



## Financial Reporting Advisory Board

### BEIS White Paper update

Issue:	BEIS's proposals to strengthen the UK's framework for major companies and the way they are audited and the potential implications on public sector reporting requirements.
Impact on guidance:	None.
IAS/IFRS adaptation?	N/A.
Impact on WGA?	None.
IPSAS compliant	N/A.
Interpretation for the public-sector context?	No adaptations or interpretations proposed.
Impact on budgetary regime and Estimates?	None.
Alignment with National Accounts	No impact on the National Accounts.
Recommendation:	For the Board to consider the implications of the government's proposals for the public sector.
Timing:	N/A

#### DETAIL

##### *Background*

1. At Financial Reporting Advisory Board (FRAB) meeting 144, June 2021, the National Audit Office (NAO) provided a brief overview of the Department for Business, Energy & Industrial Strategy (BEIS) consultation white paper on ['Restoring trust in audit and corporate governance'](#) (FRAB 144 04).
2. The BEIS white paper set out the government's response to recommendations made by three independent reviews commissioned by the government in 2018: Sir John Kingman's Independent review of the Financial Reporting Council (FRC), the Competition and Market Authority's statutory audit market study, and Sir Donald Brydon's independent review of the quality and effectiveness of audit and the responses received in response to the initial consultation.

3. The FRC Review found that the existing regulator lacked the necessary powers and clarity of purpose to hold auditors and directors sufficiently to account and recommended that it be replaced. The Brydon Review concluded that there was a need for statutory audit to become more informative, and that higher expectations should be placed on both directors and auditors to deliver more useful information to the users of reports. The CMA Market Study revealed that a small number of audit firms dominate the statutory audit market and called for new measures to increase quality, competition, and resilience in the delivery of audit.
4. The main findings from the reviews highlighted long-standing concern over a lack of competition and resilience in the statutory audit market and a perceived gap between the expectation of users of financial reports and the audit product. The BEIS consultation, which ran between 18<sup>th</sup> March 2021 and 8<sup>th</sup> July 2021, set out a package of measures aimed at improving the UK's audit, corporate reporting and corporate governance framework based on these findings.
5. The white paper focused on the arrangements in place for entities defined as Public Interest Entities (PIEs). Although wide ranging, the consultation primarily covered four broad areas of the corporate governance and audit framework in the UK:
  - Director responsibilities for governance;
  - Audit, auditors, and audit firms;
  - Shareholder stewardship responsibilities; and
  - The audit regulator.
6. Although the paper did not specifically address proposals for the reporting or audit of public sector entities, the NAO set out various points considering how the principles of the paper may be applied in the public sector in relation to:
  - Public sector equivalence of strengthened requirements on Directors;
  - Audit and Assurance policies for public sector entities;
  - Expansion of the definition of Public Interest Entities; and
  - Audit scope and reporting in the public sector.
7. The NAO paper noted that proposals in relation to internal controls and resilience planning could be extended to public sector entities, alongside additional assurance requirements, and that further consideration would be needed in relation to the proposals concerning audit and assurance, such as the authority to set audit and assurance policy.
8. The NAO set out that it would be for the relevant authorities to determine the scope of any extension to existing requirements and where they would apply, considering the benefit and cost.
9. The white paper also proposed that the responsibility for overseeing the quality of the Comptroller and Auditor General's (C&AG) statutory audit work should transfer from the Secretary of State to Parliament. This proposal was designed to respect the C&AG's statutory independence from the bodies they audit and align their accountability to Parliament, rather than to a Secretary of State through a government appointed regulator.
10. The consultation period closed on 8<sup>th</sup> July 2021 with over 600 comments received, which were then reviewed by BEIS. The final government [response](#) to the consultation was published on 31<sup>st</sup> May 2022.

