the following:

- The Resilience Statement should incorporate and build on the existing going concern and viability statements;
- The short-term section of the Resilience Statement should include material uncertainties to a company being a going concern even if these were rendered immaterial following mitigating action or the use of significant judgement;
- The short- and/or medium-term sections should at a minimum provide disclosures on how a company is addressing certain risks or resilience issues, including threats to business continuity, supply chain resilience and cyber security; and
- The medium-term section should include two reverse stress testing scenarios and should cover a five-year forward look.

Issues arising from consultation

3.1.3 There was broad support for the Resilience Statement in principle, including from a large majority of civil society and investor respondents, and from most business respondents. Many respondents said there was a need for a clearer understanding of the risks that companies face over the short, medium and long term which might threaten the resilience of the business, and a corresponding interest in understanding the mitigating actions being taken

by management in response. It was generally accepted that existing disclosures under the viability statement often lacked specificity and sufficient detail to provide confidence that a company had robust plans in place to prepare for business shocks while also delivering sustainable value.

3.1.4 With supportive comments came a number of suggestions – including from investors, civil society groups, a trade union body, audit firms and a number of business respondents – for how the Resilience Statement could be made more effective than the viability statement, including by:

- providing an over-arching management narrative on resilience planning, covering both operational and financial resilience and links to the business strategy;
- incorporating existing disclosures on principal risks and uncertainties made within the Strategic Report;
- highlighting critical accounting judgements and estimates made in the company's financial statements;
- requiring management to set out the mitigating actions they had put in place to address individual risks, and to explain how they saw particular risks crystallising over time;
- focusing less on whether a company would remain viable and meet its liabilities over a given time – which some commented had led to unhelpful and minimalist binary reporting in the viability statement – and more on the company's actions to help ensure it remained viable, on which investors and other interested stakeholders could then form a view; and/or
- including wider disclosures on sustainability, and matters arising from business operations that might be material to society and the environment, which took account of existing international and European Union proposals on sustainability reporting, highlighting any risks to a company's resilience arising from major contract dependencies and complex business structures (including extensive use of sub-contracting and out-sourcing).

3.1.5 While a large majority of business respondents, including business groups and individual companies, supported the introduction of a Resilience Statement, this support in many cases came with the following two qualifications. First, there was concern over the White Paper proposal that every Resilience Statement should address a minimum set of risks or resilience issues, such as a business continuity shock or major supply chain dependency. Both businesses and many investors argued that this could produce a tick-box approach to resilience reporting, while undermining the responsibility of the board of directors to determine what risk and resilience matters were specifically material for their company in any given year. Second, many companies were concerned about the proposal to mandate a minimum five-year forward look for the medium-term section of the Resilience Statement (the length of the long-term section being left to the discretion of each company). It was argued that this did not take account of the varying business cycles of different companies and sectors, and many businesses said it would not align with their typical three-year business planning process.

3.1.6 Around a quarter of business respondents raised concerns, or otherwise asked for more clarification, on the proposal that companies should carry out two reverse stress tests each year and report on this within the Resilience Statement. Some commented that this risked providing commercially sensitive information and/or could create a false expectation that a company was genuinely at risk of failure. Others asked why two reverse stress tests were needed and suggested that just one test was needed which focused on the key variable in a company's business model and planning which, if not managed correctly, could threaten its survival. A small number of respondents highlighted existing reverse stress testing requirements covering banks and other financial institutions and asked how the new obligation in the Resilience Statement would interact with those for companies subject to both measures.

3.1.7 A further concern, raised by a small number of business respondents, was over the proposal to expand the going concern statement to include material uncertainties that existed prior to the exercise of significant judgement or the taking of mitigating action by management. It was argued that this could potentially lead to disclosure of a long list of material uncertainties that routine management action rendered immaterial every year and so create an unjustified impression that a company was struggling to remain a going concern.

3.1.8 The White Paper also invited views on whether new mandatory reporting under the framework of the Taskforce on Climate-related Financial Disclosures (TCFD) should be included within the Resilience Statement in whole or part. A large majority of respondents were opposed to this, with most arguing that since TCFD reporting will be both substantial and focused on a particular issue, it should be reported separately. Nonetheless, a number of respondents noted the parallel short, medium and long-term structures of the Resilience Statement and the TCFD framework and said it would be helpful for companies to cross-refer to relevant TCFD disclosures within their Resilience Statement.

3.1.9 Finally, a small number of business respondents said the Government should review whether the implementing legislation for the Resilience Statement should include a 'safe harbour' protection for directors given the greater and potentially longer-term information it would provide concerning the future of businesses. The reasoning here was that directors should be able to set out their views on the resilience of their business on the basis of what could be reasonably known and planned for at the time, and not be constrained by liability concerns which might arise if future events called into question those previous judgements and actions.

Government response

3.1.10 The Government welcomes the general support for the Resilience Statement proposal and the constructive feedback offered by many respondents on how it can be most effectively implemented. The Government intends to continue with this proposal, subject to the changes set out below. The Government confirms that the Resilience Statement will apply to companies which are Public Interest Entities in line with the size thresholds set out in Chapter 1 of this document (see paragraph 1.6.48); that is, public and private companies with 750 employees or more and an annual turnover of at least £750m.

Identification of material resilience matters

3.1.11 The Government accepts that mandating a common set of risks to be addressed in every statement would cut across the directors' responsibility to identify, manage and report on those risk and resilience issues that are most material to their business. Instead, **the Government intends to legislate for companies to report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have arrived at this judgement of materiality.** In doing so, companies will be required to *have regard* to the following³¹:

- any materially significant financial liabilities or expected refinancing needs occurring during the assessment period of the short and medium term sections of the Resilience Statement;
- the company's operational and financial preparedness for a significant and prolonged disruption to its normal business trading;
- significant accounting judgements or estimates contained in the company's latest financial statements that are material to the future solvency of the company;
- the company's ability to manage digital security risks, including cyber security threats and the risk of significant breaches of its data protection obligations;
- the sustainability of the company's dividend policy;
- any significant areas of business dependency with regard to the company's suppliers, customers, products, contracts, services or markets which may constitute a material risk; and
- the impact on the company's business model of climate change, to the extent that this is not already addressed by the company in other statutory reporting.

3.1.12 Supporting guidance by the regulator will set out more detail of how the potential materiality of these matters should be considered as well as on the Resilience Statement as a whole.

3.1.13 On the suggestion by some respondents that the Resilience Statement should be a vehicle for sustainability reporting, in October the Government published "Greening Finance: A Roadmap to Sustainable Investing"³², a roadmap which sets out plans for a new Sustainability Disclosures Requirement (SDR) regime for UK corporates, financial services firms, asset owners and financial products. It recognises the crucial role of industry, investors and stewardship in delivering a sustainable future. The new SDR regime will require disclosures relevant to enterprise value creation against International Sustainability Standards and disclosures relevant to a company's impact on the environment using the UK's Green Taxonomy. In preparing the implementing legislation for the Resilience Statement, and its supporting guidance, the Government and the regulator will consider how the Resilience

³¹ This list of matters to which companies will be required to have regard does not necessarily reflect the precise wording that will be set out in the implementing legislation in due course.

³² <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>

Statement can effectively reference, make links to and provide a coherent reporting framework with wider sustainability disclosures.

Assessment period

3.1.14 The Government continues to believe that companies should be able to demonstrate to shareholders (where relevant) and other interested stakeholders that they are working to help ensure the resilience of the company's business model, its financial base and its operations over the short, medium and long term. Nonetheless, the Government accepts that having a one-size-fits-all minimum assessment period would be inflexible, given the variation in business cycles and business planning processes across different companies and sectors.

The Government therefore intends to replace the five-year mandatory assessment period previously proposed for the combined short- and medium-term sections of the Resilience Statement with an obligation on companies to choose and explain the length of the assessment period for the medium-term section. Companies will be required to include a description of how resilience planning over the chosen period aligns with the company's strategy and business investment cycle³³. If the assessment period is the same as the one chosen in the previous year, the company will need to explain why it continues to be justified.

High-level narrative

3.1.15 The Government accepts that the statement should contain a high-level explanation of the company's approach to maintaining or enhancing its operational and financial resilience over the short and medium term. This explanation should clearly set out how the company's assumptions on resilience planning and risk management are influenced by and relate to its strategy on the one hand, and also the main trends and factors that are likely to affect the future development, performance and position of the company's business³⁴. This reporting should precede the company's specific reporting on individual risk and resilience issues. Again, the supporting guidance by the regulator will provide more detailed advice on good practice.

Disclosure of principal risks and uncertainties

3.1.16 The Government recognises that, in the interest of integrated and holistic reporting on risk and resilience, the existing Strategic Report requirement on companies to describe the principal risks and uncertainties facing them should be incorporated within the Resilience Statement. **The Government intends that companies within scope be given the flexibility to report these risks within the short- and/or medium-term sections of the Resilience Statement, noting that different kinds of risk or uncertainty may crystallise or resolve over different time periods.**

³³ Existing FRC guidance on the viability statement asks companies to take account of its investment and planning periods in choosing their assessment period, but does not require them to explain how the assessment period aligns with both the investment cycle and company strategy. (<https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf>)

³⁴ Section 414C of the Companies Act already requires quoted companies' strategic reports to include a description of their strategy and of the main trends and factors likely to affect the future development, performance and position of the company's business.

3.1.17 Given that companies' existing description of their principal risks and uncertainties may well overlap with the new requirement to identify and report on material risk and resilience issues facing the company over the short to medium term, the Government intends that the implementing legislation will give companies flexibility to meet the existing requirement through their assessment of risk and resilience issues over the short to medium term. The implementing legislation will also require companies to report, for each risk or resilience issue identified over the short to medium term:

- the likelihood of the risk and its impact on the company's operations or financial health if it were to materialise;
- the time period over which the risk is expected to remain, and potentially crystallise, if known;
- what mitigating action, if any, the company has put or plans to put in place to manage the risk; and
- any significant changes to any of the above since the previous year's Resilience Statement.

Reverse stress testing

3.1.18 The Government recognises that reverse stress testing may require significant time and internal management resource. However, this investment can provide management with valuable tools and insight with which to re-appraise a company's capacity to cope with severe but plausible scenarios which, if not planned for properly, could cause the business to fail or otherwise lose the confidence of its customers and finance providers. The Government believes it is appropriate that large public interest entities should be able to demonstrate that they have undergone such a critical evaluation of their business's key potential vulnerabilities. The Government also notes that a number of large businesses outside the financial services sector are already voluntarily making use of reverse stress testing to understand their resilience³⁵ and improve their risk management.

3.1.19 The Government therefore intends to continue with its proposal that companies within scope of the Resilience Statement should perform reverse stress testing. However, in light of the consultation feedback, companies will be required to perform at least one reverse stress test rather than a minimum of two. The Government also recognises the need for consistency between this new requirement and existing reverse stress testing obligations covering banks and insurance companies³⁶, while not replicating in full obligations that are designed to test solvency and capital adequacy in the financial system. **It therefore intends that the Resilience Statement will require a company to:**

- **identify annually a combination of adverse circumstances which would cause its business plan to become unviable;**

³⁵ The FRC's Thematic Review of the Going Concern and Viability Statements published in September 2021 found that 5 of the 27 non-financial service companies it sampled which had prepared a viability statement had also carried out a reverse stress test.

³⁶ For example, see the existing FCA rules on reverse stress testing under the Senior Management, Systems and Controls Framework <https://www.handbook.fca.org.uk/handbook/SYSC/20.pdf>

- **assess the likelihood of such a combination of circumstances occurring; and**
- **summarise within the Resilience Statement the results of this assessment and any mitigating action put in place by management as a result. The summary would not be required to include any information which, in the opinion of the directors, would be seriously prejudicial to the commercial interests of the company.**

3.1.20 The process should be documented and carried out according to the nature, size and complexity of the business. The supporting documentation will not be required to be published but should be available to the regulator to review on request. The Government will address in its design of the implementing legislation how banks and other financial service companies which already carry out mandatory reverse stress testing may rely on this existing activity to comply with the Resilience Statement requirement.

Material uncertainties

3.1.21 The Government acknowledges the concern that requiring companies to disclose all material uncertainties to a company being a going concern prior to mitigating action or the use of significant judgement could potentially produce a long list of risks that are routinely rendered immaterial by business-as-usual action. At the same time, consultation responses from investors and other stakeholders show there is significant interest in understanding critical judgements or actions taken by management to conclude that an identified material uncertainty is no longer material.

3.1.22 This information need is arguably already met to an extent by international accounting standards. International Accounting Standard 1 requires companies to disclose the management judgements that have had the most significant effect on the financial statements and also requires disclosure of major sources of estimation uncertainty. Additionally, since 2014, US GAAP has required that management's initial going concern evaluation should not take account of mitigating actions that are ongoing.

3.1.23 Balancing the need for proportionality with legitimate and wider investor interest in the going concern assessment process, **the Government intends that companies within scope of the Resilience Statement should identify any material uncertainties to going concern, that existed prior to the taking of mitigating action or the use of significant judgement, which the directors consider are necessary for shareholders and other users of the statement to understand the current position and prospects of the business.**

Viability statement and Going Concern statement

3.1.24 **The Government confirms that, for companies within scope of the Resilience Statement, the existing viability statement provision in the UK Corporate Governance Code (Provision 31) extending to premium listed companies will be incorporated and adapted within the statutory requirements for the Resilience Statement.** As part of this, and taking account of consultation feedback on the viability statement's provisions on prospects and liabilities, the Government and the FRC will consider how the existing objectives of the viability statement can be adapted within the Resilience Statement, while meeting the

aims set out in the White Paper and this response to deliver more meaningful and extensive reporting on risk and resilience.

3.1.25 The Government and the FRC intend that the existing viability statement provision in the Code (Provision 31) will no longer apply after the Resilience Statement enters into force. Its removal will be subject to consultation by the FRC at the same time it consults on other proposed changes to the Code in response to the Government's final policy position set out in this response. Existing FRC guidance³⁷ under the Code on risk and viability will continue in force, since it is relevant to other Code Principles and Provisions relating to resilience and risk management³⁸ which will continue to apply to all companies that follow the Code.

3.1.26 The FRC also intends to consult on removing Provision 30 from the Code, covering the Going Concern statement, on the basis that this will also be included and built on within the Resilience Statement, and also since all companies subject to the Code will continue to provide a Going Concern statement as required by accounting standards and company law, irrespective of whether they are subject to the new Resilience Statement requirement. Again, the FRC will retain its existing Code guidance on going concern, since it will remain of relevance to all companies which follow the Code.

Safe harbour

3.1.27 The Government confirms that the Resilience Statement will form part of the Strategic Report. Information provided by directors in the Statement will therefore be covered by the existing 'safe harbour' provision in Section 463 of the Companies Act 2006. That means that directors would be liable to the company for untrue or misleading information in the Resilience Statement only if they knew the information was untrue or misleading (or were reckless as to whether it was so) or if they dishonestly concealed a material fact.

³⁷ <https://www.frc.org.uk/getattachment/d672c107-b1fb-4051-84b0-f5b83a1b93f6/Guidance-on-Risk-Management-Internal-Control-and-Related-Reporting.pdf>

³⁸ In particular:

Principles N + O – The board should present a fair, balanced and understandable assessment of the company's position and prospects. The board should establish procedures to manage risk, oversee the internal control framework,

and determine the nature and extent of the principal risks the company is willing to take in order to achieve its long-term strategic objectives.

Provision 1 – The board should describe in the annual report how opportunities and risks to the future success of the business have been considered and addressed, the sustainability of the company's business model and how its governance contributes to the delivery of its strategy

Provision 28 - The board should carry out a robust assessment of the company's emerging and principal risks.⁹ The board should confirm in the annual report that it has completed this assessment, including a description of its principal risks, what procedures are in place to identify emerging risks, and an explanation of how these are being managed or mitigated.

3.2 Audit and Assurance Policy

What the White Paper proposed

3.2.1 The White Paper proposed that public interest entities should publish an Audit and Assurance Policy (AAP) which sets out a company's approach to assuring the quality of the information it reports to shareholders beyond that contained in the financial statements. The White Paper invited views on whether the AAP should be published annually or every three years, and whether it should be subject to an advisory shareholder vote. Views were also invited on the following proposed minimum content for the AAP:

- an explanation of what independent assurance, if any, the company proposes to seek over its Resilience Statement (in whole or part) or over the effectiveness of its internal controls framework;
- a description of the company's internal auditing and assurance process, which might include how management conclusions and judgements in the annual report can be challenged and verified internally;
- a description of the company's policies in relation to the tendering of external audit services, including whether a company is prepared to commission non-audit services from its statutory auditor; and
- an explanation of whether, and if so how, shareholder and employee views have been taken into account in the development of the AAP.

Issues arising from consultation

3.2.2 A large majority of respondents across all stakeholder groups supported the introduction of the AAP. Many individual businesses welcomed the AAP as providing an opportunity to demonstrate to shareholders and other interested parties how companies assure the quality of their corporate disclosures. Many investors said that investment decisions increasingly depended on matters reported by companies that are not assured during the statutory audit of the financial statements, including reporting on environmental, societal and governance issues, and how a company's strategy and risk management address such issues. They therefore welcomed the AAP as providing a means to demonstrate how such reporting is assured by the company, whether internally or externally.

3.2.3 There was broad support for the proposed minimum content of the AAP. However, some investor and other stakeholder respondents felt that the requirements should go further and mandate independent assurance on certain areas of company reporting beyond the financial statements. These included key performance indicators associated with directors' remuneration, any alternative performance measures used by a company and reporting on internal controls, risk, resilience and sustainability. Others commented that the AAP could provide a tool for every company in scope to show how it was assuring information, judgements or assumptions that were most critical to the success of its particular business model, and in which shareholders would therefore have a strong interest. Some respondents

argued that the AAP should focus on how a company is providing assurance – internal and/or external – over the identification and management of its principal risks.

3.2.4 At the same time, a clear majority of investors, and most business respondents, were not in favour of the proposed advisory shareholder vote on the AAP. It was argued that the annual shareholder vote on the election or re-election of the Audit Committee Chair already provides a route through which shareholders can express concern over a company's handling of audit and assurance matters. Another concern expressed by some investors was the perceived risk that a shareholder vote on the AAP risked making investors in part responsible for the AAP, when this should be squarely a management responsibility.

3.2.5 A majority of respondents favoured the AAP being published every three years rather than annually. Comments in favour of a triennial approach included the longer time that this would give audit committees to engage with shareholders and others on the preparation of a new AAP, and the greater attention that a new AAP would arguably receive from shareholders if it was launched every three years. However, several respondents said that it would be sensible for the audit committee to provide an annual update on how the AAP was being implemented.

3.2.6 Other comments and suggestions included:

- highlighting the important role that internal audit plays in many companies, as the 'third line of defence' in ensuring rigour and reliability in management reporting – a number of respondents argued that internal audit was arguably more effective than independent assurance as it had the ability to enquire deeper and more continuously into a company's reporting and controls than a one-off independent assurance exercise;
- the desirability of having some kind of common benchmark or set of standards for independent assurance commissioned by companies as part of their AAP;
- the suggestion that effective assurance of management reporting also required assurance of the controls and processes underpinning such reporting;
- the possible role that ARGA could play in providing more advice to companies and shareholders on the different kinds of assurance model that companies could use;
- the role that the AAP could play in explaining the existing role of the annual statutory audit in reviewing information beyond the financial statements;
- the possible need to revisit and relax existing rules covering the provision of non-audit services by auditors, to enable companies to use their existing auditor to carry out assurance linked to the AAP, for example on internal controls; and
- the need for the AAP not to duplicate or overlap confusingly with existing Audit Committee responsibilities under the UK Corporate Governance Code, and also the desirability of the AAP being published alongside or as part of the Audit Committee report.

Government response

3.2.7 The Government welcomes the wide support that the AAP concept has received, and also the constructive challenge and range of suggestions over how it could be made more effective in practice. The Government confirms that it will implement the proposal, while making certain additional changes in light of consultation feedback, as set out below. The Government confirms that the Audit and Assurance Policy will apply to companies which are Public Interest Entities in line with the size thresholds set out in Chapter 1 of this document; that is, public and private companies with 750 employees or more and an annual turnover of at least £750m.

3.2.8 **The Government agrees with the majority of respondents who commented that the AAP should be published every three years**, to give companies sufficient time to review their existing assurance arrangements and gather shareholder and other views before bringing forward a new AAP. This triennial publication will, however, be complemented by an annual implementation report, in which the directors (typically through the audit committee³⁹) provide a summary update of how the assurance activity outlined in the AAP is working in practice. Companies will also be free to update their AAP from year to year should they judge this necessary – for example, if issues arise that highlight or increase the value of seeking further internal or external assurance in particular areas of company reporting or activity.

3.2.9 The Government remains keen that shareholders should engage with companies in the development of the AAP. Investors have made clear in consultation responses that they place increasing importance on the reliability of company reporting beyond the financial statements. On balance, the Government accepts the argument of many investors and companies that a new statutory shareholder vote is not essential to promote this engagement with and by investors in companies' approach to audit and assurance, and could risk blurring the boundaries of responsibility in this area between company boards and shareholders. **The Government is therefore not proceeding with the proposal that the AAP should be subject to an advisory shareholder vote. However, in the absence of a vote, the Government will make it mandatory that companies state within the AAP how they have taken account of shareholder views⁴⁰ in its development.** Companies will also be required to state whether, and if so how, they have taken account of employee views, as proposed in the White Paper and noting that employees working in critical areas of a company's business may be well-placed to advise on where any additional assurance would be helpful.

3.2.10 Having considered respondent views on the proposed content of the AAP, the Government believes that the approach set out in the White Paper remains proportionate. The Government recognises that there is considerable investor and other interest in a wide range of company reporting beyond the financial statements, including on key performance indicators and alternative performance measures. However, the Government is not convinced that any new assurance activity should be mandatory. The primary purpose of the AAP is to require companies to demonstrate to their shareholders and others with a direct interest in a

³⁹ Relevant companies which are not required to have an audit committee, and do not choose voluntarily to have an audit committee, will still be required to produce an annual implementation statement on the AAP

⁴⁰ This statement will also cover the views of shareholders of privately-owned companies

company's reporting and prospects – including creditors, customers and suppliers – how they are assuring information beyond the financial statements, whether internally or externally, and how they are considering where any additional internal or external assurance may be needed going forward.

3.2.11 The Government continues to believe that the AAP should set out whether, and if so how, a company intends to seek independent (external) assurance over any part of the Resilience Statement or over reporting on its internal control framework (whether this is required or provided voluntarily). Reporting on risk and viability, and on internal controls, is of considerable interest to shareholders, regulators and others, since the consequences of poor management of these matters can be serious, and it is right that companies should explain on an ongoing basis how they are assuring such information.

3.2.12 The Government also confirms that the AAP will require companies to describe their internal auditing and assurance process, including how management conclusions and judgements are challenged and verified internally. The Government recognises, as many respondents highlighted, that internal audit can be an important 'third line of defence', for example by helping to maintain an effective system of internal controls. It is important that companies explain how they are ensuring the integrity of their internal assurance process, and considering whether any improvements are needed in light of experience.

3.2.13 The Government confirms that the AAP will require a description of the company's policy in relation to the tendering of external audit services, including whether a company is prepared to commission non-audit services from its statutory auditor. Audit Committees of premium listed companies are already required to develop and implement such a policy under the UK Corporate Governance Code. However, in view of the enhanced audit requirements being extended to large private companies through the revised PIE definition, and to which the AAP will also apply, the Government believes that it is appropriate that this should be a requirement of all companies within scope of the AAP. In developing the implementing legislation for the AAP, the Government will consult with the FRC regarding how the new reporting requirement can most effectively work alongside existing and forthcoming requirements for audit committees in the Code.

3.2.14 The Government accepts the suggestion of a number of respondents that shareholders and other users of AAP reporting should be able to understand whether, and if so how, any independent (external) assurance commissioned by a company beyond the statutory audit will be carried out according to a commonly recognised assurance standard or model. The AAP will therefore be required to state whether any independent assurance proposed within it will be 'limited' or 'reasonable' assurance, as defined in the FRC's Glossary of Terms⁴¹, or whether an alternative form of engagement or review, as agreed between the company and the external provider, will be undertaken. The AAP will also be required to state whether any independent assurance beyond the statutory audit will be carried out according to a recognised professional standard, such as the

⁴¹ [https://www.frc.org.uk/getattachment/d4968a74-15d1-47ce-8fc4-220ae3536b06/Glossary-of-Terms-\(Auditing-and-Ethics\)-With-Covers.pdf](https://www.frc.org.uk/getattachment/d4968a74-15d1-47ce-8fc4-220ae3536b06/Glossary-of-Terms-(Auditing-and-Ethics)-With-Covers.pdf)

International Standard on Assurance Engagements (ISAE) (UK) 3000 (covering assurance other than audits of historical financial information)⁴².

3.2.15 The Government recognises, as set out by some respondents, that assurance of management reporting may also require some level of assurance or review of the internal systems and controls that underpin such reporting. The Government continues to believe that the AAP should focus on how companies are ensuring the integrity of their annual statutory and voluntary disclosures beyond the financial statements. However, it is important that companies consider how they can demonstrate that such disclosures are provided on the basis of robust and reliable internal processes.

3.2.16 Guidance on the AAP, to be developed by ARGA, is expected to provide advice on good practice in this and other areas related to the new reporting requirement. The ARGA guidance is also expected to offer advice on how companies can document clearly within their annual report the different kinds of assurance or review that have been carried out. This would include the existing review carried out by the statutory auditor of information in the annual report that sits outside the financial statements.

3.2.17 Finally, **the Government confirms that, for PIEs that are required to produce an audit committee report, the triennial AAP and the annual implementation report on the AAP should be published within the same section of the annual report as the audit committee report.** For companies that are PIEs by virtue of the new size threshold, which will not be required to have an audit committee, the Government is considering whether this reporting should be in the strategic report or elsewhere in the annual report.

3.3 Reporting on payment practices

What the White Paper proposed

3.3.1 Responding to a recommendation in the Brydon Review, the White Paper proposed that Public Interest Entities should provide a summary of their payment practice policies and performance within their annual report, with this summary to be provided at a group level in the case of PIEs that are parent companies. The White Paper proposed that the summary should include:

- the company's supplier payments policy, including its standard payment terms and shortest and longest standard payment period;
- the percentage of the company's supplier payments that met its standard terms over the previous year and, where this figure was less than 80%, an explanation of why this occurred and what actions the company planned to take to improve its payments record; and

⁴² [https://www.frc.org.uk/getattachment/2dc92f3e-df64-47d8-a9de-0292795fc8c3/ISAE-\(UK\)-3000-Jul-2020.pdf](https://www.frc.org.uk/getattachment/2dc92f3e-df64-47d8-a9de-0292795fc8c3/ISAE-(UK)-3000-Jul-2020.pdf)

- where such an explanation was required in the previous year's annual report, an update in the following year's report on the actions that were taken to improve the payments record and any additional steps proposed.

Issues arising from consultation

3.3.2 Most comments on this White Paper proposal came from individual businesses, business representative groups and professional bodies. A majority of individual businesses and around half of the professional bodies were not supportive of the proposal. The main arguments against were that:

- it would in part duplicate existing reporting by companies under The Reporting on Payment Practices and Performance Regulations 2017, albeit at a summary, consolidated group level; and
- it would be challenging and potentially misleading for large, complex multi-nationals to report on payment practices and performance at a group level, since supplier payments in other jurisdictions often follow local practices and norms.

3.3.3 Representatives of smaller businesses, around half of professional bodies and a minority of individual companies (including some large listed companies) were in favour of the proposal, subject to various suggested changes. A recurring argument in favour was that large companies in particular need to do more to show that they are driving a prompt payment culture across all their subsidiaries. Others were also keen to see supplier payment reporting subject to some kind of audit or other assurance.

3.3.4 The main suggested changes to the proposal were:

- to limit group reporting to 'material' subsidiaries, defined as subsidiaries which contribute at least 25% of the group's revenues;
- to limit group reporting to supplier payments that are 'sufficiently linked to the UK' (as the existing regulations allow);
- to require companies to disclose the total payments they make within 1-30 days, 30-60 days and 60-90 days (on the basis that a good performance against a company's standard payment terms may be misleading if those standard payment terms exceed 90 days);
- to link supplier payment reporting to directors' existing annual statement on how they are meeting their duty under Section 172 of the Companies Act 2006 to have regard (among other matters) to the need to foster the company's business relationships with its suppliers;
- to require companies' average supplier payment period to be included in the annual financial statements, which would ensure it was subject to the annual statutory audit; and
- to include the new consolidated summary separately on the company's website, or on the government portal where existing supplier payment reporting at subsidiary level is provided, rather than within the annual report.

Government response

3.3.5 The Government continues to believe that there is a case for increasing transparency over how large public interest entities are performing on their payments to suppliers at a consolidated, group level, and that such summary reporting would benefit from greater attention by directors, including the audit committee. At the same time, the Government recognises the challenges that the proposal could cause for large, complex multi-nationals with a range of separate business units.

3.3.6 The Government has recently completed a statutory post-implementation review of the existing Reporting on Payment Practices and Performance Regulations 2017⁴³. As confirmed in that review, the Government now intends to consult on whether these regulations should be amended to further enhance transparency and accountability in supplier payment reporting, taking account also of responses to the proposal in the White Paper on 'Restoring Trust in Audit and Corporate Governance', and whether the regulations as a whole should be extended beyond their current expiry date of 6th April 2024.

3.4 Public interest statement

What the White Paper proposed

3.4.1 In response to a Brydon Review recommendation that companies be required to produce an annual public interest statement, the White Paper stated that the Government was not minded to introduce such a new statutory disclosure at this time. The White Paper highlighted a range of recent new company reporting introduced by Government which addresses public interest matters, including an annual requirement since 2019 that directors report on how they have had regard to their employees, suppliers, customers, the environment and the community (among other things) in their decision-making.

Issues arising from consultation

3.4.2 A large majority of respondents who commented on this aspect of the White Paper were supportive of the Government's position not to introduce a statutory public interest statement at this time. There was wide agreement – including from most business and investor respondents, most audit firms and professional bodies, and some civil society groups and think tanks – that a public interest statement would overlap confusingly with recently introduced corporate reporting covering public interest matters. The risk of duplication with the Section 172 reporting requirement⁴⁴, by which all large companies have since 2019 been obliged to report on how directors' decision-making has had regard to various public interest matters, was highlighted by many respondents.

⁴³ <https://www.legislation.gov.uk/ukxi/2017/395/resources>

⁴⁴ Part 2 of The Companies (Miscellaneous Reporting) Regulations 2018.
(<https://www.legislation.gov.uk/ukdsi/2018/9780111170298/contents>)

3.4.3 Another concern expressed by several respondents was that there is arguably a public interest in all company reporting, and it could be misleading to create a public interest statement requirement which could imply that other reporting was not of public interest. A number of respondents also highlighted developing international, EU and UK thinking on sustainability reporting, which may include business impacts on society and the environment and commented that this could better achieve the aims of a public interest statement.

3.4.4 Some think tanks and some responses from academics expressed disappointment at the intention not to legislate to introduce a public interest statement. Several argued that such a statement provided an opportunity to integrate existing reporting that addresses public interest matters, while providing a consistent framework for companies to report on their public interest impacts.

Government response

3.4.5 The Government confirms that it will not legislate at this time to create a new public interest statement reporting requirement, given the risks of confusion with or duplication of existing corporate reporting which already addresses public interest matters. The Government also recognises the potential for any such statement to overlap with the new sustainability disclosures regime that the Government is developing, as set out in *Greening Finance: A Roadmap to Sustainable Investing*⁴⁵, published in October.

3.4.6 Nonetheless, the Government and the FRC will keep under review whether, and if so how, the UK's corporate reporting framework could provide a more holistic picture of how companies assess their impacts on the public interest. As part of this, the Government and the FRC will continue to monitor the quality of non-financial reporting by companies, including the recently introduced Section 172 reporting requirement. That monitoring will be enhanced by the new corporate reporting review powers to be given to the new regulator.

3.4.7 The FRC's consideration of how any future public interest reporting could best be designed will also take account of responses to its recent discussion paper, *A Matter of Principles: The Future of Corporate Reporting*, as summarised in an FRC feedback statement on that paper published in July 2021⁴⁶. Around half of respondents to that paper expressed support for the principle of public interest reporting, but much of that support came with caveats and reservations, including the risk of overlaps with other company reporting and the question of whether a public interest report could be meaningfully distinguished from sustainability disclosures.

⁴⁵ <https://www.gov.uk/government/publications/greening-finance-a-roadmap-to-sustainable-investing>

⁴⁶ <https://www.frc.org.uk/getattachment/dd02e72e-fac2-4c4d-a80a-988be58e54e4/Feedback-Statement-A-Matter-of-Principles-The-Future-of-Corporate-Reporting-2021.pdf>

4 Supervision of corporate reporting

The Government confirms that it intends to proceed with most of its proposals for strengthening the regulator's corporate reporting review powers set out in the White Paper. It intends to ensure that ARGA has powers to direct changes to company reports and accounts, rather than having to seek a court order, along with powers to publish summary findings following a review. The Government also intends to ensure that the regulator's new power to require or commission an expert review will be available to support its corporate reporting review work. In addition, the Government will extend the regulator's powers to cover the entire contents of the annual report and accounts so that it can review areas that are not currently within scope, such as corporate governance statements and directors' remuneration and audit committee reports as well as voluntary elements such as the CEO's and chairman's reports. It does not now intend to give ARGA new powers to offer a pre-clearance service.

What the White Paper proposed

4.1 The regulator has an important role in supervising, guiding and challenging the information that companies make public, through its corporate reporting review (CRR) activities. It currently checks the directors' report, the strategic report and annual accounts of public and large private companies for compliance with the Companies Act and applicable accounting standards and, where relevant, for compliance with accounting requirements imposed by FCA rules. The FRC Review made recommendations for strengthening this aspect of the regulator's work as a way of improving the quality of corporate reporting.

4.2 The White Paper took this forward, setting out proposals for widening and strengthening the regulator's powers. In particular, it proposed giving ARGA stronger powers to direct companies to amend their reporting where necessary, replacing the FRC's existing ability to seek a court order. It proposed giving ARGA a wider remit to scrutinise the entire contents of annual reports and accounts, including corporate governance reporting and voluntary elements, rather than just selected parts. It also proposed that the powers to require or commission an expert review set out in Chapter 11 of the White Paper should extend to the regulator's corporate reporting review work. The White Paper also set out proposals for increasing the transparency and visibility of the regulator's work by giving it powers to publish summary findings and correspondence following a review, and powers to offer a pre-clearance service for novel or contentious matters connected with the interpretation of accounting standards.

Issues arising from consultation

4.3 Most respondents agreed that ARGA should have powers to direct amendments to reports and accounts rather than having to go to court to seek a court order. The power of direction was seen as a quicker, more direct and efficient means of securing necessary

changes. One respondent disagreed, arguing that it would be wrong to replace a court process with an untested new regulator which would have accounting but not legal expertise. Many of those who supported the new power stressed the need for it to be balanced by an independent appeals or reconsideration process for companies that disagreed with the regulator.

4.4 Some professional body respondents sought clarity about whether the Secretary of State's current powers to secure changes to a company's report and accounts, set out in sections 455 to 457 of the Companies Act 2006, would be retained and how they would relate to ARGA's new powers.

4.5 There was wide support for extending ARGA's review powers to the contents of the entire annual report, including from environmental groups. Several respondents suggested that the regulator's role in relation to the voluntary elements of reporting should be limited to challenging untrue or misleading statements or material inconsistencies with the required reporting.

