ICAEW
REPRESENTATION 68/19

REVIEW OF THE FINANCIAL REPORTING COUNCIL BY SIR JOHN KINGMAN

Issued 17 June 2019

ICAEW welcomes the opportunity to respond to the initial consultation (available here) launched on 11 March 2019 by the Department for Business, Energy and Industrial Strategy (BEIS) on the recommendations made by the Independent Review of the Financial Reporting Council (FRC) led by Sir John Kingman, published on 18 December (available here). This response follows our previous evidence to the Independent Review on 6 August 2018 and 9 November 2018 (ICAEW representation 92/18 and ICAEW representation 127/18).

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 152,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and to apply the highest professional, technical and ethical standards.

Audit and regulation is currently undergoing an unprecedented level of scrutiny: alongside Sir John Kingman's Independent Review two other major reviews are in progress. The Competition and Markets Authority (CMA) has completed its market study of statutory audit services and issued final recommendations on 18 April 2019. We expect BEIS to carry out further public consultation on these over the summer. An Independent Review into the quality and effectiveness of audit led by Sir Donald Brydon was announced in December and is now under way, reporting to the Secretary of State in December. Meanwhile, public and parliamentary interest remains high, as demonstrated by the decision of the Business, Energy & Industrial Strategy Parliamentary Select Committee (the BEIS Committee) to conduct its own inquiry into the future of audit earlier this year.

Taken together, ICAEW believes these challenges have the potential to produce the kind of bold systemic intervention we need to tackle underlying issues of regulation, quality and competition in the audit market. We have already welcomed Sir John Kingman's vision for a strong and credible new regulator - the Audit, Reporting and Governance Authority (ARGA) – with enhanced powers to intervene in the large corporate market. While accepting the analysis of the BEIS Committee that the audit sector is showing signs not just of an 'expectation gap' but a 'delivery gap' as well, we have argued that a necessary foundation for coherent and comprehensive reform should be a fundamental examination of the role of audit itself. The expectations of investors and other stakeholders – such as employees, customers, suppliers and pension-holders – have rightly increased in recent years, and the purpose, scope and practice of audit need to keep pace. Sir Donald's Independent Review is therefore timely and has our full support.

ICAEW feels strongly that early and urgent action to address public concerns is vital to maintaining confidence in business. It therefore makes sense for the Government to get the process of reform under way, and to achieve as much as possible even in advance of any new legislation. Chartered accountants acknowledge this as a watershed moment for their profession and are ready to be willing partners in change. We look forward to working with all parties to produce effective measures which will improve quality and increase choice in the market, while ensuring that audit meets the future needs of the British economy and wider society.

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MAJOR POINTS

Introduction

1. ICAEW welcomes the vision of Sir John Kingman's Independent Review for a strong and credible new regulator – ARGA – with enhanced abilities to intervene in the large corporate market. We agree that the core remit of this regulator should be to protect the interests of investors and the wider public interest by setting high standards for corporate governance, financial reporting and statutory audit, with the power to hold to account the companies and the professional advisers responsible for meeting those standards.

Priorities for delivery: authority and focus

2. While we understand the requirement for primary legislation and the pressures on the Parliamentary timetable, we regard the establishment of ARGA as soon as possible as the paramount priority. It should be taken forward with much greater urgency than is implied by its place in BEIS' Category 3 for implementation. We feel strongly that the FRC - even strengthened by a new remit letter from the government, by amended articles of association, and with, in time, new senior leadership – lacks the necessary authority to ensure that the reform programme gets under way with the necessary pace and momentum.

3. The importance of not over-burdening the new regulator cannot, in our view, be overstated. ARGA must take robust and potentially difficult decisions on its early goals and how it can most effectively achieve them. It will take time to acquire the resourcing and capabilities needed to undertake all of its proposed objectives, duties and functions: the current issues affecting UK corporate governance and audit cannot wait for that. Rather than attempting to do everything at once, we recommend that ARGA concentrate from the start on improving audit quality, governance and reporting, leaving some complex technical matters discussed in the Independent Review, which are important but less urgent, to be worked through in due course. These might include, for example, proposals relating to the pre-clearance of accounts, the duty of alert for auditors and the extension of the Corporate Reporting Review (CRR) process.

4. The default should be to retain existing FRC guidance unless there are clear reasons not to, building on and making full use of existing regulatory tools as far as possible and avoiding overlap with the powers and roles of other regulators.

Better regulation principles

5. At this stage, ICAEW has some questions about the very wide scope of entities that ARGA's new regulatory powers would apply to, their extent, and the time and resources necessary to implement them. Therefore, we would be pleased to see an explicit commitment to the Hampton principles for better regulation written into ARGA's remit. We expect that the details of how the proposed new regulator will be equipped to deliver on its objectives will be refined following this public consultation and by ARGA itself, once established.

6. In doing this it is important to remain mindful of **Better Regulation principles**. A rigorous impact assessment for the package of reforms taken together is essential; including the recommendations to come from Sir Donald Brydon's independent review of the quality and effectiveness of audit and the CMA market study. This has not been carried out yet and the government's own Better Regulation Framework suggests it should be. The overall cost of

the package to business is likely to be very significant and it is essential that the expected benefits that justify this are carefully identified. To ensure that the final package of reforms is effective and delivers what is expected of it, it is essential that there is a comprehensive consultation with stakeholders once the detail of the measures and the results of impact assessments have been established.

7. To be clear, the audit problems we have witnessed are in many cases simple failures of conduct or quality. They demand a simple but robust reaction that focuses on the core objectives of governance, reporting and audit and avoids being distracted by less effective measures of peripheral impact. There are important actions to be taken to enhance and strengthen regulation for both auditors and directors. But the sheer scale of the proposed reforms and the work required to ensure that they are properly framed and assessed therefore means that there needs to be a rigorous upfront assessment of priorities. Without this, legislators and regulators will not have the capacity to do a proper job and public expectations of meaningful change will not be delivered.

8. We therefore suggest the following specific priorities for enhancing and strengthening regulation for both auditors and directors:

   - ICAEW believes that the current regime should be improved with a renewed focus on avoiding disorderly failure, fresh thinking on fraud, better audit reporting and championing proportionality – this is set out in full in ICAEW's response to the Call for Views by Sir Donald Brydon's Independent Review into the quality and effectiveness of audit (ICAEW representation 64/19).

   - ICAEW believes the new regulator could be given powers to supplement directors' accountabilities and responsibilities under the Companies Act, enabling it to bring effective action. One example is the duty directors have under section 386 of the Companies Act to maintain adequate accounting records. We suggest in REP 64/19 that this could be the basis for a new UK framework strengthening the internal control responsibilities of directors and auditors. Similarly, we also support an increased emphasis on Section 501 of the Companies Act – the legislation that makes it a criminal offence to provide misleading information to auditors. Greater focus on this would reinforce the obligations of executives and directors to provide auditors with all the information they need. This legislation has been held by the Court of Appeal not to apply to companies under its present drafting. Consideration should be given to changing the legislation to allow prosecution of companies and conferring this power on ARGA.