### *Government proposals*

11. The document sets out the government's plan of action in response to the feedback received, focussing on proportionality and looking at the opportunity for market-based solutions and non-regulatory options in preference to regulation, as well as at reducing the costs to the entities that the proposals would affect.
12. The main measures the government intends to take forward are:
  - establishing a new regulator, the Audit, Reporting and Governance Authority (ARGA);
  - ensuring high standards of reporting and accountability for large private companies;
  - more useful risk reporting by large companies, with information on the level of assurance, and strengthened review powers for the regulator;
  - strengthening internal controls reporting through the Corporate Governance Code;
  - improving the quality of audit and making it more informative;
  - the introduction of a 'managed shared audit' requirement for FTSE 350 companies, and requiring an operational separation of audit and non-audit practices to boost resilience, competition and choice in the audit market;
  - making directors of large companies more accountable for significant failures in their corporate reporting and audit related duties; and
  - strengthening oversight of the accountancy and actuarial professions.
13. The government will prepare and publish a draft Bill in this session of parliament. Changes will be effected through the new regulator. On publication of the government response, a new Ministerial Direction was issued to the regulator (reproduced in [Annex C](#) of the government response).
14. A 2016 Ministerial Direction set out that FRC was the competent authority responsible for the public oversight of statutory auditors, including responsibility for the approval and registration of statutory auditors, monitoring and investigation of statutory auditors and audit work and imposing and enforcing sanctions. The Ministerial Direction also directed the FRC to delegate all those tasks which the law permits to the Recognised Supervisor Bodies, other than in certain circumstances.
15. This new Ministerial Direction retracts the 2016 Ministerial Direction, effective on and from 23:59 on 31 July 2022, to lay the foundations for introduction of PIE auditor registration by the FRC in the near future by enabling the regulator to move forward with reclaiming the function of determining the eligibility criteria for approval of statutory auditors of PIEs.
16. The FRC has also recently published its three-year plan and budget, setting out how it is preparing for the transition to ARGA.
17. The government response sets out which of the recommendations from the three independent reviews have been accepted and the progress of these recommendations will be reviewed after 5 years, with a post-implementation review.

### *Impact on the public sector*

18. The main measures the government intends to proceed with in the private sector have been outlined above. In conjunction with BEIS, the Treasury is considering the potential impact on the public sector of the measures being taken forward by the government applicable to the private sector and public sector PIEs. This work is currently in an early assessment phase and will be brought to FRAB when more work has been undertaken with BEIS and ministers.
19. These considerations include both direct effects and thematic issues raised:

- The impact of an updated PIE definition;
- Keeping pace with new and additional reporting requirements in the private sector; and
- Implications for public sector audit.

### *Public interest entities*

20. As part of the proposal package, the government has updated the definition of a public interest entity and the scope of the measures. The definition captures companies based on a turnover of £750m+ and employee numbers of 750m+.
21. Some public sector bodies already fall into the PIE definition and the scope of the proposals.
22. Per the government response, local authorities will not become PIEs through having 750+ employees and £750m+ turnover, although they may be PIEs for other reasons (for example, because they have listed debt).
23. The government also intends to exclude other public sector bodies, as appropriate (for example because they are already subject to similar requirements). Although the government will consider whether there is a case for including any other public bodies as PIEs in drafting reform legislation.
24. The government response seeks to set out the public interest in any group of entities being added to the scope of the PIE definition and ensuring that the benefit of such entities becoming PIEs would justify the extra regulation that would be required of them.
25. Public sector bodies are already subject to enhanced scrutiny and additional regulation compared to the private sector through, for example:
  - Parliamentary control and scrutiny;
  - Wider scope of public audit, including regulatory opinions and value for money studies;
  - Treasury and Cabinet Office controls, e.g., ring-fenced budgets, accountability arrangements from for example, Managing Public Money (MPM); and
  - more stringent reporting requirements and extensive expenditure disclosures.
26. The ICAEW noted in its response to the initial consultation that there was concern that the increased requirements associated with PIE audits would be of little benefit for public sector bodies and would put additional strain on the audit market.
27. There are potential areas of development for the public sector, particularly in relation to the proposals made in the areas of internal controls, the resilience statement, and the statement on fraud.