4.6 There was some opposition to the proposal to give ARGA powers to publish full correspondence following the conclusion of CRR reviews, particularly from companies. There were concerns that this would affect the openness of the preceding dialogue and make the process more legalistic and ultimately less useful in terms of improving reporting. Companies stressed the need for adequate protection for commercial or proprietorial information. Several also suggested a right for the company to respond to publication of the findings.

4.7 There was support from some companies for the principle of ARGA being able to offer a pre-clearance service for novel or contentious matters connected with accounting standards. This would involve a prior determination by the regulator that an accounting treatment that a company proposed to adopt would be compliant with the relevant accounting standards.

4.8 A number of large listed companies and large audit firms and, however, opposed the concept or had serious doubts about its workability. Their arguments included the need to avoid ARGA duplicating the role of the International Financial Reporting Interpretations Committee, which can provide clarifications. There were concerns about introducing a third party into discussions between companies and their auditors, and doubts about whether ARGA would, in practice, have deeper insights into international accounting standards than the audit firms themselves. Further, there were concerns about whether the regulator would have the necessary resources and expertise to be able to respond quickly to requests for pre-clearance, particularly given that they were likely to be concentrated in the first few months of the year when most companies were reporting their annual results.

Government response

4.9 **The Government intends to proceed with the proposals set out in the White Paper to strengthen and widen the regulator's powers to review corporate reporting other than in respect of pre-clearance.** These include the proposals to extend the regulator's

review powers to the entire annual report, including the voluntary elements, and to give the regulator power to require or commission an expert review. (This power is addressed in more detail in Chapter 11.)

4.10 Taking forward powers for the regulator to order companies to amend their reporting, rather than having to seek a court order, will require modification of the current powers⁴⁷ enabling the Secretary of State and – by delegation – the FRC to require information and secure changes to a company’s report and accounts. The Government intends to give ARGAs these new powers in its own right, not through delegation, consistent with its full statutory status. ARGAs will set out its approach to the use of these new powers, but its main focus will be on reporting by PIEs. As suggested by some professional bodies, the Government will give careful consideration to what powers the Secretary of State needs to retain in this area. The Government will also ensure that there are fair processes in place to allow companies to challenge the regulator’s decisions.

4.11 The White Paper proposed giving ARGAs powers to publish both case summaries and the correspondence leading up to the conclusion of a review, but that an approach based on the publication of case summaries only should be tried first to see if that would achieve sufficient transparency. The FRC has now started to publish case summaries with the voluntary consent of companies. This is proving successful. In the light of the results of this pilot and concerns expressed in responses to the White Paper that publication of correspondence could make the review process more legalistic and less open, the Government has concluded that ARGAs should have powers to publish summaries of reviews but does not need specific powers to publish correspondence. In giving ARGAs powers to publish summaries, the Government will ensure that there are safeguards for commercially sensitive information and privilege.

4.12 Although ARGAs will not have specific powers to publish correspondence, the Government intends to equip it with a broader general power that would allow it to publish the information necessary for it to be an effective regulator⁴⁸. This could allow for the publication of correspondence in exceptional circumstances where the regulator deems it necessary and in the public interest.

4.13 The Government recognises the advantages, in principle, of the regulator being able to offer a pre-clearance service. However, consultation responses have highlighted significant difficulties in providing such a service in practice, including resourcing issues for the regulator, timing issues for companies and concerns about whether the regulator should be intervening in the dialogue between a company and its auditor on accounting standards issues. The Government does not therefore intend to proceed with giving the regulator new powers to provide a pre-clearance service.

4.14 The FRC Review recommended that the FRC and the FCA should consider the case for strengthening qualitative regulation of a wider range of investor information than is covered by the FRC’s existing CRR work. The Government announced in the White Paper that it was

⁴⁷ Sections 455 – 457 and section 459 of the Companies Act 2006.

⁴⁸ See paragraph 9.2.14 for a further example of where the general power to publish information might be used.

addressing this by asking the FRC to undertake a pilot study of preliminary results and investor presentations, working with the FCA, to establish the extent of any inconsistencies between this information and the subsequent annual report and accounts. The pilot work did not identify any areas of concern. The Government will not therefore be taking any further steps to strengthen the regulator's powers to scrutinise a wider range of investor information.

5 Company directors

5.1 Enforcement against company directors

The Government confirms its intention to give the new regulator, the Audit, Reporting and Governance Authority (ARGA) powers to enforce Public Interest Entity (PIE) directors' statutory duties relating to corporate reporting and audit. The new civil enforcement regime will be targeted, proportionate and transparent, and directors will only be accountable for what could reasonably be expected of a person in their position. The Government is also considering whether in exceptional circumstances ARGA's powers could also be applied to a non-PIE's directors, if doing so was justified by the public interest (for example, if it appears that a large group is structured in such a way as to frustrate proper scrutiny).

The Government wishes to avoid overlap or duplication of enforcement, so ARGA will work closely with other regulators to manage this. The Government will also work with the Financial Reporting Council (the FRC) to consider the best way to hold directors of PIEs to account if their conduct falls short of certain behavioural expectations, such as engaging in dishonest conduct, where this relates to their duties around corporate reporting and audit.

What the White Paper proposed

5.1.1 The White Paper proposed that ARGA should be given powers to hold directors of public interest entities (PIEs) to account for failings in their duties in relation to corporate reporting and audit⁴⁹.

5.1.2 To facilitate effective civil enforcement by the new regulator, and to clarify for companies and directors what is necessary to demonstrate compliance, the White Paper proposed that ARGA should have the power to elaborate on directors' statutory duties with more detailed requirements as to how they should be met. It also proposed that directors of PIEs might be required to meet certain specific behavioural requirements in the way that they carry out their duties relating to corporate reporting and audit. Respondents were asked to comment on:

⁴⁹ In the current enforcement regime, the FRC regulates auditors, accountants, and actuaries, and is responsible for the UK's Corporate Governance and Stewardship Codes. However, with limited exceptions, the current regulator has no powers to enforce directors' duties. This issue was identified by the Independent Review of the Financial Reporting Council (the FRC Review). The FCA sets, supervises, and enforces the Listing Rules, the Disclosure and Transparency Rules (which include corporate reporting and financial reporting) and the Senior Managers and Certification Regime. FCA also has civil and criminal powers in relation to market abuse in respect of public markets. The Insolvency Service also has enforcement powers and can investigate and prosecute offences arising from breaches of directors' statutory duties. It can also bring company director disqualification proceedings in cases where a director's conduct in relation to one or more companies renders them unfit to be a company director. Such investigations can, however, be resource intensive and, as a result, the Insolvency Service's resources tend to be directed towards the most serious cases where it is important that individuals who have abused the privilege of limited liability are held to account.

- whether directors of PIEs should be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audit;
- whether these requirements should be set by the new regulator; and
- what requirements directors should have to meet in this context.

5.1.3 The White Paper also asked respondents to comment on:

- arrangements to ensure that the new regulator's powers are managed effectively where they overlap with those of other regulators;
- any additional directors' duties which should be in scope of ARGAs enforcement powers; and
- any existing or proposed directors' duties relating to corporate reporting and audit that should be specifically included in, or excluded from, further elaboration for the purposes of the new directors' enforcement regime.

5.1.4 Directors are already subject to various statutory duties relating to corporate reporting and audit, many of which are backed up by criminal sanctions, under the Companies Act 2006. For example, directors have a statutory duty to keep adequate accounting records; and to approve the annual accounts only if they give a "true and fair" view of the company's affairs as at the end of the financial year, and of the company's profits or losses for that year.

5.1.5 The White Paper proposed that ARGAs should be able to take enforcement action if these statutory duties were not adhered to. This would involve the introduction of a new civil enforcement regime, under which ARGAs would have various sanctions at its disposal⁵⁰, including reprimands, fines, orders to take action to mitigate the effect of a breach of directors' duties (or prevent the recurrence of a breach); the ability to make declarations about non-compliance (that is, publicise enforcement action taken against directors of PIEs) and, in the most serious cases, the ability to temporarily prohibit the individual concerned from acting as a director of a PIE.

5.1.6 To facilitate effective civil enforcement by the new regulator, and to clarify for companies and directors what is necessary to demonstrate compliance, the White Paper proposed that ARGAs should have the power to elaborate on these statutory duties with more detailed requirements as to how they should be met. It also proposed that directors of PIEs might be required to meet certain specific behavioural requirements in the way that they carry out their duties relating to corporate reporting and audit. Respondents were asked to comment on:

- whether directors of PIEs should be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audit;

⁵⁰ See White Paper, paragraph 5.1.26.

- whether these requirements should be set by the new regulator; and
- what requirements directors should have to meet in this context.

5.1.7 The White Paper also asked respondents to comment on:

- arrangements which the Government should consider to ensure that the new regulator's powers are managed effectively where they overlap with those of other regulators;
- any additional directors' duties which should be in scope of ARGAs enforcement powers; and
- any existing or proposed directors' duties relating to corporate reporting and audit that should be specifically included in, or excluded from, further elaboration for the purposes of the new directors' enforcement regime.

Issues arising from consultation

5.1.8 Views expressed by those who responded to the White Paper consultation were mixed. There was an even split between respondents who were generally in favour of the Government's proposals, those who had mixed views or were non-committal, and those who were against the proposals. Most respondents who had mixed views were generally in agreement with the principles behind the proposals but thought there should be further consultation or conditions applied to the new directors' enforcement regime.

Where objections were raised these largely fell under the following themes:

- the scope of the new enforcement regime;
- that sufficient mechanisms are already in place for sanctioning directors who have breached their duties;
- concerns that ARGAs would be setting and enforcing rules with insufficient external scrutiny or redress;
- perceived risk of reducing the attractiveness of positions on UK boards for non-executive directors;
- perceived risk of reducing the attractiveness of the UK as a place to do business;
- implications for company law. For example, some respondents held the view that ARGAs would be taking over functions currently undertaken by the courts and effectively setting precedents – which they argued was inappropriate; and
- that the new directors' enforcement regime could potentially increase the cost of directors' and officers' (D&O) insurance.

5.1.9 Among those who provided a view on whether the Government's proposed enforcement powers should be made available to the new regulator in respect of breaches of directors' duties, 43% said yes, 38% said no, and 19% were neutral or unclear. Those that agreed mainly comprised audit and accountancy firms, professional associations and individual

respondents. Whilst negative responses did not make up the majority from any one respondent group, those who disagreed or expressed mixed or unclear positions mainly comprised listed companies.

Relationship with existing enforcement regimes

5.1.10 Most respondents supported ARGA and the FCA putting in place a Memorandum of Understanding to define clearly how any overlapping powers would be managed and to provide transparency and clarity for those who were in scope of one or more regulators' enforcement regimes. Some respondents suggested a review and redesign of the scheme for the delegation of enforcement powers under the Companies Act 2006.

5.1.11 Some respondents thought that overlap should be avoided entirely by centralising all powers within one regulator, with some suggesting this should be ARGA. Some respondents stated that the FCA should have primary jurisdiction over listed companies and ARGA the rest.

5.1.12 A concern was expressed that directors could be subject to parallel enforcement action by different regulators.

Directors in scope of new enforcement powers

5.1.13 The White Paper proposed that all directors of all PIEs should be within the scope of the new civil enforcement regime. The White Paper did not ask specific questions about this, however many respondents provided views. Common themes that emerged from respondents who were supportive of this proposal were that it made sense to align the regulator's enforcement powers with existing directors' duties in statute (which apply to executive and non-executive directors alike) and that giving the regulator powers to take enforcement action against all directors was consistent with the board of directors having collective responsibility for preparing and approving the financial statements.

5.1.14 Among those who expressed concerns about the scope of the new enforcement regime, there was a common view that directors should not be treated equally, as some directors had specific management responsibilities and others had a more general remit. Some thought that non-executive directors should not be held responsible in the same way as executive directors.

5.1.15 Some respondents thought that directors of third sector organisations such as charities and directors of PIE subsidiary companies should be out of the scope of the new directors' enforcement regime.

Duties in scope of new enforcement powers

5.1.16 Among those who thought that additional existing duties should be within scope of ARGAs enforcement powers, the most common suggestions related to covering the whole of the annual report; maintaining controls over the accounting records; reporting on operational effectiveness; and preventing and identifying material misstatements whether caused by error or fraud. There were also suggestions that duties in scope should extend beyond financial reporting breaches, and should encompass, for example, the statutory duties to: promote the

success of the company⁵¹, exercise independent judgement⁵², exercise reasonable skill, care, and diligence⁵³, avoid conflicts of interest⁵⁴, and disclose interests in a proposed transaction or arrangement⁵⁵.

5.1.17 Some respondents suggested creating new duties for directors that would then be enforceable by ARGA. New duties suggested included the prevention and detection of fraud (wider than the White Paper's proposal to introduce a fraud statement); a duty to identify and address human rights and environmental risks; and a duty to declare interests (which went wider than the existing Companies Act duties⁵⁶).

5.1.18 There was broad support from respondents for the proposal that ARGA should elaborate on the duties that would be in scope of the directors' enforcement regime, with detailed guidance being provided on how these duties should be met. Some suggested that this would help avoid the potential risk of deterring individuals from taking up a post on the board of directors because they were uncertain as to what was expected of them and feared personal liability. Respondents suggested that ARGA should provide clear advice and detailed guidance on its interpretation of relevant statutory duties to support this and called for the regulator to update its guidance on the meaning of "true and fair".

5.1.19 Some respondents identified a potential risk of a tick-box approach if requirements were overly prescriptive and argued that increasingly detailed duties would add complexity to the enforcement regime and regulatory exposure for directors. Respondents asked for companies and directors to be given sufficient time, ahead of implementation, to enable them to review their processes and ensure they met the requirements of the new regulator.

Behavioural requirements

5.1.20 There was a disparity between responses from corporates and those from investors and most other stakeholder groups. Corporate respondents were generally not in favour of the introduction of behavioural requirements, whilst respondents from other groups tended to be supportive of the proposal. Respondents from the audit and accountancy profession were mostly in favour of the introduction of behavioural requirements, as they believe that the current arrangements are unsuitable, and that directors should be more accountable. Those who agreed with the overarching proposal that enforcement powers should be made available to the new regulator in respect of breaches of directors' duties tended to agree that behavioural requirements should be introduced. Those who disagreed with the overarching proposal that

⁵¹ Section 172 of the Companies Act 2006 provides that a director "*must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole*".

⁵² Companies Act 2006, section 173: A director must exercise independent judgement.

⁵³ Companies Act 2006, section 174: A director must act with the care, skill and diligence that would be exercised by a reasonably diligent person with both (i) the general knowledge, skill and experience to be expected of a director and (ii) the general knowledge, skill and experience that the director has.

⁵⁴ Companies Act 2006, section 175: A director must avoid any situation where they have or can have an interest that directly or indirectly conflicts with or may conflict with the company's interests.

⁵⁵ Companies Act 2006, section 177.

⁵⁶ Companies Act 2006, sections 177 and 182: Directors must declare to their company's board the "nature and extent" of any interest they may have in any transaction or arrangement to which the company is or may be a party.

enforcement powers should be made available to the new regulator in respect of breaches of directors' duties tended not to be in favour of the introduction of behavioural requirements.

5.1.21 Some concerns were raised that directors were already required to meet certain behavioural standards and that duplicate regulation should be avoided. Respondents pointed to the UK Corporate Governance Code (which currently applies to premium listed companies) and to the FCA's Senior Managers and Certification Regime (SMCR) for financial services firms.

5.1.22 Concern was expressed about the difficulty of defining and applying behavioural requirements in the context of existing statutory duties: some respondents stated that enforcement action should remain a matter for the courts. Overall, there was a view that further consultation would be needed to develop behavioural requirements and create an agreed framework within which ARGA would operate.

5.1.23 There were mixed views on whether directors of small and medium businesses should also meet behavioural requirements. Some respondents said that they should apply to SMEs to encourage good practice across the board; some stated that they should but only as a matter of good practice (that is, the requirements should not be enforceable in the case of small and medium businesses). Some respondents expressed agreement with the proposal in the White Paper that there should be a clear distinction between PIE and non-PIE directors. There was also general agreement that education should be prioritised across all directors.

Government response

5.1.24 Having fully considered the arguments for and against giving the new regulator powers to enforce directors' duties, the Government remains convinced that such powers are necessary. The Government welcomes the fact that the majority of respondents agreed that there is a significant public interest in having an effective enforcement regime that holds directors of PIEs to account where they fail to fulfil their duties relating to corporate reporting and audit. Leaving decisions on whether to take enforcement action to the company's shareholders may be appropriate for many smaller companies, but where it concerns PIEs, there are thousands of other people who have an interest in how a PIE is managed, such as creditors, customers, pensioners, and employees.

5.1.25 The Government believes that it would undermine the effectiveness of the new regulatory regime, and ARGA's credibility as a regulator, if ARGA were able to take enforcement action against the auditors of a PIE's accounts and reports, but not against those who are responsible for preparing them and signing them off – that is, the directors. The Government does not intend to make it significantly more onerous to be a director of a PIE: rather, it is proposing to ensure that such directors can be held to account by civil regulatory action where they fail to perform their duties in a way that could reasonably be expected of someone in their position. The Government considers, on balance, that people would prefer to invest in, do business with or work for an organisation which is subject to higher levels of scrutiny and where the directors are accountable for their actions. **The Government therefore intends to give ARGA the necessary powers to investigate and sanction breaches of**

corporate reporting and audit related responsibilities by PIE directors. The Government intends that this regime should follow similar principles to the FRC's audit enforcement regime, in line with the recommendation of the FRC Review.

5.1.26 Some PIEs take other forms⁵⁷ and the new regulator may also need to have enforcement powers in relation to persons responsible for managing such entities in respect of their obligations relating to corporate reporting and audits. **The Government therefore intends to ensure that, where appropriate, the scope of the regulator's enforcement powers apply to PIEs which are not companies.**

5.1.27 The Government is clear that the failure of a PIE can have a significant and widespread impact on the broad range of stakeholders that have an interest in its success. On that basis, in giving the regulator powers to enforce directors' duties, it is necessary to provide it with a range of sanctions of varying severity.

5.1.28 The Government notes the concern expressed by a small number of respondents that ARGAs might be setting and enforcing rules without sufficient external scrutiny or redress. Whilst it is important for ARGAs to have sufficient powers to be a credible and effective regulator, in line with better regulation principles, the Government is clear that enforcement action needs to be transparent, accountable, proportionate, consistent, and targeted only at cases where action is needed. Further details on governance arrangements are provided in Chapter 10.

Relationship with existing enforcement regimes

5.1.29 As set out in the White Paper, the Government is committed to avoiding overlap or duplication between the role of ARGAs and the existing scope or powers of the FCA and other regulators wherever possible. A degree of overlap in powers is, however, necessary, since the remits of the different regulators are complementary. In the case of the FCA, for example, there are likely to be cases that fall within the FCA's remit but where it has been decided that it is not appropriate for a case concerning the conduct of the director to be addressed by the FCA. ARGAs will therefore need powers to enable it to take enforcement action against directors for corporate reporting and audit related failings in all PIEs, including in the case of listed companies and financial services entities. At the same time, the Government is clear that companies and directors should not face any unfairness as a consequence of parallel or competing investigations by two different regulators into essentially the same circumstances.

5.1.30 The Government maintains the view that where ARGAs' powers relating to directors' enforcement necessarily overlap with those of other regulators, this can be managed through effective coordination and cooperation. The FRC and FCA have committed to work together to update their existing Memorandum of Understanding (MoU) to set out the respective roles and

⁵⁷ In addition to the entities which fall under the current definition of a PIE (listed companies and other entities with securities traded on a regulated exchange, credit institutions and insurance undertakings), entities will become PIEs if they exceed the new 750:750 threshold including UK: private companies; entities traded on AIM or other Multilateral Trading Facilities (MTFs); third sector entities including charities, housing associations, education establishments; and Limited Liability Partnerships (LLPs). See section 1.6. Note: this is not intended to be an exhaustive list of the entities that will become PIEs.

responsibilities of ARGA and FCA and how they will manage any overlap in their respective powers. In the interests of transparency this will be published. The Government does not intend to prescribe the contents of the MoU and believes that this is best left to the regulators. At a minimum, however, the MoU would be expected to make clear, for example, what types of cases the respective regulators will normally lead on. The Government would also expect criminal investigations to take priority over civil enforcement in appropriate cases, albeit that one type of action will not necessarily rule out the other. The Government believes this approach is sufficient to ensure effective joint working.

5.1.31 As set out in the White Paper, the new directors' enforcement regime will not replace existing arrangements for taking action against company directors, for example in respect of offences under the Companies Act 2006 or breaches of the FCA Listing Rules, FCA Transparency Rules or Market Abuse Regulation. Similarly it will not prevent the Insolvency Service from taking action under the Company Directors Disqualification Act 1986. ARGA's powers to take civil regulatory enforcement action against PIE directors will work in tandem with those of other regulators, including the FCA, the Insolvency Service and the Serious Fraud Office. ARGA will not have any powers to prosecute offences and will refer relevant cases on to other regulators, for example the Serious Fraud Office or the Insolvency Service. Finally, the Government will ensure ARGA's powers complement the Insolvency Service's existing powers to disqualify individuals from acting as a director of any company for a period of up to 15 years.

Directors in scope of new enforcement powers

5.1.32 To maintain the long-standing corporate governance principle that the directors have collective responsibility for decisions taken by the Board (the unitary board principle), the Government continues to believe that it is important for all directors (that is, both executive and non-executive directors) to be within the scope of the new civil enforcement regime. All directors are currently subject to the same statutory directors' duties and are potentially within scope of any action commenced by the company against its directors or criminal prosecution brought by the relevant authorities.

5.1.33 The Government has considered the concern that potential enforcement against directors might deter some individuals from taking positions on UK boards, which could reduce the diversity of PIE boards by deterring individuals from non-financial backgrounds. The Government recognises the advantages of having a broad range of skills and backgrounds in the membership of a company's board and is clear that the new directors' enforcement regime should be targeted and proportionate, taking account of an individual director's role, responsibilities, and experience so they are only accountable for what could be reasonably expected of a person in their position. Indeed, it is a feature in existing law⁵⁸ that an individual director's culpability for failure in their statutory duties to the company is affected by their level of experience and expertise and their role within the company. This principle will carry across to the new directors' enforcement regime. This should also alleviate concerns about potential

⁵⁸ See Companies Act 2006, section 174 which imposes an objective minimum standard on directors but notes that a director will be assessed by reference to their actual experience and expertise, if this would result in a higher standard.

increases in the cost of director fees and insurance premiums due to misconceived perceptions around potential liability (see below). At the same time, the Government also believes that directors of PIEs, including non-executive directors, recognise that their position comes with responsibilities to a broad range of stakeholders who have an interest in the organisation's success – so it is justified that they are held to account for their decisions and the way they exercised their judgement when making those decisions. On that basis, the Government does not believe that the intended new enforcement regime would have a significant adverse impact on the recruitment of non-executive directors, nor on the diversity of PIE boards.

5.1.34 The Government is aware that not all PIEs are financially successful. Directors will not be judged against the company's financial position but against the duties that they owe to the company and its stakeholders.

Companies and organisations in scope of new enforcement powers

5.1.35 All PIEs will be in scope of the new directors' enforcement regime⁵⁹. As set out in Chapter 1, if a subsidiary company meets the new size threshold for a PIE its parent company will also become a PIE (if it is UK incorporated), irrespective of whether the parent company meets the PIE definition in its own right. The directors of both companies will therefore be subject to the new directors' enforcement regime.

5.1.36 A parent company will also be a PIE (provided it is UK incorporated) if the consolidated accounts of the group collectively meet the new size threshold, even if the parent company does not meet the PIE definition in its own right. In these circumstances, the directors of the parent company will be subject to the new enforcement regime. However, the directors of a subsidiary in such a group would not be subject to the directors' enforcement regime unless the subsidiary company meets the definition of a PIE in its own right⁶⁰.

5.1.37 The Government is considering further whether, in exceptional cases, ARGAs should have powers to investigate and take action against directors of non-PIEs, where it is in the public interest for the regulator to do so. For example, in the case of non-PIE subsidiaries of a parent company which is a PIE, this may be appropriate to ensure that the directors of the subsidiary companies are accountable for the reporting that feeds into the group's annual report and financial statements. The Government would also wish to ensure that the new regime does not lead to corporate structures being used as an avoidance measure. Nevertheless, the focus of ARGAs will remain on PIEs. The Government will ensure that these exceptional cases are both genuinely exceptional and genuinely in the public interest. The Government is also considering how to ensure that, in these exceptional cases, the requirements on the relevant directors are fair.

5.1.38 The Government has considered whether the directors of third sector organisations, including charities, should be exempt from the directors' enforcement regime even where the organisations are PIEs, and concluded that such an exemption would not be in the spirit of the

⁵⁹ See section 1.6 for further information on the new definition of a public interest entity (PIE).

⁶⁰ Subject to what is said at paragraphs 5.1.37 and 5.1.45 regarding exceptional cases where it may be in the public interest for ARGAs to investigate and enforce directors' duties in non-PIE cases.

measures outlined in Chapter 1 of this document. These measures are intended to apply to all PIEs in view of the significant public interest in the trustworthiness of their reporting.

5.1.39 In cases where ARGA has no authority to investigate, because a company is not a PIE and does not fall into the exceptional public interest category, ARGA will still be able to refer matters to other regulators, such as the Insolvency Service and the Serious Fraud Office if the circumstances warrant such a referral.

Duties in scope of new enforcement powers

5.1.40 ARGA's new enforcement powers will apply to breaches of the directors' statutory duties relating to corporate reporting and audit⁶¹. For civil regulatory enforcement to work effectively, ARGA will need to set out what it reasonably expects of PIE directors by way of compliance with their legal duties. This will provide a further opportunity to reassure directors, and individuals who are considering taking up a position as a director of a PIE, that they will be accountable only for what could reasonably be expected of a person in their position. This should also alleviate concerns about potential increases in the cost of director fees and insurance premia due to overstated perceptions around potential liability.

5.1.41 The White Paper proposed that ARGA should have powers to set further requirements which elaborate on directors' statutory duties relating to corporate reporting and audit and clarify how directors would be expected to demonstrate that they have complied with these duties. This approach would potentially make the new directors' enforcement regime more transparent. The Government also wants to make it as easy as possible for directors to understand their legal obligations.

5.1.42 The Government intends to work with the FRC in considering how best to elaborate on directors' statutory duties, so as to enable regulatory enforcement to apply effectively to all directors in scope of the new regime.

Behavioural requirements

5.1.43 While some respondents pointed out that some directors are already required to meet certain standards of behaviour, these do not apply to all PIE directors. The FRC's UK Corporate Governance Code is neither mandatory nor prescriptive, and beyond premium listed companies⁶² there is no requirement for companies to apply the Code at all. Similarly, the FCA's Senior Managers and Certification Regime does not apply to all companies' directors. It is designed to increase the accountability of senior financial services executives and employees for malfeasance.

5.1.44 The Government believes that it is in the public interest for directors of PIEs to be held to account if their conduct falls short of certain behavioural expectations, in the context of directors' duties relating to corporate reporting and audit: for example, where key decisions taken by the directors were improper – perhaps because the decision-making was dishonest or

⁶¹ For example, see Companies Act 2003, Parts 15 and 16.

⁶² Although companies with a Premium Listing of equity shares in the UK are required under the Listing Rules to report in their annual report and accounts on how they have applied the Code.

tainted by bias. Such questions are potentially more serious than whether the financial statements strictly complied with the legal requirements. The intention is that PIE directors may be held to account if they fail to comply with well-established values that are already embodied in directors' existing general duties in statute⁶³. These are values that directors of PIEs would already be expected to understand and subscribe to. This will maximise the effectiveness of the new directors' enforcement regime as the regulator will be able to investigate the nature of directors' decisions and take action in cases where the directors have complied with the letter of the law but are nevertheless engaged in dishonest or improper conduct.

5.1.45 The Government believes that there may be exceptional cases where it is in the public interest for ARGA to investigate and enforce directors' duties, notwithstanding that the entity in question is not a PIE and is considering how and whether the behavioural aspect of the new directors' enforcement regime should apply in such cases.

5.1.46 The Government notes that there was general agreement amongst respondents on the importance of ensuring that directors have sufficient knowledge and understanding of their duties and what they need to do to meet those duties. The Government is clear that an effective enforcement regime should promote compliance with the law and with what stakeholders can reasonably expect of PIE directors. The aim of the new civil enforcement regime is not to catch directors out, but to improve standards of corporate reporting and engagement with audit, in the public interest.

Implications for UK company law

5.1.47 The Government has considered the representations made by some respondents from the legal sector, who were concerned that the new civil enforcement regime would have implications for UK company law.

5.1.48 The Government recognises that the directors' general duties in Part 10 of the Companies Act⁶⁴ are owed to the company itself and has no intention of interfering with the relationship between the directors and shareholders (acting on behalf of the company). Shareholders will still be able to seek redress through the courts to the same extent that they can now. Such proceedings may or may not be taken in parallel with investigations and enforcement action taken by ARGA – the new regulator will act in line with its own objectives, on behalf of the public interest, not on behalf of shareholders.

5.1.49 The Government accepts that, in a small minority of cases, shareholders may in future decide not to take action against the directors because ARGA is already investigating. However, it is relatively rare for a company to take enforcement action against its directors in any event: partly because by the time the issue has come to the attention of the shareholders the company may be insolvent or on the verge of insolvency; and partly because the shareholders may instead seek to recover the money that they have invested in the company in other ways, such as by taking action against the company's auditors. In addition, as

⁶³ See Companies Act 2006, Part 10.

⁶⁴ See Companies Act 2006, Part 10, Chapter 2, sections 170 to 181.

mentioned above, there would be nothing to preclude a company from taking action against its directors in parallel to ARGA.

5.1.50 The ability of the courts to set precedents around directors' breach of their statutory duties is limited to the number of cases that progress far enough for the court to make a ruling. Some directors' disputes will be resolved out of court and subject to non-disclosure agreements. Other proceedings are dropped (or not commenced in the first place) due to costs. Given that court enforcement of directors' duties is rare, it is not obvious to the Government that the new civil enforcement regime risks displacing a great body of expertise.

Directors' and officers' insurance

5.1.51 The Government notes that some respondents thought the new directors' enforcement regime could potentially increase the cost of directors' and officers' (D&O) insurance.

5.1.52 Underwriters take many factors into account in pricing risk, including the likelihood, in practice, of enforcement action being taken and directors' liability being established. The Government is clear that ARGA must act appropriately and proportionately when taking decisions about enforcement action and target resources at the most serious cases. Given that the regulator will need to be selective and that significant failings in financial reporting are in the minority, the Government would not expect to see a dramatic impact on the price or the availability of insurance for directors of PIEs.

5.1.53 Whilst the new enforcement regime may prompt insurers to reconsider their exposure to risk in the case of individual PIEs, and price their products accordingly, this would provide further incentive for companies and directors to adopt good practice in corporate governance.

Guidance and informing directors

5.1.54 The Government notes that there was general agreement amongst respondents on the importance of informing directors of the regulator's expectations. The Government is clear that an effective enforcement regime should promote compliance with the law and with society's expectations of PIE directors. The aim of the new civil enforcement regime is not to catch directors out, but to improve standards of corporate reporting and engagement with audit, in the public interest.

5.2 Clawback and malus provisions in directors' remuneration arrangements

Given the Government's intention to give the regulator stronger powers to take enforcement action against PIE directors for breaches of their statutory duties, relating to corporate reporting and audit, the White Paper also considered how directors' remuneration arrangements could be strengthened in the event of serious director failings. Following consultation feedback, the FRC will be invited to consult on how the existing malus and clawback provisions in the UK Corporate Governance Code can be developed to be more transparent and rigorous, and yet flexible to meet individual business needs.

What the White Paper proposed

5.2.1 The White Paper proposed to build on existing provisions in the UK Corporate Governance Code (the Code) covering malus (the withholding of directors' remuneration) and clawback (the recovery of directors' remuneration) to provide better reassurance against rewards for failure. For the avoidance of doubt, this does not apply to non-executive directors.

5.2.2 The White Paper invited views on a proposed list of minimum conditions for malus and clawback provisions that remuneration committees could be asked to adhere to, on a comply or explain basis, through the Code. These were:

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

Issues arising from consultation

5.2.3 Just over half of respondents to the White Paper commented on this proposal. Of those who did, most were supportive in principle of increasing transparency and rigour in malus and clawback arrangements. This included most investors, most audit firms, several businesses and business representative bodies and most civil society stakeholders. Arguments in favour of the proposal including the perceived value it could play in promoting greater alignment between management culture and ethical behaviours.

5.2.4 Opposition to the proposal came mainly from a number of listed companies, and some professional bodies, who felt that the existing malus and clawback conditions were sufficient. They also argued that there were risks in taking a more prescriptive approach which could limit the ability of a remuneration committee to focus on conditions most appropriate and useful to a particular business.

5.2.5 Many respondents – both those in favour of and those against the proposal – said the conditions proposed in the White Paper could be more specific and measurable in order to be useful to remuneration committees. For example, it was suggested that the proposed condition of directors’ ‘misconduct’ should be reworded to ‘gross misconduct’, which is a more typical and well-understood term in performance agreements and employment law. Others suggested that a materiality threshold be introduced to address any ambiguities in the conditions. The proposed minimum condition of ‘conduct leading to financial loss’ was seen by a number of respondents as potentially penalising directors who made decisions which incurred short-term financial loss in order to secure the long-term future of the company.

5.2.6 Other consultation feedback on the proposal asked the Government and the FRC to:

- take account of PRA and FCA requirements on malus and clawback that financial services firms are already required to meet; and
- consider how the proposed condition ‘failure to protect the interests of employees and customers’ interacts with the obligation to “have regard to the interest of” these stakeholders in section 172 of the Companies Act.

Government response

5.2.7 The Government continues to believe that companies that follow the UK Corporate Governance Code should explain more clearly to shareholders and other interested parties what malus and clawback conditions they have in place and be encouraged to consider a range of possible conditions. However, the Government accepts that the proposed conditions in the White Paper could benefit from increased clarity, and that there are risks in prescribing a one-size-fits-all approach for every remuneration committee to follow. The Government also accepts that it is important for remuneration committees to retain flexibility to design and enforce their own malus and clawback policies so that they can be tailored to a company's specific circumstances.

5.2.8 Taking account of consultation feedback, the Government will invite the FRC to consult on how the existing malus and clawback provisions in the Code can be developed to deliver greater transparency and to encourage consideration and adoption of a broader range of conditions in which executive remuneration could be withheld or recovered, beyond that of ‘gross misconduct’ or ‘material misstatements’ (which account for the majority of malus and clawback conditions currently). For example, the Code could set out an illustrative set of malus and clawback conditions, taking account of stakeholder feedback on the conditions proposed in the White Paper, which remuneration committees should consider in developing their own arrangements.

6 Audit purpose and scope

6.1 The purpose and scope of audit

The Government supports the Brydon Review’s vision for the long-term scope and purpose of audit which goes beyond the scope of the financial statements in order to become more informative for audit users. The Government will look to the new regulator ARGA to drive improvements in audit as an integral part of its core objectives. The Government believes this will be more effective and targeted than advancing new legislation in this area.

The Government will not seek to establish a new professional body or regulatory oversight of a new ‘corporate auditing’ framework at this stage. Instead, the Government will create the conditions for the market to develop wider external assurance services, including through the new requirement on large Public Interest Entities to publish an Audit and Assurance Policy setting out their approach to the assurance of information beyond the financial statements. It will also seek improvements from existing professional bodies to auditor qualifications, skills, and training to make for a more effective and distinctive audit profession. Progress will be assessed in the planned Post-Implementation Review.