9. In summary, while we welcome and support audit reform, it is essential to consider the proposals within the context of the wider financial reporting system. In particular, the role and responsibility of directors to make judgments on how to reflect transactions in accordance with financial reporting requirements, to prepare and approve the company accounts, and to prevent failure. It is the auditors' role, to test and challenge these judgments, and seek to detect issues that might lead to corporate failure. Focusing solely on auditor requirements, without equal consideration of directors' responsibilities, only takes into account one aspect of corporate failure.

Our role as a professional body

10. We recognise, in making suggestions for better and more effective regulation, the importance of our own role and responsibilities as a major professional body. We appreciate that there is more we can do and are committed to put that into action, starting with explaining better to those with an interest in governance, reporting and audit, what we and our members do. ICAEW determines the qualification and CPD requirements applicable to its membership, regulates and disciplines its members, encourages the development of an appropriate culture within member firms and provides members with appropriate guidance and advice. We also seek to influence the development of thinking and policy in the wider public interest. The most relevant aspects of our role are:

    - Equipping members to meet both current and new public expectations;
    - Encouraging and contributing to the policy debate;
    - Developing new thinking.

11. Starting with **equipping members to meet both current and new public expectations**, we recognise that the new objectives and scope of ARGA will rightly place fresh demands on ICAEW members. The Review aims to enhance the quality, accuracy and reliability of corporate reporting, governance and audit. To achieve this, we need to ensure those carrying out these functions can deliver what the public expects to a high professional and ethical standard.

12. We expect policy makers to focus on ensuring that there is a sound basis for confidence in the quality of those activities. We recognise that we need to demonstrate that our qualification and CPD requirements can adapt to meet these new demands, and that we provide members with appropriate advice and guidance on technical and ethical issues and developments.

13. With regard to **encouraging and contributing to the policy debate**, ICAEW is responding in detail to each of the governance, reporting and audit-related reviews. In determining the way ahead, we will continue to consult extensively with our members and ICAEW working groups and committees. We will also continue to engage closely with academics, for example via our participation in sessions on the Future of Audit at the British Accounting and Finance Association conference in May 2019.

14. Achieving high quality, reliable governance, reporting and audit is a process of continuing improvement. ICAEW has helped support key developments on the road to more stable, transparent and international capital markets and has played a significant role in the evolution of corporate governance since the Cadbury report in 1991. We will continue to be active in encouraging discussion in coming months and will continue to share insights which may be of relevance to the debate.

15. For example, the scope of the AuditFutures programme is currently being adapted to ensure that it contributes in the best possible way to addressing current and future concerns about audit and the audit profession. Our corporate governance and financial reporting work will similarly continue to develop to address key issues as they emerge.

16. Importantly, we will also in due course facilitate discussion and the sharing of experience around the implementation and consequences of the changes brought about by the current reform process. We anticipate that the Audit Quality Forum (AQF) will play a major role. The AQF, hosted by ICAEW and supported by the FRC, ICAEW and BEIS, has encouraged open

and constructive debate among stakeholders about how to improve audit quality over the past 15 years, and we see that role as being highly relevant in the coming years.

17. Finally, on **developing new thinking** ICAEW also plays a key role here, working closely with academics and others. In particular, our Audit and Assurance Faculty and our Corporate Governance programme 'Connect and Reflect' have recently published on a range of issues relevant to the debate. The thought leadership publications are intended to help directors, politicians and policy makers understand the key issues and we hope they will help inform the various reviews currently in progress.

18. Our background paper, *Financial reporting: who does what?*, is intended to help readers understand who is involved in the preparation of financial statements, how they are involved, and the role of auditors in challenging those responsible. *What auditors do: the scope of audit* explains what auditors do, why audits are necessary, their current limitations, and what auditors do and don't audit. Further papers in this series will be issued in coming months.

19. Our Corporate Governance thought leadership programme Connect and Reflect encourages companies to adopt a positive approach to corporate governance, recognising the importance of connecting with and reflecting society. In How to end excessive pay, we acknowledge how executive pay can overshadow other business achievements and problems when it is seen as excessive. We approach excessive pay as a business issue that can be solved in a business-like way. In How whistleblowing helps companies we set out an action plan to help businesses recognise the benefit of transparent whistleblowing policies in encouraging continuous improvement.

Our role as a regulator

20. ICAEW does not agree with the recommendations of Sir John Kingman's Independent Review regarding the registration of audit firms, to the extent that we cannot identify the problem they are trying to solve. The recommendations imply and then seek to address a perception that it is inappropriate for decisions regarding the registrations of firms carrying out Public-Interest Entity (PIE) audit work to be taken by the audit registration committees of the four recognised supervisory bodies (RSBs) – as is presently the case, in accordance with Schedule 10 of the Companies Act 2006, as amended by SATCAR 2016.

21. The recommendations propose a reclamation and consolidation of the audit registration process and associated responsibilities within ARGA. We are concerned that this is based on a limited understanding of the current system, and in particular, a fundamental misunderstanding of the proven independence of audit registration committees, and their ability – and readiness – to use a wide range of measures to tackle issues of poor performance by firms.

22. Finally, in keeping with our recommendation that ARGA, once established, should focus on a tight set of urgent priorities, we believe that a radical change in the regime for audit registration would prove seriously disruptive, and create a major distraction for the new regulator, drawing in very significant resources and effort.

Conclusion

23. Separate Independent Reviews by Sir John Kingman and Sir Donald Brydon are underway, together with the CMA's market study of statutory audit services. Necessarily these projects have had different starting points and terms of reference, but they must now be aligned and

coordinated so that together they constitute a coherent programme of reform, implemented in a practicable and proportionate fashion.

24. Measures to tackle underlying and interlocking issues of regulation, quality and competition must therefore be seen in the context of the need for the UK after its exit from the European Union to be perceived positively as a place where the business and investment environment is both attractive and well-governed.

ANSWERS TO SPECIFIC QUESTIONS

CHAPTER 1: FRC STRUCTURE AND PURPOSE

Question 1: What comments do you have on the proposed objective set out in Recommendation 4?

25. The stakeholders affected by audit have changed in recent decades, and the strategic objective suggested for the proposed new regulator appropriately reflects this. However, the stakeholder requirements set out in the Companies Act 2006 have not changed. The 'wider public interest' referred to in the strategic objective lacks formal definition and is therefore open to being constrained within the limits of the Act.
26. For the strategic objective to be fully effective, the stakeholder requirements in the Act must be updated, and therefore we believe this recommendation may need higher priority for implementation than Category 2.
27. There would be merit in developing operational objectives to sit alongside the strategic objective, as in the case of the model for the Financial Conduct Authority (FCA). For example, holding companies and individuals to account could be an operational objective in its own right. Holding the relevant individuals to account must include an ability to hold any company director to account, in line with Recommendation 36.
28. 'Professional advisers' is a generic and broad description which includes unregulated proxy advisers, as well as advisers who are regulated by other bodies, for example solicitors, who are regulated by the Solicitors Regulation Authority.
29. All preventative measures begin with standard setting, but further measures are also needed. The proposed new regulator should publish details of enforcement actions, plans for thematic reviews and guidance for best practice.

Question 2: What comments do you have on the duties and functions set out in Recommendations 5 & 6?