### *Internal controls*

28. In relation to internal controls, there are measures already in place in the public sector, such as [accounting officer systems statements](#), which set out all of the accountability relationships and processes within a public sector body, making clear who is accountable for what at all levels of the system.
29. Additionally, a Dear Accounting Officer (DAO) letter was issued on 30 September 2021, mandating compliance with functional standards. For example, [Government Functional Standard GovS 006: Finance](#) sets out expectations for effective management and use of public funds. However, there is currently no requirement to make a public statement on compliance with functional standards.

30. The BEIS white paper response recommends that the FRC consults on how to strengthen the internal control provisions in the [UK Corporate Governance Code](#) and explores 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. The progress and outcome of further consultations will be considered in relation to internal controls in the public sector.

### *The Resilience Statement*

31. The Government intends for companies to report on matters considered as 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.
32. The contents of governance statements in the public sector are set out in the FReM, MPM and additional guidance is in the [code of good practice](#).
33. The resilience statement as a concept may also provide useful information for the users of government accounts. However, specific guidance for application in the public sector would be required. As above, many entities within the public sector are funded via parliamentary supply and associated functions are set out in statute meaning going concern in the public sector does not entail the same considerations as in the private sector.

### *Audit and assurance*

34. The Government response to the consultation supported publication of an Audit and Assurance Policy every three years, set out views on the assurance over the Resilience Statement and reporting on the internal control framework, and confirmed a requirement for companies to describe their internal auditing and assurance process, among other matters.
35. In the public sector, Practice note 10 sets out the responsibilities of Public Sector Auditors and Accounting Officers and the Public Sector Internal Audit Standards set out the principles for internal audit in the public sector. Additionally, Audit Committees are already well established for public sector entities and are accountable to the Parliamentary Select Committee.
36. All entities (other than in Scotland) are required to have their financial statements audited by the auditor named in the relevant legislation, other legislation or governing statute or as agreed with their relevant authority. Supported by the NAO, the Comptroller and Auditor General (C&AG) is the independent auditor of nearly all central government institutions in England. Audit Scotland, Wales Audit Office and Northern Ireland Audit Office perform this work in the devolved nations. Using extensive statutory rights of access to records, the Auditor General provides direct advice and assurance to Parliament. The rights and duties of the Auditor General are set out in several documents, including [Codes of Audit practice](#), Statements and MPM.
37. In relation to audit, the Government does not intend to legislate to give the regulator oversight of 'corporate audit' at this stage but recommends that the regulator should seek to raise standards of auditor behaviour using its existing powers.
38. There is the potential that the indirect effects of these changes feed back into the audit regime in central government. Proposals around changing the scope and purpose of audit will be enacted through changes to standards and guidance through ARGA and DLUHC will have a relationship with ARGAs to cover local audit, however there is not a similar relationship between HMT and ARGAs with respect to central government. Any proposals that make changes to the scope and purpose of audit that affect public audit in the central government sector will be monitored.

### *Fraud reporting*

39. In relation to 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.
40. There is ongoing work in relation to fraud within the public sector, such as the new Public Sector Fraud Authority, and investment in the DWP and HMRC fraud functions. Fraud reporting and the quality of fraud reporting could also be strengthened in the public sector. This is being discussed with the Cabinet Office.

### *Next steps*

41. Based on the proposals presented in the White Paper and the government's response to the consultation, HM Treasury will review where comparable changes to practice in the public sector may be needed to keep pace with the private sector. Public sector audit and corporate governance remains under constant review and interest in the public sector parallels for emergent specific reforms in the private sector is expected to remain high. HMT will return to the Board in due course as BEIS' legislative and policy proposals develop further.
42. 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. Similarly, any areas for development within public sector reporting and audit will be discussed with the devolved nations.