The Government is not planning any legislative changes regarding the assurance of Alternative Performance Measures (APMs) and Key Performance Indicators (KPIs), and intends to retain the current ‘true and fair’ standard and current audit liability framework.

What the White Paper proposed

6.1.1 Chapter 6 of the Government’s White Paper set out a number of proposals, in line with the spirit of the Brydon Review, to enhance the quality and trustworthiness of audit and to make it more informative for users of audit. The White Paper proposals centred around the Brydon Review’s core long-term vision of a new ‘corporate audit’ that combines the current statutory audit with wider external assurance on areas such as cyber, ESG (environmental, social and governance) and mineral reserves.

6.1.2 Very broadly, the White Paper made proposals around the purpose of audit, and particularly around *making audit fit for purpose*, including:

- introducing a new purpose statement for auditors, which the regulator would enforce (section 6.1);
- introducing a new statutory duty for auditors to consider wider information and director conduct in reaching their judgements on financial statements (section 6.1); and
- enhancing auditor reporting (section 6.5).

6.1.3 There were proposals around the future *scope of audit*, and giving a legal and regulatory framework for ‘corporate auditing’:

- regulatory oversight of a new corporate auditing framework (section 6.2);
- giving the regulator a new power to set enforceable principles for corporate auditing (section 6.3); and
- establishing a new distinct professional body focused solely on audit (section 6.9).

6.1.4 The White Paper also asked a series of *further questions* about:

- whether stakeholders agreed with retaining “true and fair” as the standard for company financial reporting (section 6.6);
- whether Alternative Performance Measures (APMs) and Key Performance Indicators (KPIs) should also be subject to audit (section 6.7);
- audit liability (section 6.8); and
- proposed new obligations on auditors and directors relating to the detection and prevention of material fraud (section 6.4).

Making audit fit for purpose

Issues arising from consultation

A new purpose statement for auditors

6.1.5 92 respondents gave a clear view on these proposals. Of these, 52% (48 respondents) were clearly supportive of having a new non-binding purpose statement for audit adopted by the regulator, with 48% (44 respondents) clearly opposed. Quite a number of other respondents felt that it was difficult to give a view as they were unclear what a new purpose statement would mean in practice. Views were fairly evenly split within most stakeholder groups. For example, there was a 50/50 split in views from (12) investor groups and (14) audit firms with a clear position. Listed companies were more supportive, with 15 of 24 respondents supportive of introducing a new non-binding purpose statement. Private companies were least supportive with 4 of 4 opposed to the proposal.

6.1.6 Those in favour saw the benefit of clarifying the role of an auditor as a way to narrow the gap between the expectations of an audit and its reality. There was relatively broad agreement that a purpose statement should not be written in law, and so could evolve over time. Some who supported a new non-binding purpose statement stated that it should only be adopted by the regulator after full and proper consultation, as is usual practice for an initiative of this kind. One respondent thought that the purpose statement should be reflected in ARGAs objectives, to provide an outcome-based objective which could be used to assess the effectiveness of the regulator.

6.1.7 Some respondents agreed with the idea of a new purpose statement, but disagreed with the form proposed by the Brydon Review: that audit should “help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements”. Some of those who disagreed with

the Brydon Review's purpose statement suggested alternatives. For example, one respondent stated that the purpose should include the need to 'challenge and inform' rather than 'establish and maintain confidence'.

6.1.8 There were concerns with certain elements of the Brydon Review's purpose statement, including that it could lead to a perception that audit is forward-looking, and provides confidence in an entity's continued viability. The argument was that this would widen the gap between expectations of audit and its actual outcomes.

6.1.9 A few respondents pointed to previous court rulings as evidence that there is already an established purpose of audit, and therefore any purpose statement should reflect these rulings. A very small number of respondents argued that the purpose of audit should not be redefined since audit as a whole was 'not broken'.

A new statutory duty for auditors to consider wider information

6.1.10 Of the 135 respondents that expressed a clear view, there was broadly a 50/50 split for (66) and against (69) the proposal to introduce a statutory duty for auditors to consider relevant director conduct and wider financial or other information in reaching their judgements (White Paper paragraph 6.1.10). Views were mixed within stakeholder groups. There was a 50/50 split in views from 18 audit firms and 4 private companies, while 2 of 3 think tanks and academics, 2 of 3 business representative bodies, and 8 of 15 professional associations were supportive of the proposal. Most responses from investors (14 of 25 with a clear view) were opposed to the proposal, as were a majority of listed companies (23 of 36 responses). The majority of public sector bodies (3 of the 4 which gave a clear view) were also supportive of this proposal, and provided examples of how this is already done to some extent in public sector audits.

6.1.11 A significant number of respondents wanted further clarity on what 'wider information' meant in practice. There was particular concern about what 'relevant director conduct' meant in practice, with a number of respondents stating that this needed careful consideration.

6.1.12 Those in favour of the proposal supported the principle of having a general duty to ensure auditors fully considered the wider risks that companies face, over and above existing requirements for the auditor to develop a robust understanding of the entity and its environment throughout the course of an audit. Some argued that this duty would increase professional scepticism, and help produce a more trusted and informative opinion for shareholders and could lead to greater shareholder engagement. One investor wanted the Government to go further and require companies and auditors to address public criticism of their accounting or their business models.

6.1.13 Some respondents thought the proposal could be a good idea in theory but needed more clarity, while others argued the policy aims could be better achieved through changes to standards rather than legislative change. This reflected a more general view among these respondents that audit standards were the most effective way to influence and change auditor behaviour directly, and standalone legislation would sit somewhat uneasily on top of the standards. A few respondents stated that while it would be helpful to state more explicitly that

auditors must consider wider information, the focus would need to be on the regulator's enforcement of this: for example, ensuring that this did not become just a box-ticking exercise, or simply lead to boilerplate reporting.

6.1.14 On the other hand, a number of respondents, predominantly (but not exclusively) from audit firms, argued that there are already existing requirements for auditors to consider wider information and director conduct. They felt that a new duty would duplicate existing requirements, causing additional cost and/or confusion, and that it would not improve outcomes as the majority of auditors will already be doing this. Some cited specific examples of where auditors are already required to consider wider information in certain scenarios, within existing standards (for example, ISA (UK) 315⁶⁵, 540⁶⁶ and 570⁶⁷).

Enhancing auditor reporting

6.1.15 There was a wide range of views on the merits and drawbacks of enhancing the content of the auditor's report to explain better how the audit had been conducted, along the lines proposed by the Brydon Review. Respondents also gave a range of views on the various specific Brydon Review recommendations set out in section 6.5.2 of the White Paper.

6.1.16 Some respondents (mostly investors) strongly supported more detailed reports by auditors, including graduated findings, as it would provide useful insights for shareholders to be able to understand and engage with the audit risks better. There was some support for additional reporting on external signals that influenced the audit.

6.1.17 Others agreed that the audit report could be more useful to investors, but were concerned that the report is already a lengthy document. They said it was currently difficult to navigate and engage with, and expanding the content was unlikely to help with this. Some were doubtful about the benefits of any further disclosures.

6.1.18 Some respondents (mostly audit firms and companies) were concerned about reporting on director behaviour and the practical challenges of obtaining evidence that section 172 statements⁶⁸ reflected observed reality. A number felt that any reporting on director conduct should not be done publicly and should be limited to disclosure to the audit committee.

6.1.19 There was also concern from some respondents about reporting on the number of hours spent conducting an audit, split by seniority, largely on the grounds that it would not improve understanding of the risks or how the audit was conducted. A small number also held

⁶⁵ *Identify and Assessing the Risks of Material Misstatement*, [https://www.frc.org.uk/document-library/audit-and-assurance/2020/isa-\(uk\)-315-jul-2020](https://www.frc.org.uk/document-library/audit-and-assurance/2020/isa-(uk)-315-jul-2020)

⁶⁶ *Auditing Accounting Estimates and Related Disclosures*, [https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-\(UK\)-540_Revised-December-2018_final.pdf](https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf)

⁶⁷ *Going Concern*, <https://www.frc.org.uk/getattachment/13b19e6c-4d2c-425e-84f9-da8b6c1a19c9/ISA-UK-570-revised-September-2019-Full-Covers.pdf>

⁶⁸ The Companies Act 2006 requires 'large' companies to include a 'section 172 statement' in their strategic report describing how the directors have had regard to specified matters, including the interests of wider stakeholders, in carrying out their duty to promote the success of the company.

that there would be an increase in audit costs if there were greater incentives to increase senior hours.

6.1.20 A number of respondents also directly addressed the consultation question as to whether the proposed duty to consider wider information would be sufficient to encourage a more detailed consideration of risks and director conduct, as set out in the section 172 statement (White Paper, Question 43). Some argued that it seemed logical that by considering wider information, the auditor would be able to make better judgements regarding the risks and director conduct of a company. Others argued that most auditors are already considering wider information and so the duty would not make much of a difference. A number of respondents took the view that auditors would not have access to some of the information needed to assess directors' conduct without, for example, attending board meetings regularly.

Government response

6.1.21 Consultation responses have generally supported the Government's aim for audit to become more trusted, more informative, and hence more valuable (White Paper, paragraph 6.1.7), but raised a number of issues about how best to achieve this in practice.

6.1.22 It remains the Government's intention that ARGA should ensure audit will "help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements", by incorporating this as a broad ambition across the relevant parts of its work (White Paper, paragraph 6.1.19). ARGA's objectives (outlined in Chapter 10 of this document) will drive this. The decision on whether to develop a non-binding purpose statement for audit, and its content, will be for ARGA.

6.1.23 The Government maintains the view set out in the White Paper (paragraph 6.1.9) that there needs to be a shift along the broad lines proposed by the Brydon Review, in terms of auditor mindset and behaviour. While existing audit standards require auditors to consider wider information in some respects and in limited examples, more needs to be done to ensure that auditors are considering wider information in reaching their overall judgements more consistently and more effectively, in line with the intentions of the Brydon Review.

6.1.24 A change of auditor mindset, judgement and knowledge is needed in this regard. Noting the strong view in responses that audit standards were the most effective way to influence and change auditor behaviour directly, the Government agrees that this impact on auditor mindset and behaviour can be achieved through changes to standards, additional guidance, and enforcement by the new, stronger regulator, rather than through additional legislation.

6.1.25 **The regulator should therefore seek to deliver change in this area through ongoing improvements to auditing standards and guidance, to help ensure auditors are fully and consistently considering wider information in reaching their audit judgements.** This includes the regulator effectively enforcing UK standards, and also influencing the development of international standards in this regard. The Government is keen for the UK to

remain a trailblazer in the development of international standards but is not looking for the UK to diverge significantly from those standards.

6.1.26 While it is up to the regulator to determine the content of any changes to standards or guidance, the Government would encourage active consideration of the aims of the Brydon Review in this context (for example, around signalling concern as set out in section 16.8 of the Brydon Review).

6.1.27 The Government continues to believe that **the regulator should consider the Brydon Review’s recommendations to provide users of audit with more meaningful and useful information, whilst also ensuring that reports are clear, concise and accessible.** As is usual practice, the regulator would consult as appropriate on any proposed changes to its standards in this regard.

Widening the scope of audit

Issues arising from consultation

The scope of audit

6.1.28 A minority of stakeholder responses (from across the spectrum, including some investors and audit firms, and individual responses) supported the concept of ‘corporate auditing’ in which audit would cover wider issues beyond financial statements. However, there was a very strong sense from stakeholders across different groups (including investors, listed and private companies, audit firms, academics, etc.) that the vision for a legal and regulatory framework supporting corporate auditing, as set out in the Brydon Review and the Government’s White Paper, was unlikely to be achieved quickly.

6.1.29 A significant number of respondents from across stakeholder groups set out a wide range of concerns, including about the capability of the regulator to oversee wider audit, especially in the short term; about significantly increased audit fees; about the possibility of a new ‘expectations gap’; and about competition, that corporate auditing could be dominated by the strong consulting arms of the Big Four firms, leading to a potential impact on aggregate capacity in the audit market.

6.1.30 There were further concerns raised about risks to audit quality of the current statutory audit, and that ‘corporate auditing’ could potentially – and unhelpfully – duplicate the roles and responsibilities of internal auditors.

Regulatory oversight of corporate auditing

6.1.31 Generally, there was strong support for the principle of companies and investors determining what wider metrics should be subject to external assurance, and what non-statutory areas should be subject to audit, with the Audit and Assurance Policy (AAP) setting out this additional information.

6.1.32 There was some support from a relatively small number of stakeholders (including some investors and audit firms, as well as individual responses) for regulatory oversight of wider audit and the creation of a new regulatory framework for 'corporate auditing'. There were also a number of respondents who supported the regulator's quality inspection regime for PIE audits being extended to corporate auditing. However, some respondents stated that the regulator should instead focus on improving the existing Audit Quality Review process. Those in favour of a corporate auditing framework often stated that assurance of areas beyond financial statements was increasingly important to investors, and recognised the benefit of this assurance having regulatory oversight.

6.1.33 Many respondents agreed with the principle of regulatory oversight. However, there were also strong concerns from many respondents about the regulator's capability to provide this oversight, especially in the short term where it would not yet have the skills or expertise required. It was argued by some respondents that for the regulator to be able to effectively assess these reports, it would need to recruit a number of specialists across a wider range of areas. There were also concerns that it would lead to significant costs passed on to businesses through the ARGV levy.

6.1.34 A number of respondents also identified a need for clear guidance on assurance or auditing of areas such as ESG and cyber, where the underlying standards are not as well defined as accounting standards.

6.1.35 Some respondents thought that the regulator should be focussing its efforts on proposals relating to the audit of financial reporting. They argued that the use of wider assurance services is currently much less significant than the audit of financial statements.

New enforceable principles for corporate auditing

6.1.36 Of the 98 respondents that expressed a clear view on this proposal, 70% (69) supported it and thought that new enforceable principles proposed by the Brydon Review (White Paper 6.3.3) could help improve audit quality. While there was support from across different stakeholder groups, it was predominantly investors (10 of 12), professional associations (13 of 15), and private companies (3 of 3) who were most supportive of this proposal, as well as listed companies (16 of 23) and business representative bodies (3 of 4). 30% (29) were clearly opposed. This included some audit firms (9 of 19 were opposed), and 5 of 8 individual responses.

6.1.37 Many of those who agreed with the White Paper proposal agreed with the motivation to promote a more ethical and sceptical framework for audit.

6.1.38 Some respondents, including a number of those who supported the proposal, thought that the principles would have little impact on statutory audit, as statutory auditors are already subject to similar principles through FRC standards and the professional bodies' codes of ethics. However, a number of respondents thought that new principles might reinforce and clarify these existing principles, as well as extending them to cover wider corporate auditing.

6.1.39 A number of respondents (many of which were audit firms) had concerns that any new principles would confuse and duplicate existing requirements and would need further substantial guidance. Some said they would prefer the professional bodies to improve their standards, with regulatory oversight of this, rather than having new enforceable principles.

6.1.40 A small number of respondents suggested additional principles. For example, one respondent suggested that the principles should include: considering wider information, having a more holistic approach to audits, and considering contradictory information. Another suggested that the principles should include obtaining sufficient reliable and relevant audit evidence.

6.1.41 Some respondents commented on specific principles (set out in 6.3.3 of the White Paper), with particular concern about three of the Brydon Review's suggested principles:

- That *“Auditors’ reports give transparency to any differences of view with management and how they were resolved”*. Some respondents argued that there were no longer differences of view if they had been resolved and therefore they should not be disclosed, or that only differences of view on material matters should be disclosed. However, other respondents supported this principle, with one arguing that it would help reduce the ‘expectation gap’ by revealing what had happened ‘behind closed doors’.
- That *“Auditors ask the directors to report any material information that may legitimately be disclosed to assist the understanding of users of an audit report, and, if necessary, disclose it themselves.”* Concerns were expressed about the practicality of this, predominantly due to issues of judgement and subjectivity that the auditor would need to exercise, and also around possible commercial sensitivity.
- That *“Auditors act in the public interest and have regard to the interests of the users of their report beyond solely those of shareholders”*. Some respondents stated that shareholders should remain the primary audience and their needs should be paramount. Others were concerned that this principle could lead to issues of indeterminate liability to an indeterminate number of stakeholders.

Establishing a new professional body

6.1.42 73% of stakeholders (69 of 95) who gave a clear view were opposed to the proposal for a new professional body for corporate auditors. This was a view shared across different stakeholder groups, but there was particularly strong opposition from audit firms (15 of 18), public sector bodies (4 of 4), professional associations (14 of 17), listed companies (15 of 21), and individual responses (7 of 8). Investor groups were most supportive of the proposal (5 of 9), as were some think tanks and academics (3 of 6).

6.1.43 There were a significant number of respondents who had concerns about this proposal. These concerns largely centred around the risk that this would negatively impact audit quality in the short term, as creation of this new body would be disruptive, and would be an unnecessary distraction from other important reforms. There were also concerns about the potentially significant cost of establishing a new body, which could be passed on to companies

through higher audit fees. There were also concerns about how a new body would fit with the internal audit profession, and with existing bodies and accredited institutions.

6.1.44 Many stakeholders (particularly audit firms and professional bodies) were also concerned that the proposal could detract from the attractiveness of the profession for new entrants and from the retention of existing staff in audit roles. For example, a few respondents argued that if there were a separate profession which did not allow for obtaining wider, more generalist skills, then the profession would find it difficult to recruit the best students.

6.1.45 A number of stakeholders shared the Brydon Review's concerns⁶⁹ about the lack of a distinct audit profession, as well as the role and performance of the existing professional bodies. Those that supported the proposal generally saw the benefit of having a sole audit body to support wider corporate auditing, and wanted to see a stronger, more distinct audit profession.

6.1.46 Some respondents agreed that there needed to be change but preferred doing this through the existing bodies and/or thought that complete systemic change was unrealistic. Several respondents thought change needed to happen straight away, and that establishing a new body would slow down this change. A number argued that the Government should defer this proposal and revisit it in the future.

6.1.47 The existing professional bodies also set out various measures that could be put in place in order to make improvements within the existing structures. In some cases, there were examples of changes that professional bodies have already made or that they plan to make.

Government response

The scope of audit

6.1.48 The Government continues to share the Brydon Review's long-term vision of corporate auditing, for audit to expand beyond the scope of financial statements in order to become more informative for users of audit. However, while corporate auditing is still a positive vision for what audit could and should be, the Government accepts that it will take some time for the market to develop to the point at which a regulatory framework is needed. **The Government will leave the market – companies, directors, investors – to shape the development of an enhanced wider assurance services market in the coming years, stimulated by the requirement to publish an Audit and Assurance Policy (see section 3.2).**

6.1.49 Regulatory oversight of this activity that is yet to be developed would be premature, and so **at this stage the Government does not intend to legislate to give the regulator oversight of 'corporate audit'**. However, the Government will monitor the market-led development of wider assurance to determine when regulatory oversight is necessary.

New enforceable principles for corporate auditing

⁶⁹ For example Brydon Review 6.0.1-6.0.10.

6.1.50 Without a regulatory framework for corporate auditing, there is less reason to establish in law the proposed principles of corporate auditing: most of the proposed principles already apply to statutory auditors through current auditing and ethical standards. Instead, **the regulator should seek to raise standards of auditor behaviour using its existing powers, for example by incorporating aspects of the principles proposed in the Brydon Review that are not already covered into existing standards, in order to improve audit quality.** An example of this could be developing an agreed framework for the application of professional judgement including consideration of the public interest.

The audit profession

6.1.51 Given this, the Government does not believe there is a sufficiently strong case for establishing a separate professional body for audit at this stage. However, the Government is clear that further action is needed. While the Government is pleased to see that the existing bodies are already making some changes, more is needed to address the Brydon Review's criticisms of the lack of professional identity for audit, to improve the audit qualifications for statutory auditors, and to bolster the skills and certification of the 'responsible individuals' (RIs) who lead statutory audits.

6.1.52 The Government thinks that the most effective and immediate way of driving this change is for the existing professional bodies to develop further their audit qualification regimes, practical audit training and continued development of skills over the next five years.

6.1.53 In this regard, consultation responses gave many specific and detailed examples of changes to the training, qualifications and skills for both statutory audit and wider assurance that could be made within the current structures. These included: 'top up' audit qualifications and new qualifications for current auditors including an 'audit masters' qualification; a more advanced qualification or additional learning units for RIs who lead statutory audits; dedicated programmes of post-qualification continued professional development; reaccreditation at set intervals; periodic assessments; developing an 'ethical exam' for all members; and creating RI equivalents for assurance.

6.1.54 The Government expects the existing professional bodies to make substantial improvements to auditor qualification, training and skills over this period in order to deliver the higher levels of scepticism and insight recommended by the Brydon Review, and to further the development of audit as a profession distinct from accountancy.

6.1.55 While professional bodies should lead this work, the Government is keen for the professional bodies to engage with audit firms and wider stakeholders, and to actively seek the regulator's input, expertise, and feedback on proposed changes. **The Government will invite the regulator to work with the professional bodies to establish a suitable timetable for change.**

6.1.56 As part of its Post-Implementation Review, the Government will ask the regulator to report on progress, including an assessment of progress on statutory auditor qualification, training, and skills. If insufficient progress has been made, then the Government will consider what additional measures might be necessary. The Government will also re-evaluate the state

of the market for wider external assurance, and what more could be done to further its development, as part of the Post-Implementation Review.

6.1.57 Together, these measures balance the need for action in the short term with keeping a longer-term perspective, while also ensuring that risks to audit quality, audit capacity and additional costs for business are minimised.

Further Questions

Issues arising from the consultation

True and fair view requirement

6.1.58 Most respondents who commented agreed with the Government's position in the White Paper (6.6.5) of retaining 'true and fair' as the standard for company financial reporting. A number of respondents also supported the FRC taking forward the proposal to develop a new user guide to audit, to explain clearly the meaning of different elements of the audit report (White Paper 6.6.4).

6.1.59 A small number of respondents disagreed with the White Paper approach, and preferred the Brydon Review's recommendation⁷⁰ to replace 'true and fair' with 'present fairly, in all material respects', as this would bring the UK in line with other definitions elsewhere internationally and would help to address the 'expectation gap'. A small number of respondents raised wider concerns about the concept of 'a true and fair view'. One respondent urged the Government to undertake an independent legal review of what 'true and fair view' means.

6.1.60 There were also concerns about referencing the proposed principles for corporate auditing in any departures from International Financial Reporting Standards (IFRS). It was felt that this would cause confusion for international users of audit, and that any departures should refer to the legal true and fair view override requirement. A number of respondents were supportive of the true and fair override. One respondent described it as a valuable safety valve for situations when the financial reporting framework will give the wrong answer.

Alternative Performance Measures (APMs) and Key Performance Indicators (KPIs)

6.1.61 82% of 106 respondents who gave a clear view on the proposal agreed with the Government's White Paper position (6.7.8) 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. In most stakeholder groups, a majority of respondents supported the proposal: including 34 of 37 listed companies, 8 of 8 professional associations, 15 of 18 audit firms, and 13 of 19 investor groups. However, 3 of 3 think tanks and academics opposed the proposal.

6.1.62 Despite overwhelming support for the proposal, there were still a number of respondents who had concerns that it relied on voluntary engagement by investors which might not happen. One respondent recommended that the regulator should consider

⁷⁰ Brydon Review 11.9.

developing a framework for reporting on the more common APMs and KPIs, and guidance on how assurance might be provided.

6.1.63 Some respondents thought that there were sufficient frameworks in place to allow for shareholder engagement in this area, and that there was already a reasonable degree of engagement.

6.1.64 A minority of respondents thought that APMs and KPIs should be within the normal scope of statutory audit or that a level of assurance should be compulsory. Some pointed to the importance of these metrics, and thus the importance for them to be properly audited.

Audit liability

6.1.65 A range of views on audit liability were expressed, with many respondents on the topic articulating their experience regarding Liability Limitation Agreements (LLAs).

6.1.66 In the vast majority of these responses, there was a general consensus that in practice LLAs were neither sought by audit firms nor offered by audited entities. For the most part, audit firms felt that this was the case because seeking an LLA would firstly be seen as a minus point against them in any tendering exercise, and secondly would not be successful.

6.1.67 Some respondents (principally companies) suggested it could be viewed as a breach of directors' duties to enter into an LLA since there was little benefit for the company or its investors from doing so, with the only benefit being to the auditor. A number were strongly against LLAs on the grounds that they insulated auditors from accountability to investors, and some argued that it should be made easier for investors to take action against an audit firm, for example by legislating away the *Caparo* principle⁷¹. Others thought that more accountability and/or stronger sanctions were needed, rather than LLAs.

6.1.68 Some respondents (predominantly audit firms) argued that the litigation risk facing audit firms was a barrier to increasing competition and resilience in the audit market, deterring entrants and innovation. It was suggested that expanding the scope of audit would increase these risks. Respondents argued that liability should therefore be reduced; there were several suggestions for how this might be done (such as building on the auditor liability limitation of the *Caparo* ruling). A number called for an in-depth review of liability arrangements for auditors.

⁷¹ *Caparo Industries plc v Dickman* [1990] UKHL is a landmark case in which the House of Lords set out the test that needs to be satisfied by a claimant when seeking to establish that a defendant owed the claimant a duty of care in the tort of negligence. On the facts of the case, the claimant, Caparo, had bought shares in a company, Fidelity plc, in reliance on the audited accounts which transpired not to reveal the true extent of Fidelity's poor financial affairs. Caparo sued the auditors in negligence but the court concluded that there was not a sufficiently proximate relationship between the defendant and the claimant. The defendant was unaware of the claimant or that it was relying on the audited accounts in the context of its investment. The generally applicable test drawn from these facts by the court is that: the harm must be reasonably foreseeable as a result of the defendant's conduct; the parties must be in a relationship of proximity; and it must be fair, just and reasonable to impose liability.

Government response

6.1.69 Having considered the points made in consultation on these areas, the Government is not convinced of the benefits of departing from the proposals outlined in the White Paper. As a result:

- **The Government will retain ‘true and fair’ as the standard for company financial reporting.** There is a general view that this is meant to be functionally identical to the alternative formulation of “present fairly, in all material respects”, so any change is likely to be of limited value in practice.
- **The Government will leave directors and investors to decide whether specific assurance on APMs and KPIs is necessary through the Audit and Assurance Policy process.** The Government invites the regulator to consider whether further guidance is required, as part of any wider AAP guidance, for the reporting and assurance of APMs and KPIs. The Government also notes potential changes to international standards in this area (set out in the White Paper paragraphs 6.7.4 - 6.7.6). As per the White Paper (6.7.6) it will be for the new UK Endorsement Board to decide whether any new international standards issued by the International Accounting Standards Board should be adopted in the UK and for the regulator to decide whether to introduce any similar requirements in UK auditing standards.

6.1.70 The Government is not minded to make legislative changes in regards to auditor liability at this stage. While the Government is keen to see increased innovation and competition in the audit market, it does not believe that changes to audit liability in either direction are the most effective way of addressing this. The Government is concerned that auditor liability reduction could have perverse outcomes in terms of audit accountability, while any moves to increase auditors’ liability could lead to greater risk-aversion in audits.

6.1.71 Concerns over any increase in liability from a move to regulated ‘corporate auditing’ are addressed by adopting the market-led approach to the development of an enhanced wider external assurance market, as outlined above.

6.1.72 Given the general consensus that LLAs are not sought because they are not offered and vice versa, the Government does not see sufficient evidence that a change of the current LLA arrangements would be helpful.

6.2 Tackling fraud

Following consultation, the Government intends to proceed with a new requirement for directors to report on the steps that they have taken to prevent and detect fraud. The Government will see how recent revisions to auditing standards impact auditors’ reporting on fraud before considering any further change.

What the White Paper proposed

6.2.1 Directors have responsibilities around the detection and prevention of material fraud; auditors have responsibilities around its detection. However, these responsibilities can appear vague and unclear. The Brydon Review found the question of fraud and auditors' responsibilities to be the most complex and misunderstood. While it is very clear that management and the board have primary responsibility for preventing and detecting fraud, the Brydon Review recommended that all would benefit from much more communicative reporting and a clarified auditing standard.

6.2.2 In the White Paper, the Government proposed a set of new reporting obligations for both directors of Public Interest Entities and their auditors that would see:

- directors report on their actions to detect and prevent material fraud (paragraph 6.4.2);
- auditors report on their work to conclude that the directors' report of their actions to detect and prevent fraud is factually accurate (paragraph 6.4.5); and
- auditors report on their steps to detect material fraud and assess the effectiveness of relevant controls (paragraph 6.4.6).

6.2.3 The Government also indicated its intention to discuss how to enhance auditor education and continuing professional development with the FRC and the professional bodies; its agreement with the Brydon Review's proposal for an accessible case study register of corporate frauds; and its willingness to consider whether the regulator's audit enforcement arrangements should differ for fraud-related cases, if consultation responses suggested strong demand.

Issues arising from consultation

6.2.4 120 out of 159 responses (75%) expressed support for at least some elements of the Government's proposed response to the Brydon Review's package of reforms relating to fraud. Of those respondents that remarked on improving auditor education, the vast majority agreed that this was a positive step that would better equip auditors. There was also a lot of support for an accessible case study register, with a small number expressing a preference for the regulator or recognised supervisory bodies maintaining the register.

Directors to report on steps taken to prevent and detect material fraud

6.2.5 A significant majority of respondents (about 74%) supported the directors' statement on fraud measures. Many respondents acknowledged that the board (and management) hold primary responsibility for the prevention and detection of fraud. Most listed companies agreed that this proposal would reinforce this responsibility. Others, including some investors and professional associations, felt it would focus directors' minds more acutely on the risks associated with fraud. A number of respondents, across different stakeholder groups, commented that this reporting could be bolstered by also requiring directors to publish a fraud risk assessment – providing more information to investors and other stakeholders about which parts of a business are most at risk and showing how directors are responding to issues over time.

6.2.6 Most companies, business representative organisations and investors emphasised the need for the new measure to be proportionate. It was common amongst respondents to stress the need for accompanying guidance on ‘materiality’, and that the types of ‘fraud’ that directors are required to report on should be those most relevant and important to investors.

Auditors to conclude on the factual accuracy of the directors’ statement

6.2.7 This proposal attracted slightly more opposition than support, with 46% supporting the proposal. A minority of those that supported the proposal (including some audit firms and others) felt that auditor reporting on the directors’ statement should go further: not just commenting on the factual accuracy of the directors’ statement but also commenting on the quality of the directors’ reported actions on fraud and/or giving a view on the strength of relevant internal controls.

6.2.8 Most respondents tended toward caution: many were uncertain about what auditor reporting on ‘factual accuracy’ entailed and how much work would be required, with even many of those in favour of this proposal concerned about the potential for confusion. Some respondents remarked that ‘factual accuracy’ is not a recognised form of assurance provided by external auditors, with one suggesting that establishing factual accuracy would go beyond reasonable assurance. Many listed companies expressed concern that auditors would in practice go beyond concluding on factual accuracy to judging the effectiveness or quality of directors’ actions on fraud. A handful of respondents suggested that this proposal carried the risk of contributing to an ‘expectations gap’.

Auditors to report on their steps to detect fraud and assess the relevant internal controls

6.2.9 Respondents were divided in their views on this proposal and on how they treated it. (Reporting on fraud detection and reporting on the work done to assess relevant internal controls were often treated as two separate issues.) Respondents from a cross-section of stakeholder groups – business representative organisations, audit firms, professional associations, and limited companies – readily agreed that greater reporting from auditors on their steps to detect fraud would be helpful. Some elaborated that this measure would increase general understanding of how auditors discharged their responsibilities, which many felt was needed. Others noted the FRC’s recent revisions to ISA (UK) 240 – the audit standard related to fraud, whose revisions come into effect for audits of financial statements for periods commencing on or after 15 December 2021, with early adoption permitted – and thought these could be sufficient to encourage more reporting on auditors’ work on fraud, without Government needing to intervene further.⁷²

6.2.10 Responses to the consultation suggest that many stakeholders interpreted the proposal as requiring auditors to do much more work on internal controls and provide a much higher level of assurance over their effectiveness. On that basis, several stakeholders, across different groups, were keen to highlight the relationship between fraud and internal controls.

⁷² [International Standard on Auditing \(UK\) 240 \(Revised May 2021\): The auditor’s responsibilities relating to fraud in an audit of financial statements](#). The revised standard is effective for audits of financial statements commencing on or after 15 December 2021

Many responses emphasised that a strong internal control framework is the basis of much of the work done by management to prevent and detect fraud – and that the two could not easily be separated as it was felt the proposals were suggesting. Many advised that the Government’s fraud proposals should be developed in tandem with the proposals for strengthening internal controls.

Government response

6.2.11 Given the support among respondents for the proposal for a directors’ statement on fraud, and the wide acceptance that the board (and management) have primary responsibility for the prevention and detection of fraud, **the Government intends to proceed with the proposal that directors should report on the steps they have taken to prevent and detect material fraud. This requirement will apply to PIEs above the size threshold set out in Chapter 1.** (See paragraph 1.6.48.)

6.2.12 The consultation responses to the proposal for auditors to conclude on the factual accuracy of a directors’ fraud statement highlighted the risk of creating an expectation gap. This would be a gap between the conclusions that auditors would draw on factual accuracy and an expectation from readers that auditors are (or should be) concluding on the quality or sufficiency of the steps directors have taken to prevent and detect fraud. Furthermore, ‘factual accuracy’ is not a commonly accepted level of assurance, which has the potential to confuse matters.

6.2.13 Auditors already have clear existing requirements to review other statutory information – which the directors’ statement on fraud would qualify as. The auditing standard ISA (UK) 720 sets out the auditor’s responsibilities relating to other information.⁷³ It requires auditors to read and consider ‘statutory other information’ to identify whether any of it is (a) materially inconsistent with the financial statements, (b) materially inconsistent with knowledge the auditor’s obtained during the audit, and (c) materially misstated in the context of the applicable legal and regulatory requirements.⁷⁴ Auditors will be required to fulfil the requirements of ISA (UK) 720 with respect to directors’ statements on fraud. And based on their existing requirements to understand an audited entity’s control environment, they are in good position to identify significant factual errors in a directors’ fraud statement. **The Government considers that auditors’ existing requirements to identify and report material inconsistencies in directors’ reporting will be sufficient in reporting on directors’ fraud statements.**

6.2.14 The Government proposed that auditors should report on the steps they have carried out to detect fraud and to assess relevant controls. This proposal was intended to encourage auditors to communicate more about the procedures they already undertake to enable them to form an opinion as to whether a set of accounts is free from material misstatement due to

⁷³ [International Standard on Auditing \(UK\) 720 \(Revised November 2019\)](#): The auditor’s responsibilities relating to other information

⁷⁴ ‘Other information’ in ISA (UK) 720 refers to financial or non-financial information (other than financial statements and the auditor’s report) included in an entity’s annual report. ‘Statutory other information’ refers to those documents or reports that are required to be prepared and issued by the entity. This includes the directors’ report, the strategic report, and the separate corporate governance statement.

fraud. This includes the work they already do to understand internal controls, as set out in ISA (UK) 315.⁷⁵

6.2.15 ISA (UK) 700 – the standard which establishes the requirements about how auditors report – and the FRC’s recent revisions to audit standard ISA (UK) 240 clarify the auditors’ responsibilities and require that auditors provide context-specific explanations of the extent to which their audit was considered capable of detecting irregularities, including fraud.⁷⁶ The revisions provide examples of what aspects of their work to detect irregularities auditors could refer to. This may go some way to shift focus away from what is referred to as ‘the inherent limitations of audit’. It will take time for these audit standard revisions to bed in and improve the level of insight that auditors provide.