30. We agree with the proposed duties set out in Recommendation 5 and believe they could also be adopted by recognised supervisory bodies (RSBs). However, they are imbalanced due to the only partial inclusion of the Hampton principles for good regulation. These are set out in Section 21 of the Legislative and Regulatory Reform Act 2006 and require that;
    - *'regulatory activities should be carried out in a way which is transparent, accountable, proportionate and consistent';*
    - *'regulatory activities should be targeted only at cases in which action is needed'.*
31. It might be assumed that this would apply anyway to the proposed new regulator's objectives, duties and functions, but a concern raised in submissions to this Review's original call for evidence was that the FRC had not always demonstrated due regard for these principles or, indeed, felt bound by them. In setting out the responsibilities of the Legal Services Board, Section 28 of the Legal Services Act 2007 reiterates these principles alongside those pertinent to legal services. This provides emphasis and balance for the benefit of all stakeholders and may be a helpful precedent.
32. We also agree with the proposed functions set out in Recommendation 6.

Question 3: How do other regulators mitigate the potential for conflict between their standard setting roles and enforcement roles as set out in Recommendation 14?

33. The FRC has been criticised for being too close to those that it regulates, so avoiding even the perception of 'regulatory capture' will be critical to the credibility and effectiveness of the proposed new regulator.

34. The FRC sets standards for corporate governance and stewardship, but it is the FCA's Listing Rules and Conduct of Business Sourcebook which lend status to these codes. There has been no direct enforcement of corporate governance or stewardship, although the FCA has recently described stewardship as 'an area of focus'.
35. In other sectors it is commonplace for one body to both set and enforce standards, although the operation of these functions should remain separate, with the unitary board merely exercising oversight functions. Different skillsets are required for each function, so separation of day-to-day activities is not usually a problem.
36. Consolidation under one body delivers many advantages, for example a single regulator can provide clarity of priorities and expectations. A single regulator is also better equipped to monitor and update standards because it will tend to have stronger relationships with those that it regulates. This enables and encourages direct feedback to the regulator, in areas such as the practical application of standards, whether regulatory objectives are being achieved, and about loopholes, ambiguities and emerging trends.
37. The governance structure needs to be carefully designed so that the board does not become involved with the detail of specific cases and the conduct committee is able to function independently.
38. There will inevitably be greater scrutiny and higher expectations of the proposed new regulator. Governance arrangements must be sufficiently robust to avoid decisions by the regulator's investigation and enforcement functions being influenced by political and media pressure on the board.

Question 4: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

39. We comment further below on the duration of investigations. The length of time taken to complete major investigations is - in part - driven by the legal processes dictated by the Human Rights Act and other judicial procedural law, which enshrine principles such as the right to make representations and the right to have a reasonable time to consider and respond.
40. There is currently little scope to accelerate this process and, in any case, this could lead to unintended consequences, including judicial review applications to court where those subject to enforcement processes consider that their rights have been violated. However, while recognising this, we agree that the proposed new regulator's board should challenge the Director of Enforcement on the speed of internal process.

CHAPTER 2: FRC: EFFECTIVENESS OF CORE FUNCTIONS

Question 5: How will the change in focus of CRR [Corporate Reporting Review] work to PIEs [Public Interest Entities] affect corporate reporting for non-PIE entities?

41. We are concerned that Recommendation 27 might, over time, result in a gap in the quality of reporting between PIEs and other entities which, although not meeting the definition of a PIE, have a significant public interest. If the decision is taken for CRR work to be limited to PIEs as currently defined, then we encourage consideration of how the proposed new regulator will monitor and encourage high quality corporate reporting by those entities that are not PIEs but which nonetheless have a significant public interest.
42. Our initial opinion on Recommendation 62 is supportive of the application in full of Freedom of Information provisions to the proposed new regulator. However, we are concerned that the publication of full correspondence following all corporate reporting reviews could have a negative impact on behaviours - for example, encouraging a litigious and defensive mentality

which subsequently restrains dialogue with the regulator. We will continue to consider detailed arguments on this matter.

Question 6: What are your views on how the pre-clearance of accounts proposed in Recommendation 28 could work?

43. We agree that robust debate and challenge on novel or contentious issues prior to publication of accounts has the potential to improve the quality of accounts by preparers. Indeed, we understand that pre-clearance procedures have already been introduced with some success in several markets around the world. However, we also recognise that this would be a significant change for the UK market, and we have questions and concerns about how this would be successfully implemented by the proposed new regulator.

44. In particular, pre-clearance raises questions as to who holds the ultimate responsibility for judgements in the financial statements. Currently, management makes judgements on how to reflect transactions in accordance with financial reporting requirements, while auditors test and challenge these judgements. If the proposed new regulator were to propose and approve treatments, it is unclear what would happen when management and/or an auditor disagrees with the regulator's treatment. This could undermine both management and auditor judgement. If pre-clearance is introduced, it must not erode the ultimate responsibility of directors to prepare and approve company accounts.

45. In addition, if this recommendation is to be progressed further, a number of practical considerations would need to be addressed. For example, liability issues will have to be considered, including in situations whereby pre-clearance is given, but where the future facts and circumstances of the final transaction differ from that previously concluded on. In this scenario, it is unclear who would be liable if future facts or circumstances demonstrate that the treatment signed off by the regulator was flawed or incorrect. It is also important to ensure clarity and consistency in the eligibility of pre-clearance so that both companies and auditors are aware of its availability from year to year.

46. We also note that the arrangement is proposed as a fee-based service. We have doubts about this approach. At the very least it would require further development, to address questions such as:

    - Would this be paid for by the company when used, or funded through a general levy?
    - Will using this service be voluntary or mandatory for companies?
    - If mandatory, how will pricing be set?

47. The proposed new regulator would need to issue clear guidance on what issues must be consulted on, so that there is no risk of the proposed new regulator being conflicted through the delivery of this advisory service. Furthermore, we expect that this would present significant resource challenges to the proposed new regulator. Pre-clearance assessors will need to possess significant specialist, technical financial reporting skills. These skills are not in abundance in the market, and many of those in possession of them will have Big Four backgrounds which could conflict them from undertaking the work.

48. The timing of pre-clearance reviews could present practical challenges. The proposed new regulator will face pressure to provide quick clearance so that sensitive information can be released in a timely manner. Combined with resourcing challenges, this may result in risks to the quality of pre-clearance work.

49. We urge careful consideration of these practical implications. It may be helpful to consider any lessons learned from the experience of other markets in these matters, and if the case for pre-clearance is accepted in principle, perhaps to undertake a pilot exercise in relation to pre-clearance arrangements.

Question 7: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

General

50. Regarding Recommendation 36, in theory, by law all company directors (both executive and non-executive) have collective and equal accountability, even if CEOs, CFOs, Chairs and Audit Committee Chairs are most likely to be subject to censure because of their seniority or specialism.
51. Recommendation 42 is reflected in the revised Stewardship Code. Driving compliance may require additional powers, but it will also require increased regulatory resources.
52. With regard to Recommendation 43, the Investors Forum was formed in 2014. Its core objectives are, *'to make the case for long-term investment approaches'* and '*to create an effective model for collective engagement with UK companies'*. More recently, the FRC formed its own Investors Advisory Group.
53. To some extent, the Investors Forum and FRC's Investors Advisory Group are likely to duplicate other ongoing initiatives - for example, considering current consultations. However, they should also identify new areas of focus, such as investor concerns about accounting judgments and new business models. In due course, investors' activities and outcomes reports, and closer monitoring by the proposed new regulator, will provide the basis for informed feedback to the Forum and the Advisory Group about good and bad practice.
54. Persuading fund managers to engage will always be a challenge. We suggest making fund managers' engagement a condition of an investor becoming a signatory of the Stewardship Code. The proposed new regulator may also be able to encourage companies to meet only with investors who are signatories, or to give precedence to signatories.
55. The FCA has acknowledged that investors need greater clarity about how they can engage with issuers and other investors for stewardship purposes, without becoming subject to obligations in respect of inside information.

Registration of firms and statutory powers of ARGA

56. We do not agree that Recommendation 15 should be implemented in the way suggested by this Review. This recommendation posits, and then seeks to address, a perception that it is inappropriate for decisions on renewing the audit registrations of firms carrying out PIE audit work be taken by the audit registration committees of the RSBs. The Review considered that these decisions (and any other decisions on whether any conditions should be imposed based on the most recent audit quality review) should be taken by a suitable committee within the proposed new regulator.
57. Recommendation 15 does not take account of the fact that all the RSBs have independent audit registration committees, which have lay parity in their membership. Auditors sitting on these committees are given the technical content of the reports and they support the lay members in analysing and addressing the issues under consideration. It is difficult to see how the constitution of an independent committee making decisions on audit registrations would be any different to the constitution of the current committees and would act any differently.
58. This Review quoted no evidence that any of the RSBs' audit registration committees had made any poor decisions on the renewal of registrations or have ever declined to implement any recommendation made by the FRC's Audit Quality Review (AQR) team arising out of their inspections of the larger firms. Therefore, Recommendation 15 appears to be driven by

a public perception concern but without appreciation for the fact that these decisions are made by independent committees.

59. We are also concerned that the wording of Recommendation 16 demonstrates a lack of understanding of the current audit registration renewal process. Recommendation 16 seems to suggest that the Review team believed that the only option available to deal with poor-performing audit firms is the so-called 'nuclear' option of deregistration. This is incorrect. All RSBs' independent registration committees have a full range of interim measures which they can - and do - impose if they are concerned about the quality of audit work being carried out by a registered firm.

60. For example, ICAEW's Audit Registration Committee can, and does, impose onerous restrictions on firms' registrations, whereby a firm can be restricted from taking on any new audit clients, or a category of audit clients, until they have implemented improvement measures and proven that they are able to operate without that restriction. Other conditions include the requirement on firms to carry out a hot file review (a review carried out by another firm of the audit work before the audit report is signed by the Responsible Individual) or cold file reviews (reviews conducted after audit reports are signed off – imposed in less serious cases) on one or more future audits. These conditions are usually imposed with a requirement that the results of those reviews are provided to the Audit Registration Committee for review. There could also be a requirement imposed for a further, additional audit quality review by the RSBs' audit monitoring teams.

61. The FRC's AQR monitoring team, which submits reports on its audit review work to ICAEW's Audit Registration Committee, is aware of the range of sanctions available to that Committee and can make recommendations regarding the imposition of suitable conditions on the registrations of even the largest audit firms. As the RSB which registers the largest audit firms, ICAEW's Audit Registration Committee receives the largest number of reports from the FRC's AQR team and it has always implemented all recommendations made to it by that team. We therefore cannot identify the problem which Recommendations 15 and 16 are seeking to solve, and we are concerned that they display a fundamental lack of understanding of the current system.

62. Unlike the FRC and the RSBs, Sir John Kingman may not have felt constrained by the Hampton principles set out in the Legislative and Regulatory Reform Act. However, the principles of proportionality and targeting continue to be a requirement of regulation in the UK, overseen and enforced by the Better Regulation Executive. The EU Audit Regulation and Audit Directives of 2014 were good examples of that: audit firms carrying out PIE audits are subject to a greater degree of scrutiny under the Regulation than those performing non-PIE audits covered by the Directive. The EU considered licensing to be a lower risk area and therefore the rules concerning this for both PIE and non-PIE audit firms were contained solely in the Directive, and the registration was specifically allowed to be a delegable function of competent authorities.

63. If, despite these clarifications and concerns, BEIS still considers that changes should be made to the audit registration process, we believe that the reclaiming of audit registrations is not the only solution which can achieve the objective of more independent scrutiny of firms carrying out PIE audit work. Indeed, we believe that there are a number of different solutions which could be implemented far more quickly and cheaply, with much less disruption and without removing responsibility from those whose work has not been criticised by this Review.

64. For example, a dual-licensing system could be created, whereby all firms would continue to be registered with the RSBs to carry out audit work, but that firms which carry out PIE audit work would, in addition, have to seek a separate licence or registration from the proposed

new regulator to carry out PIE audit work. In this way, a firm which was considered unsuitable to carry out PIE audit work would lose the registration provided by the regulator, but would maintain its ability to carry out other audit work as a result of its underlying registration with the RSBs whose independent audit registration committees would continue to monitor the quality of that work.

65. The adoption of this alternative solution would be less disruptive and easier to implement. For example, the experienced audit reviewers employed by the RSBs who review larger firms' non-PIE audits, would continue with that role.

66. There was no suggestion in the Independent Review by Kingman of any failings by any of the RSBs' monitoring teams in their non-PIE audit review work, yet the reclaiming of audit registration would transfer responsibility for monitoring all audit work of the largest firms, PIE and non-PIE, to the proposed new regulator. The lack of criticism of the RSBs' teams' work in this area is also corroborated by the lack of any significant criticism of the quality of their work by the FRC Oversight team, which carries out inspections of the quality of these reviews every year, including the live shadowing of RSB review visits to firms.

67. The adoption of a dual-licensing system would allow this work to continue and avoid the cost and disruption of having to increase the number of reviewers (to ensure that it could monitor both the PIE and non-PIE audit work of the largest firms) and the need for the RSBs to reduce commensurately the size of their review teams with the subsequent loss of significant reviewing experience (as many older reviewers are unlikely to transfer). Quality checks would still remain in place with the proposed new regulator continuing to monitor the quality of reviews carried out by the RSBs' monitoring teams.

68. The adoption of Recommendation 15, without consideration of other options, could also create challenges for the financing of the regulation of non-PIE audit firms by the RSBs, given that the registration fees paid by the largest firms contribute to the funding of RSBs' overall audit regulatory work. A reclaiming of the whole registration of all of the largest firms, with loss of the entire registration fees, may throw into question the financial viability of the RSBs' work in regulating the audit activity of thousands of audit firms which do not carry out PIE audit work. This may lead to the need to consider significant increases in audit registration fees for those firms which may, in turn, lead many smaller firms to withdraw from audit work. Such a scenario may result in reduced competition in certain areas for audit work, with possible implications for quality and costs. This would clearly run contrary to the desire of the CMA for greater competition in the audit market.

69. It should also be borne in mind that many statutes and regulations require accounts to be audited by a registered auditor, and a large number of firms exiting the audit market may make it more difficult for those account preparers to find a suitable, local auditor.

70. We are also concerned at the proposal that the implementation of Recommendation 15 should be the subject of an FRC consultation, rather than part of the current BEIS consultation or a separate, specific BEIS consultation. In delegating this matter to an FRC consultation, there would appear to be no incentive for the FRC to consider the alternative proposals set out above and for such a consultation to focus just on the implementation of the reclaiming. It also creates a conflict of interest, given that the breadth of the proposed new regulator's work will be directly impacted by the outcome.