6.2.16 Before considering further action, **the Government intends to wait to see if these revised standards have the anticipated effect in clarifying what is expected of auditors in explaining the work they have done to detect fraud and to assess the effectiveness of relevant fraud controls.**

6.2.17 The Government will invite the regulator to discuss with the professional bodies how to enhance auditor education and continuing professional development (in line with paragraph 6.1.54 of this document), including in relation to detecting fraud. It is clear from responses to the White Paper that enhancing auditors’ skills in detecting fraud and encouraging the take-up of improved technologies is important to stakeholders. Responses have also indicated support for the idea of developing an accessible fraud case study register, building on the information that the FRC already makes available through publishing its Decision Notices. Such a register would enhance auditor education. **The Government will discuss how an accessible case study register could be taken forward with the FRC and the professional bodies as Recognised Supervisory Bodies.**

⁷⁵ [International Standard on Auditing \(UK\) 315](#) (Revised July 2020): *Identifying and assessing the risks of material misstatement*.

⁷⁶ [International Standard on Auditing \(UK\) 700](#): Forming an opinion and reporting on financial statements.

7 Audit committee oversight and engagement with shareholders

Audit committees and active shareholders perform important functions within the corporate governance ecosystem, and both can help to drive high-quality, sceptical audits that provide meaningful information for investors and others. The White Paper outlined a series of measures in relation to both groups and this chapter summarises the Government's final position on those proposals. First, the Government intends to take forward the White Paper proposals to give ARGA powers to set new minimum requirements for audit committees relating to the appointment and oversight of auditors as well as powers to monitor compliance with the new requirements. Second, the Government has decided not to pursue Sir John Kingman's proposal that ARGA should be able to appoint the auditor in limited circumstances. Finally, the Government is taking forward a series of proposals to empower shareholders to engage more meaningfully with audits and matters affecting audit quality.

7.1 Audit committee oversight

What the White Paper proposed

7.1.1 Both the CMA study and the FRC Review noted that the commercial relationship between a company's audit committee and its auditor could result in a lack of professional scepticism from both sides. The CMA study also noted that there was significant variation in the performance of audit committees within FTSE 350 companies.

7.1.2 To address these concerns, the White Paper explained the Government's proposal to give ARGA powers to set minimum requirements for audit committees in relation to the appointment and oversight of auditors, alongside powers to monitor and enforce those standards. The Government suggested that ARGA would take a risk-based approach to monitoring and, where significant concerns arise, that ARGA could operate a specific power to place an observer on the audit committee. The White Paper also proposed that ARGA would be able to take action against company directors and/or the audit committee for breaching requirements. These actions could include issuing public notices detailing findings of unsatisfactory performance or making direct statements to shareholders where ARGA is unsatisfied with an audit committee's response. Finally, the White Paper proposed that these requirements should apply initially to audit committees of FTSE 350 companies. At a later stage, the Government would give consideration to whether they should be extended to a wider community of PIEs, taking account of the effectiveness of implementation across FTSE 350 companies.

Issues arising from consultation

Additional requirements for audit committees

7.1.3 The Government received 121 responses to the question, “*Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?*”. Of these, 59% agreed with the proposal, compared to 41% who disagreed. Of those that disagreed, several respondents believed that current requirements were already sufficient: the requirements on audit committees in the UK Corporate Governance Code were given as an example, with support for the ‘comply or explain’ approach in the code.

7.1.4 Although the proposals received broad support, several respondents observed that the power would create potential for overlaps or conflicts with existing FCA and PRA requirements on audit committees in the financial services sector. This was given as a reason against the proposal by some respondents, although others suggested that the potential for overlap and duplication could be managed by ARGAs when it sets its requirements. Similarly, a major bank suggested that the requirements should be consulted on and proportionate. This was a common theme for those in favour of the new power for ARGAs, as well as a need for the requirements to be clearly defined.

7.1.5 Various listed companies raised concerns that additional requirements would make it harder to attract candidates with suitable qualifications to join boards and audit committees. There were also concerns that additional requirements could cause audit committees to conduct work that should be for management to undertake, resulting in a clouding of responsibilities and a loss of quality non-executive oversight.

Monitoring compliance with new audit committee requirements

7.1.6 As part of the proposal to set requirements on audit committees in the White Paper, the Government proposed giving ARGAs powers to monitor compliance, including the power to require information and to place an observer on the audit committee. The purpose of these proposals was to allow ARGAs to consider whether any remedial action was needed without putting disproportionate pressure on audit committees.

7.1.7 The power to require information from the audit committee was generally received positively by respondents. Three of the Big Four commented that they agreed that ARGAs should be given this power. This view was shared by many of the challenger firms, with the caveat that the use of the power needs to be proportionate. Responses from many investor firms, professional associations and some listed companies also considered it appropriate to grant ARGAs these powers.

7.1.8 However, the suggestion to allow ARGAs to place an observer on an audit committee did not receive broad support. Many listed companies stated that placing an observer on the audit committee would impede its independence and could cause a departure from the ‘unitary board’ principle in UK company law. Further concerns were raised that having an observer could impact the quality of conversation between companies and the regulator. One audit firm

also stated that giving ARGA a power to place an observer on the audit committee would “blur the lines between the regulator and the regulated”.

7.1.9 Responses from listed companies suggested that if an observer were to be placed on an audit committee, then appropriate safeguards should be in place to prevent disclosure of confidential information.

Government response

Additional requirements for audit committees

7.1.10 The Government has considered responses to the White Paper and is confident that new requirements on audit committees will increase consistency and ensure that auditor appointments are made based on auditor competence and their ability to challenge the company critically. The **Government therefore intends to proceed with giving ARGA the power to set minimum requirements on audit committees in relation to the appointment and oversight of auditors.** This will ensure the requirements are enforceable, which the Government regards as preferable to the ‘comply or explain’ approach of the UK Corporate Governance Code in this case, which only premium listed entities are currently required to apply. As part of the standards, ARGA will also include appropriate provisions to encourage shareholder engagement with an audit. For more detail, see section 7.3.

7.1.11 The Government has listened to respondents’ concerns about the risk of overlaps with other requirements on audit committees. To address these concerns, the Government intends to ask the regulator to draft clear and concise minimum standards that do not conflict with current requirements in place for audit committees from the FCA, PRA, CMA and the UK Corporate Governance Code and to consult on the draft standards before they are introduced.

7.1.12 The scope of these requirements will be set out in legislation and the Government intends that they should apply initially to FTSE 350 companies. Once the requirements have been implemented, ARGA will monitor their impact and the Government will consider whether they should be extended to a wider community of PIEs. In doing so, the Government will consider whether the requirements would be proportionate.

Monitoring compliance with new audit committee requirements

7.1.13 In line with the White Paper proposals, the Government will also empower ARGA to monitor compliance with the new requirements on audit committees. Monitoring will be conducted through reviews of publicly available information as well as new powers to obtain information and reports. In cases of failures of compliance ARGA would also be able to impose sanctions by means of accompanying enforcement powers.

7.1.14 **The Government has concluded that it is not appropriate or necessary to provide a power for ARGA to place an independent observer on the audit committee.** An appropriate monitoring system will be possible without this potentially intrusive power through information provided by other means and, where necessary, through expert reviews (see section 11.4). The Government envisages that an expert reviewer would be appointed to consider the work of an audit committee only in very limited cases, such as when a company

has parted with its auditor outside the normal rotation cycle or audit quality issues have been identified and the audit committee appears to be implicated by audit failings.

7.2 Independent auditor appointment

What the White Paper proposed

7.2.1 In a letter sent to the Secretary of State in December 2018 alongside the FRC Review, Sir John Kingman argued that an auditor's commercial relationship with a company may undermine professional scepticism on the part of the auditor. His letter considered the merits of giving the regulator power to appoint a company's auditors but concluded that a general power of appointment should not be taken forward, as there was little support for this radical change among the investment community that relied on high-quality audits to make investment decisions. However, Sir John did recommend that ARGA should be given limited powers to appoint auditors in specific circumstances, including when quality issues had been identified around the company's audit; when a company had parted with its auditor outside the normal rotation cycle; and when there had been a meaningful shareholder vote against an auditor appointment.

7.2.2 In the White Paper the Government explained that there was little evidence that the power proposed by Sir John Kingman would be useful in practice. In particular, the Government noted that the power might need to be supplemented by an additional power to compel auditors to take on a specific audit engagement. This would be a very significant step and, as a result, the Government was not inclined to take forward Sir John Kingman's recommendation. However, the Government sought stakeholder views about whether to provide flexibility for ARGA to be given such powers in the future.

Issues arising from consultation

7.2.3 Respondents to the White Paper broadly agreed with the Government's view on Sir John Kingman's recommendation. The Government received 120 responses to the question, "*Do you agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors in specific, limited circumstances?*". Of these, 73% agreed with the Government's opinion that it should not legislate at this stage to grant ARGA this power. In particular, respondents expressed concern that the proposal might remove the independence of the audit committee and might force an audit firm to take on an audit where it may not have the capability, capacity or risk appetite to do so. Similarly, large listed companies suggested the proposal could undermine the credibility of the audit committee and would be likely to result in other risks, including regulator liability in the event of an audit failure.

7.2.4 However, 22 responses supported Sir John Kingman's recommendation, including responses from some investors, shareholders, and professional associations, who thought the power could be used in very extreme and limited cases. Some of these responses suggested that any conflicts of interests or risks from an appointment by ARGA were outweighed by the public interest in ensuring an audit was completed.

7.2.5 The Government also sought views on the other regulatory tools that could be made available to ARGA in the circumstances described in Sir John Kingman's letter. 47 responses commented on this question, with many respondents stating that the current arrangements in the Companies Act (which give the Secretary of State the power to appoint an auditor in certain circumstances) were sufficient.

7.2.6 However, some listed company responses also observed that, in the event that a company had not been able to appoint an auditor, there could be an option for them to issue unaudited accounts. The view was that this would send a strong direct message to a company's stakeholders about the business and was preferable to requiring an appointment in any circumstances. Two responses from listed companies suggested that shareholder and market reaction to a company being unable to find an auditor would be the most effective mechanism to encourage companies to find a solution.

7.2.7 A challenger firm and some other respondents suggested that the National Audit Office could be used as an "auditor of last resort" for a limited period. This proposal would apply to cases where there were particular difficulties (such as failure of a large audit firm), to allow more time for companies to find a new auditor in the private sector.

Government response

7.2.8 On balance, the Government believes that the drawbacks of giving ARGA the power to appoint the auditor in the specific circumstances described by Sir John Kingman would outweigh any benefits. While his recommendation received some support, the Government has concluded that it would risk undermining the independence of the audit committee, would be difficult to implement without a supplementary power to compel the auditor to undertake an audit and would present significant challenges to ARGA's ability to supervise and inspect any such audits independently. As a result, **the Government has decided not to legislate to provide flexibility for ARGA to be given such powers by the Government in future**⁷⁷.

7.2.9 Instead, the Government intends to continue to rely on the powers in the Companies Act for the audit committee, directors and ultimately shareholders to appoint the auditor. The existing fallback provisions for the Secretary of State to do so will be amended as part of an enhanced framework for the enforcement of tendering, rotation and managed shared audit requirements by ARGA, which is being developed.

7.3 Shareholder engagement with audit

What the White Paper proposed

7.3.1 Although shareholders are the primary users of company accounts, the Brydon Review raised concerns that they were giving insufficient attention to the quality and robustness of audit and were not sufficiently engaged with audit. To address this, the Brydon

⁷⁷ Given the Government's decision not to pursue this proposal from the FRC Review, a detailed summary of responses has not been provided to questions 55 and 56 of the White Paper.

Review made a series of recommendations in relation to shareholder engagement on risk and audit planning, shareholder engagement on audits at general meetings, and shareholder engagement on auditors leaving office. The White Paper explored the merits of these recommendations and set out the Government's proposed approach.

7.3.2 With respect to shareholder engagement on risk and audit planning, the Government agreed with the Brydon Review's proposal that a formal mechanism should be established to enable audit committees to gather shareholder views on the audit plan. The Government also agreed that shareholders would benefit from having access to the latest risk assessment but concluded that the audit committee should only be expected to make an additional disclosure if there had been a material change in the principal risks facing the company.

7.3.3 In relation to shareholder engagement at general meetings, the Brydon Review suggested that there should be a standing item on annual general meeting (AGM) agendas so that shareholders could put questions to the auditor and audit committee chair. The Government agreed that shareholders should have better opportunities to ask questions about the audit but did not propose to require a standing AGM agenda item. Instead, the Government proposed to invite the regulator to revise guidance to audit committees to gather questions from shareholders about the company audit. This was accompanied by an invitation for the regulator to revise its guidance on the Stewardship Code to encourage engagement from investors on matters relating to audit quality.

7.3.4 In the final point on shareholder engagement with auditors leaving office, the White Paper agreed with the Brydon Review that existing Companies Act provisions were failing to provide shareholders with meaningful information on why an auditor has left. The Review recommended that the statement of auditors leaving office could be enhanced with specific statements about the departure and that the company should hold a general meeting following a departure. The White Paper proposed that the Government should consider further whether and how to implement these recommendations following responses to the White Paper.

7.3.5 Finally, the White Paper set out the Government's support for the Brydon Review recommendation that an Audit Users Review Board be established to facilitate discussion and ideas on audit quality affecting users of the audit report (shareholders, companies, regulators and others). The Investment Association (IA) agreed to act as secretariat to the Review Board, as noted and welcomed by the Government in the White Paper. The IA has since commenced an engagement programme with representatives of key audit user groups – including the Audit Committee Chairs Independent Forum, the 100 Group and representatives of retail shareholders – to understand their perspectives on the role of the Review Board, including how its Terms of Reference should best support user-driven audit. Those Terms of Reference will be finalised and published by the IA following the first meeting of the Review Board, and after discussion with BEIS and the FRC. The IA expects that the Review Board will meet for the first time in the third quarter of 2022.

Issues arising from consultation

Shareholder engagement on risk and audit planning

7.3.6 The White Paper asked respondents if they agreed with proposals to provide shareholders with a formal opportunity to engage with the audit plan. In response, there was broad agreement from professional associations and investors, as well as some listed companies, that shareholders' views on the audit plan should be considered by the audit committee.

7.3.7 Although the majority of respondents agreed with the overriding proposal, some took the opportunity to highlight specific concerns. Some respondents noted concerns relating to additional time and cost burdens, while others stated that the proposal should not blur the roles and responsibilities of directors and shareholders. Meanwhile, some listed companies agreed with the proposal in principle but thought it could be better achieved through inclusion of measures on shareholder engagement in the Stewardship Code (to which many institutional investors are signatories) and the Corporate Governance Code rather than in legislation.

7.3.8 Finally, some listed companies expressed concern about the proposal that shareholders should have a formal opportunity to engage with risks assessed as part of audit planning. These responses were of the view that shareholders would be less well-placed than management or the board to be able to assess business risks.

Shareholder engagement on audits at general meetings

7.3.9 The proposal to ensure greater participation by the audit committee chair and auditor in the AGM was positively received, with 70% of the respondents who engaged with this question agreeing with the Government's proposed approach for increased engagement.

7.3.10 Listed companies were 68% in favour of increased shareholder engagement at general meetings. However, there were also several responses from listed companies that indicated shareholders already have ample opportunity to engage including approving the appointment and remuneration of auditors.

7.3.11 All the Big Four firms stated their support for increased shareholder engagement at meetings, but there were also queries as to whether encouraging questions from shareholders would have the benefits that the White Paper suggested. One of the Big Four firms highlighted that under current legislation shareholders are already allowed to put questions to the auditors in AGMs, but in practice such questions are extremely rare. Despite this a response from a group representing investors emphasised evidence from other jurisdictions, where a standing item on audit had been added to the agenda and it had resulted in positive outcomes.

7.3.12 A challenger firm and some listed companies raised concerns that there could be legal risks to the auditor if the auditor were required to be available for questions at the AGM. The respondent felt the better party to respond to some types of questions would be the audit committee chair or other non-executive directors rather than the auditor.

Shareholder engagement on removal or resignation

7.3.13 On shareholder engagement with instances of an auditor ceasing to hold office, the Government asked, *“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?”*

7.3.14 This question elicited 120 responses. 55% of these considered the existing provisions were adequate and 45% believed them to be inadequate.

7.3.15 Audit firms had different views with 61% of their responses (including the Big Four, challenger firms and mid-lower tier firms) believing the current provisions were not adequate. 83% of professional associations that responded also believed they were inadequate. Generally, support was expressed for the Brydon Review recommendations among these groups.

7.3.16 This was in contrast to the views of listed companies and shareholder representatives and investment companies. 70% of these believed the current provisions in the Companies Act were adequate.

7.3.17 Some respondents thought that, if an auditor were required to state further reasons for leaving, this could have unintended consequences and cause harm to the company if shareholders misinterpreted the further explanation given. Views were also expressed that there are already sufficient ways for auditors to raise concerns with shareholders in the case of a change of auditor.

Government response

7.3.18 The Government continues to believe that a formal mechanism should be established to enable audit committees to gather shareholder views on the audit plan. Similarly, the Government continues to believe that shareholders should have better opportunities to ask questions about the audit at an AGM, although it does not believe a standing AGM item is necessary or sufficient to achieve greater shareholder engagement. Such engagement would be beneficial for improving transparency and help shareholders to hold companies to account.

7.3.19 Having considered these proposals further, the Government believes that the most appropriate way to encourage shareholder engagement with audits is to include appropriate provisions in the audit committee requirements that ARGA will have the power to put in place. Those powers will need to be somewhat wider than those proposed in the White Paper to allow the new audit committee requirements to cover the ability for shareholders to consider and respond on the audit plan and to consider the risk report. The changes would also enable greater engagement with the auditor at the AGM of the company. Alongside this, and when appropriate, the regulator will also put forward revisions to the Stewardship Code along the lines proposed in the White Paper. The regulator will consult on specific proposed changes in due course and consider how they might enhance engagement by shareholders at AGMs.

7.3.20 Finally, the Government has considered stakeholder views in relation to the information provided to shareholders when an auditor ceases to hold office. The Government acknowledges that many responses expressed the view that the current provisions in the Companies Act were adequate. However, the Government notes that auditors themselves disagree and this suggests auditors see potential for the framework to be more effective in exposing aspects of their relationship with the company, prior to ceasing to hold office, in which shareholders have an interest. The Government therefore intends to introduce legislation to improve notices of auditors ceasing to hold office for PIE audits by implementing proposals in line with the recommendations made in the Brydon Review, to require certain positive statements by the auditor relating to their recent relationship with the company and its audit committee.

8 Competition, choice and resilience in the audit market

In the White Paper, the Government proposed that ARGA's objectives should promote high-quality audit and effective competition in the audit market. To support those objectives, the Government has decided to proceed with a package of measures to increase choice and improve resilience in the audit market and to enhance professional scepticism.

First, the Government will legislate to require UK-incorporated FTSE 350 companies to appoint a challenger as sole group auditor or, alternatively, appoint a challenger firm to conduct a meaningful proportion of its subsidiary audits within a shared audit. This 'managed shared audit' requirement will be introduced on a phased basis. In recognition of the scale and complexity of certain audits, the requirement will be subject to an exemptions regime that ARGA will operate.

Second, the Government will make powers available for ARGA to operate a 'market share cap', either in the event of a significant firm collapse or in the event that further intervention is required once managed shared audit has had opportunity to take effect.

Third, the Government will legislate to give ARGA powers to require an 'operational separation' of the largest firms: this proposal will require enhanced governance of the audit practice with a view to promoting greater professional scepticism within multidisciplinary firms.

Finally, the Government will equip the regulator with powers to monitor the health of audit firms, including sufficient powers to address concerns around an audit firm's resilience.

8.1 Market opening measures

What the White Paper proposed

8.1.1 In the White Paper, the Government agreed with the CMA's assessment that FTSE 350 companies face limited choice when appointing an auditor and that challenger firms⁷⁸ face significant barriers to entering this market. It is highly unlikely that these long-standing issues can be resolved by the market alone, so the Government made two proposals to increase choice in the audit market and, ultimately, its long-term resilience.

8.1.2 The first of these proposals was to put in place market opening measures that would apply to all UK-registered FTSE 350 companies and would be introduced over time as audits fall to be tendered under the existing audit tender cycle. Under these proposals, UK-registered

⁷⁸ In line with the CMA's Market Study, the term 'challenger' is used to denote audit firms other than the Big Four audit firms that conduct the audits of the vast majority of FTSE 350 companies.

FTSE 350 companies would be required either to appoint a challenger as their sole group auditor or to be subject to a 'managed shared audit' requirement to appoint a challenger firm to conduct a 'meaningful proportion' of the audit of statutory entities within the group. Together, these market opening measures would give challenger firms access to FTSE 350 audit committees, to gain experience auditing some of the UK's largest groups and their subsidiaries, and gradually to increase the resilience of the market. The proposal would also allow exemptions under limited circumstances, including circumstances where a challenger firm cannot be identified to conduct a meaningful proportion of the audit of statutory entities within the group. In the White Paper, the Government also explained its intention to review the managed shared audit regime to assess its effectiveness in increasing choice. This review would take place five to ten years after initial implementation.

8.1.3 The Government's second proposal was to take a secondary power so that the Secretary of State could introduce a market share cap if the review of the managed shared audit regime concluded that challenger firms were not becoming sole auditors in the FTSE 350. The market share cap would require a proportion of audits to be tendered exclusively for challenger firms, based on their capability and capacity. The Government would consult before exercising this power and, in practice, ARGA would take an active role in overseeing the cap by reviewing the pipeline of FTSE 350 tenders and reserving a proportion of them for challenger firms.

Issues arising from consultation

Managed shared audit

8.1.4 The Government's proposals on managed shared audit generated significant debate: the majority of respondents agreed with the Government's aim to increase resilience and choice in the market, but there was disagreement about the best mechanism to achieve that aim. The managed shared audit proposals were broadly supported by challenger firms and the CMA. A small number of challenger firms also stated that they supported the proposal but preferred to bid initially for sole audit tenders and to benefit from the proposal to require the appointment of a challenger firm as the sole group auditor as an alternative to the managed shared audit requirement.

8.1.5 However, other stakeholder groups raised significant concerns, among them the Big Four audit firms, large listed companies and some investor groups. To varying degrees, these respondents stated that challenger firms lacked the capacity, capability and experience to conduct a quality audit of subsidiaries of the UK's largest companies. In addition, a professional association and a number of listed companies expressed concern that audit quality might decline as a result of communication and transparency problems between the group auditor and the challenger. Others also expressed concerns around additional costs that might arise due to duplication of work.

The definition and composition of 'meaningful proportion' within managed shared audit

8.1.6 In the White Paper, the Government explained that 'meaningful proportion' would be defined and calculated with reference to one or more of the total audit fee, group revenues,

profits and assets of the company, with the challenger's proportion to be no less than 10% of these criteria and preferably closer to 30%. To test and refine this policy, the Government then asked two inter-related questions. First, the Government asked whether the meaningful proportion should be based on legal subsidiaries (with the result that a FTSE350 company would be compliant with the shared audit regime when, for example, it appoints a challenger firm to audit two legal subsidiaries that represent 10% or more of group revenues, fees, profits or assets). Second, the Government asked how the meaningful proportion should be measured and what minimum percentage should be chosen to best increase choice.

8.1.7 In response to the first question, respondents provided mixed views. On the one hand, many investor organisations, a small number of listed companies, and a large proportion of audit firms expressed concern about the prospect of the meaningful proportion being based on legal subsidiaries. These respondents noted that certain group structures might not be organised in ways that would support the audit being separated by legal subsidiaries and hence would be unworkable. Instead, some of these respondents suggested that an alternative approach would be to determine the meaningful proportion based on a division of the group audit according to workstreams, components, divisions, or risk profile. On the other hand, a large professional body stated that the meaningful proportion should be based on a combination of business components and legal subsidiaries. Meanwhile, some of the respondents who were opposed to managed shared audit stated that, if the policy is pursued, the meaningful proportion should be defined in terms of legal subsidiaries.

8.1.8 The second part of the question was not commented on by many respondents, with only 20 mentioning their preferred minimum percentage. Audit firms were most engaged with this question, with firms outside the Big Four favouring the higher end of the range suggested in the White Paper. Three other professional association responses also stated that the threshold should be at the higher end of the range, as a lower threshold may hinder meaningful change. However, five listed companies engaged with this question, of which four preferred the lower proportion of 10% while giving the regulator power to increase this percentage over time. This suggestion was also echoed by a professional association and one individual response.

8.1.9 Finally, 34 respondents commented on whether international subsidiaries of companies should be within the scope of the meaningful proportion. Of these, 82% suggested that it should not, citing a lack of challenger capability, increased cost and complexity as reasons. These responses included a majority of large listed companies, but two challenger firms also expressed concern that the inclusion of international subsidiaries would not increase audit quality in the UK. By contrast, several challenger audit firms and one Big Four firm expressed support for the inclusion of international subsidiaries, with one suggesting it would lead to more meaningful change in the audit market, enabling challenger firms to develop strong international networks and to develop the expertise and skills required to become sole auditors for larger, more complex UK groups. Some challenger firms also stated that the inclusion of international subsidiaries would enable challenger firms to demonstrate their ability to coordinate and direct their international operations, which is a critical component of conducting an audit of a large multinational company.

Other aspects of the design of the managed shared audit regime

8.1.10 As well as asking for views on the composition of the meaningful proportion, the White Paper asked how else the managed shared audit regime should be designed to incentivise challenger firms to invest in building capability and capacity. In response, many stakeholders took the opportunity to discuss the current capacity of challenger firms in general terms, without directly addressing the design of the managed shared audit regime. These responses have been summarised above and are broadly in line with the responses received in response to the Government's previous consultation and the CMA's market study.

8.1.11 Finally, 26 respondents commented on the White Paper's proposal for the regulator to be permitted to grant exemptions in exceptional circumstances where a managed shared audit may not be viable, including in circumstances where a FTSE 350 company does not receive bids or bids of sufficient quality. These responses included investors, shareholder groups and various listed companies and unanimously voiced support for the concept of an exemption framework of some kind. For example, suggested exemptions included large and complex FTSE 100 companies, listed 'single entities', listed groups with only one meaningful entity, and companies with significant overseas trading. A group that represents finance directors suggested exemptions would also need to be available for groups (such as financial institutions) where subsidiaries were also PIEs, to uphold audit quality. Some representative organisations of investment companies also suggested there should be exemptions for Alternative Investment Funds within scope of the Alternative Investment Fund Managers Directive: this respondent explained that the directive placed certain additional requirements on investment companies and their managers which would not be compatible with shared audits. Finally, two challenger firms argued that exemptions should be limited to the higher end of the FTSE 100, where exemptions would be necessary due to the absence of suitably skilled challenger firms to take on complex audits.

Market share cap

8.1.12 The White Paper also proposed taking a reserve power to introduce a market share cap. The power would be activated following a consultation by the Government and only if mandatory shared audits do not bring about the desired change to the FTSE 350 audit market within a reasonable period of time. The Government did not ask any specific questions on the design of the power, but welcomed any comments about the use of the power in future.

8.1.13 In response, the Big Four audit firms, two challengers and two large banks suggested that a market share cap should be introduced instead of the managed shared audit regime. Some of the largest FTSE companies also called for the introduction of a market share cap. One Big Four firm suggested that the market share cap should be introduced on a sector-by-sector basis with the regulator determining which segments of the market should be subject to a cap.

8.1.14 By contrast, some mid-tier investment firms suggested that a cap would cause an uneven restriction in choice for companies seeking an auditor. They viewed this as intrusive regulatory intervention within the tendering process, which would limit challenger access to the more profitable end of the market. Similarly, a finance directors' representative group, professional bodies and some business representative organisations stated that they did not

support an immediate market share cap, believing it would have a detrimental impact on audit quality and on competition in the market. The majority of challenger firms also argued against the introduction of a market share cap. They stated that an immediate market share cap would not resolve the issue of lack of resilience at the upper end of the FTSE 350. They also expressed concerns that a market share cap would allow the Big Four to cherry-pick appointments, reducing the opportunities for challenger firms to grow and build their skills.

Government response

8.1.15 The Government recognises that the proposal for a managed shared audit regime elicited mixed views, raising complex operational and definitional questions that will need to be addressed by the Government and ARGA when implemented. **The Government is confident those questions can be addressed and has decided to proceed with the market opening measures**, which will be implemented over time and in a phased manner as audits fall to be tendered under the existing tender cycle. In particular, the Government believes that the managed shared audit requirement provides a strong foundation to build capability and increase choice in the audit market, especially when coupled with the alternative for FTSE 350 companies of appointing a challenger as a sole auditor. This approach builds flexibility into the new regime and offers greater simplicity for those audits that are less complex and those that cannot easily be distributed across two auditors.

8.1.16 In relation to the percentages that should be used to define the boundaries of 'meaningful proportion', the Government plans to legislate to give ARGA the power to set this percentage. This approach will allow the regulator to amend and to increase the percentage over time as challengers grow in capacity and capability, and as the regulator learns more about the effectiveness of the overall managed shared audit regime. The regulator will also have the ability to define the percentage in terms of revenues, profits, assets or audit fees and to set requirements and issue guidance accordingly.

8.1.17 When considering the composition of the meaningful proportion, the Government acknowledges that many stakeholders expressed concern about the prospect of legal subsidiaries being used as the basis of the managed shared audit regime. The Government has listened to these concerns, but notes that in many cases the appointment of challengers to one or more legal subsidiaries will continue to be the cleanest and simplest basis for FTSE 350 companies to divide the group audit, to appoint challenger firms, and to meet the meaningful definition threshold set by the regulator. In addition, the use of subsidiaries also enables challengers to take sole responsibility for their audit and to be accountable to the audit committee. **The Government has therefore decided that legal subsidiaries should remain the primary basis of the managed shared audit regime.** However, the Government does not wish to prevent those companies that believe they can reach the minimum threshold in other ways from doing so in exceptional circumstances. As a result, the Government will provide some flexibility to those companies to seek alternative approaches to identify a meaningful proportion through the exemptions regime in collaboration with the regulator (as described below).

8.1.18 **With respect to international subsidiaries, the Government has decided that FTSE 350 companies should have flexibility to include international subsidiaries when allocating a meaningful proportion if they choose to do so.** The Government believes this approach will enable challenger firms to develop stronger international networks and is persuaded by the argument that removing international subsidiaries from scope would restrict challenger firms' ability to demonstrate the necessary experience to win a group audit in future. As a consequence, an audit committee will have the option to appoint a challenger firm to conduct audits of one or more international subsidiaries in order to meet the minimum threshold as defined by the regulator. However, it is important to note that the audit committee will not be required to include an international subsidiary when deciding how to allocate the group audit under the managed shared audit regime.

8.1.19 **The Government also agrees with those respondents that argued that an exemptions framework should be built into the market opening measures.** It is acknowledged that circumstances may arise where challenger firms may not be able to act as sole group auditor or may not wish to bid for a meaningful proportion of an audit, and where a lack of experience or capacity may significantly compromise audit quality. In addition, the Government acknowledges that the minimum meaningful proportion threshold may represent a very large quantity of audit work in absolute terms for the very largest companies in the FTSE 350. As a result, the Government and the regulator will work together to develop an exemptions framework that balances these practical considerations with the Government's overall objective to increase competition. This framework will allow the regulator to grant exemptions under limited circumstances and to impose conditions on those companies that are granted exemptions, where appropriate.

8.1.20 In addition to pursuing the market opening measures, **the Government intends to make powers available to introduce a market share cap in future.** The Government agrees with those respondents that argued a market share cap should not be pursued at this time, but will retain the option to introduce a market share cap regime if it becomes clear that choice in the FTSE 350 has not significantly improved. This would include a proportion of audits being reserved for challenger firms based on challenger firm capacity and capabilities.

8.1.21 Finally, **the Government and the regulator will continue to work together to identify further non-legislative opportunities to increase choice in the audit market and to stimulate a pipeline of potential market entrants.** The FRC is committed to acting as an 'improvement' and 'educating' regulator, engaging with the sector to explain 'what good audit looks like' and working collaboratively to help firms understand the requirements they must adhere to as they expand. Although the market opening measures will be the main driver for increasing competition in the medium term, the Government expects ARGAs to continue this work and would welcome any supply or demand-side policy proposals it identifies as it takes on additional responsibility for developing competition in the market.

8.2 Operational separation between audit and non-audit practices

What the White Paper proposed

8.2.1 In its market study, the CMA concluded that tensions can arise between the audit and non-audit functions within multidisciplinary firm: in particular, the CMA concluded that the driving motives behind non-audit functions are often poorly aligned with the culture of objectivity, professional scepticism and challenge required by auditors performing a public interest function.

8.2.2 In response to these issues, the White Paper agreed with the CMA's recommendation to give ARGA powers to require and to enforce an 'operational separation' among the largest audit firms. In the White Paper, the largest firms were defined as those firms that carry out statutory audits of 15% or more of the FTSE 350 by audit fees (White Paper, paragraph 8.2.7).

8.2.3 These powers would enable ARGA to: require the creation of independent audit boards within firms (which would have oversight of the firm's audit strategy and audit partner remuneration); require the publication of separate profit and loss accounts for the audit practice; and oversee the remuneration of audit partners with a view to supporting policies and practices that reward high-quality audits. These powers broadly align with the CMA's recommendations, but the White Paper explained that the Government had decided not to take forward the CMA's proposal to introduce a requirement for separate profit pools between the audit and non-audit divisions within firms on a statutory basis. It is also important to note that the Big Four firms are currently working to implement an operational separation on a voluntary basis, and the Government is grateful to the FRC for developing voluntary principles for operational separation in advance of legislation.

8.2.4 The White Paper also sought views on taking a reserve power for the Secretary of State to require full structural separation of audit and non-audit businesses in future, should the operational separation proposals not deliver sufficient improvements in audit quality. The White Paper acknowledged that a full split would pose significant challenges, but these powers would provide policy flexibility to act once the Government and regulator had gained further evidence on the efficacy of the proposed suite of measures.

Issues arising from consultation

8.2.5 The Government received 74 responses to the questions on whether ARGA should be given formal powers to deliver the operational separation of audit firms' statutory audit and non-audit functions. The responses were split, with 60% in favour of the proposals and 40% against.

8.2.6 Among audit firms, 69% of challenger and other mid-tier firms were in favour of operational separation, but suggested that the proposal should apply only to the largest firms. Overall, these responses suggested that operational separation would be a method to increase

independence and professional scepticism. At the same time, several respondents, including the Big Four audit firms, highlighted that the Big Four were already voluntarily implementing operational separation. On this basis, they felt that legislation to implement operational separation was unnecessary.

8.2.7 Three of the 16 listed companies that responded on these questions, as well as nine other respondents from different stakeholder groups, were concerned that operational separation might drive up the cost of audits without sufficiently improving audit quality. Six listed companies, as well as a representative body for finance directors and several other responses emphasised that, where operational separation is in place, there is a need for audit firms still to be able to access other specialist resources and expertise drawn from the wider firm, such as valuation experts, actuaries, pensions experts or IT experts. However, two listed companies and a few responses from think tanks, investors and their representatives expressed the view that the proposed measures would not go far enough. They proposed that the Government should instead mandate a full structural separation of audit and non-audit businesses within the firms to improve resilience and quality.

8.2.8 The White Paper also asked for comments on the proposal to require audit firms to provide annual reports on their partners' remuneration to the regulator. In response, the Big Four expressed the concern that there was no justification for providing detailed information such as the names of individual partners, their performance and rewards. Instead, they suggested that information should focus on a clear correlation between overall partner audit quality and performance or reward. Separately, one of the Big Four firms and a challenger firm expressed concerns about any possible publication of this information, stating it could lead to confidentiality issues.

8.2.9 Some professional associations and some challenger audit firms suggested that requiring reports on remuneration would be excessive regulation. An investor representative body suggested the Government look for alternative measures that would enable shareholders to hold the auditors of the companies they owned to account. Responses from another investor representative body suggested that operational separation proposals would lead to greater transparency of audit partner remuneration and they were therefore supportive of the proposals.

8.2.10 The White Paper also asked for comments on how mandating split profit pools could work effectively, if the Government decided to pursue this proposal at a later stage. Several audit firms including some of the Big Four stated that they were against split profit pools. They were concerned that separating profit pools could reduce access to investment capital for audit firms as they would have a smaller pool to draw from. One investor did not think split profit pools would impact on a firm's access to capital. Instead, they suggested that firms could reduce profit distribution to partners in the short term in order to create a future capital investment pot.

8.2.11 Of the 19 comments received on the proposal for full structural separation, the Government received 14 comments which clearly opposed the suggestion, including responses from the Big Four, some mid-tier audit firms, two stakeholders in investments and a

professional body. Their predominant concern was that full structural separation would significantly increase the cost of audit, through costs for staff, overheads and subcontracting of specialist services, while there was a lack of evidence that it would improve audit quality. However, five other responses stated that – although they did not support the introduction of structural separation now – they might be open to the proposal following another full stage of consultation on what those proposals would be at the time.

Government response

8.2.12 The Government has considered responses to the White Paper and welcomes the progress that FRC has made in implementing operational separation on a voluntary basis with the Big Four firms. However, the Government believes that it is important to underpin these voluntary arrangements with legislation, which will ensure clarity and provide ARGA with the power to maintain a clear set of rules that will apply consistently across the largest firms. As a result, **the Government will legislate to give ARGA powers to design and deliver an operational separation**. Overall, the Government believes that operational separation will encourage greater professional scepticism and reform the balance of incentives within firms, while maintaining the advantages of their multidisciplinary structures. In particular, the Government continues to support the CMA's vision of independent audit boards within firms, which will provide greater oversight of auditor training, remuneration and the overall strategy of the audit practice.

8.2.13 Alongside measures relating to internal governance, **the Government continues to support increased transparency in relation to the financial statements of the audit practice and remuneration policies that set audit partner pay. ARGA will be given appropriate powers to increase transparency in both of these areas, including rules to require the publication of separate financial profit and loss financial statements for audit practices**. These powers will also enable ARGA to oversee audit partner remuneration structures to ensure the partners' incentives are effectively aligned to audit quality, and to require the publication of remuneration policies within the largest firms. These rule-making powers will be used proportionately and the Government agrees with those respondents that stated that public disclosures relating to pay should not include detailed information on the pay of individual audit partners.

8.2.14 Looking to the future, **the Government continues to believe that it would not be proportionate at this stage to mandate separate profit pools within multidisciplinary firms**. Responses to the White Paper, alongside responses to previous consultation exercises, raised a wide range of concerns about this proposal and the Government agrees that this should not be taken forward on a legislative basis until evidence is available to demonstrate that shared profit pools result in a detrimental impact on audit quality.

8.2.15 Finally, **the Government intends to seek a power to make regulations to deliver full structural separation of audit and non-audit parts of the business if operational separation fails to yield an increase in audit scepticism, independence and quality**. Were these regulations ever needed, they would be subject to consultation, as well as Parliamentary scrutiny, before they were implemented.

8.3 Resilience of audit firms and the audit market

What the White Paper proposed

Regulatory powers to monitor resilience of the audit market and to take action in the event of an audit firm failure

8.3.1 In the White Paper, the Government noted that the collapse of a major audit firm, while unlikely, would have a very detrimental impact on competition in the market and choice for audited entities. As a result, the White Paper stated the Government's intention to give ARGA a series of powers to identify and address resilience issues before a collapse occurred and to take a reserve power that would enable ARGA to take action in the event of a collapse.

8.3.2 Firstly, these powers would give ARGA the ability to require information from audit firms that conduct audits of PIEs (White Paper, paragraphs 8.3.12, 8.3.15, 8.3.18). The intention behind this was to place the FRC's existing monitoring arrangements on a statutory footing, so that ARGA can identify systemic issues that might have adverse consequence on firm-level resilience. This will include enabling ARGA to require information about firms' ongoing financial viability, including information relating to their risk management, internal controls and budgets. It would also include powers to gather information in relation to insurance arrangements and capital reserves. The FRC currently has a duty to monitor the developments of the PIE audit market and, collectively, the information-powers described above would enable ARGA to fulfil this duty when it is extended to the whole statutory audit market in line with recommendation 72 of the FRC Review.

8.3.3 Secondly, ARGA would have the power to commission an expert review of an audit firm (White Paper, paragraph 8.3.16). This would enable the regulator to receive expert information about aspects of a firm's activities where it has concerns or requires further analysis. Under this proposal, the costs of any report commissioned by the regulator would be paid by the audit firm.

8.3.4 Thirdly, the White Paper proposed to enable the regulator to require firms to address any viability concerns that are identified during the course of its monitoring (White Paper, paragraph 8.3.19). Among other things, the regulator could require firms to model the impact of certain distress scenarios (such as reputational damage, network contagion and the loss of key staff or contracts) or to require firms to put in place additional safeguards within their internal monitoring arrangements.

8.3.5 Fourth, the White paper stated that the Government was considering whether to give the regulator powers to mandate minimum insurance levels and capital requirements (White Paper, paragraphs 8.3.20) to ensure that firms are adequately protected against future liabilities and risk. This Government recognised that this proposal would increase the cost of audit firm insurance and welcomed views on this proposal in response to the White Paper.

8.3.6 Finally, the White Paper noted that the regulator may require certain powers to act in the event of the collapse or pending collapse of a major audit firm. The Government did not agree with the CMA's proposal that the regulator should have the ability to take executive

control of a failing audit firm on a temporary basis: the Government concluded that this proposal was unlikely to be effective in practice. However, a collapse would be likely to lead to further concentration in the market, so the White Paper proposed that the regulator would have the ability to operate a market share cap in the event of a pending collapse (White Paper, paragraph 8.3.24). This share cap mechanism would be used to limit the proportion of audits from the collapsing firm that could be taken on by the remaining large audit firms. As a result, the cap might incentivise audit partners and staff from the collapsing firm to join the challenger firms that received new audit work through the market share cap mechanism.

Further competition and market powers

8.3.7 In addition to the proposed powers relating to firm resilience, the White Paper also made two proposals to give ARGA specific competition powers.

8.3.8 First, the White Paper proposed that ARGA would be given the power to carry out market studies under Part 4 of the Enterprise Act 2002. ARGA would exercise this power concurrently with the CMA and, having conducted a market study, it would be able to make a referral to the CMA to conduct a full market investigation.

8.3.9 Second, the White Paper proposed to give the regulator powers to take enforcement action to address anti-competitive practices and an abuse of dominant position within the statutory audit market under the Competition Act 1998. The White Paper noted that several regulators (such as the FCA and Payment Systems Regulator) already have similar powers, which they exercise concurrently with the CMA in respect of the sectors they regulate.

Issues arising from consultation

Regulatory powers to monitor resilience of the audit market and to take action in the event of an audit firm failure

8.3.10 In the White Paper, the Government sought views on the measures described above and asked whether the Government should consider any additional measures to address the lack of resilience in the audit market. The Government received 44 responses. Of these, a very small proportion provided detailed responses to each of the individual measures described above, but the majority of responses either commented on isolated measures or provided general views on the resilience of the audit market. As a result, it is not possible to summarise the level of support or opposition to specific measures in a statistically meaningful way.

8.3.11 Turning to the individual measures, stakeholders generally appeared to share the Government's overriding proposition that ARGA should have a duty to monitor the resilience of the audit market and be equipped with appropriate information gathering powers to do so. The Government received no responses that actively opposed this proposal, while support included respondents from the largest audit firms. A small number of respondents provided specific comments about the use of information and the scope of the information gathering powers, however. For instance, a professional body stated that the powers to gather information should not extend to firms that did not audit PIEs. Another respondent also noted that the current audit firm monitoring and supervision scheme could significantly alter the business strategies and models of some challenger firms if its scope is expanded in future.

8.3.12 Similarly, the Government did not receive many responses in relation to its proposal to give the regulator powers to commission an expert review of PIE audit firms, with only seven respondents engaging with this issue. One Big Four firm stated that it did not object to the proposal in principle, but noted that the regulator should make proportionate use of this power, given the costs it would incur. In addition, one challenger firm and an accountancy body noted that a clear implementation framework would be needed to outline the scope of the regulator's powers to commission an expert review of an audit firm.

8.3.13 The White Paper also sought views on giving the regulator powers to mandate minimum insurance levels and capital requirements and to require firms to address viability concerns during monitoring. Very few respondents offered views on the proposal to address viability concerns, though some reiterated the importance of maintaining confidentiality as ARGA acquires new information relating to audit firms' finances. However, more comments were provided in response to the proposals regarding insurance and capital requirements, which were not supported by the Big Four, some listed companies and some challenger firms on the basis that there were insufficient commercial insurance options in the market to make it viable. Large listed companies, professional bodies and challenger firms also highlighted that minimum insurance levels might lead to disproportionate costs, without any beneficial impacts on quality or resilience.

8.3.14 The Government's proposal in relation to a market share cap that could be activated in the event of a collapse also received comparatively few comments. A Big Four firm commented on the proposal, noting that further information would be helpful to understand how it would work in practice. One large listed company did not respond to this particular proposal but noted that they would not support any measure that imposed a particular audit firm or undermined the responsibilities of audit committees.

8.3.15 Finally, a small number of respondents offered alternative measures to increase resilience in the audit market. In particular, all Big Four firms, large challengers and some mid-tier firms stated that the introduction of liability caps, or liability limitation agreements, would deliver greater market resilience. Some firms also suggested that this would also incentivise mid-tier firms to step up to managed shared audits.

Further competition and market powers

8.3.16 These proposals did not generate significant attention from stakeholders, with very few engaging with them or distinguishing between the proposed powers in the Enterprise Act 2002 and the Competition Act 1998.

8.3.17 Of those that did respond, a challenger audit firm, a Big Four audit firm, a listed company and a professional association broadly stated that ARGA should be given powers to monitor competition to conduct market studies. However, a professional association suggested that the Competition Act 1998 powers should remain solely with the CMA and should not be extended to ARGA. A Big Four audit firm also expressed concern at ARGA's lack of experience in handling competition issues and urged caution in giving ARGA competition powers.

Government response

Regulatory powers to monitor resilience of the audit market and to take action in the event of an audit firm failure

8.3.18 The Government has considered the views offered in relation to monitoring the resilience of the audit market.

8.3.19 Going forward, **the Government has decided to extend the FRC's duties to monitor developments in the PIE audit market to the whole statutory audit market** in line with recommendations 72 and 73 of the FRC review. To support this decision, the Government will also pursue the proposal to give ARGA the power to require information to monitor the health and viability of firms. ARGA will be required to use these powers proportionately and the Government will legislate to create a clear framework to establish the purpose behind these powers. As stated in the White Paper, these powers will allow ARGA to require information relating to firms' audit quality and firm-level resilience, including in relation to performance, financial resources, insurance arrangements, risk management, internal controls and budgets.

8.3.20 To supplement its information gathering powers, **ARGA will also be given appropriate powers to require audit firms to address any audit quality and resilience concerns identified**. For instance, ARGA could use these powers to require a firm to conduct modelling of distress scenarios or to include certain measures when updating a contingency plan. In turn, **ARGA will also be provided with necessary powers to enforce against any non-compliance if firms fail to comply with information requests or with ARGA's use of its powers to address viability concerns**. However, the Government does not anticipate that ARGA's enforcement powers will need to be routinely relied upon in practice and would encourage firms and the regulator to continue to take a collaborative approach as they have done under the current voluntary arrangements.

8.3.21 The Government has also considered the responses offered in relation to giving the regulator the power to commission an expert review of audit firms. The respondents who engaged were broadly supportive of this proposal **and the Government intends to proceed to give ARGA similar powers to those contained in section 166 of the Financial Services and Markets Act 2000**. Having reflected further on the appropriate alignment between the expert review powers being introduced for companies and for audit firms, and to ensure that an expert review of a company can be supplemented by a review of its auditor, the Government intends to make the power available in relation to all statutory audits. However, **the Government has decided not to proceed with proposals to require minimum insurance levels and capital requirements**. Having considered responses to the White Paper, the Government acknowledges that the lack of suitable commercial options available within the market is likely to make this proposal unworkable in practice.

8.3.22 **The Government has also noted submissions that propose a statutory liability cap as a mechanism to improve resilience in the market. The Government has considered these proposals and does not believe they are necessary in light of the**

other proposals that are being taken forward. A liability cap would limit the ability of companies and shareholders to seek sufficient resolution in the event of audit failure.

8.3.23 **The Government will also legislate to provide ARGA with the ability to operate a market share cap in the event of a failure of a major audit firm.** This measure is intended to give the regulator the ability to react quickly and to limit further concentration in the FTSE 350 audit market in the event of firm failure.

Further competition and market powers

8.3.24 Finally, **the Government intends to extend the market monitoring powers under the Enterprise Act 2002 to ARGA, so that the regulator can effectively conduct market studies. However, the Government will not extend the Competition Act 1998 powers to ARGA.** In light of the responses, the Government does not believe that it is necessary for ARGA to hold powers under the Competition Act, as ARGA would still be able to refer concerns to the CMA about anti-competitive practices within the audit market. The CMA will carefully consider any concerns raised by ARGA to decide whether an investigation is required.

9 Supervision of audit quality

It is important that ARGAs responsibilities and role in supervising audit quality are clear and can be carried out effectively. The Government will therefore enable the regulator to reclaim the approval of statutory auditors of PIEs. It will ask the regulator to consult stakeholders to identify ways to increase the usefulness of information published on Audit Quality Review (AQR) findings and enhance the AQR process. The Government will also encourage the regulator to work with relevant stakeholders on the issue of legal professional privilege and this issue will be reassessed in the planned Post-Implementation Review.

9.1 Approval and registration of statutory auditors of PIEs

What the White Paper proposed

9.1.1 In section 9.1 of the White Paper, the Government set out its proposals for allowing the regulator to reclaim from the Recognised Supervisory Bodies (RSBs) the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs. The aim of reclaiming this function was to ensure that the regulator as the competent authority had the necessary autonomy over approving those who are in charge of auditing PIEs. The consultation asked whether respondents agreed with this approach.

9.1.2 To achieve this, the Government stated its intention to revoke a Ministerial Direction from 2016 that requires the FRC to delegate certain tasks to the RSBs other than in certain circumstances.

Issues arising from consultation

9.1.3 There was much more support for the proposal for the FRC to reclaim this function than there was disagreement: around 50% of respondents who commented agreed with the proposals compared to 17% against them. Other responses did not express a clear view one way or another.

9.1.4 Some respondents, including two of the Big Four, a number of challenger firms and a small number of smaller accountancy firms, suggested that the current regime with the RSBs determining the eligibility criteria was sufficient.

9.1.5 On the other hand, two Big Four firms, as well as the majority of smaller audit firms, agreed in principle with the proposal. Respondents also emphasised that details and practicalities of the new regime would need further clarification from the regulator.

9.1.6 Respondents who expressed support for this proposal felt it was logical and sensible for the regulator to have the responsibility of determining eligibility of statutory auditors of PIEs. There was also a suggestion that this might increase the quality of PIE audits.

9.1.7 Two RSBs indicated that they were in principle supportive of the move for the FRC to reclaim this function. Another RSB raised objections specifically on the proposed revocation of the 2016 Ministerial Direction and suggested that maintaining the Ministerial Direction on delegation offered certain protections and assurance for them that the regulator would not take precipitate action, for example to reclaim non-PIE auditor registration.

Government response

9.1.8 While the Government notes the points of concern expressed, it believes any risks can be mitigated effectively, including the issue of certainty for the RSBs. Effective engagement and subsequently amended delegation agreements can provide any necessary assurances between the regulator and the RSBs. While this does not entirely rule out further justified changes in the longer term, the risk of shorter-term disruption would be managed.

9.1.9 As the White Paper set out, the Government's aim is for the regulator to have more control over who audits the most significant UK entities (that is, PIEs). Ultimately the Government's proposals in this area will provide the regulator with the necessary ownership for the approval of statutory auditors of PIEs, enabling more oversight of the registration process. The Government believes this will help strengthen the regulator's ability to hold those it regulates to account.

9.1.10 **The Government is therefore retracting the 2016 Ministerial Direction** that currently directs the FRC to delegate all those tasks which the law permits to be delegated to the RSBs, other than in certain circumstances. A copy of the new Ministerial Direction which achieves this retraction is attached to this document as Annex C; this Direction has been sent to the FRC and copied to the relevant professional bodies. This new Ministerial Direction will come into effect on 31 July 2022. This will enable the regulator to move forward with reclaiming the function of determining the eligibility criteria for approval of statutory auditors of PIEs.

9.1.11 The Government is keen to see a smooth transition in responsibility for the various steps involved in PIE auditor registration, and is grateful for the engagement that RSBs have shown in discussion with the regulator to date. The Government encourages the RSBs to continue to work cooperatively with the FRC in giving effect to the new Ministerial Direction. The Government also expects the regulator to act proportionately, and in a manner consistent with the Regulators' Code⁷⁹, in deciding whether and how tasks arising from its responsibilities⁸⁰ may be delegated or reclaimed from any RSB in future, and in the implementation of any changes.

9.1.12 The regulator will set out in due course how its PIE auditor approval function will operate once it is reclaimed. The FRC is already engaging with relevant RSBs and other stakeholders in preparing for this new regime.

⁷⁹ The Regulators' Code provides a clear, flexible, and principles-based framework for how regulators should engage with those they regulate. See: <https://www.gov.uk/government/publications/regulators-code>. The Regulators' Code applies to the FRC by virtue of the Financial Reporting Council (Miscellaneous Provisions) Order 2021 (SI 2021/408).

⁸⁰ Regulation 3(1) of Statutory Auditors and Third Country Auditors Regulations 2016

9.2 Monitoring of audit quality

What the White Paper proposed

9.2.1 Section 9.2 of the White Paper set out proposals to legislate for the publication of Audit Quality Review (AQR) reports. The aim was to allow the regulator to publish its AQR reports on individual audits without the need for consent from both the audit firm and the audited entity, as is the case at present.

9.2.2 Recognising that publication of AQR reports, even in summary form, could result in the inappropriate disclosure of sensitive information, the Government asked respondents specifically what types of sensitive information within AQR reports on individual audits should be exempt from disclosure.

9.2.3 The Government also asked what other safeguards would be required to protect the audited entity. The overall intention of these proposals was to provide users such as investors with more transparency regarding the information contained in AQR reports, enabling them to make better informed decisions.

Issues arising from consultation

9.2.4 The responses from the Big Four and challenger audit firms, as well as many companies, indicated they did not agree with proposals to remove the consent mechanism for publication, and proposals to “publish in full” without anonymisation. Reasons for opposition included a view that AQR reports could easily be misinterpreted if published in full without relevant consent. Respondents also highlighted that internationally no other audit regulator published equivalent reports without anonymisation.

9.2.5 Many responses focused on the overall principles of AQR report publication and offered limited insight into the particular information that would need to be safeguarded under the White Paper proposal. Of responses that expressed a view on safeguards, there was a common theme in responses that commercially sensitive information should be redacted from AQR reports. Some respondents said it would be difficult to pre-determine exactly what types of information should be prevented from disclosure, as it would differ depending on circumstances.

9.2.6 Investors generally agreed that they would like to see greater transparency relating to AQR reports. However, some also suggested it would be preferable to gain consent from the audit firm and the audited entity first. One group of investors emphasised that to ensure disclosures were useful, investors should have an opportunity to feed into the design of the regulator’s AQR reporting template.

9.2.7 There were also criticisms from respondents, including a number of the Big Four and audit committee representatives, regarding the regulator’s AQR process itself. A number of these respondents suggested the AQR process should do more to help audit firms improve their standards and to encourage market entry by smaller firms. In addition, there was concern

that the AQR assessment process focused more on individual areas of an audit rather than the overall quality of the audit work.

Government response

9.2.8 This proposal was set out in the White Paper as a measure to increase the transparency of the regulator's review of audit quality. The Government agrees that publication of AQR reports without discussion with the relevant audit firm and audited entity could be problematic – a point that many respondents have raised.

9.2.9 Nevertheless, the Government also believes that delaying or preventing publication of significant findings in AQR reports, where the regulator believes publication to be in the public interest, is also problematic and could prevent the disclosure of potentially useful information to investors and other users. This is a particular risk where consent is required to publish reports of unsatisfactory audits.

9.2.10 An important consideration raised in consultation responses is whether the current AQR process itself could be improved, both in terms of how it is carried out and how it is reported. In particular, the Government welcomes the suggestion that investors should play an active role in shaping what information relating to the findings of audit monitoring and supervisory activities is published by the regulator.

9.2.11 Taking these points together, the Government considers that measures to enhance the information published on AQR findings should focus on ensuring the publication of more useful information for investors (including private equity firms) and other users of audited financial information. It also believes that audit committees have an important role to play in providing such information. Accordingly, the FRC plans to enhance its engagement with audit committee chairs on AQR findings and will revise and strengthen its current guidance for audit committees regarding reporting on AQR findings.

9.2.12 Rather than legislating specifically for the publication of AQR responses by the regulator, **the Government is asking the FRC to look at non-legislative ways of improving the AQR process and continuing to seek consent from audit firms and audited entities where possible before publication. In addition, the Government is asking the regulator to engage with investors and other users to improve the usefulness to them of the information published on AQR.**

9.2.13 Nevertheless, the Government believes that ARGAs will need a proportionate mechanism for publishing information for which consent cannot be obtained, where it is in the public interest to do so. This would tackle issues where consent to publish is sought but is ultimately withheld to suppress information that would reflect badly on an audit firm, for example. These situations are not necessarily exclusive to AQR report publication.

9.2.14 **The Government will therefore ensure that ARGAs are equipped with general broader powers and functions that allow them to publish the information necessary for them to**

be an effective regulator⁸¹. This could allow publication of AQR reports where consent has been withheld, only after a process of discussion with stakeholders. Publication of reports without consent would only be in instances where the regulator deems it is necessary and in the public interest to publish, and would be done as a last resort.

9.3 Regulating component audit work done outside the UK

What the White Paper proposed

9.3.1 Section 9.3 of the White Paper summarised the Government's intention to equip the regulator with its own powers to require a UK group auditor to provide it with access to the working papers of auditors of overseas components of the group. This would be a departure from relying on the RSB rules for access to be provided to the regulator, as is the case at present.

9.3.2 The consultation asked if respondents agreed with the Government's approach in this area. The aim of the Government's proposals was to ensure that it was the regulator who set out the rules and requirements regarding access to audit working papers, rather than having the RSBs and their rules as an intermediary.

Issues arising from consultation

9.3.3 There was broad support for this proposal: the majority of respondents who expressed a view agreed with the Government's plan to provide ARGAs with powers to require a UK group auditor to provide it with access to overseas component working papers.

9.3.4 76% of respondents who expressed a clear view indicated that they were in agreement with the Government's proposed approach, compared to 24% of respondents who were against this approach. The majority of listed companies and investors were in support of the Government's proposals.

9.3.5 Although there were mixed views from some audit firms, on the whole there was more support than opposition from audit firms for this measure.

9.3.6 Some respondents who were against the Government's proposed approach described potential challenges to accessing working papers due to overseas laws. For example, it was mentioned that local overseas laws around professional privilege or professional secrecy could impede access to component working papers from certain countries. A Big Four firm questioned why the regulator would require its own powers over and above what is provided for in the RSB rules and International Standards on Auditing.

Government response

9.3.7 Having considered the comments on this measure set out above and discussed them with the FRC, the Government has concluded that current arrangements already allow the

⁸¹ See Chapter 4.12 for a further example of where the general power to publish information might be used.

regulator to obtain access to overseas component working papers, without needing to rely solely on RSB rules, subject to the issue of restrictions imposed by other countries. **The Government therefore intends to maintain the existing arrangements on access to overseas component working papers.** This will give ARGA access to relevant overseas component working papers where possible, so it can carry out its regulatory functions effectively and can assess thoroughly how well the UK group auditor has discharged its responsibilities.

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

What the White Paper proposed

9.4.1 Legal professional privilege is a special legal protection for certain confidential communications between a client and their lawyer. The FRC previously identified that particular documents may in some cases be inaccessible to the regulator when it is reviewing the work of the auditor, because of the audited entity's legal professional privilege.

9.4.2 Section 9.4 of the White Paper asked respondents if they agreed if it was problematic that documents that the auditor reviewed as part of the audit were sometimes unavailable to the regulator due to the audited entity's legal professional privilege. The White Paper also sought views from respondents on any potential solutions they had for resolving this issue.

Issues arising from consultation

9.4.3 Of respondents who expressed a clear view, 59% disagreed that the regulator not having access to legally privileged material was problematic. This included most audit firm respondents including the Big Four, challenger firms and smaller audit firms. Some respondents also added their view that this was not an issue that occurred frequently.

9.4.4 Many respondents (particularly legal professionals) emphasised that legal professional privilege was a fundamental principle to maintain. These respondents underlined that it would be challenging to come to a resolution that did not dilute the principle of legal professional privilege.

9.4.5 Of those respondents who expressed a view, including some investor groups and listed companies, 41% agreed that unavailability of documents subject to legal professional privilege was problematic. Some respondents who indicated that unavailability of documents was problematic also stressed that it would be crucial to ensure there was limited circulation if the regulator did have access to privileged material. Respondents on the whole were also inclined to think that privileged material should only be accessed in limited circumstances.

9.4.6 The Big Four audit firms and business representative groups did not agree there should be measures to waive or set aside legal professional privilege. Some suggested that any type of waiver on legal profession privilege without consent might reduce the transparency

and quality of audit, as audited entities might choose to withhold information if there was a risk it could be disclosed more widely.

Government response

9.4.7 Legal professional privilege is a cornerstone of the UK legal system. The Government notes the concerns around any waiver or disapplication, particularly from legal professionals, and understands there are concerns around how any waivers for the regulator would work in practice. While it is undesirable for the regulator's access to important audit documents to be restricted, the Government acknowledges the real challenges to finding a workable solution to this complex issue.

9.4.8 The Government encourages legal and audit professionals to work with the regulator to resolve any issues that arise from instances where privileged documents shared with the auditor are not available to the regulator's quality review system and enforcement system. Auditors who cannot share key documents will find it hard to demonstrate the quality of their audit, and may need to convince audited entities to provide access to the regulator in some mutually acceptable manner. This might for example involve a data room or other mechanism that allows the regulator to see a document but not retain a copy.

9.4.9 In the event that lack of access to documents due to claims of legal professional privilege poses ongoing difficulties for effective regulation, the Government would expect this to be identified as part of its planned Post-Implementation Review.

10 A strengthened regulator

ARGA will have clearly defined roles and powers and will be empowered to exercise its expert judgement to further its objectives. The Government intends to implement the White Paper proposals regarding the objectives and governance arrangements for ARGA, as well as proposals to fund the regulator through a statutory levy. As ARGA is given new enforcement powers, it is crucial that the appropriate mechanisms are in place in the event that decisions taken by the regulator are challenged.

What the White Paper proposed

10.1 The White Paper set out the Government's decision to set up ARGA on a statutory basis. It asked for comments on proposals that the regulator should have a general objective to "protect and promote the interests of investors, other users of corporate reporting and the wider public interest"; and on the two operational objectives:

- "to promote high quality audit, corporate reporting, corporate governance, accounting and actuarial work"; and
- "to promote effective competition in the market for statutory audit work".

10.2 As noted in section 1.5, the Government has proposed that ARGA take on an additional role as system leader for local public audit in England. This proposal includes setting a dedicated objective for ARGA's local audit work: to ensure the local audit system operates effectively. More detail on the Government's wider local audit proposals is in section 11.5 below.

10.3 The White Paper also set out four regulatory principles to which ARGA should have regard when carrying out its policy-making functions:

- promoting innovation in statutory audit work, corporate reporting and corporate governance;
- promoting brevity, clarity and usefulness in corporate reporting;
- working closely with other regulators from the UK and internationally; and
- anticipating emerging corporate governance, reporting or audit risks by being forward-looking and acting proactively where possible.

10.4 These are in addition to those duties to which ARGA will be subject by virtue of public law.

10.5 The White Paper also set out details of the Government's intention that ARGA will be:

- established as a company limited by guarantee;
- governed by a new, smaller board to improve effectiveness and responsiveness;

- given strategic direction by Government and accountable to Parliament; and
- funded by a statutory levy.

10.6 Distinct arrangements have been proposed for local public audit (potentially including health audit) in England. These, and the proposed local audit objective, are subject to a separate technical consultation⁸² but will be outlined below to show how they relate to the Government's intentions for creating ARGA.

Issues arising from consultation

10.7 Just under a third (189) of all responses addressed the issues in this chapter.

Objectives

10.8 Of the 112 responses received regarding objectives, the vast majority – nearly three quarters (79) – agreed that ARGA should have the general objective set out, with most also agreeing with the two operational objectives. There were some concerns raised that the general objective was too broadly defined and suggestions were made that rather than just specifying investors, it should refer to stakeholders, with one respondent suggesting replacing the reference to investors in its entirety.

10.9 Some respondents questioned how ARGA would be able to balance its two operational objectives and made a case for the quality objective to have primacy. There were some responses which called for ARGA to have an additional economic objective.

Regulatory principles

10.10 Of the 104 responses, over 90% supported adoption of the regulatory principles set out. A significant minority of respondents recognised that ARGA would be bound to act in a proportionate manner – both in terms of risk-based enforcement and in terms of value for money and impact – by current legal requirements and the Regulators' Code, but many still supported inclusion of an additional principle explicitly covering "proportionality". A few respondents suggested that two further principles should be considered: "promoting quality in statutory audit work, corporate reporting and corporate governance", and "anticipating emerging corporate governance, reporting or audit benefits". Respondents argued that the first of these principles would ensure that ARGA was not just focused on "negatively inclined risks but also on potential benefits". This was consistent with calls from a number of respondents to promote ARGA as an "improvement" regulator.

Governance

10.11 Whilst there were no specific questions on governance or funding, a few respondents commented on these.

⁸² <https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical-consultation>

10.12 Just under 5% of those responding to this chapter called for greater Parliamentary oversight of ARGA beyond that set out in the White Paper, including a requirement to appear before the BEIS Select Committee.

Funding

10.13 Just over 5% of those responding on this chapter raised the issue of funding. These responses made the point that it was important that ARGA was adequately funded on a fair and proportionate basis, by all of those that it regulated, and that funding from some groups should not cross-subsidise others.

Government response

Objectives

10.14 The Government has noted the near overwhelming support for the general objective – to protect and promote the interests of investors, other users of corporate reporting and the wider public interest – expressed in the responses and therefore **the Government intends to proceed with the formulation set out in the White Paper**. A few respondents suggested changing the general objective to refer to stakeholders and not just investors. The Government does not wish to use ARGA's objectives to adjust the statutory position in relation to shareholder primacy, so is not convinced to make this change.

10.15 With regards to the operational objectives – (i) the Quality objective: To promote high quality audit, corporate reporting, corporate governance, accounting and actuarial work, and (ii) the Competition objective: To promote effective competition in the market for statutory audit work – the Government is not persuaded that one objective should always take primacy over another. The Government considers that ARGA will be best placed to judge how to balance the operational objectives against each other in the carrying out of its functions. The Government notes that this is likely to change from one function to another, and potentially over time as reforms drive greater competition in the market.

10.16 It was suggested that ARGA should have an economic objective. The FRC already has a current economic growth duty via section 108 of the Deregulation Act 2015, which applies to the FRC by virtue of The Economic Growth (Regulatory Functions) Order 2017 (S.I. 2017/267). This duty and the FRC's duties under the Freedom of Information Act 2000 and the Equality Act 2010 will be carried over to ARGA.

10.17 For these reasons the Government intends to adopt the objectives for ARGA as set out in the White Paper.

10.18 As set out in the Government's response to *Local Audit Framework: technical consultation*⁸³, the Government proposes that as the system leader for local audit, ARGA

⁸³<https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical-consultation>

should have a further objective, to ensure the local public audit system in England operates effectively, that applies to its local audit work.

Regulatory principles

10.19 In response to the suggestion of an additional regulatory principle setting out the need for proportionality, the Government does not believe this is necessary. In the same way as there is already an economic duty on FRC which will carry over to ARGA, there is also already a clear requirement on regulators to act proportionately both in general public law and in the Regulators' Code⁸⁴.

10.20 The Government has considered whether it is beneficial to add two further principles suggested: “promoting quality in statutory audit work, corporate reporting and corporate governance” and “anticipating emerging corporate governance, reporting or audit benefits”. The principles proposed in the White Paper already require ARGAs to promote innovation in statutory audit work, corporate reporting and corporate governance as well as promoting brevity, clarity and usefulness in corporate reporting. Those principles already address the concerns raised that ARGAs should have a positive developmental effect on the delivery of audit and reporting, much as the FRC already endeavours to drive best practice in these spaces. The Government does not therefore believe that it is necessary to include the additional principles suggested. **The Government intends to adopt the regulatory principles for ARGAs to have regard to, as set out in the White Paper with slight amendments to the first and fourth to include specific mention of the actuarial profession:**

10.21 Regulatory principles (for ARGAs to ‘have regard’ to):

- Promoting innovation in statutory audit work, corporate reporting, corporate governance and actuarial work;
- Promoting brevity, clarity and usefulness in corporate reporting;
- Working closely with other regulators from the UK and internationally;
- Anticipating emerging corporate governance, reporting, professional regulation, actuarial or audit risks by being forward-looking and acting proactively where possible.

10.22 The Government also proposes to give ARGAs responsibility for ensuring that local public audit in England includes a commentary on value for money arrangements as required by the Local Audit and Accountability Act 2014.

Governance

10.23 As set out in the White Paper, it is the intention that ARGAs will be accountable to Parliament, but the Government recognises that it will need to remain sufficiently independent

⁸⁴ The Regulators' Code provides a clear, flexible, and principles-based framework for how regulators should engage with those they regulate. See: <https://www.gov.uk/government/publications/regulators-code>. The Regulators' Code applies to the FRC by virtue of the Financial Reporting Council (Miscellaneous Provisions) Order 2021 (SI 2021/408).

of Government in order to exercise its functions effectively. In the Government's recent paper *The benefits of Brexit*⁸⁵, the Government set out that its first principle of regulation would be "A sovereign approach: we will use our new freedoms to follow a distinctive approach based on UK law, protected by independent UK regulators, and designed to strengthen UK markets."

10.24 The White Paper set out that it is **the Government's intention to issue ARGAs with a remit letter at least once during the lifetime of each Parliament**, setting out those matters which the regulator should consider when exercising its policy-making functions. ARGAs will have a duty to respond to that letter setting out what it intends to do as a consequence of the letter. The letter and the reply will be published and laid before Parliament. This process will be placed on a statutory basis, which is consistent with other regulators who are similarly required to consider the Government's strategic priorities or certain aspects of the Government policies when exercising their functions. It is proposed that a separate remit letter will be sent in respect of local public audit in England, reflecting the different lines of Ministerial accountability for corporate reporting and for local audit.