71. The continuing vacancy in the 'Head of Audit' position at the FRC, and the fact that the current 'Interim Head of Audit' is working his notice before joining one of the RSBs, also presents a challenge in finding someone of sufficient experience and expertise to lead such a consultation, were it to be carried out in the near future.

72. We believe that BEIS should first consider the lack of evidential basis for these recommendations before there is any consultation on implementation. If change is

considered necessary, BEIS should then consult on the alternative options to achieve greater independence around decisions being taken on the renewal of PIE audit firms' registrations.

Definition of PIE

73. The definition of PIE is something that has not previously been considered, with government preferring to rely on the definitions provided in the Audit Directives since 1984. ICAEW considers a review timely given Brexit, and also given the move to more finely address the areas of systemic risk that the proposed new regulator should be focused upon.

74. However, while this particular recommendation is going to be consulted on later in the year, this issue must be considered at the same time as Recommendation 15 and within the same consultation. This is because, if it is determined that all audit work of any firm carrying out even one PIE audit will fall within the direct supervision of the proposed new regulator, the number of firms which would be supervised could be increased considerably by any widening of the PIE definition to include, for example, large charities. This would increase the resource requirement for the regulator, reduce the resource requirement for professional bodies and have greater impact on potential funding of the supervision of non-PIE audit work.

75. Government should note that the move to extend the definition of PIE in SATCAR 2016 brought an additional number of firms into FRC supervision, many of which had only one PIE audit. The disproportionate demands placed on the firms by this repositioning have resulted in most of those firms now having exited the PIE market. This may have improved the quality associated with those audits, but has also contributed significantly to the reduced size of the market and the increasing lack of competition, which is of concern both to Sir John Kingman and the CMA. The advantages and disadvantages of any extension of the definition need to be carefully weighed.

AQR Resourcing

76. We agree it is essential that those who carry out monitoring activity should be highly skilled in identifying and challenging where audit work is not of the required standard. Recommendations and action should be based on a fully informed background. Accordingly, we support Recommendation 22 and believe that it should be actioned as quickly as possible. We note that the current AQR has lost reviewers as the Independent Review by Kingman has progressed, and there is now an urgent need to improve the numbers and quality within the team.

77. It follows that this high-value resource should not be spread too thinly but rather focused on the areas of high risk. The current arrangement with the RSBs does mean that the AQR has that focus. There is a risk with some of the other recommendations that the volume of work would dilute that targeting and effectiveness.

Enforcement – monitoring

78. We agree that the regulator should be held accountable by Parliament for its enforcement activity. However there needs to be a greater understanding by Parliament and others, of the complexity of some of these investigations and of the legal requirements of fairness which must be observed. This will often mean that progress is a lot slower than what might otherwise be expected. Care is also required to ensure there is not seen to be political interference in what is a quasi-judicial process.

Enforcement – publication policy

79. Recommendation 33, concerning review of publication policy relates to matters which are considered by case examiners, and where decisions are taken not to refer them for formal

investigation due to the minor nature of the failure, but where undertakings are accepted from the firms to carry out remedial action. While we encourage greater transparency, it should be recognised that full transparency may make firms reluctant to accept undertakings to correct matters, in order to avoid a formal investigation if they were to receive adverse publicity. This could lead to more matters being defended and more formal investigations, and the underlying issue not being promptly addressed. This has impacts on audit quality and on the demand for resources that are better used to identify and rectify problems.

80. The reputational impact of a full disclosure policy also should not be underestimated. Audit firms are already closely assessing the risk to their business model by remaining in the audit market. If that risk is significantly heightened by the threat of publication, even in cases of minor infringement, they will opt to leave the market. Over-regulation in this area therefore would be counter-productive to the need to increase competition, as identified by the different reviews.

Enforcement – international

81. We believe BEIS is right to be cautious about endorsing Recommendation 34. It is not clear how easy it would be for the proposed new regulator to extend its international jurisdiction. It also involves economic and political risk, due to perceived interference into how a third country runs its affairs. The US experience with the rollout of the Sarbanes-Oxley provisions in 2003 serves as an example of the difficulties that such an approach can bring. Resolution may be resource-intensive when that resource is better directed at the more immediate issues within the Kingman recommendations. Government may also consider it unwise for such delicate matters to be devolved to a separate regulatory body.

Enforcement – in-house accountants

82. Currently, the investigation of in-house accountants can only take place under the Accountancy Scheme if there is a public interest issue. We are cautiously supportive of Recommendation 35 to turn this into a statutory right. Arguably this is a further erosion of ICAEW's historical powers to take action against in-house accountants in respect of their conduct. However, RSBs have significant problems in carrying out such investigations because they have no powers to demand relevant papers from the subject's employers, powers which the proposed new regulator will possess. In addition, we consider that it is logical that only one regulator should investigate the actions of the in-house accountant and the auditor, and the inter-reaction between the two.

Enforcement – company directors

83. We welcome the proposed extension of liability to all directors and not just those who happened to be members of an accountancy body. However, it is important that such additional powers are proportionate and do not, through over-use, become counter-productive through diluting the talent pool that might otherwise sit on the boards of the UK's largest businesses.

84. The threshold set for action to be taken against directors should be carefully considered. If it is placed too low, it will discourage the most astute and suitable candidates from becoming non-executive directors on the boards of companies with a high-risk profile, thus damaging corporate governance.

85. It is unclear as to why Recommendation 36 suggests that the new regime should only apply to the CEO, CFO and the Audit Committee Chair. Under current UK company and financial services law, the board of directors is collectively responsible for the actions of the board, including approval of the financial statements. This power should apply to all directors, with

the proposed new regulator then deciding whether to bring actions against any or all of them, and with sanctions reflecting the differing degrees of involvement. Otherwise, there will be a lack of candidates for Audit Committee Chair at many companies when the CMA recommendations in particular are keen that audit committees increase their involvement.

Enforcement – insolvency

86. We are not in complete agreement with Recommendation 38, as it does not fully reflect the current position under insolvency law. The Insolvency Service will usually only get involved in disqualifying a director after the collapse of a company, but this proposal envisages taking actions against directors for misconduct which may occur without the company being in any serious difficulties. The mechanics of such a framework would therefore need careful consideration.

87. We also reiterate our concern that there has been a failure of regulatory bodies either to own or to use the power in the Companies Act 2006 and the Financial Services and Markets Act 2012 to prosecute directors for misleading auditors. The focus has been on misconduct and enforcement powers. The actions associated with this recommendation will need to include considering if it falls within criminal rather than civil law and if it replaces the current criminal law powers. If not, some clarification and certainty around these little-used laws will be required, as it is currently unclear who has the vires and responsibility to use them.

Oversight of the accountancy profession

88. The current oversight arrangements for accountancy are purely voluntary and effected by an exchange of letters between the FRC and the accountancy bodies in 2004. They are restricted to oversight of the professional bodies' own oversight of the accountancy work of their members. How this area of activity is conducted is currently at the behest of the profession itself. If it is intended that accountancy be regulated, this is an issue that needs to be considered under legislation.

89. It should be noted that the current oversight arrangements do not apply to the whole of the accountancy profession, as accountants do not need to be members of a professional body. In order to achieve oversight of the whole accountancy profession, 'accountant' will need to be made a proprietary title, and all accountants will have to be forced into becoming members of professional bodies. This is something which we would welcome in the public interest and so that there is a level playing field for all those offering accountancy services. However, this cannot be decided solely by BEIS and the proposed new regulator.

90. We are also concerned at the lack of evidence that there are problems with the quality of accountancy work generally outside of audit, and of any failings by the professional bodies in their oversight of these areas. The Independent Review by Kingman rightly concentrated on failings in the regulation of audit but did not identify any significant failings, suggesting there is a wider problem with the regulation of accountants. Continued and increased involvement of the regulator into this area would appear ill-targeted and disproportionate.

91. It is unclear what is meant by the 'wider work programme'. The FRC is not the only regulator currently engaged in the area of accountancy. To avoid significant regulatory conflict and consumer confusion, any continuing role in this area needs to respect that many services provided by accountants, or other actions and responsibilities by accountancy personnel outside of audit, are subject to regulation through different statutory frameworks. These frameworks are supervised by different oversight regulators including the Insolvency Service, the FCA (for investment business advice), the Legal Services Board (legal services) and OPBAS (anti-money laundering).

92. There is also considerable concern as to whether the FRC possesses the staff with the necessary expertise in the wider nature of accountancy services to make informed views on trends, as it has traditionally been very audit-focused. We believe that the only true expertise lies with the professional bodies; if the reach of the proposed new regulator is to be extended in this area, it will need to be adequately resourced with the appropriate skills and experience with which to make the role effective and properly targeted.

93. The proposal for a statutory backstop enforcement power is incongruous, given that the regulation of accountancy is itself voluntary, except in the areas covered by other oversight regimes.

94. As regards Recommendation 41, applying formal memoranda of understanding to replace the exchange of letters in 2004; we welcome this suggestion as it will clear up many of the previous misunderstandings and make the arrangements more consistent with current market trends and demands. Depending on what the aims and ambit of these memoranda are, it may be appropriate to extend them to other regulatory bodies that oversee firms that provide accountancy services, for example the SRA, as many legal practices under the freedoms afforded by the Legal Services Act are now extending into the area of accountancy.

The Brydon Review

95. Regarding Recommendation 17, audit is currently undergoing an unprecedented level of scrutiny. We had argued for some time that the natural and necessary complement to the work of the Independent Review of the FRC and the CMA should be a fundamental and independent examination of the role of audit itself, together with a review of corporate reporting. The expectations of investors and other stakeholders – such as employees, customers, suppliers and pension-holders – have rightly increased in recent years, and the purpose, scope and practice of audit need to keep pace.

96. We feel strongly that early and urgent action to address public concerns regarding audit - alongside wider issues of corporate governance and management accountability - is vital to maintaining confidence in business. It therefore makes sense for the Government to get the process of reform under way, and to achieve as much as possible even in advance of any new legislation. Chartered accountants acknowledge this as a watershed moment for their profession and are ready to be willing partners in change. We look forward to working with all parties to produce effective measures which will improve quality and increase choice in the market, while ensuring that audit meets the future needs of the UK economy and wider society.

97. The expectation gap has developed over many years and previous attempts to address it have tended to be gradual rather than fundamental – and have generally achieved little. We are encouraging Sir Donald Brydon's Independent Review to embrace generational reform rather than incremental change. We regard that Review as an opportunity to tackle the key challenges in a coherent, comprehensive and conclusive fashion which will help to restore trust in audit.

Brevity and comprehensibility

98. The first part of Recommendation 23 notes that the regulator should be required to promote brevity and comprehensibility in accounts and annual reports, engage meaningfully with users and asset owners about their information needs, and ensure the proportionality and value of reports. However, many of the reporting requirements for UK companies' accounts are not in fact the responsibility of the FRC. For example, the reporting requirements set out in UK company law or International Financial Reporting Standards, which are the

responsibility of the IASB. Therefore, it is not entirely clear what role is envisaged for the FRC or its successor here.

99. We acknowledge that promoting brevity and comprehensibility in accounts and annual reports, engaging meaningfully with users and asset owners about their information needs, and ensuring the proportionality and value of reports could be important and helpful goals for the proposed new regulator. However, it is important to recognise the possibility of tensions and conflicts between these goals. For example, promoting brevity might rightly focus on the need for companies to identify and report on those matters considered most significant to shareholders. However, this needs to be balanced against the ever-growing demand for companies to provide information on a wider range of matters to a broader set of stakeholders. For example, in recent years we have seen the introduction of new detailed regulatory reporting requirements on carbon and energy use, corporate governance arrangements, and non-financial information. We believe that these goals need to be carefully re-considered and formulated within the context of the FRC's responsibility, its capacity and influence over the UK reporting regime as a whole.

100. The second part of Recommendation 23 relates to the requirement for the FRC to provide BEIS, at least once in every Parliament, with a public assessment of the extent to which the statutory reporting framework is serving the interests of the users of company reports together with any recommendations for how it can be improved. Again, it is not entirely clear from the paper how the FRC would collate this information or what criteria would be used to make this assessment. For example, how would users be defined for this purpose and how would success be measured? Without this detail it is not possible to comment on the assessment itself. However, we accept that this process reflects the fact that the new regulator will be accountable to Parliament and that some level of assessment might therefore be necessary. That said, as noted above, it is important to be clear on the responsibility and extent of influence that the FRC has in the UK reporting regime as a whole, before establishing any specific assessment criteria in this area.

Power to direct changes

101. While we support Recommendation 25 in principle, we believe it requires further careful consideration to ensure appropriate checks and balances. In a similar vein to our response to Recommendation 28 on pre-clearance, we also think that the introduction of this power must not erode the ultimate responsibility of directors to prepare and approve company accounts and we note that all of this adds to the role and responsibilities of the new regulator.

102. At a more practical level, we believe it would also be important to clearly establish the circumstances under which this power would be exercised. In our view, changes should only be forced for clear errors which directors would otherwise not correct, rather than judgemental differences between the proposed new regulator and an entity's management. It would also be necessary to ensure a clear process for dealing with these matters, including a mechanism allowing companies to appeal the decision reached by the regulator.

Public reporting

103. While we are strong supporters of transparency of information, we are concerned that Recommendation 26 might result in companies becoming more guarded in their communications with the regulator, for example out of concern of inadvertently revealing confidential information. It is important for a company, subject to a CRR, to have an open and frank communication with the regulator, and in our view the current system allows for this while also providing a sufficient level of detail about the reviews.

104. In particular, we support the current requirement for companies to disclose in the following year's accounts, the details of a previous investigation which resulted in the change of an accounting policy.

Extension of the corporate review process

105. While we do not disagree with Recommendation 29, to extend the corporate reporting review process to cover the entire annual report, we would welcome further clarity around any consequential effect, if any, on the scope of audit and on the resource requirements of the new regulator. It is not well understood that much of the information in the annual report is unaudited, and it should be borne in mind that the proposed extension would involve the regulator reviewing unaudited information. Further consideration and clarity over how this might affect the scope of audit work carried out on the annual report would be helpful.
106. We also note that BEIS has suggested that this recommendation be introduced with immediate effect. However, it is not entirely clear what is meant by this, whether the FRC will begin arranging to extend the corporate reporting process with immediate effect, or that this extension is now already in place. In our view, it would be better to allow some time to consider the implications of this proposal, raise awareness of any agreed change and to provide clarity around the impact, if any, on the scope of audit.