10.25 The White Paper also set out that ARGAs will be required to produce an annual report that is submitted to the Secretary of State and laid before Parliament. The annual report will include reporting on the regulator's broader regulatory activities, including performance of the regulator's enforcement function, to enable greater parliamentary scrutiny of the regulator's work and performance. It is also proposed that reporting on local public audit should be a distinct, standing element of ARGAs' annual reporting.

10.26 It is a matter for the BEIS Select Committee to decide when it wishes to take evidence from particular organisations or individuals, not for legislation, so there is no need for Government to prescribe a timetable for this form of accountability. The White Paper did however set out the Government's intention to seek agreement from the Chair of the BEIS Select Committee for the appointment of the Chair of ARGAs to be subject to a pre-appointment scrutiny hearing – as is already the case with the Chair of the FRC.

10.27 **The Government therefore intends to go forward with the proposals from the White Paper to introduce a duty on ARGAs to respond to the remit letter, and to provide an annual report.**

10.28 Acknowledging that some aspects of these reforms are devolved, the Government recognises the need for ARGAs also to be accountable to the respective legislatures and/or administrations of the devolved nations in relation to these aspects. The Government will engage further with the devolved nations to agree suitable mechanisms.

Legal form

10.29 Whilst not raised as an issue by respondents, the White Paper set out **the Government's intention to establish ARGAs as a company limited by guarantee by adopting the existing legal corporate entity used by the FRC**. The Government considers

⁸⁵ *The benefits of Brexit: How the UK is taking advantage of leaving the EU*, January 2022.

that this approach will enable ARGA to be established while minimising the transitional costs which would be involved in setting up a new statutory corporation.

Board

10.30 Further to the White Paper, **the Government will bring forward legislation which will make provision as to the governance of the new regulator, particularly the appointment of the board.** The Government intends that the Secretary of State will be responsible for the appointment of non-executive members including the Chair, and that they will be subject to regulation by the Commissioner for Public Appointments. A nominated board member will have responsibilities for local public audit.

10.31 The Government welcomes the recent changes to the FRC's leadership and board, following the appointment of its new Chair Sir Jan du Plessis and additional non-executive directors. All non-executive appointments to the Board including the Chair are public appointments – the Government has placed the FRC on the Public Appointments Order in Council, so that these appointments are subject to regulation by the Commissioner for Public Appointments. The FRC Board has approved a new governance structure. The new structure gives effect to the FRC Review's recommendations and will be subject to periodic review.

Funding

10.32 **The Government intends to give ARGA statutory powers to raise a levy so that it has a sustainable and independent basis to carry out its regulatory activities.** In particular, the Government intends to carry forward the proposals set out in the White Paper, including giving ARGA the power to make rules requiring that market participants pay a levy to meet the regulator's costs of carrying out its regulatory functions. The FRC will consult on the mechanisms for charging and ensuring that the right people and organisations are levied in a proportionate manner. However, it is proposed that ARGA's local public audit functions should be funded directly via DLUHC rather than a statutory levy.

Enforcement and the right to challenge decisions taken by the regulator

10.33 ARGA will be responsible for setting and applying high standards of corporate governance; monitoring the market and audit firm viability; and regulating the activities of auditors, accountants, accountancy firms and actuaries. It will also have new powers to enforce certain directors' duties.

10.34 As a statutory regulator, ARGA will of course need to adhere to the same high standards that it will expect of those that it regulates, and the Government is clear that ARGA will need to promote proportionate, consistent, and targeted regulatory activity. In line with the Regulators' Code this will involve the development of transparent and effective dialogue with those whose activities ARGA will oversee, along with transparent and effective regulation and enforcement policies.

10.35 Notwithstanding the Government's high expectations of the new regulator, and the various checks and balances in place, it is unrealistic to expect that those who are subject to

regulation and potential enforcement action will always agree with decisions taken by ARGA. So it is right that those who are affected by decisions taken by ARGA should have a right to challenge those decisions and have those challenges heard by an independent and impartial third party. This is a fundamental safeguard, particularly given that, like the FRC, ARGA will have autonomy to set its own enforcement procedures and policies with a view to achieving its objectives in a more agile and flexible way, counterbalanced by increased accountability and scrutiny.

10.36 The method for challenging a decision taken by ARGA needs to be clear, transparent, proportionate, and appropriate to the circumstances that have given rise to the regulator's decision being challenged; including the power that ARGA is exercising and the potential outcomes pursuant to that power. As such, a "one size fits all" approach is both unnecessary and undesirable.

10.37 The types of new powers that ARGA will have at its disposal are summarised below. In addition, the new regulator will assume responsibility for regulatory activities which are currently undertaken by the FRC⁸⁶. Where this is the case, the current arrangements for challenging decisions will continue.

Summary of new powers

10.38 As outlined in this document, ARGA will have new powers to hold PIE directors to account if, in reporting, they do not fulfil their statutory duties (section 5.1 (Enforcement against company directors)), including those relating to the new transparency measures that the Government intends to introduce. The new transparency measures will require directors to prepare and publish: an Audit and Assurance Policy (section 3.2 (Audit and Assurance Policy)); a fraud statement (section 6.2 (Tackling fraud)); a Resilience Statement (section 3.1 (Resilience Statement)); and information about the company's distributable reserves (section 2.2 (Dividends and capital maintenance)). In addition, the regulator's enforcement regimes for accountants and actuaries will be put on a statutory footing, as set out in the White Paper and in Chapter 11 below.

10.39 ARGA will also have a strengthened corporate reporting review function, including a power to direct certain entities to change their reports or accounts (Chapter 4 (Supervision of corporate reporting)), rather than applying to the court for an order to this effect.

10.40 The Government also intends to legislate to give ARGA powers to monitor the audit market and audit firm resilience more effectively and powers to take action to act against regulatory non-compliance (section 8.3 (Resilience of audit firms and the audit market)). The Government also intends to give ARGA powers under the Enterprise Act 2002, to undertake market studies, within its market monitoring functions (section 8.3 (Resilience of audit firms and the audit market)).

10.41 The new regulator will also have powers to obtain information from companies, accountants, auditors, actuaries and relevant third parties and powers to set minimum

⁸⁶ To the extent that regulatory functions continue to exist in their current form.

requirements for audit committees in relation to the appointment and oversight of auditors, and to require information and/or reports from audit committees (section 7.1 (Audit committee oversight)).

10.42 In exercising both the new powers and powers that it will “inherit” from the FRC, ARGAs will need to determine if those that it regulates have met their legal and other obligations, for example requirements set by a relevant recognised supervisory body. Where there has been a breach of legal duties or recognised and accepted standards, ARGAs will have powers to take action and the types of actions that ARGAs will be able to take will depend on the nature and seriousness of the breach in question.

10.43 In cases unrelated to enforcement, judicial review may provide a sufficient means by which to challenge the regulator’s decisions. The Government will consider further the appropriate mechanism in each case when legislating to give effect to these reforms.

Framework for the exercise of ARGAs’ enforcement powers

10.44 The FRC operates a statutory investigation and enforcement regime in respect of auditors under The Statutory Auditors and Third Country Auditors Regulations 2016 (SATCAR). It also currently operates non-statutory investigation and enforcement regimes⁸⁷ in respect of accountants and actuaries. Going forward, responsibility for all of these regimes will transfer to ARGAs. As outlined elsewhere in this document, the current regimes in relation to the oversight of accountants and actuaries will be replaced by new statutory regimes and the new regulator will have powers to hold members of the relevant professional bodies to account⁸⁸. Further, the regulator will have powers to hold directors of PIEs to account where they breach their statutory duties relating to corporate reporting and audit⁸⁹.

10.45 All of these regimes will need to provide for:

- threshold tests for commencing investigations and enforcement action;
- powers to gather information, including through interviews;
- powers to impose specified sanctions in pre-defined circumstances;
- procedures that apply to the exercise of those powers (which define the different roles of ARGAs’ Board, Committees and Executive Counsel, and provide due process safeguards); and
- a right of appeal to an independent tribunal.

10.46 The FRC has devised its own procedure (the Audit Enforcement Procedure) which deals with all these matters, and reflects accepted public law principles and human rights obligations, in the context of enforcement proceedings against statutory auditors under SATCAR. It includes provisions for the FRC to convene its own tribunals made up of

⁸⁷ The non-statutory regimes for accountants and actuaries are based on contractual arrangements that the FRC has with the relevant professional bodies.

⁸⁸ See sections 11.1 (Supervision: Accountants and their professional bodies) and 11.2 (Oversight and regulation of the actuarial profession).

⁸⁹ See section 5.1 (Enforcement against company directors).

independent legal, expert and lay members. Similar arrangements are in place for accountants and actuaries under the FRC's Accountancy and Actuarial Schemes.

10.47 The Government believes that these arrangements have operated satisfactorily to date and that a similar approach is broadly appropriate with respect to enforcement action that is taken against company directors, accountants, and actuaries under ARGA's new powers. However, the Government will consider further the appropriate appeal mechanism for each aspect of ARGA's enforcement activity when legislating to give effect to these reforms.

11 Additional changes to the regulator's responsibilities

11.1 Supervision: Accountants and their professional bodies

The FRC's regulatory functions in relation to auditors are largely underpinned by legislation, but in the case of accountants, they are dependent on voluntary arrangements between the FRC and professional accountancy bodies. Such arrangements restrict the regulator's effectiveness. The FRC Review recommended that they be strengthened.

The White Paper proposed to strengthen the existing voluntary arrangements for oversight of the chartered professional accountancy bodies by placing them on a statutory footing; that oversight should extend to all aspects of the professional bodies' functions; and that the regulator should have a new power to require action. It sought views on which bodies should be in scope and what safeguards might be needed. Having considered responses, the Government intends to proceed to introduce a new statutory regime. The scope will include all relevant professional accountancy bodies (not only the chartered bodies) and appropriate governance arrangements and mechanisms for independently challenging ARGA's decisions will be put in place.

In addition, the White Paper described the voluntary arrangements for the FRC to investigate and sanction members of the chartered professional accountancy bodies. The White Paper proposed to replace these with a statutory enforcement regime for accountants, limited to members of the chartered professional accountancy bodies and to cases where wrongdoing gives rise to public interest concerns. In light of the consultation responses, the Government intends to proceed with the proposal, but with amendments to the scope including to extend the remit of the regime to all relevant professional accountancy bodies (not just chartered bodies), and to limit the regime to cases that relate to corporate reporting (principally by PIEs) and which give rise to public interest concerns.

What the White Paper proposed

11.1.1 The White Paper consulted upon new statutory arrangements for the oversight of the chartered professional accountancy bodies⁹⁰ that would involve ARGA monitoring and reviewing the regulation of their members; and a power for the regulator to require the chartered bodies to take specific actions where significant public interest concerns are identified.

11.1.2 The White Paper sought views on:

⁹⁰ In this chapter "chartered bodies" is used to refer to chartered professional accountancy bodies; whereas "professional bodies" (or "professional accountancy bodies") is used to refer to all professional accountancy bodies, including both chartered and unchartered status.

- which professional bodies should be within scope of oversight by ARGA, and proposed to limit the oversight arrangements to the chartered bodies, with flexibility to extend the arrangements to other professional accountancy bodies if appropriate;
- whether to require the professional bodies in scope to comply with the oversight arrangements set by ARGA;
- what oversight should entail, including that it should extend to all aspects of the professional bodies' regulatory functions; and
- what safeguards, if any, might be needed to ensure the power to compel compliance was used appropriately by ARGA.

11.1.3 Proposals were also made for a new statutory enforcement regime for accountants, limited to accountants and accountancy firms that are members of the chartered bodies, in cases where wrongdoing gives rise to public interest concerns. Sanctions envisaged to be available to the regulator included reprimands, fines, requiring the waiver or repayment of client fees, the imposing of certain conditions, exclusion from membership of the chartered bodies, and exclusion from acting as an accountant within a Public Interest Entity (PIE). The White Paper sought views on:

- which accountants should be covered by ARGA's enforcement powers, and specifically, whether the regulator's enforcement powers should be limited to members of professional bodies; and flexibility to extend the scope of these powers to other accountants if evidence of an enforcement gap emerges in the future;
- when ARGA should take enforcement action, including to replace the existing misconduct test with a test based on a breach of requirements which apply to accountants; and
- whether ARGA should be able to set and enforce a code of ethics and what sanctions should be available to the regulator.

Issues arising from consultation

Oversight of professional accountancy bodies

11.1.4 Only 76 respondents commented on the proposals relating to the oversight of the accountancy profession, providing mixed views (25% supportive, 32% unsupportive and 42% neutral). Those most affected by the proposals – the professional bodies – were mainly opposed, while those from other stakeholder groups including listed companies were mostly generally supportive of strengthened arrangements. Views from accountancy firms were mixed, with some supportive and some opposed, and most fairly neutral.

11.1.5 The professional bodies opposed a new statutory regime for the oversight of the accountancy profession, expressing the view that there was insufficient evidence of problems with their regulation of members to provide an adequate case for enhanced arrangements. Two chartered bodies contended that sufficient oversight arrangements were already in place, drawing attention to the regulatory boards that provided oversight of their regulatory functions, the degree of independence that those boards had, and the oversight undertaken by various regulators, including the FRC in respect of statutory auditors. Furthermore, one of these

professional bodies believed that the creation of any additional oversight role would lead to duplication and confusion. Several chartered bodies highlighted that their Royal Charters placed an obligation on them to act in the public interest and that changes to their bye-laws required Privy Council approval, on which the FRC acted as an advisor for any changes in relation to audit.

11.1.6 One chartered body suggested the proposals would risk ARGA being distracted from improvements needed in its core areas of focus and stretching its resources even more thinly. Another chartered body was concerned that additional regulation of the member-funded chartered bodies would disincentivise membership, damaging the benefits that qualification and professional regulation offered.

11.1.7 The regulatory board of one chartered body recognised that the Government might be concerned if the primary responsibility for oversight fell entirely to the regulatory boards of chartered bodies without assurance that they were operating independently and with the primary objective of acting in the public interest. To address that potential concern, it suggested a lighter-touch legislative regime that focused on setting and assessing the governance standards for the regulatory boards.

11.1.8 Several large accountancy firms opposed the proposals, sharing the professional bodies' concerns as to whether there was sufficient evidence that the existing model was proving to be ineffective and expressing the view that the professional bodies themselves were best placed to regulate their members. Two firms suggested that such changes would result in unintended consequences such as a significant proportion of accountants ceasing to retain their professional qualification and membership.

11.1.9 A number of respondents took the view that efforts should either focus solely on, or include, accountants who are not members of any professional body and who operate outside the professional bodies' regulatory regimes. Suggestions included reserving the term 'accountant' to members of a chartered professional accountancy body or requiring all those providing financial reporting services to a PIE to be a member of a recognised professional body. Four listed companies were unsupportive of the proposals, preferring a lighter touch, voluntary regime.

11.1.10 Various other stakeholders gave their general support for the proposals. A Big Four firm highlighted that it was important that oversight of the professional bodies was proportionate and reflected the existing structures that those bodies had in place. Another Big Four firm suggested that the interactions with other oversight regimes would need careful consideration.

Scope of the regulator's oversight arrangements

11.1.11 60% of respondents who commented on the proposed scope of the regime supported arrangements being confined to the chartered bodies with a number of respondents recognising that this would focus ARGA's effort and resource on the most relevant bodies and avoid its focus becoming too broad.

11.1.12 Those with concerns about the proposed scope fell into three categories: those in favour of extending the arrangements to all professional accountancy bodies; those in favour of focusing the scope on accountants who were not members of professional bodies; and those who suggested that the regulator's powers should be focused on the small percentage of accountants who are involved in the preparation of financial statements within PIEs.

11.1.13 Those in favour of extending the arrangements to all professional accountancy bodies or all 'qualified accountants' included several accountancy firms, an advisory firm and a number of individuals. One Big Four firm highlighted that non-chartered accountancy bodies increasingly play an important role and suggested that if ARGA's powers were to extend beyond the chartered bodies, due consideration should be given to including all relevant professional bodies including the Association of Accounting Technicians (AAT) and professional bodies where accountancy is not the core activity such as the Chartered Governance Institute. An individual also highlighted that many audit and accounting firms used staff with AAT qualifications and their exclusion might disadvantage those with other qualifications.

11.1.14 A non-chartered professional body strongly opposed the limitation of the oversight arrangements to chartered bodies, arguing that this would lead to a semi-regulated profession, giving commercial advantage and dominance to the chartered bodies. The organisation also suggested it would lead to its own accountancy qualification becoming less recognised, leading to reduced choice in the market, limitations on career mobility and restrictions in the scope of work available for non-chartered accountants.

11.1.15 A chartered body's regulatory board stressed that while it might be true that virtually all accountants holding senior positions within the financial reporting process at PIEs or providing accountancy services to PIEs were members of chartered bodies, those individuals accounted for a very small percentage of its members. Furthermore, broad oversight across all its members would include considering public interest issues arising beyond financial reporting, including areas such as tax, leading to a requirement for ARGA to acquire such expertise.

11.1.16 A large accountancy firm had similar views, believing that there was not public interest in the work of all chartered accountants. It argued that a full review of the use of the term "accountant" should be undertaken to determine the work undertaken that was in the public interest. Other accountancy firms preferred the scope to be focused on non-members, stressing that this is where the greatest risk lies.

Requirement to comply with oversight arrangements

11.1.17 Five respondents directly addressed the question of whether the professional bodies should be required to comply with the oversight arrangements. Three respondents supported a requirement to comply, to avoid ARGA's ability to regulate being undermined. One firm suggested that professional bodies would have no reason not to consider and implement recommendations from the regulator if those recommendations were in the public interest. This view was shared by a corporate, which suggested that such a power would be unnecessary because if the regulator's input added value, the professional bodies would be keen to engage.

Safeguards required to ensure power to secure compliance was used appropriately

11.1.18 Only 16 respondents provided views on the proposal to introduce a power to compel compliance with oversight arrangements. Of those who did comment, the majority disagreed that the power to secure compliance was necessary. However, 66% of respondents agreed that if introduced, some safeguards were necessary to ensure its appropriate use. Almost half of those stressed the importance of a robust and independent process to review ARGA's decisions. Several professional bodies and a number of other respondents viewed that there should be a clear and transparent regulatory framework that set out a clear process to follow before and after ARGA directed action to take.

11.1.19 With respect to what safeguards should be put in place, suggestions included: that the power should only be used when certain criteria had been met; use of independent third parties to give an opinion on whether the use of the power was necessary; oversight by either the Secretary of State or Parliament; an escalation or dispute resolution process; that proposed change to regulatory arrangements should be agreed with all other oversight regulators; approval to be given by ARGA's own board before directing action; a proportionality test; ARGA having to demonstrate its technical capabilities in assessing the professional bodies' regulatory functions; and a formal review after an elapsed period, including to assess the impact of the measure on the professional bodies.

11.1.20 Several respondents pointed to the judicial review mechanism as a standard safeguard used by other regulators. One respondent argued that no additional safeguards were necessary and deemed ARGA's requirement to follow the Regulators' Code sufficient.

Enforcement powers in relation to accountants

11.1.21 Seventy-four respondents from a range of stakeholder groups commented on these proposals providing mixed views. Some respondents expressed support without further elaboration. Several large accountancy firms opposed the proposals, with some suggesting that ARGA's enforcement action should focus on accountants who are not members of the professional bodies. A professional body questioned whether there remained a case for ARGA to have any role in the enforcement of its members' conduct other than under the FRC's Audit Enforcement Procedure or the proposed regime for directors.

11.1.22 A chartered body raised concerns about lowering the threshold for action (to 'breach of relevant requirements', rather than 'misconduct'), stating that it would give accountancy a lower threshold for enforcement action than any other UK profession, without any justification. Other respondents including a FTSE 100 company and a large accountancy firm also shared concerns on a lower threshold for enforcement action, with the latter calling for an independent review of this matter.

Scope of the regulator's enforcement powers

11.1.23 A majority of the 74 respondents commented on the scope of the regulator's enforcement powers, with calls to widen the scope to include members of other professional bodies and to include all accountants regardless of whether they held membership of a

professional body. Several respondents suggested that there was a natural fairness argument that such arrangements should be aligned with particular roles, rather than with an individual's qualification and membership status. Some respondents suggested that because the Government was not proposing to limit the enforcement power to PIEs, it was not true that the majority of affected accountants would be members of one of the chartered bodies.

11.1.24 A non-chartered professional body strongly opposed the powers being limited to the chartered bodies, suggesting that members of the public expected accountants with recognised qualifications to be subject to the same oversight, and that on that basis there was a key public interest argument for extending this disciplinary framework to all qualified accountants.

11.1.25 A chartered body suggested that the proposed approach to accountancy oversight was inconsistent with the proposals that new statutory enforcement powers would extend beyond PIEs to all complaints which raised 'public interest concerns'. Another chartered body argued that there was a significant risk that making only chartered accountants subject to the enforcement powers would encourage a drift away from the chartered bodies, undermine the intention to increase corporate reporting standards and distort the market in favour of the non-chartered bodies. Another accountancy firm also disagreed that there would remain sufficient incentives for accountants to remain members of chartered bodies and avoid an exodus from the profession.

11.1.26 A variety of other respondents, including accountancy firms, investors, listed companies and individuals supported the proposed scope, as did a chartered body which believed extending ARGAs powers beyond the chartered bodies at this point would be disproportionate, giving rise to unnecessary expense.

11.1.27 Several listed companies suggested that the regulator's focus should be on the financial reporting activities of PIEs rather than all public interest cases, whereas a chartered body agreed with the proposal that ARGAs should have the ability to take action wherever a public interest issue arose and not just where the work involved a PIE. A Big Four firm highlighted that it was not always clear which cases the FRC would investigate under the existing Accountancy Scheme, in the absence of guidance on what constituted "the public interest".

Flexibility to extend the scope of powers

11.1.28 The majority of those who provided views on whether the Government should have the flexibility to extend the scope of the powers to other accountants in the future were in favour, with several respondents calling for the potential enforcement gap to be addressed now rather than in the future. A Big Four firm highlighted that the nature of the roles held by members of non-chartered professional bodies tended to be either at entities which posed a lower risk to the public interest or at more junior levels – but that this was not always the case, and flexibility to address the changing structure of the profession was important.

11.1.29 Several respondents suggested that any extension should only be introduced by the Secretary of State, not by ARGA, and only following consideration of the evidence and a period of public consultation.

Power to set and enforce a code of ethics

11.1.30 A small majority of respondents (30 of 57) opposed ARGA having the power to set and enforce a new standardised code of ethics, stating that the professional bodies' existing codes of ethics adhered to the International Ethics Standards Board for Accountants (IESBA) Code of Ethics so it was unnecessary for ARGA to have a power to set a code of ethics. Some respondents were concerned about a potential divergence between the ethical standards set by ARGA and those issued by IESBA, resulting in complications for accountants working across borders. One professional body stated that removing its ability to set its own rules fundamentally affected its constitution.

Sanctions

11.1.31 Few respondents commented on the proposed sanctions, but they were largely supportive of sanctions remaining broadly consistent with the existing Accountancy Scheme. Two respondents suggested that it would not be appropriate for the regulator to impose a sanction of exclusion from being a member of professional body as that was for the bodies themselves to decide. A number of respondents suggested that higher fines should be imposed by the regulator.

Additional information on regulatory frameworks

11.1.32 In addition to considering the consultation responses, the Government invited seven professional bodies⁹¹ to provide additional evidence on their existing regulatory frameworks, focusing in particular on the regulatory functions set out in the White Paper: training and qualifications, licensing, practice assurance, complaint handling, disciplinary procedures and governance arrangements. Extensive information was provided, demonstrating the various regulatory arrangements in place. A summary of the information provided by the professional bodies for each function is set out in the sections which follow.

11.1.33 As might be expected with organisations of differing size and maturity, the comprehensiveness of the regulatory frameworks varies across the professional bodies. However, it was noted that all of the seven bodies are members of the International Federation of Accountants, the global organisation for the accountancy profession, whose membership requires adoption and implementation of international standards, and investigation and discipline systems which serve the public interest.

Training and qualifications

11.1.34 Information the professional bodies provided included:

⁹¹ The professional bodies which submitted information on their regulatory frameworks were: ACCA, AIA, CAI, CIMA, CIPFA, ICAEW, and ICAS.

- qualifications offered and component modules; some professional bodies detailed the independent benchmarking and oversight to assess, and quality assure the standard of the qualifications as well as detailing how syllabuses evolve to respond to changing needs;
- arrangements for the mutual recognition of qualifications, some provided details of international collaboration including membership of the International Federation of Accountants (IFAC), the Global Accounting Alliance and the Common Content Project; and
- mandatory Continuing Professional Development requirements for members.

Licensing

11.1.35 The professional bodies provided details of the processes and procedures for the issuing of licences for a number of regulated services and for those members engaged in public practice. Additional requirements for those wishing to undertake public practice included:

- continued assessment of holders' fitness and propriety;
- professional indemnity insurance at an appropriate level; and
- continuity of practice agreement in the event of death or incapacity.

Practice assurance

11.1.36 Information the professional bodies provided included:

- non-statutory practice assurance for members holding practising certificates, including quality assurance reviews in order to ensure compliance with standards and regulations; imposition of financial penalties for non-compliance; and referral of cases for professional conduct investigation;
- practice assurance standards (including compliance with laws, regulations and professional standards and client acceptance and disengagement); and
- member compliance with money laundering regulations and associated regulatory oversight inspections.

Complaint handling

11.1.37 Information the professional bodies provided included:

- processes for considering, determining and overseeing the handling of complaints, some provided details of case management systems and the number and sources of complaints and disciplinary tribunal hearings; and
- arrangements for the reviewing and updating of disciplinary bye-laws to ensure processes are efficient and effective.

Disciplinary procedures

11.1.38 Professional bodies provided details of the processes through which all disciplinary complaints are prosecuted, including

- arrangements for the assessment and investigation of cases, and the process for disciplinary hearing and appeal stages (some provided relevant statistics);
- guidance on sanctions;
- procedures for changing disciplinary bye-laws (including the role of the Privy Council; and the FRC and the Legal Services Board as advisors to it); and
- oversight of disciplinary procedures.

Governance arrangements

11.1.39 Information the professional bodies provided included:

- their governance structures and arrangements to provide oversight of each regulatory function;
- specific information on the independence of aspects of governance;
- the composition of specific boards/committees including details of any lay membership, whether lay members form a minority, majority or there is parity, and prohibition of office holders from positions on specific boards/committees;
- specific projects and strategic initiatives to deliver improvements and in protecting the public interest; and
- other regulators' reviews of governance arrangements.

Government response

11.1.40 Matters relating to the regulation of the accountancy profession are devolved in Scotland, Wales and Northern Ireland. The Government sets out its plans for these matters below and is in discussion with the three devolved administrations, seeking to agree an approach to cover the whole of the UK.

Oversight of professional accountancy bodies

11.1.41 As set out in the White Paper, the FRC's current regulatory functions in relation to accountants are based on a voluntary agreement between the FRC and the Consultative Committee of Accountancy Bodies (CCAB). The operation of this agreement is entirely voluntary, and its limitations have made effective oversight by the FRC difficult to achieve in practice. The FRC's activity in relation to the oversight of accountancy currently consists of a review of the chartered bodies' complaint handling only.

11.1.42 ARGA's proposed over-arching objective is to "protect and promote the interests of investors, other users of corporate reporting and the wider public interest". Given the importance of the role which accountants play – in overseeing honest and transparent reporting, to both company management and external stakeholders – the Government does not believe it is appropriate that ARGA is only able to rely on a voluntary agreement in performing its oversight function. The Government believes it is unlikely ARGA will be able to

fulfil its objective without the proper ability, underpinned by statute, to oversee the regulation of the profession responsible for the preparation of corporate financial reports.

11.1.43 Instead, the Government believes the regulation of accountancy is of significant public interest and that independent, consistent oversight of the professional bodies' regulatory functions, on a statutory basis, is both appropriate and necessary. In light of the wider calls for reform, the Government believes wider public expectations require that ARGA take up greater responsibility in this area. **The Government, therefore, intends to proceed with the White Paper proposal to introduce a new statutory regime for the oversight of accountancy.** Such arrangements will ensure both ongoing and consistent effectiveness of the regulation of accountants, efficient preventative actions being taken by ARGA, and rectification of problems and concerns where they are identified.

11.1.44 The Government notes that inappropriate accounting and disclosure in company accounts presented for audit have been contributory factors in several significant corporate failures, including that of Carillion⁹². Such failures reduce trust in company accounts and accountancy, impairing rational investment decisions and the effective operation of capital markets.

11.1.45 The Government recognises the work that the professional bodies undertake to protect the public interest and maintain trust in the profession. The oversight of that work is, however, undertaken on the basis of voluntary arrangements between the bodies and the FRC, as set out in an exchange of letters. Under those arrangements, the FRC can make recommendations to the professional bodies, which they can then choose whether or not to implement. The Government does not believe it is adequate to continue to rely on such arrangements as ARGA could expend significant resources assessing the adequacy of the bodies' arrangements for supervising their accountant members but would then have little or no power to address concerns. Yet if problems arose, ARGA would in all likelihood be held publicly accountable for the situation. The Government does not consider it satisfactory for ARGA to be held accountable for protecting users of corporate reporting without it having the appropriate powers to act.

11.1.46 In reaching this conclusion, the Government has considered the steps that the professional bodies have taken to establish some independence between their regulatory and disciplinary boards and the rest of their governance structures; and to varying degrees, the involvement of lay members on such boards. In some cases, these include lay majorities and the appointment of prominent and respected lay individuals to act as board or committee chairs. While such arrangements provide a degree of independence, it remains the case that these boards are funded by the professional bodies and are ultimately answerable to those professional bodies. The new statutory regime will introduce a greater degree of independent oversight and accountability, through an independent regulatory body which itself is accountable to both the Government and Parliament as detailed in the previous chapter.

⁹² As concluded by the Business, Energy and Industrial Strategy and Work and Pensions Committees' joint report into Carillion, dated 9 May 2018. Available at <https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf>

11.1.47 The Government has considered the role which existing statutory oversight plays in relation to specific functions performed by accountants, including statutory audit, local public audit, insolvency, probate and activities relating to investment businesses and air travel organisers. It has noted the argument presented by some professional bodies that compliance with these arrangements is sufficient and no additional benefit would be derived in introducing an additional layer of statutory oversight. However, these existing arrangements are focused on specific aspects of accountancy. The new statutory regime, on the other hand, will provide holistic oversight of the wider accountancy profession, on which corporate reporting and wider public trust depend.

11.1.48 In reviewing existing arrangements, the Government also notes that there are variations between the different professional bodies' regulatory frameworks. A benefit of the proposed statutory oversight regime will be in reviewing regulatory arrangements across the professional bodies to identify opportunities for improvement across the system as a whole, in line with the principle of proportionality.

11.1.49 Finally, a lighter-touch regime that focused on the regulatory boards' governance arrangements only would not provide the necessary assurance that the professional bodies' regulatory frameworks were effective, only that their governance arrangements were satisfactory. Risk does not always arise from improper governance arrangements and frameworks but also in the implementation and monitoring of operational arrangements. There is also a real opportunity for ARGA to identify issues and risks across the profession if ARGA undertakes consistent oversight across the multiple professional bodies in scope, but this relies on taking an approach that goes beyond assurance of governance arrangements.

Scope

11.1.50 The Government has considered the risk of unintended consequences from limiting the scope of the regime to the chartered bodies and believes that it is relatively low. Whilst there will be no requirement for those wishing to use the services of an accountant to use an accountant that belongs to a professional body regulated by ARGA, it is unlikely that this will be the primary factor in selecting the services of an accountant over other factors such as an individual or firm's relevant experience and competence.

11.1.51 However, the Government is persuaded by responses that a limited expansion to include the most relevant non-chartered professional bodies would strengthen the regime further, as it would provide a broader degree of oversight of the profession. On that basis, **the Government intends to extend the remit of the proposed statutory regime to include all relevant professional bodies, not only the chartered bodies** – that is, professional bodies whose members are required to hold professional-level accountancy qualifications⁹³.

11.1.52 The Government acknowledges that Chartered Accountants Ireland (CAI) and other accountancy bodies that will come within the scope of ARGA's oversight have members across the island of Ireland and are also subject to regulation by the Irish Auditing and Accounting

⁹³ Equivalent to a level 6 qualification or above but excluding specialist bodies whose members hold specialist qualifications.

Supervisory Authority as prescribed accountancy bodies⁹⁴. ARGA's statutory remit will be focused on the oversight of these bodies' regulation of that portion of their membership working for firms registered in the UK and providing accountancy services to UK entities and individuals, and enforcement in respect of misconduct by those members. The regulator will explore the need for protocols between the Irish Auditing and Accounting Supervisory Authority and ARGA, and any other arrangements that may be necessary to address potential regulatory gaps and/or overlap and to safeguard the UK public interest. 11.1.52 Two professional bodies highlighted that their membership also includes individuals in junior roles. The Government believes that all members of the professional bodies in scope should be subject to appropriate oversight and does not agree that it is disproportionate to include more junior members within scope of the oversight regime. Although they hold junior positions, those individuals hold professional-level qualifications and membership of a professional body which provides them with an enhanced professional reputation that justifies equivalent oversight.

11.1.53 The new statutory regime for the oversight of professional accountancy bodies will cover all aspects of the bodies' regulatory functions except for those where separate statutory oversight arrangements already exist (such as statutory audit services and those directly supervised by other regulators including insolvency services, anti-money laundering supervision and legal services). In addition, the Government is reviewing arrangements for tax advisors⁹⁵ and will ensure that any new arrangements are complementary and avoid duplication. ARGA would work with HMRC on any overlapping areas of responsibility.

Safeguards required to ensure power to secure compliance is used appropriately

11.1.54 Most respondents suggested that some safeguards were necessary to ensure the appropriate use of ARGA's proposed power to secure compliance. A clear and transparent process will be put in place for the appropriate use of ARGA's proposed power to direct action, including a requirement for ARGA to have first engaged appropriately with the professional body before a direction can be issued.

11.1.55 As part of the establishment of ARGA, **the Government will ensure appropriate governance arrangements and mechanisms for independently challenging ARGA's decisions are in place**. Further information on this is provided in Chapter 10.

11.1.56 Additional oversight over the discharge of ARGA's power to secure compliance will also be provided by the Secretary of State and Parliament. The FRC reports annually to the Secretary of State on how it has discharged its statutory oversight responsibilities. The report is laid in Parliament. Annual reporting by ARGA, once it is established, will include accountancy oversight, including its use of the power to compel compliance.

11.1.57 As the White Paper set out, the Government will monitor the implementation of its proposals and their performance in practice. The effectiveness of its legislation will be reviewed after five years by way of a Post-Implementation Review.

⁹⁴ <http://www.iaasa.ie/FAQs/General/What-is-a-Prescribed-Accountancy-Body>

⁹⁵ <https://www.gov.uk/government/consultations/raising-standards-in-the-tax-advice-market>

Enforcement powers in relation to accountants

11.1.58 The FRC's current enforcement scheme, the Accountancy Scheme, has broad objectives – to safeguard the public interest by maintaining and enhancing the standards of conduct of members and member firms. In addition, the professional accountancy bodies each operate their own disciplinary arrangements for members who fail to meet the required professional standards.

11.1.59 Having considered the concerns raised by some respondents about the scope of the new enforcement regime, the Government believes that it should be narrowed and focused only on those cases where the activity undertaken by the member is related to matters within ARGA's general objectives and functions. This will principally be corporate reporting by PIEs, where ARGA itself sets standards and monitors compliance; and will enable ARGA to address corporate reporting failings by accountants that give rise to public interest concerns. A focus on corporate reporting will also ensure that the enforcement regime aligns with ARGA's general objectives and functions, while other cases will be left to the relevant professional body to investigate and take appropriate disciplinary action.