A wider range of investor information

107. We question whether there is a need to strengthen qualitative regulation around a wider range of investor information than is covered by the FRC's existing corporate reporting work. We are not aware that this is a risk area and question what the issue is that BEIS is seeking to address and whether increased regulation is therefore necessary. Another consideration is whether this information would then be subject to assurance.

Promulgation of guidance and discussion documents

108. We disagree with Recommendation 31 as it stands. We recognise that calls for guidance need to be weighed against the need for the exercise of professional judgment, the risks of adding to the complexity of accounting and auditing literature, and the need for the status of FRC guidance to be clear and well-understood. Nonetheless, our understanding from discussions with our members in practice and business is that they read and rely upon the FRC's guidance, and do not believe there is an overabundance. They find the FRC's practice notes and other guidance documents, such as the corporate reporting staff education notes and Strategic Report Guidance, helpful and believe that reducing guidance could lower the quality of financial reporting and audit.
109. Guidance is particularly useful for smaller firms and practitioners. Our members raised concerns that removing guidance could create barriers to entry into new audit sectors or markets. We understand that many firms rely on sector-specific guidance to understand and assess the risks and work requirements of markets and industries they are considering entering.
110. We therefore recommend that in due course the proposed new regulator considers the value of developing specific auditing standards and/or guidance to support certain business sectors; the same basic auditing standards may also apply, including the same level of assurance, but with extra requirements for auditors' work and reporting for the business sector in question.

CHAPTER 3: CORPORATE FAILURE

Question 8: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

Market intelligence

111. In principle we support the proposal in Recommendation 44 for a market intelligence function. To be effective it should reap and exploit intelligence from a wide range of sources.

Duty of alert

112. We understand the intention behind the new duty of alert for auditors set out in Recommendation 45, and support the idea in principle, subject to our concerns about over-burdening the new regulator. Currently, auditors are obliged to report if they will be qualifying their audit opinion under ISA 250. There must be clarity on how this requirement would interact with the existing requirement.
113. Recommendation 45 states that this duty would relate to viability or other serious concerns. Clear requirements will need to be established if the proposal if pursued on the timing and basis for auditors to report. Currently, reporting is associated with the production of the audit opinion. It is unclear whether auditors would need to report based upon initial suspicions or results of early planning testing, and how concrete the basis of evidence to report would be.
114. We believe the bar for triggering this alert would have to be reviewed carefully. The duty of alert would need to be acted on with caution, such that reporting does not trigger the collapse that the auditor would be seeking to avoid. Publicity of the regulator intervening could be a self-fulfilling prophecy which ultimately triggers events resulting in a collapse.
115. It is also unclear under the current framework who auditors should report to. Our assumption is that this would be to the new regulator. The relevant regulator(s) will need sufficiently robust powers and resources to act on these notifications to ensure the alert helps to limit the incidence of disorderly corporate failure.
116. We also believe it should also be possible for auditors and others to voluntarily report less serious concerns.

Power to require explanations

117. The definitions which form the basis of the legal power proposed in Recommendation 46, to require rapid explanations will require careful consideration. For example, what is deemed to be a reasonable concern and who decides whether this threshold has been reached, as well as what is a rapid (and reasonable) response and which officer(s) of the company are in scope.
118. Referencing similar existing powers could be a useful starting point. The Pensions Regulator, FCA and SFO can compel interviews, and failure to answer questions can be a criminal offence.

Other powers to intervene in cases of serious concern

119. Turning to the various proposals set out in Recommendations 47-50, we agree that regulators should have access to information in order to complete their reviews and regulate effectively. The skilled person review is aimed at giving the proposed new regulator these powers through appointing a third party to undertake a review.
120. We played a leading role in developing guidance for skilled person reviews (Section 166 and Section 166A reviews) for the Prudential Regulation Authority (PRA), Financial Conduct

Authority (FCA) and the Bank of England. ICAEW updated its Guidance for Skilled Persons Reviews last year

121. Skilled persons reports are valuable, but some practical issues need to be considered if these recommendations are to be developed further. For example, how would this review interact with the role of the auditor? Are these reviews to be done by a separate individual to the auditor? How would this interact with auditor judgement during their audit work?

122. We also question the value of an additional review if it overlaps with, for example, management review, the audit and the new regulator's own review. Will having a potential fourth party reviewing the same information make a meaningful difference? What will the objective of the review be? Is it aimed at preventive measures, following an auditor making a report to the regulator? It must also be considered what additional value is envisaged for investors beyond the information they are already provided with by auditors and management.

123. There is also a need to consider how to ensure sufficient choice of skilled person where the underlying matter is audit, bearing in mind that a competitor audit firm will not be sufficiently independent. Additionally, Memoranda of Understanding will be needed in order to prevent the possibility of duplication for companies which are dual-regulated, for example there should be a MOU between the FCA and the proposed new regulator.

124. On publication, we note the proposal that the new regulator should be able to publish skilled persons' reports if such action is judged to be in the public interest. The benefits of this power must be balanced against the risk of skilled persons limiting the contents of their reports because they may be published. We also note that the FCA cannot publish skilled persons' reports. No justification has been provided for this inconsistency between the proposed new regulator and financial services.

125. Finally, we observe that reports to shareholders for the most serious cases will only be worthwhile if this prompts action. Shareholders are able to wield significant influence in private, as well as vote against company resolution, requisition general meetings and requisition resolutions at general meetings.

Internal controls

126. Evidence suggests that despite significant problems in the early years, Section 404 of the Sarbanes-Oxley Act resulted in long-overdue maintenance of internal controls by companies and an overall strengthening of internal control. In the US, the COSO framework on which Section 404 is based provides appropriate criteria against which internal controls over financial reporting can be evaluated. Section 302 is also important: essentially, this makes the CEO and CFO directly responsible to the Securities and Exchange Commission (SEC) for the accuracy and fairness of the financial reports they are required to make, including the financial statements.

127. A similarly robust framework, with clearly defined responsibilities and accountabilities for directors and auditors can and should therefore be developed and implemented in the UK. ICAEW recommends that consideration should be given to the development of such a framework based on the current duty under the Companies Act for companies to maintain adequate accounting records, and the current framework used by companies floating on (among other markets) the London Stock Exchange.

128. At the date of a company's listing, the directors are responsible for having established procedures that provide a reasonable basis for making proper judgements on an ongoing basis as to the financial position and prospects (FPP) of the company (and its group). The company (or, on some markets, its adviser) will make a declaration to the regulator at the date of listing (or admission) that such FPP procedures have been established.

129. As part of the listing application process, it is typical for accountants to report on compliance with the directors' obligation, as set out in ICAEW guidance for directors and reporting accountants, *TECH 14/14CFF Guidance on financial position and prospects procedures*. This obligation is ongoing; directors are also responsible for maintaining the procedures subsequently, and while few if any entities refresh their understanding of these responsibilities on a regular basis or seek recurring assurance on them, they could and should be required to do so.
130. The ICAEW guidance referenced above enables the scope of FPP procedures work to be derived based on risk analysis of the specific company. We will be pleased to help BEIS consider how the existing FPP procedures regime could form part of a strengthened framework around internal controls.
131. The new regulator might be tasked with studying the development of a UK framework for internal controls over financial reporting based on these existing requirements. Such a framework should not detract from the more flexible approach to internal control more broadly, as currently set out in the FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (September 2014). The new regulator could also be given powers to supplement directors' accountabilities and responsibilities under the Companies Act, enabling it to bring effective action.