11.1.60 The White Paper set out that there is insufficient evidence of problems with accountants working in PIEs who are not members of professional bodies (non-members) to justify extending ARGA's powers to such persons at this time, but that the Government intends to take a reserve power to extend the regime to non-members in the future if needed. The Government notes the concerns raised in the consultation that if the regime intends to include all public interest cases, there is a risk that there may be relevant accountants who are not members of a professional body and would fall outside ARGA's reach.

11.1.61 The Government's policy intention is that ARGA may **take enforcement action only in cases that give rise to public interest concerns, principally those arising out of corporate reporting by PIEs**. Cases that give rise to public interest concerns outside of a PIE are expected to be rare. On that basis, the Government believes that cases where ARGA would want to act will almost always concern accountants or firms that are members of a professional accountancy body. The Government intends for the scope to remain under review and will extend it to non-members if needed. The Government believes this is a proportionate approach, targeting action on the part of the profession in which there is greatest public interest but providing flexibility to address emerging future concerns.

11.1.62 The Government believes there is sufficient justification for aligning the threshold for action to that for auditors through lowering the test from 'misconduct' to 'breach of relevant requirements'. The proposed new regime is a specific regulatory regime to address weaknesses in the corporate reporting system that adversely affect the public interest: it is not a new approach to the regulation of accountants in general. Although the proposed threshold is lower than the current test of misconduct under the Accountancy Scheme, ARGA will not take action against minor breaches but by exception, in cases that give rise to public interest concerns.

11.1.63 Additionally, to address concerns raised that the proposals might encourage membership to move from the chartered professional bodies to non-chartered bodies, the Government proposes to widen the scope to include members of all relevant bodies.

11.1.64 **The Government therefore intends to proceed with the proposed enforcement regime for accountants but with the following amendments to the scope of the regime:**

- **extending the regime to members of all relevant professional bodies, not just chartered bodies; and**
- **limiting the regime to cases that relate to corporate reporting (principally by PIEs) and which give rise to public interest concerns.**

11.1.65 The Government recognises the concerns raised regarding its proposal for ARGA to set and enforce a code of ethics. Accordingly, the Government intends that **ARGA will instead use the IESBA International Code of Ethics for Professional Accountants as the basis for enforcement action.** This will allow the professional bodies to retain autonomy to set their own ethical standards while ensuring that there is a single set of standards, consistent with those of the professional bodies, as the basis for enforcement action by ARGA. The same code could also be applied to non-member accountants, should the scope of the regime need to be expanded in the future.

11.1.66 The Government believes that the sanctions available to the regulator should be broadly aligned to those available to the FRC under the Accountancy Scheme, which includes exclusion as a member of one or more participating bodies for a recommended specified period of time and a financial penalty that it considers appropriate in accordance with its own sanctions policy, with no upper limit. This is also aligned to the sanctioning powers available for statutory audit.

11.2 Oversight and regulation of the actuarial profession

The actuarial profession is currently regulated on a voluntary basis through a Memorandum of Understanding (MoU) between the FRC and the Institute and Faculty of Actuaries (IFoA). The FRC oversees the IFoA's regulation of its members, who are individuals, in the UK and operates an actuarial discipline scheme for public interest cases. The IFoA requires its members to follow the FRC's Technical Standards.

This chapter of the White Paper sought views on whether ARGA should be responsible for the oversight and regulation of the actuarial profession, whether this regime should be moved onto a statutory basis and the principles which should underpin the new regulatory regime. Views were also sought on the regulator's powers and responsibilities, whether the actuarial work by entities should be brought within the regulator's remit and, if so, whether the regulator's investigation and discipline regime should differ for entities which are public interest entities (PIEs).

The Government considers that the actuarial profession is broader than IFoA members; that there is public interest in some actuarial work carried out by, or for, PIEs, large

pension schemes and large funeral plans and that it would be disproportionate to establish a new regulatory regime for entities undertaking actuarial work.

The Government confirms that it intends to legislate to give ARGA statutory powers to oversee and regulate the actuarial profession, focused primarily on individuals, by reference to actuarial activities of public interest. The Government thinks that these proportionate changes will strengthen the actuarial regime where this is needed, consistent with the outcome of the FRC Review.

What the White Paper proposed

11.2.1 In section 11.2 of the White Paper, the Government proposed to grant ARGAs responsibility for the oversight and regulation of the actuarial profession, noting stakeholders' concerns should the Prudential Regulation Authority (PRA) be given this role. As stakeholders had not advocated a major change to the components of the regime, or a return to self-regulation, the Government proposed that ARGAs should continue to set technical standards, and to oversee the actuarial profession.

11.2.2 The Government proposed that ARGAs effectiveness was likely to be enhanced by placing the new regime on a statutory basis, that is: setting, and monitoring, legally binding technical standards; overseeing the IFoA; and operating an independent investigation and disciplinary regime for matters relating to members of the actuarial profession which raise, or appear to raise, important issues affecting the public interest. The Government proposed five principles to underpin the regime⁹⁶.

11.2.3 In question 87, the Government consulted on statutory actions and remedies to be available if ARGAs monitoring activities revealed that actuarial work fell short of technical standards.

11.2.4 The FRC Review identified weaknesses in the regulation of the actuarial profession, including the lack of credible powers. The Government completed its action to meet the Review's recommendation (no. 74), that is, to review which powers are required effectively to oversee the actuarial profession. The Government proposed that a statutory regime is required, including the setting, monitoring and enforcing of standards and oversight of the professional body, the IFoA.

11.2.5 In response to stakeholders' views, more clarity over the regulator's oversight remit was proposed in relation to the IFoA's activities that will be subject to ARGAs oversight. In question 89, the Government consulted on whether oversight of the IFoA should be placed on a statutory basis and, if so, the powers that ARGAs would need to meet its statutory objectives.

⁹⁶ (i) Proportionality of resource relative to risk; (ii) cost effectiveness, to ensure resource is used efficiently and the cost of regulation is not overly burdensome; (iii) confidentiality, to ensure that the commercial sensitivity of actuarial activity is respected; (iv) avoidance of duplication or 'gold plating' to ensure that regulation does not replicate other activities; and (v) oversight and regulation in the public interest, to ensure appropriate focus.

11.2.6 Responding to stakeholder concerns that the FRC cannot take effective enforcement action without statutory powers, the Government also proposed to place the existing independent investigation and discipline regime for actuaries on a statutory basis.

11.2.7 The Government also noted that it could be difficult for ARGA to identify the individual responsible for a piece of actuarial work. Therefore, the Government proposed that ARGA should be able to regulate the actuarial work undertaken by entities in addition to individuals.

Issues arising from consultation

11.2.8 59 respondents provided views on the proposals relating to the actuarial profession. These respondents represented a range of stakeholder groups, including insurers, consultancy firms, professional bodies, industry representative bodies, law firms, asset management firms and individuals. Views on the issues arising from the consultation varied within and across groups.

The identity of the regulator

11.2.9 Most respondents who commented agreed that ARGA was the preferred regulator to regulate and oversee the actuarial profession. However, several raised concerns that ARGA's focus on audit activities would compromise its ability to undertake its responsibilities for actuarial regulation effectively. Moreover, some stakeholders also expressed concerns that ARGA would not be able to properly resource its regulation of the actuarial profession.

A statutory basis for regulating the actuarial profession

11.2.10 The majority of respondents who expressed a view supported the proposal to place the regulation of actuaries on a statutory footing. However, some respondents discussed the relative merits of different possible approaches. For example, some respondents preferred that statutory regulation should be limited to individuals undertaking specific actuarial roles. Others suggested that the scope of regulation should be defined by reference to those undertaking well-defined types of actuarial work.

11.2.10 The scope of who, or what, is covered within ARGA's regulatory framework is critical to defining the scope of the regulatory regime. Around one-third of the responses called for greater clarity on ARGA's regulatory scope in relation to the individuals or actuarial work within scope.

11.2.11 As there are no legislative restrictions on whether an individual can describe him or herself as an 'actuary', many respondents were concerned about possible 'regulatory arbitrage' if only IFoA members were subject to statutory regulation of actuaries. In the Government's post-consultation discussions, some stakeholders described instances of overlap between some of the actuarial work carried out by IFoA members and others at their organisations. Several stakeholders suggested that any individual carrying out the same actuarial work should be subject to the same standards regardless of whether or not that individual was a member of the IFoA.

11.2.12 As actuaries undertake a wide range of actuarial work, only some of which may be considered ‘public interest actuarial work’ (see below), some respondents also considered that statutory regulation of all actuarial work undertaken by IFoA members would be disproportionate. Some stakeholders were concerned that it would be disproportionate to move the current technical standards to a statutory footing for non-public interest work while some proposed a return to greater self-regulation of the actuarial profession.

Principles to underpin the actuarial regulatory regime

11.2.13 A majority of respondents who commented were supportive of the principles proposed in the White Paper (see footnote to the above subsection: “What the White Paper proposed”) to underpin the oversight and regulation of the actuarial profession, particularly the principle of ‘proportionality’.

11.2.14 ‘Timeliness’ was suggested as an additional principle by some respondents. It was argued that ARGAs exercise of its regulatory powers should be relevant to current circumstances and that regulation should be conducted in a timely way. A few respondents proposed other principles.

Regulation of public interest actuarial work

11.2.15 Most stakeholders supported regulation of public interest actuarial work. A number of stakeholders indicated that regulation should be limited to actuarial work in the public interest.

Responsibility for setting technical and ethical standards

11.2.16 The FRC currently sets technical standards for the actuarial profession. By agreement with the IFoA, these non-statutory standards apply to IFoA members for actuarial work within UK geographic scope. The IFoA currently sets ethical standards for its members, such as the Actuaries’ Code, and its Actuarial Professional Standards (APs) which cover wider conduct matters.

11.2.17 Some stakeholders noted that a gap in coverage may result if all actuarial practitioners (including non-IFoA members) are to be regulated but the IFoA retains responsibility for setting ethical standards, since practitioners who do not belong to the IFoA cannot be regulated by the IFoA.

11.2.18 Some stakeholders also noted that there is sometimes an unclear division between ‘technical’ and ‘ethical’ standards.

Roles and responsibilities of the regulator: the components of a statutory regime

11.2.19 The White Paper set out the proposed scope of ARGAs regulatory role and responsibilities relating to actuaries: setting legally binding technical standards; monitoring compliance with technical standards; taking appropriate action if actuarial work does not meet technical standards; independent oversight of the IFoA in relation to its regulation of its members; and providing an independent investigation and disciplinary regime for matters relating to actuarial practitioners which raise, or appear to raise, important issues affecting the public interest.

11.2.20 The majority of respondents who expressed a view agreed with the above responsibilities.

Setting legally binding technical standards

11.2.21 Of the respondents to the White Paper that commented specifically, over half did not support the introduction of legally binding technical standards. The concerns of these respondents included:

- the legal enforceability of the standards – as they are currently written, the current standards are principles-based and require practitioners to use their judgement when applying them. Some respondents thought that this could make it difficult to legally enforce the standards; and
- a perception that the consequences of non-compliance with statutory standards could be more penal than those for non-compliance with non-statutory standards.

Monitoring compliance with technical standards

11.2.22 Of those that commented, most respondents to the White Paper supported the proposal for ARGA to monitor actuarial work undertaken by individuals against the technical standards. Several supported the monitoring of public interest work only, as this would align with ARGA's risk-based and proportionate approach.

11.2.23 Of those that commented specifically, a slight majority of respondents who expressed a view did not support granting ARGA the power to monitor compliance with ethical standards. Some respondents suggested that this role was more suited to the IFoA, opining that ethical matters should be solely the professional body's responsibility and that the body which sets the ethical standards should be responsible for monitoring them.

11.2.24 The majority of respondents who commented supported the proposal to empower ARGA to compel the provision of actuarial work to ARGA. Several respondents noted that this step would be essential for ARGA to carry out its monitoring role. Some respondents noted that individuals may be constrained by their employers in their ability to provide their actuarial work to ARGA.

Taking appropriate action if actuarial work does not meet technical standards

11.2.25 Of those that commented, the majority of respondents supported the proposal for ARGA to take appropriate action if actuarial work does not meet technical standards. There was little comment on the statutory actions and remedies to be available to ARGA should it assess, following its monitoring activity, that actuarial work falls below the requirements of the technical standards. There was no objection to the actions suggested in the White Paper nor any indication that graded sanctions should differ from those currently in place under the FRC's Actuarial Scheme⁹⁷.

⁹⁷ <https://www.frc.org.uk/getattachment/f7dfb3f1-cab1-484d-8d39-9b33e6e69ad9/Actuarial-Scheme-March-21.pdf>

11.2.26 Some stakeholders noted that proposals for the range of actions and sanctions available to the regulator in relation to actuaries could be usefully informed by those in the audit and accounting regimes.

Independent oversight of the IFoA in relation to its regulation of its members

11.2.27 Most of the respondents who commented supported the proposal to place the oversight of the IFoA on a statutory footing. A large majority supported the proposed list of regulatory activities that ARGA would oversee as part of its independent oversight of the IFoA⁹⁸.

Providing an independent investigation and discipline regime for public interest issues

11.2.28 Of those that commented, most respondents supported the proposal that the current disciplinary arrangements should be placed on a statutory basis, that is that ARGA should have statutory responsibility for public interest disciplinary cases. Most respondents who commented agreed that the current disciplinary scheme for actuaries remained appropriate.

Regulation of actuarial work undertaken by entities

11.2.29 Respondents to the White Paper had mixed views in relation to the case for regulating entities. Some were supportive of the proposal, stating that entities undertook actuarial work and, therefore, should be regulated on the same basis as individual actuaries. Other respondents expressed concern about the feasibility of an entirely new regulatory regime for entities, arguing that it would be costly to introduce and disproportionate to the need and benefits.

11.2.30 Many respondents queried whether the regulation of actuarial work carried out by entities would duplicate the regulatory activities by sectoral regulators, such as the PRA's regulation of insurers. Some stakeholders identified the 'working environment' within the entity for which the actuary worked as a determinant of actuarial quality. Several respondents suggested that ARGA's ability to obtain examples of individuals' work, as part of its monitoring activities, would be facilitated if ARGA also had the power to request work from the entity for which the actuary worked.

Government response

11.2.31 The Government has considered the components of the regulatory regimes for the audit and accounting professions in designing its proposals for the regulation of actuaries. While there are significant similarities between the regulatory regimes, not least that they are regulated by the same regulator (currently the FRC), there are also differences which inform a different, but related, approach to the regulation of actuaries.

⁹⁸ The Actuarial Monitoring Scheme, the Quality Assurance Scheme, the competency framework, education and qualifications, complaints made about actuaries, complaints made about the IFoA, disciplinary processes, the IFoA's development of standards, and potential future features of the IFoA's framework for its regulation of its members.

11.2.32 In reforming the regulatory regime, the Government's overarching intent is to strengthen the regime in areas where this is warranted, consistent with the assessment set out in the FRC Review.

11.2.33 As for the regulation of the accountancy profession, matters relating to the regulation of the actuarial profession are devolved in Scotland, Wales and Northern Ireland. The Government is in discussion with the three devolved administrations, seeking to agree an approach to cover the whole of the UK.

The identity of the regulator

11.2.34 **The Government confirms that ARGA should oversee and regulate the actuarial profession.** The majority of respondents to express a view on this issue agreed that ARGA should fulfil these roles. Some other respondents suggested, however, that a better outcome would be achieved by a new stand-alone regulator, with a focus only on actuarial oversight and regulation. However, this proposal would be costly and disproportionate for such a small profession.

A statutory basis for regulating the actuarial profession

11.2.35 Of those that commented, most stakeholders supported the introduction of a statutory basis for the regulation of the actuarial profession. These respondents noted that this approach would result in a more effective and credible regulatory regime. **The Government confirms that ARGA's oversight and regulation of the actuarial profession⁹⁹ will be placed on a statutory basis.**

11.2.36 The Government agrees with some stakeholders' concerns that it would be contrary to the public interest to deter membership of the IFoA or the employment of IFoA members in both traditional and emerging areas of actuarial work by regulating only the work of IFoA members on a statutory basis. **The Government confirms that ARGA's regulatory responsibilities will extend to all individuals that undertake actuarial work in the public interest.** (The determination of the public interest is discussed below.)

Principles to underpin the actuarial regulatory regime

11.2.37 The Government agrees with respondents that the resource deployed to regulate actuarial work should be proportionate to the risk arising from such work. The Government believes that ARGA should, therefore, apply a proportionate risk-based approach in order to deploy its resources with the aim of ensuring the greatest regulatory impact.

11.2.38 The Government agrees with respondents that ARGA's regulatory activities should be conducted in a timely manner. However, other principles proposed by respondents have not been adopted, either because they appear duplicative or because their practical implementation is likely to have undesirable consequences. **The Government considers that ARGA, in its role as a regulator, should discharge its regulatory functions consistent**

⁹⁹ Currently, the FRC carries out a standards-setting and oversight role in relation to the actuarial profession. The FRC has separate arrangements with the IFoA ('the Actuarial Scheme') under which the FRC can take enforcement action against members of the IFoA in public interest cases where they engage in misconduct.

with the behaviours expected of all regulators, including, but not limited, to the those set out in paragraph 11.2.15 of the White Paper, namely proportionality of resource relative to risk; cost effectiveness; confidentiality; avoidance of duplication or ‘gold plating’; oversight and regulation in the public interest. The Government also considers that ARGA should conduct its regulatory activities in a timely manner.

11.2.39 The Government’s consideration of one of the five principles consulted upon, ‘oversight and regulation in the public interest, to ensure appropriate focus’, is discussed in more detail below.

Regulation of public interest actuarial work

11.2.40 The Government considers that the scope of the regulatory regime for the actuarial profession needs to be clearly defined, specifically that the scope of the regime should be limited to public interest actuarial work. However, the Government recognises that the identification and definition of public interest actuarial work is not straightforward. Indeed, there was no consensus among respondents as to the identification, and definition, of public interest actuarial work.

11.2.41 The Government intends to identify the public interest by reference to the entity that undertakes or commissions the work.

11.2.42 In relation to the entity that undertakes or commissions the work, the Government notes that the statutory regulatory framework for the audit profession uses public interest entities (PIEs) as a reference for public interest. The Government believes that the same approach should be adopted for the regulation of the actuarial profession. Therefore, the Government intends to limit the regulation of actuarial work to actuarial work undertaken by, or for, PIEs. The Government also intends to include large pension schemes and large funeral trusts within the perimeter for statutory regulation of the actuarial profession. This decision reflects the public interest in actuarial work in these areas.

11.2.43 The specific actuarial work done by, or for, PIEs, large pension schemes and large funeral trusts will be regulated will be determined by ARGA. ARGA will need to have regard to the behaviours expected of regulators, as set out above, in its determination of actuarial work. ARGA will be required to publish, and keep under review, its list of public interest actuarial work that it plans to regulate. This list will be subject to appropriate scrutiny by the Government.

11.2.44 In its determination of the list of public interest actuarial work, ARGA will have regard to factors such as the number of individuals potentially influenced or adversely affected by the actuarial work product, the potential significance of the financial impact and the likelihood that an error could significantly undermine consumer or investor confidence.

11.2.45 The Government intends that ARGA will regulate public interest actuarial work as these activities have the most significant adverse consequences if not carried out, and completed, to an appropriate standard.

Roles and responsibilities of the regulator: the components of a statutory regime

11.2.46 The Government confirms that ARGA's responsibilities will be as set out in 11.2.19 of the White Paper:

Regulatory responsibilities

- setting legally binding technical standards;
- monitoring compliance with technical standards;
- taking appropriate action if actuarial work does not meet technical standards;

Oversight responsibilities

- independent oversight of the IFoA in relation to its regulation of its members; and

Enforcement, public interest disciplinary cases

- providing an independent investigation and discipline regime for matters relating to members of the actuarial profession which raise, or appear to raise, important issues affecting the public interest.

11.2.47 The Government thinks that the addition of new responsibilities, for example, the power to set ethical standards, would not be proportionate, or an effective use of ARGA's resources, particularly as ethical standards are already set by the IFoA.

11.2.48 However, in order to ensure consistency for all individuals undertaking public interest actuarial work and to avoid deterring IFoA membership, or the employment of IFoA members, it is important that all individuals carrying out public interest actuarial work are subject to the same standards, including the ethical standards. The Government recognises that, as noted by some respondents to the consultation, it can sometimes be difficult to separate technical and ethical issues.

11.2.49 As a result, ARGA may require individuals carrying out technical actuarial work to comply with the IFoA's ethical standards. This requirement will allow ARGA to take appropriate action against individuals who do not comply with the required standards. This is consistent with the Government's intentions for the regulation of the accountancy profession, which will allow ARGA to enforce against all accountants, potentially including non-member accountants, with reference to the IESBA¹⁰⁰ International Code of Ethics for Professional Accountants.

11.2.50 The Government confirms that ARGA will set standards for technical actuarial work. The Government further confirms that ARGA will not set ethical standards for actuaries and that ethical standards should continue to be set by the IFoA. However, ARGA may require individuals undertaking public interest actuarial work to comply with the IFoA's ethical standards.

¹⁰⁰ International Ethics Standards Board for Accountants.

Setting legally binding technical standards

11.2.51 Although a number of respondents to the White Paper did not support the introduction of legally binding technical standards, the Government considers that enforceable technical standards are necessary to underpin a credible and strengthened regime for the regulation of the actuarial profession, consistent with the findings of the FRC Review.

11.2.52 The Government confirms that ARGA will have the statutory power to set technical actuarial standards. These standards will apply to individuals who carry out actuarial work activities by, or for, PIEs, large pension schemes and large funeral trusts, for actuarial work defined and published by the regulator as set out above. **The intention is for these standards to apply to UK individuals producing work for UK individuals or entities. However, this will be subject to agreement with each of the devolved administrations.**

11.2.53 The FRC currently sets technical actuarial standards that apply to all actuarial work by IFoA members that is within UK “geographic scope” (as defined in the Framework for FRC technical actuarial standards¹⁰¹). These non-statutory standards are designed to ensure a good standard of actuarial work. It may not be desirable, or consistent with the outcome of the FRC Review, to weaken the current framework for actuarial regulation by removing this responsibility.

11.2.54 The Government further confirms that ARGA will have the statutory power to set technical actuarial standards for all IFoA members in relation to their actuarial work, including non-public interest work, for UK individuals or entities. However, this will be subject to agreement with each of the devolved administrations.

Monitoring compliance with technical standards

11.2.55 The Government confirms that ARGA will monitor adherence to the technical standards in public interest actuarial work.

11.2.56 The Government agrees that ARGA should only monitor compliance with its technical standards.

11.2.57 The Government has considered whether the effectiveness and credibility of ARGA’s monitoring programme would be enhanced by giving ARGA a power to compel an individual to provide all necessary details of the work in question to the regulator. This power is already available to the FRC in its capacity as regulator of the audit profession. Employers of individuals undertaking public interest actuarial work may cite confidentiality reasons for prohibiting, or penalising, the provision of work by that individual to ARGA. Therefore, ARGA would be expected to consider issues of confidentiality when discharging its regulatory functions, consistent with the behaviours expected of regulators as set out above.

¹⁰¹ <https://www.frc.org.uk/getattachment/03a1d210-621b-411a-8605-4f8a51cbeb21/Framework-for-FRC-actuarial-standards-April-2019.pdf>

11.2.58 The Government confirms that ARGA will be empowered to request that individuals undertaking public interest actuarial work provide timely access to their work in response to a formal request, and to compel them to do so if necessary. ARGA will have statutory powers to use, in extreme circumstances, to request a court order to compel the provision of work for monitoring in cases in which an individual does not comply with the initial request, consistent with its powers under the regulatory regime for audit.

Taking appropriate action if public interest actuarial work does not meet technical standards

11.2.59 The audit regime provides for the regulator to take appropriate action if audit work does not meet the required standards. It includes a statutory regime of supervisory responses and sanctions, with powers available to the regulator including the ability to make declarations about non-compliance (that is, publicise enforcement action) and imposing fines. A graduated set of sanctions is being proposed for the accountancy regime, including reprimands, conditions, exclusion or a recommendation of exclusion from a professional body, levying a fine and waiver or repayment of client fees. The Government considers that this model is also appropriate for the regulation of actuaries.

11.2.60 The Government confirms that ARGA will have a statutory power to take action against the individuals responsible for breaches of technical actuarial standards when public interest actuarial work is carried out by, or for, PIEs, large pension schemes or large funeral trusts. Consistent with ARGA's ability to require individuals carrying out public interest actuarial work to comply with the IFoA's ethical standards, ARGA may also take action against the individuals responsible for breaches of ethical standards.

11.2.61 The Government confirms that ARGA will have the statutory power to compel the disclosure of the information that it needs for public interest monitoring or disciplinary investigations. A graduated set of actions will be available to ARGA including, but not limited to, recommending remedial action, including correction of publicly available information if the work output is public; making public declarations about non-compliance; reporting to the IFoA and, in appropriate cases, taking enforcement action under the independent disciplinary regime discussed below, which may include the levying of fines.

Independent oversight of the IFoA in relation to its regulation of its members

11.2.62 Currently, the IFoA is the UK's only chartered professional body for actuaries, so the FRC's oversight arrangements only apply to the IFoA. However, the Government believes that the oversight regime should be extended so that any future UK actuarial professional bodies, particularly if undertaking public interest actuarial work as set out above, may be subject to ARGA's oversight subject to certain criteria.

11.2.63 The Government confirms that ARGA's oversight of the IFoA will be brought on to a statutory basis, with the scope unchanged, as set out in the White Paper. The intention is for this to be extended to allow inclusion of other UK professional bodies

which meet the criteria¹⁰². However, this will be subject to agreement with each of the devolved administrations. **ARGA's statutory oversight power will enable it to require that the IFoA continues to require its members to follow the technical actuarial standards set by ARGA.**

11.2.64 **The Government believes that the basis for ARGA's oversight of actuarial professional bodies should be broadly consistent with its powers in relation to oversight of the accounting profession and, therefore, will be brought on to a statutory basis.**

Providing an independent investigation and discipline regime for public interest issues

11.2.65 **The Government confirms that the current division of responsibilities between the regulator and the IFoA will be retained but placed on a statutory footing. ARGA will carry out its disciplinary function regarding public interest cases, as the FRC does now, but restricted to public interest actuarial work by or for PIEs, large pension schemes and large funeral trusts.**

11.2.66 **In order to ensure appropriate scrutiny and transparency, ARGA will be required to publish guidance documents about sanctions for its disciplinary scheme and to report, publicly, its performance against key performance indicators related to the principle of timeliness.**

Regulation of actuarial work undertaken by entities

11.2.67 **The Government does not think that the case has been made that a new regulatory system is required for either the regulation of entities, or the regulation of actuarial work regardless of whether it is an individual or an entity that completes that work. There was little support for this case in the responses to the consultation.**

11.2.68 **Such a new regulatory system, or a parallel regulatory system to that of individuals, would be disproportionate to the risks as identified in the FRC Review and the responses to the White Paper. Therefore, the Government does not propose to establish a system to regulate actuarial work or entities directly. The Government confirms that the regulatory regime should be focused on individuals.**

11.2.69 **However, the Government recognises that, in exceptional circumstances, action may need to be taken to regulate the public interest actuarial work completed by an entity. The Government concludes that ARGA should regulate entities only in the following scenarios:**

- **ARGA is unable to obtain the work for assessment for compliance with technical standards, for example because it is unable to identify the individual who was responsible for completing the work; or**

¹⁰² ARGA will be expected to set the enabling criteria for actuarial professional bodies within scope.

- ARGA has a compelling reason to believe that any breach of the technical standards in relation to public interest actuarial work completed by an individual may be due to wider issues arising in the entity for which the individual works.

11.2.70 In such cases, ARGA will be able to access and monitor work directly from the entity and take enforcement action at the entity level.

11.2.71 ARGA's powers and sanctions that can be deployed at the entity level will be consistent with its powers and sanctions for the regulation of individuals.

11.3 Investor stewardship and relations

11.3.1 Institutional investors have an important stewardship role, seeking to create long-term value for their clients through effective oversight of the companies in which they are invested.

11.3.2 The White Paper set out the Government's support for the FRC's revised UK Stewardship Code. The revised Code¹⁰³, which took effect in January 2020, responded to a recommendation in the FRC Review that a fundamental shift in approach was required to ensure that the Code differentiated "excellence in stewardship" and that signatories were transparent about the activities and outcomes of their stewardship, rather than just their stated approach or policies.

11.3.3 The FRC received 189 applications to follow the revised Code in the first round of applications with 125 being accepted as signatories. The first list of signatories was published in September 2021. The FRC received 105 further applications in October of which 76 were successful. This takes the total number of signatories to 201, including asset managers with £41 trillion in global assets under management. The updated list was published in March 2022¹⁰⁴. It is a positive sign that so many investors and service providers want to demonstrate their commitment to effective stewardship. 11.3.3 The White Paper also set out the Government's expectation for a review into the regulatory framework for effective stewardship in due course.

11.3.4 The Code requires transparency about the activities and outcomes of investors' stewardship activities. Signatories have evidenced their stewardship with examples in the reporting period that are reflective of the size of the organisation, and the asset classes and geographies in which they are invested. While the White Paper did not ask any specific questions about this issue, respondents to the consultation were generally supportive of the UK Stewardship Code and its evolution.

11.3.5 Since publication of the first list of signatories, the FRC has published *Effective Stewardship Reporting: Examples from 2021 and expectations for 2022*, identifying good examples of reporting and areas where it wishes to see improvements¹⁰⁵. Following this, as

¹⁰³ [https://www.frc.org.uk/document-library/corporate-governance/2019/2020-corporate-stewardship-code-\(1\)](https://www.frc.org.uk/document-library/corporate-governance/2019/2020-corporate-stewardship-code-(1))

¹⁰⁴ <https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-signatories>

¹⁰⁵ <http://www.frc.org.uk/document-library/corporate-governance/2021/effective-stewardship-reporting-examples-from-2021>

part of continuing work to encourage higher standards of effective stewardship reporting, the FRC is engaging with stakeholders and will confirm its approach to differentiating reporting quality or ‘tiering’ for asset managers and service providers to the Code in 2022.

11.3.6 Finally, the Government confirms that the FRC – working with the Financial Conduct Authority, the Department of Work and Pensions and the Pensions Regulator – will carry out a review of the regulatory framework for effective stewardship including the operation of the Code. It expects this review will take place in 2023, to allow two full years of reporting under the revised Code. The review will assess whether the Code is creating a market for effective stewardship and the need for any further regulation in this area. The Government will work with these bodies to determine the criteria by which the success of the Code will be measured.

11.4 Powers of the regulator in cases of serious concern

What the White Paper proposed

11.4.1 The White Paper considered ways to prompt auditors and the regulator to identify and act on serious concerns in PIEs at an earlier stage, so as to limit the likelihood of corporate failure as far as possible. This included building on the regulator’s use of market intelligence and consideration of the disclosures that auditors are required to make to the regulator. The Government also set out its intention to give the regulator powers to require rapid explanations from PIEs and to commission expert reviews where it has concerns relating to compliance with corporate reporting requirements and obligations. Views were sought on whether the existing duty requiring auditors to disclose certain matters to the regulator was sufficient, or if it could be expanded or improved upon in any other way. In addition, views were sought on whether auditors of PIEs should receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator, as provided for auditors of FCA or PRA-authorized firms, and whether this might encourage auditors to report concerns to the regulator.

11.4.2 The White Paper also asked respondents for views on how much time companies should have to respond to a request for a rapid explanation and whether the regulator should be able to publish a summary of the expert reviewer’s report where it considered it to be in the public interest.

Issues arising from consultation

Building on the regulator’s use of market intelligence

11.4.3 Only one respondent (a Big Four audit firm) commented on the regulator’s use of market intelligence, expressing support for its increased use.

Disclosures by auditors to the regulator

Matters to be reported to the regulator

11.4.4 There were mixed views from the 50 respondents who commented on whether the existing requirements for auditors to disclose matters to the regulator were sufficient, or

whether additions or improvements were necessary. Half of respondents believed that the existing provisions were sufficient. Several respondents also remarked on the expected outcome of such disclosures and whether ARGA would have the powers to do anything with the information it received and two respondents from the academic sector believed it was not clear where such provisions might have prevented the failure of a PIE.

11.4.5 A number of respondents identified risks with extending the number of reportable matters to the regulator: one respondent believed it might deter transparency between the audited entity and auditor and a Big Four accounting firm suggested it could result in over-reporting, meaning that short-term issues were reported which could have otherwise been resolved without intervention. There were also concerns from two respondents from the charity sector who highlighted that in respect of charities this would increase regulatory costs without any enhanced oversight, because a separate regime was already in place for charity auditors.

11.4.6 Those suggesting that the matters to be reported to the regulator should be expanded were generally supportive of auditors being required to report serious concerns on a range of risk factors. These included factors beyond financial reporting, including weaknesses in controls, governance, strategy, culture or fraud.

11.4.7 Specific suggested additions included concerns about matters related to climate change, the veracity of information provided or the motivations of those providing it, and suspected criminal matters – including fraud or withholding information essential to the audit, blocking attempts to investigate, or failing to co-operate with the auditor.

Other suggested improvements to the duty to report certain matters to the regulator

11.4.8 Several respondents wanted to encourage greater transparency and communication between the regulator and PIE auditors, including whether past disclosures (or the absence of them) had met expectations and as a way to identify emerging risks. An audit firm suggested that consideration should be given to whether directors should be required to self-report issues of concern, and whether others such as audit committees and board reviewers should also be within the scope of this requirement.

11.4.9 Several respondents, including a FTSE 100 company and two large accounting firms, made suggested changes to the process and guidance for any existing and new reportable matters. Suggested changes to the process included:

- time-bound requirements for reporting, with reference to the date on which auditors became aware or first had concerns;
- a requirement for the auditor to be obliged to discuss the matter with the board of directors in advance of reporting the matter to the regulator; and
- appropriate safeguards being in place to restrict the disclosure of commercially or price sensitive information that the company had not shared with investors.

11.4.10 Suggested changes to the guidance included:

- further elaboration of the existing disclosures (including what was meant by viability concerns and clarity that existing reportable matters included short to medium-term threats);
- what the regulator considered to be of importance;
- what evidence was considered to be appropriate; and
- when matters should be reported.

Statutory protection from breach of duty claims

11.4.11 The overwhelming majority (54 of 57) of respondents were supportive of auditors having statutory protection from breach of duty claims in relation to disclosures to the regulator, agreeing that it would encourage greater disclosure. A large accountancy firm stated that it was important on the grounds of fairness that public interest reporting to ARGA by PIE auditors was given the same protection as that given for disclosures to the PRA or FCA. Another respondent stated that it was essential that there were no barriers to auditors feeling free to report viability and other matters of concern to ARGA with two respondents specifically remarking that this might encourage matters to be reported. A Big Four firm highlighted that such protection would be particularly important as challenger firms sought to grow; because the impact of an entity taking its audit business elsewhere in retaliation for a report made to a regulator would be greater for smaller firms with a smaller client base.

11.4.12 Of the few who were unsupportive, an academic suggested that auditors might rely on this as a precaution or that it might result in so many referrals that the regulator was inundated.

Powers to address serious concerns about PIEs

Power to require rapid explanations

11.4.13 The large majority of respondents who commented on the power to commission rapid explanations supported the concept. Several respondents, however, said that in considering stronger powers, account should be taken of the FRC's existing information-gathering powers and how the new powers would interact with this.

11.4.14 On the question of how much time should be allowed, suggestions ranged from one day to 60. Most suggested that the timetable set by the regulator should be reasonable and set on a case-by-case basis to reflect the nature, complexity and urgency of the information being sought. Some suggested that, in setting deadlines, the regulator should be sensitive to monthly and year-end pressures on companies, and potentially the limited availability of audit committee members. One audit firm said that deadlines should reflect the fact that companies might sometimes have to wait for an external party to respond before being able to reply to the regulator: for example, where it was negotiating with lenders for new lending facilities. One law firm suggested that particular care should be taken to provide enough time for an accurate and complete response and potential input from lawyers if enforcement action was envisaged. Some respondents wanted clarity about whether information obtained in this way would be published.

Power to require an expert review

11.4.15 The majority of the responses favoured giving ARGA a power to commission or require an expert review provided there was a fair process and safeguards surrounding use of the power. A typical view was that the decision to commission an expert review needed to take account of the principle of proportionality and be based on reasonable evidence and with a scope that is reasonable. Some respondents stressed that the power should not be used to compensate for a lack of internal resource on the part of the regulator. It should also not be a way for the regulator to contract out difficult regulatory decisions. Ultimately, final decisions were for the regulator.

11.4.16 Most respondents were supportive of ARGA being able to publish a summary of the expert review but generally only in exceptional circumstances when it was in the public interest to do so, as the White Paper had suggested. A minority thought that an expert review should be seen as a “means to an end” – the end being a potential direction from the regulator to a company to amend its report and accounts or other enforcement action. This meant that the review did not need to be published, because the outcome would be apparent from the final decision and the regulator’s own summary of the outcome. Some investors thought that publication, even in summary form, would be likely to make the review process more contentious, time consuming and costly. Some audit firms suggested that it would be difficult for summaries to provide enough of the context to enable all parties to understand them fully.

11.4.17 Several respondents pointed out that the FCA and PRA, who already had powers to commission skilled persons’ reviews under financial services legislation, did not have powers to publish the end result.

Government response

Building on the regulator’s use of market intelligence

11.4.18 The Government continues to welcome ongoing action by the FRC to develop and strengthen its use of market intelligence to give it a more holistic view of emerging risks. This should enable the FRC to take a more proactive approach to ensuring compliance and to target its enforcement activities more effectively.

Disclosures by auditors to the regulator

11.4.19 The International Standard on Auditing (ISA) (UK) 240 already provides a requirement for auditors to report fraud-related matters to the authorities responsible for investigating such matters, under certain conditions. The Government does not therefore consider that any further requirement to report on such matters is necessary at this time.

11.4.20 Other suggestions for possible additional matters to be reported to the regulator such as withholding information essential to the audit, blocking attempts to investigate, or failing to co-operate with the auditor would likely result in a qualified audit opinion being given, and the regulator subsequently being alerted. A separate report on these matters is therefore deemed unnecessary.

11.4.21 The Government believes that the existing reportable matters contained in ISA (UK) 250 Section B, combined with those required in ISA (UK) 240, include the most serious matters of interest to the regulator, and therefore **does not propose to introduce any additional matters to be reported to the regulator at this time**. Doing so would risk the potential for over-reporting to the regulator, and a loss of transparency between the auditor and the company being audited.

11.4.22 ISA (UK) 250 Section B details the circumstances that would give rise to a requirement for a PIE auditor to make a report to the regulator. However, the Government agrees that further clarification on the circumstances in which reports should be made by auditors, especially with regards to concerns around viability and resilience, is likely to be helpful and potentially encourage reports to be made where they are appropriate. **The Government will invite the regulator to consider whether amendments to the auditing standards or the introduction of standalone guidance may be helpful to improve clarity on these matters.**

11.4.23 Acknowledging the strong support for offering statutory auditors of PIEs the same level of protection as auditors of Financial Conduct Authority (FCA) or Prudential Regulation Authority (PRA) authorised firms, **the Government intends to ensure appropriate protections are in place**. It is the Government's intention that this statutory protection will cover auditors with respect to all statutory audit work. While the consultation question only concerned the auditors of PIEs, audit standards require all auditors to consider reporting to the regulator when they come across relevant matters during an audit – regardless of the size or status of the audited entity. All auditors should be protected in the fulfilment of their requirements. Furthermore, should the regulator deem it appropriate to review the audit of a non-PIE, as it may choose to do, it follows that the auditors of that entity should have the same protections to report and share information with the regulator. Although there were mixed views on whether this might encourage auditors to report concerns to the regulators, the Government believes the removal of any potential disincentives is appropriate, particularly when that protection is provided for the auditors of other firms.

Powers to address serious concerns about PIEs

11.4.24 The aim of the proposals for rapid explanations and expert reviews in this context is to strengthen the regulator's powers to identify and address any serious concerns about a company's corporate reporting in a timely manner, thereby strengthening confidence in UK markets.

Power to require rapid explanations

11.4.25 The White Paper said that the Government would consider how the power to commission rapid explanations would fit with the FRC's existing information-gathering powers in this area. Several respondents also suggested that this should be considered carefully. The FRC already has powers under the Companies Act 2006¹⁰⁶ to require documents, information and explanations from a company where there are concerns about its corporate reporting. It

¹⁰⁶ Section 459, Companies Act 2006.

has separate, more recently acquired powers in the Statutory Auditors and Third Country Auditors Regulations 2016 to require information from companies (and auditors) about a statutory audit.

11.4.26 The Government's assessment, following further analysis, is that the regulator's powers with respect to a company's statutory audit are already sufficient and should be transferred to ARGA. The powers in respect of corporate reporting are also adequate, although Government will give further consideration to ensuring that these powers are sufficient to enable ARGA to prescribe a timetable for responding to requests which a court would be able to enforce. In exercising these powers, the Government will expect the new regulator to act reasonably and proportionately and in line with a clearly articulated framework.

Power to require an expert review

11.4.27 Responses to the White Paper continue to support the case for giving ARGA powers to commission expert reviews of matters of concern in relation to corporate reporting. The FRC's existing corporate reporting review powers allow it to request information from a company and, if necessary, to secure changes to the report and accounts. However, there are challenges for the regulator in directing changes to matters involving significant judgements such as accounting for long-term contracts and impairment reviews. The power to commission an expert review will allow the regulator to instigate a review into the underlying reasons for an accounting application and allow it to make a better assessment of what changes might be required. (Other proposals to strengthen the regulator's corporate reporting review work are addressed in Chapter 4.)

11.4.28 The Government anticipates that the power to commission an expert review will only be used in exceptional circumstances where ARGA has been unable to obtain the information and explanations it requires directly from a company or its auditor. The Government intends to give the regulator powers to publish summaries of these reviews where it is in the public interest to do so and subject to the need to safeguard commercially confidential material. The regulator will be expected to publish its policy and procedures for the use of these powers. The Government separately intends to give the regulator powers to commission expert reviews of audit firms, including in relation to their health and resilience. This is addressed in Chapter 8.

11.5 Local public audit

Government proposals

11.5.1 As the White Paper noted, in December 2020, the Government provided an initial response¹⁰⁷ to Sir Tony Redmond's independent review of local authority financial reporting and external audit ("local audit") in England¹⁰⁸. This initial response indicated that the

¹⁰⁷ <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-government-response-to-the-redmond-review/local-authority-financial-reporting-and-external-audit-government-response-to-the-independent-review>

¹⁰⁸ <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review>

Government would explore the full range of options to deliver that review's recommendation to create a system leader for local audit, and that the (then) Ministry for Housing, Communities and Local Government (MHCLG) – now the Department for Levelling Up, Housing and Communities (DLUHC) – would engage with stakeholders by Spring 2021.

11.5.2 In May 2021, MHCLG published a full response¹⁰⁹ to the Redmond Review's recommendations, including a potential role of ARGAs as system leader for local audit. A further technical consultation¹¹⁰ has since been carried out on:

- a new system leader for the local government audit framework, along lines proposed by the Redmond Review;
- proposals to strengthen audit committee arrangements within councils;
- measures to address ongoing capacity issues with the pipeline of local auditors; and
- action to consider local audit functions further for smaller bodies in the system of local authorities.

11.5.3 This consultation, which closed on 22 September 2021, set out the Government's view that:

- ARGAs are best placed to take on the system leader role because in the current local audit framework the FRC is the only organisation which undertakes the core functions in relation to the quality framework needed by a system leader, as well as being an existing regulator;
- local audit should remain within the broader audit landscape, so that the benefits of the Local Audit and Accountability Act 2014 can be maintained and the broader reforms that the Government is making to transparency and governance within corporate audit can be harnessed for local audit; and
- given the clear interdependencies between local government and health audit, maintaining the current alignment between local government audit and health audit is a priority. Appointing ARGAs as local audit system leader enables that and would allow ARGAs to act as system leader for health audit also, subject to the outcome of the consultation.

Issues arising from consultation

11.5.4 Six substantive comments were made on this topic in the consultation on the White Paper. Respondents generally agreed with the Government's view that ARGAs could be an appropriate regulator for local audit, and that BEIS and MHCLG/DLUHC should work closely to ensure the needs of local audit are taken into account fully.

11.5.5 Concern was expressed as to the potential impact of White Paper reforms on the local government audit landscape, which one respondent described as "fragile". It was

¹⁰⁹ <https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-spring-update/local-authority-financial-reporting-and-external-audit-spring-update>

¹¹⁰ <https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical-consultation>

suggested that public sector audit resources were under pressure, and increases in the demand for PIE auditors could compete for resources with local audit.

11.5.6 Other suggestions made were that:

- public sector audit could provide a model for a number of measures proposed in the White Paper, such as audit committee arrangements and review of governance statements;
- local authority accountability could be improved by ensuring taxpayers are notified by email of accounts being finalised, and are able to make appropriate and timely objections; and
- the proposed new audit profession should include specific content on the constitutional status of public sector audit which should be mandatory for all auditors.

11.5.7 Generally, further detail and updates were requested.

Government response

11.5.8 The Government notes the points made, which have been shared in anonymised form with DLUHC, and welcomes support for its plans to make ARGA the system leader for local audit in England. BEIS and DLUHC are working together closely. For example, BEIS is a member of the Local Audit Liaison Committee¹¹¹ established by DLUHC to ensure a joined-up response to the challenges and emerging priorities across local audit until the new system leader is established.

11.5.9 Concerns about the capacity of the audit market as a whole, including local audit, have been a factor in the Government's decision to scale back a number of proposed measures including plans for a new audit profession. The phased introduction of new measures (outlined in Chapter 1) will also help to manage short-term impacts and support the longer-term growth of capacity and choice in audit markets.

11.5.10 The outcome of DLUHC's technical consultation is being published alongside this document¹¹².

11.6 Independent supervision of the Auditors General

What the White Paper proposed

11.6.1 The Comptroller and Auditor General's statutory audit work – which principally means the National Audit Office's work auditing certain companies – must be overseen by an "Independent Supervisor" appointed by the Secretary of State, currently the FRC.

¹¹¹ <https://www.gov.uk/government/groups/local-audit-liaison-committee>

¹¹² <https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation/local-audit-framework-technical-consultation>

11.6.2 The Comptroller and Auditor General is an officer of the House of Commons appointed by The Queen. The White Paper therefore set out that it would be more appropriate for oversight arrangements over the quality of the Comptroller and Auditor General's financial audit work to be established by Parliament. Similar issues exist with the Auditors General of other UK nations.

11.6.3 The Government therefore proposed in the White Paper to transfer responsibility for arranging supervision to appropriate Parliamentary bodies.

Issues arising from consultation and Government response

11.6.4 Most stakeholders are unaffected by the proposals and only five substantive comments were received. Of these, the most significant is a joint response from all four Auditors General agreeing the principle of the proposed change but suggesting that further consultation with devolved administrations is needed. **The Government welcomes this response, and will work with the relevant government, audit and legislative bodies in UK nations to agree and deliver the White Paper proposal.**

11.6.5 One respondent said it was potentially appropriate for ARGA to supervise the Auditors General, which was how arrangements in some other countries worked. They queried whether the Parliamentary body responsible would have the necessary skills. Another respondent said it was essential that a Parliamentary body carried out the work, not an agent of the executive. **The Government recognises that other choices could be made, but believes it is most appropriate for Parliamentary bodies to determine these arrangements.** The intention is that those bodies will have the option to continue with existing arrangements (for example, to use the expertise of ARGA) if they wish, but are free to develop alternative arrangements if they prefer.

11.7 Whistleblowing

What the White Paper proposed

11.7.1 The White Paper set out that the Government wishes to support genuine whistleblowing. The Government welcomed the intent behind the Brydon Review's recommendations relating to whistleblowing disclosures and protections; however, it was not convinced the recommendations could reasonably be followed, and any proposed extension in protections would have broad implications and require substantial changes to the existing whistleblowing framework. The Government acknowledged wider interest in making reforms to the whistleblowing framework and has committed to conducting a review in due course.

Issues arising from consultation

11.7.2 Twelve substantive comments were made on this topic. All were supportive of appropriate protections for genuine whistleblowers, as was the White Paper. However, nine (75%) disagreed to some degree with the White Paper position that any changes to whistleblowing arrangements should be considered through a forthcoming review of the wider

whistleblowing framework. One argument made for change was that whistleblowing rates in audit were rather lower than in other commercial contexts. The US system, where dedicated whistleblowing case officers are available and compensation is paid to whistleblowers who suffer financial consequences, was contrasted favourably with the UK's.

11.7.3 Three responses agreed that the planned broader review of whistleblowing was an appropriate mechanism to use; one of these (from a large audit firm) also agreed that extending whistleblower protections to cover disclosures to auditors was unnecessary.

11.7.4 Some respondents suggested that the regulator should consider whether its arrangements could do more to encourage those with relevant information to come forward.

Government response

11.7.5 The Government acknowledges the comments made, including the suggestion that “speaking up” would be a less loaded term and likely to encourage more reporting of concerns. The FRC has processes in place to deal with complaints and whistleblowing, which are regularly reviewed to ensure any cases received are dealt with in line with its policies and procedures.

11.7.6 The reforms set out in this document will give ARGA greater powers and probably greater public profile than the FRC has currently. Both of these are likely in themselves to encourage reporting to the regulator from people who are aware of suspected wrongdoing. For example, ARGA's powers to review the whole of companies' annual reports (see Chapter 4) will enable it to investigate some allegations which the FRC currently cannot. In light of its expanded powers, ARGA will need to establish a fresh policy in relation to whistleblowing, which will be expected to take account of available evidence on effective ways to encourage disclosures. ARGA will of course treat complaints and disclosures in line with the applicable legal frameworks, including in its capacity as a 'prescribed person' under Part IVA of the Employment Rights Act 1996¹¹³.

11.7.7 The Government is currently considering the appropriate scope and timing of the planned review referred to in paragraph 11.7.4 of the White Paper, which is beyond the scope of audit and corporate governance.

¹¹³ originally inserted by the Public Interest Disclosure Act 1998.

Annex A: List of consultation questions

Chapter 1 The Government's approach to reform

1.3 Resetting the scope of regulation

- Q1. Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.
- Q2. What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.
- Q3. Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.
- Q4. Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?
- Q5. Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.
- Q6. 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?
- Q7. 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?
- Q8. Should any other types of entity be classed as PIEs? Why should those entities be included?
- Q9. How would an increase in the number of PIEs impact on the number of auditors operating in the PIE audit market?
- Q10. Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?
- Q11. Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?

Chapter 2 Directors' accountability for internal controls, dividends and capital maintenance

2.1 Stronger internal company controls

Q12. 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?

Q13. 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?

Q14. If the framework were to be strengthened, which types of company should be within scope of the new requirements?

2.2 Dividends and capital maintenance

Q15. 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?

Q16. 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?

Q17. 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?

Q18. Do you agree that the combination of recently introduced Companies Act section 172(1) reporting requirements along with encouragement from the investment community and ARGAs will be enough to ensure that companies are sufficiently transparent about their distribution and capital allocation policies? Should a new reporting requirement be considered?

Chapter 3 New corporate reporting

3.1 Resilience Statement

Q19. 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?

Q20. Should the Resilience Statement be a vehicle for TCFD reporting in whole or part?

Q21. 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?

3.2 Audit and Assurance Policy

Q22. 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?

Q23. 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?

Q24. Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?

3.3 Reporting on Payment Practices

Q25. 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?

Q26. 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?

3.4 Public Interest Statement

Q27. 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?

Chapter 4 Supervision of corporate reporting

4.4 Influencing the corporate reporting framework

Q28. Do you have any comments on the Government's proposals for strengthening the regulator's corporate reporting review function set out in this chapter?

Chapter 5 Company directors

5.1 Enforcement against company directors

Q29. Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?

Q30. Are there any additional duties that you think should be in scope of the regulator's enforcement powers?

Q31. 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?

Q32. 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?

Q33. Should the Government's proposed enforcement powers be made available to the regulator in respect of breaches of directors' duties?

5.2 Strengthening clawback and malus provisions in directors' remuneration arrangements

Q34. 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?

Chapter 6 Audit purpose and scope

6.1 The purpose of audit

Q35. 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?

Q36. 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?

6.2 Scope of audit

Q37. 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?

Q38. 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?

Q39. What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?

6.3 Principles of corporate auditing

Q40. 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?

Q41. 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?

6.4 Tackling fraud

Q42. 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.

6.5 Auditor reporting

Q43. 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.

6.6 True and fair view requirement

Q44. 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?

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

Q45. 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?

6.8 Auditor liability

Q46. 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?

Q47. 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?

6.9 A new professional body for corporate auditors

Q48. Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.

Q49. 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?

Q50. Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?

Q51. Do you agree that a new audit professional body should cover all corporate auditors, not just PIE auditors?

Chapter 7 Audit Committee Oversight and Engagement with Shareholders

7.1 Audit Committees – role and oversight

Q52. Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

Q53. 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?

7.2 Independent auditor appointment

Q54. 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)?

Q55. 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?

Q56. 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?

Q57. 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)?

7.3 Shareholder engagement with audit

Q58. 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?

Q59. Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?

Q60. 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?

Chapter 8 Competition, choice and resilience in the audit market

8.1 Market opening measures

Q61. 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?

Q62. 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?

Q63. 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?

8.2 Operational separation between audit and non-audit practices

Q64. 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?

Q65. 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?

Q66. 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?

Q67. 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?

8.3 Resilience of audit firms and the audit market

Q68. 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?

Chapter 9 Supervision of audit quality

9.1 Approval and registration of statutory auditors of PIEs

Q69. 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?

9.2 Monitoring of audit quality

Q70. What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?

Q71. 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?

9.3 Regulating component audit work done outside the UK

Q72. Do you agree with the Government's approach to component audit work done outside the UK? How could it be improved?

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

Q73. 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?

Chapter 10 A strengthened regulator

10.1 Establishing the regulator

Q74. Do you agree with the proposed general objective for ARGA?

Q75. 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?

Chapter 11 Additional changes in the regulator's responsibilities

11.1 Supervision: Accountants and their professional bodies

Q76. 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?

Q77. What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?

Q78. 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)?

Q79. 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?

11.2 Oversight and regulation of the actuarial profession

Q80. Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?

Q81. Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?

Q82. Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.

Q83. Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?

Q84. 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?

Q85. Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?

Q86. 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?

Q87. 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?

Q88. Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?

Q89. 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?

Q90. 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?

Q91. 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?

Q92. 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?

Q93. Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?

11.4 Powers of the regulator in cases of serious concern

Q94. 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?

Q95. 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?

Q96. How much time should be given to respond to a request for a rapid explanation?

Q97. 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?

Q98. 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?

Annex B: List of respondents

Only organisations that gave permission for their response to be made public have been included on the list below. Responses received from organisations that did not give permission for their response to be made public; or organisations that indicated they do not want identifying information published; or from individuals, have been taken into account but are not included on the list below.

100 Group	Antofagasta plc
3i Group plc	Aon
3i Infrastructure plc	APAX Global Alpha Limited
4imprint, Inc.	Aptitude Software plc
A.I.Cherry Chartered Accountants and Auditors	Archetype Agency Limited
Academy for Board Excellence	Arthur J. Gallagher Holdings (UK) Limited
ACAS	Ascot Underwriting Limited
ACCA Global	Aspire Consulting Solutions
Accelerate	Associated British Ports
Accountancy Europe	Association of Consulting Actuaries Limited
Accuro Fiduciary	Association of Financial Mutuals
Airbus Operations Limited	Association of Foreign Banks
Airmic	Association of International Accountants
All Party Parliamentary Group for Corporate Governance	Association of International Certified Professional Accountants
Alliance Manchester Business School	Association of Investment Companies
ALPHA Investments and Financial Planning Ltd	Association of Practising Accountants
Alumasc Group plc	ASTA UK
Amino	Atrium Underwriters Limited
Anglo American plc	Audit Committee Chairs Independent Forum (ACCIF)

Audit Scotland	Bloor Homes
Audit Wales	Blueprint for Business
Avery and Brown	Boardroom Review
AVEVA	Boparan Holdings Ltd (trading as 2 Sisters Food Group)
Azets	BP plc
Aztec Group	Brit Insurance
B Limited	British American Tobacco
Baccma	British Chambers of Commerce
Baillie Gifford & Co	British Heart Foundation
Baillie Gifford China Growth Trust plc	British Private Equity & Venture Capital Association (BVCA)
Baillie Gifford European Growth Trust plc	BritishAmerican Business
Baillie Gifford Japan Trust plc	Brunel Pension Partnership Ltd
Baillie Gifford Shin Nippon plc	British Universities Finance Directors Group (BUFDG)
Baillie Gifford UK Growth Trust plc	Building Societies Association
Bakkavor Group	Burberry
Bank Sepah International plc	Business Information Providers Association
Bar Council	Cabinet Office SME Panel Payment Group
Barclays plc	Cairn Energy plc
Barnett Waddingham LLP	Cancer Research UK
Barratt Developments plc	Capita plc
BDO UK LLP	Castlefield Investment Partners
Beazley plc	Catalysers
Better Business Act coalition	CBI
Beverley Building Society	Center for Audit Quality
BlackRock	
Blick Rothenberg	

Centrica plc	Clyde & Co
CFA Institute	CML Microsystems plc
CFA Society of the United Kingdom	Cohort plc
CFO & More	Compass Group plc
Charity Commission for England and Wales	Competition and Markets Authority
Charity Finance Group	Computacenter
Chartered Accountants Australia and New Zealand and the Association of Chartered Certified Accountants	ConvaTec Group plc
Chartered Accountants Ireland	Co-operative UK
Chartered Governance Institute UK & Ireland	Corporate Justice Coalition, Oxfam, Amnesty, Share Action, London Mining Network, Labour Behind the Label, Forest Peoples Programme and Traidcraft
Chartered Institute of Internal Auditors	Corporate Reporting Users' Forum
Chartered Institute of Public Finance and Accountancy (CIPFA)	Countryside Properties plc
Chartered Institute of Taxation and the Association of Taxation Technicians	Crest Nicholson plc
Chorley Building Society	Croda International plc
City of London Investment Trust plc	Crowe U.K. LLP
Civil Society groups and academics - Spotlight on Corruption, Greenpeace, CLES, OpenSecrets, ClientEarth, Fair Tax Mark, The Equality Trust, Research for Action, Corporate Accountability Network, Tax Justice Network, International Lawyers Project, Global Legal Action Network, Women's Budget Group, Prof. Adam Leaver, Prof. Duncan Wigan and Prof. Atul K. Shah	Dechra Pharmaceuticals plc
ClientEarth	Deloitte
Climate Change Committee	Department of Health and Social Care
Climate Disclosure Standards Board	Derwent London plc
	Diageo plc
	Diploma plc
	Direct Line Group
	Duncan & Toplis Limited
	Dunelm Group plc
	Durham University

Durham University Business School	GEMFIELDS LTD
Earl Shilton Building Society	Genus plc
Ebiquity	GlaxoSmithKline
Ecology Building Society	Global Infrastructure Investor Association
Edinburgh Worldwide Investment Trust plc	GO Investment Partners LLP
Education & Skills Funding Agency	Government Actuary's Department
Employment Lawyers Association	Grant Thornton UK
EnQuest plc	Great Ormond Street Hospital Children's Charity
Ernst & Young LLP	Great Portland Estates plc
EUMAEUS	Greenergy
Euromoney Institutional Investor plc	Greenpeace UK
European Assets Trust plc	Group A accountancy and audit firms - Crowe, Haines Watts, Haysmacintyre, Mazars, Moore Kingston Smith, RSM, Saffery Champness, and Smith & Williamson
Experian plc	Haines Watts UK Group Services
FDM Group (Holdings) plc	Halma plc
Federation of Small Businesses	Harbour Energy
FERREXPO plc	HarbourVest Global Private Equity Limited
FIA European Principal Traders Association	Hardide
Fidelity International	Haydale Ltd
First Actuarial plc	Heathrow Airport Limited
Fit for Purpose Consulting	Henderson High Income Trust plc
FNZ	Henderson International Income Trust plc
Frasers Group	Herald Investment Management Limited
Fraud Advisory Panel	Herbert Smith Freehills LLP
Fresnillo plc	
Galvanize	
GC100	

Hermes Investment	Institute for Family Business (UK)
Higher Education Funding Council for Wales	Institute of Board Members, trading as NEDonBoard
Hoden Group Holdings	Institute of Business Ethics
Home Builders Federation	Institute of Directors
Hong Kong Institute of Certified Public Accountants	Institutional Investors Group on Climate Change
HSBC	Intermediate Capital Group
Human Organising Co	International Actuarial Association
Hunting plc	International Capital Market Association
Hymans Robertson LLP	International Corporate Governance Network
Institute of Chartered Accountants in England and Wales (ICAEW)	International Federation of Accountants
ICAEW Regulatory Board	International Underwriters Association
Institute of Chartered Accountants Scotland (ICAS)	Invesco UK Ltd
ICG-Longbow Senior Secured UK Property Debt Investments Limited	Investment Association
Institute and Faculty of Actuaries (IFoA)	Investor Forum
Inchcape plc	Investor Relations Society
Independent Anti-Slavery Commissioner	ISACA
Independent Audit Limited	ITV plc
Informa Group	Japan Income & Growth Trust plc
InfraRed Capital Partners Limited	Japan Tobacco International
Inland Homes	John Lewis Partnership
Innocent Drinks	John Swire & Sons Ltd
Institute and Faculty of Actuaries (IFoA) non-executive director ('NED') member interest group	Johnson Matthey plc
	Jupiter Asset Management Limited
	Keller Group plc

Keystone Positive Change Investment Trust plc	Mazars
Kingfisher plc	MB Dean Accountants
Kingsley Napley LLP	McGill and Partners Group Ltd
KPMG LLP	Mercer UK
Kreston Reeves LLP	Milk & Honey PR
Lancaster University	Milliman LLP
Landsec	Monks Investment Trust plc
Law Debenture Corporation	Moore Kingston Smith LLP
The Law Society and The City of London Law Society	Morses Club
Lloyds	MP Evans Group plc
Lloyds Market Association	National Audit Office
Local Authority Pension Fund Forum	National Express Group plc
Local Government Association	National Grid plc
Local Government Pension Scheme Advisory Board	Natwest Group
London Finance & Investment Group plc	Nest Corporation
London Stock Exchange Group	Nestle UK & Ireland
LPA Group	Nestor Advisors
Luceco plc	Newcastle University
M&G	Next plc
Macintyre Hudson LLP	NHS England and NHS Improvement
Manchester Metropolitan University	Norges Bank Investment Management
Mansfield Building Society	Northern Ireland Audit Office
Marsh Limited	Ocado
Marvel FMCG Ltd	Office for Students
	OneSavings Bank
	Open Data Institute

Pacific Horizon Investment Trust plc	Quoted Companies Alliance
Penrith Building Society	R3
Pension Protection Fund	Rank Group
Pentland Group Limited	Reckitt
Perendie	Reed
Persimmon plc	Regulatory Board of ACCA
PKF Littlejohn LLP	Renishaw plc
Polar Capital	Rentokil Initial plc
Portmeirion Group plc	Resilient Corporates
Porvair plc	Right Move
Price Bailey LLP	Rio Tinto
Principles for Responsible Investment (PRI)	Risk Oversight Solutions Inc
Prism Cosec	RM Secured Direct Lending plc
Project On Government Oversight	RNLI
Protect	Rockhopper Exploration plc
Proxima	Rolls Royce plc
PRS for Music	Royal London
Public Accounts Commission	RPMI Railpen
Public Sector Audit Appointments Limited	RSM UK Audit LLP
Pulse	Saffery Champness LLP
PwC	Sage Group plc
PwC Independent Non-Executives	Salford University
QinetiQ	Samworth Brothers (Holdings) Limited
Qualcomm Technologies International, Limited	Sarasin
Queen Mary University of London	Schroder Oriental Income (SOI) Fund Limited

Schroders	St Andrew's Healthcare
Scottish American Investment Company plc	St. Modwen
Scottish Mortgage Investment Trust	Standard Chartered Bank
SDI Group plc	Standard Life Aberdeen
Segro plc	Standing CT
Serco Group plc	Star Crest Education
SGS	SThree plc
ShareAction	Sumo Group plc
ShareSoc & UKSA	Sustainability Academy
Sheffield University	Syncona
Sheffield University Management School	T. Rowe Price International Ltd
Shell International B.V.	Talbot Underwriting LLP
SIG plc	TalkTalk
Simmons & Simmons LLP	Tapestry Networks and the European Audit Committee Leadership Network
Sky Group UK	Taylor Wessing
Small Business Crown Representative	Tesco
Smith & Nephew plc	TheCityUK
Smith & Williamson LLP	Thruvision
Smiths Group plc	Tiger Global
Smiths News plc	TPICAP Group
Society of Conservative Lawyers	Trackwise
Society of Professional Pensions	Transparency International UK
Softcat plc	TRU (UK) Asia Limited, (Toys "R" Us UK)
Spirax-Sarco Engineering plc	Trustpilot Group plc
Spotlight on Corruption	UK Auditors General
SSE plc	

UK Equity Markets Association (UKEMA)	Vivo Energy plc
UK Finance	Vodafone Group plc
UK Sustainable Investment and Finance Association	W & R Barnett Ltd
Unilever	Warpaint London plc
United Utilities	Weir Group plc
Universities Superannuation Scheme Ltd	Wellcome Trust
University of Aberdeen	Westcoast Ltd
University of Birmingham	Western Selection plc
University of Exeter	Whitbread plc
University of Greenwich	Willis Towers Watson
University of Hertfordshire	Witan Investment Trust plc
University of Manchester	Women in Sustainability Network
Value Reporting Foundation	Woolcool
Vernon Building Society	Xerox Ltd
Vesuvius plc	Young & Co's Brewery, plc
Victrex plc	Zenith Audit UK
Vitec Group plc	Zurich Insurance plc

Annex C: Ministerial Direction

Direction by the Secretary of State for Business, Energy and Industrial Strategy under regulation 3(12) of the Statutory Auditors and Third Country Auditors Regulations 2016

Legal Framework:

Under regulation 3(1) of Statutory Auditors and Third Country Auditors Regulations 2016 (“the 2016 Regulations”), the Financial Reporting Council (“FRC”) is the competent authority responsible for the public oversight of statutory auditors, for the regulatory tasks provided for in EU Regulation 537/2014 (“the Audit Regulation”, which forms part of domestic law as direct EU legislation under section 3 of the European Union (Withdrawal Act) 2018) and for:

- the approval and registration of statutory auditors;
- technical standards and standards of professional ethics and internal quality control of statutory auditors and audit work;
- continuing education of statutory auditors;
- monitoring (by means of inspections) of statutory auditors and audit work;
- investigation of statutory auditors and audit work; and
- imposing and enforcing sanctions.

Regulation 3 enables the FRC to delegate tasks to any Recognised Supervisory Body (RSB)¹¹⁴ in accordance with the following framework:

Under regulation 3(2) the FRC must consider whether and how tasks arising from its responsibilities listed above may be delegated to any RSB.

Tasks may be delegated by reference to particular descriptions of activity for which the FRC is responsible, particular descriptions of statutory auditor or particular descriptions of audited person (e.g. whether in relation to an individual engagement of an auditor by an audited entity, or in relation to a category of engagements defined by reference to an individual auditor or a category of auditors or audited entities).

However under regulation 3(5), as is required by Article 24(1) of the Audit Regulation, the FRC may not delegate certain tasks arising from its responsibilities for inspection, investigation, enforcement and sanctions.

¹¹⁴ Recognised Supervisory Bodies are those bodies recognised by the FRC as having appropriate arrangements and resources in place for the supervision of statutory auditors under section 1217 of the Companies Act 2006 and Part 1 of Schedule 10 to that Act.

Under regulation 3(6) and (7) the FRC must specify the tasks delegated and any conditions under which those tasks are to be carried out and may specify exceptions to any delegation.

Under regulation 3(8) the FRC may reclaim tasks it has delegated, including those which relate to particular descriptions of regulatory activity, of statutory auditor or audited person.

Under regulation 3(12) the Secretary of State may give directions to the FRC in connection with the delegation of tasks to the RSBs.

A Direction was given to the FRC on 17 June 2016 by the Parliamentary Under-Secretary of State, Baroness Neville Rolfe in the following terms:

1. In considering whether and how tasks arising from the responsibilities listed in regulation 3(1)(e) to (m) of the 2016 Regulations may be delegated to any RSB, the FRC should work on the basis that, apart from in circumstances mentioned in paragraphs 2, 3, 4 and 5 below, these tasks are to be delegated to the RSBs.
2. The FRC may perform a task directly and not delegate it or, if it has delegated task, may reclaim it:
 - a) by agreement with an RSB;
 - b) where the FRC considers that the RSB is unable to carry out the task;
 - c) if the task arises from the FRC's responsibilities listed in regulation 3(1)(k) to (m) of the 2016 Regulations and relates to a particular audit engagement that is the subject of a joint inspection involving a third country competent authority; or
 - d) if the task arises from the FRC's responsibilities listed in regulation 3(1)(k) to (m) of the 2016 Regulations and relates to a one or more audit engagements where, given the circumstances relating to those engagements, the FRC considers there are public interest reasons for carrying out the task itself.
3. Where the FRC or RSB proposes that a task should be performed directly by the FRC or reclaimed by the FRC on the basis of paragraph 2(a) above, and there is no agreement on the proposal, the FRC or RSB may seek a further Direction from the Secretary of State.
4. Where the FRC or RSB proposes that a task should be performed directly by the FRC or reclaimed by the FRC on the basis of paragraph 2(d) above then, if the task relates to more than one audit engagement, the FRC must consult those whose interests would be affected by the proposal.
5. The Secretary of State may give a further Direction in connection with a task to which a proposal under paragraph 4 relates.
6. Tasks relating to the investigation of statutory auditors and audit work in relation to Public Interest Entities where they are permitted to be delegated by Article 24(1)(b) of

the Audit Regulation (though tasks relating to imposing and enforcing sanctions in relation to those audits may not be delegated) are not included in the Direction under paragraphs 1 to 5 above and may be delegated, retained or reclaimed by the FRC.

The Secretary of State makes the following further Direction:

Direction:

1. This Direction takes effect on 31 July 2022.
2. The FRC is directed that the Direction of the Parliamentary Under-Secretary of State, Baroness Neville Rolfe, made under regulation 3(12) of the 2016 Regulations and dated 17 June 2016, shall cease to have effect on and from 23:59 on 31 July 2022.

Rt Hon Kwasi Kwarteng MP

Secretary of State

Made on 31 May 2022

(Issued to FRC with copies sent to the RSBs on 31 May 2022)

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