Viability statements

132. At present, many viability statements fail to provide useful intelligence and, in some cases, have failed to highlight impending distress. However, the concept of viability is crucial. Investors want a better indication that companies are looking at the longer term. At the heart of this is more robust and more focused risk reporting on the business model. We need to examine how such risk reporting can be improved to provide a clear indication of the principal factors that could reasonably be considered to affect viability.

'Graduated' audit findings

133. Extended audit reports have increased the value of the audit, but we can go further. Auditors have already experimented with 'graduated' auditor findings, including commentary on positions adopted by companies. In addition to presenting a binary opinion and drawing attention to key audit matters, auditors can present graduated auditor findings that describe judgements as, for example, cautious, balanced or optimistic.
134. Graduated auditor findings can cover a wide range of disclosures, including commentary on, for example, which accounting estimates auditors believe are more risky, or those they consider to be at the more 'aggressive' end of the spectrum, on the overall degree of conservatism displayed in the preparation of the financial statements, or on the level of subjectivity involved in determining a valuation. We need to consider the comparability of such reports. Allied to this is the possibility of conveying some sense of the variation in the levels of assurance auditors are able to gather in different audit areas.
135. We understand that companies have not embraced this style of reporting universally or enthusiastically and it is important to understand the reasons for this. We stand ready to support the Brydon Review with an urgent exploration of ways of improving audit reporting, along with other communication between auditors and users, and how it might bring benefits to users, particularly in relation to key areas such as fraud.

CHAPTER 4: THE NEW REGULATOR: OVERSIGHT AND ACCOUNTABILITY

Question 9: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

Diversity

136. The need for promoting diversity (as described in Recommendation 56,) in the context of corporate governance is, in part, already driven by EU and UK statute law regarding the disclosures required of companies in their financial statements. However, in the Equality Act 2010, the FRC is absent from the list of regulators in Schedule 19 who are required to comply with the equality duty of Section 149. As the aim of this Chapter to is ensure the proposed new regulator's responsibilities are consistent with those of other public bodies, diversity should be given greater emphasis across the body's full range of activities, perhaps through inclusion in the objectives set out in in Recommendation 6.
137. The proposed new regulator should avoid prioritising some categories of diversity over others.

Conflicts of interest

138. As Recommendation 57 recognises, effectively managing conflicts of interest is important for the perception of the proposed new regulator.
139. This Review refers to a complete prohibition on the proposed new regulator' employees, board or committee members ever working on any regulatory functions relating to a past employer. However, Kingman refers to this prohibition as 'wise.' Greater clarity on the time period to which this would apply is needed, with the only reference being to the 'foreseeable future'.
140. Written declarations, the recording of mitigations and the exercise of management discretion is realistic and prudent.

Complaint handling

141. Turning to Recommendations 59-61, we agree that complaints provide a useful insight, and this applies to any complaints about the proposed new regulator.
142. We broadly welcome the recommendations on complaints but caution the performance of a regulator being judged by the speed at which matters are progressed when audit investigations deal with complex areas. There is a need to respect the legal right to a fair trial, which includes providing reasonable periods to firms and accountants to respond to concerns raised during investigations.
143. It is not clear from Recommendation 60 what is proposed beyond current practice. We refer complainants to the FRC if they have issues with ICAEW's handling of complaints and the FRC investigates ICAEW's handling and, in the vast majority of cases, they agree with the approach we have taken. The increasing number of complaints appears to be a cultural development whereby a refusal to agree with a complaint is automatically complained about. We are concerned about what 'actively interested' means, and whether it is being suggested that the proposed new regulator should interfere during the process or with the decision reached by the independent committees. We believe that the role of the proposed new regulator should be limited to reviewing RSBs' handling of complaints on inspections and where matters are referred to them on an ad-hoc basis.

Transparency and confidentiality

144. We continue to support the application of requests made under the Freedom of Information Act, as envisaged by Recommendation 62

145. While we welcome the move to greater transparency, this does come at a potential cost unless carefully couched. For example, the RSBs sometimes undertake confidential activities, including interchange with third country governments where they have regulatory duties. They are currently prepared to share details of these with the FRC on a confidential basis, aiding the regulator in their understanding of the market and the impact of certain measures on other parts of industry and internationally. Such knowledge-sharing would be curtailed if Freedom of Information requirements extended to this volunteered information.

146. Turning to Recommendation 63, the proposed new regulator's internal whistleblowing procedures, employment contracts and disciplinary procedures will be crucial to the prevention of leaks. Security vetting and the Official Secrets Act (1989) could be appropriate for some employees, for example those working in the market intelligence unit.

CHAPTER 5: STAFFING AND RESOURCES

Question 10: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

147. We note and welcome Recommendations 64-66 on funding, and the fact that various groups of market participants will be assessed as part of this exercise. However, the gross amount to be funded should not only embrace the operations of the proposed new regulator, but also those to which some of its activities are devolved, especially if the licensing income is diverted to the regulator away from the RSBs. The function of the regulatory activity needs to be adequately funded at all relevant levels.

CHAPTER 6: OTHER MATTERS

Question 11: Are there specific considerations you think should be borne in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

148. We agree with BEIS that it is premature when a new regime has only just been embedded, to judge whether that regime will be more effective than the regime it replaced. It is also clear that the Review proposed no alternative solution and that it will take time for another regime to be considered and put in place.

149. Development of the local audit arrangements was the responsibility of another government department, and it is therefore for the Ministry of Housing, Communities & Local Government, rather than BEIS, to take decisions in this area. Also, the current framework was carefully developed and discussed over a three year period, 2010-2013, with a number of stakeholders including the National Audit Office, so it would be strange to discount this weight of input so early in the process.

CHAPTER 7: INTERIM STEPS

Question 12: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

150. The wider tone of these recommendations is that the proposed new regulator should be seen to be more independent and more relevantly engaged with the risks associated with the audit

market. The implementation of some recommendations immediately, without waiting for the new management to have input into them, may not be completely helpful. However, we recognise that the current statutory impasse in Parliament would likely impede progress to be made on these items.

151. We have in some of the responses above, alluded to our concern about inter-dependencies of the recommendations, and where they straddle the three categories this could cause complications. In particular, the definition of PIE in Recommendation 18 as a medium-term area needing legislation would seem to be an important pre-requisite for an impact assessment on the proposed balance of future licensing regulatory arrangements set out in the first two columns.

CONCLUSIONS

Question 13: What evidence or information do you have on the costs and benefits of these reforms?

152. Other regulators may be in a position to provide evidence, although evidencing the preventative impact of regulation and improved confidence is unrealistic. Benefits will only be enjoyed if the proposed new regulator has sufficient resources to manage the information it will receive through market intelligence, compulsory alerts and its review work.

153. The reforms largely focus on PIEs, given the large corporate collapses which were the impetus for these reviews. However, in reviewing the role of the new regulator it is important not to lose sight of how any changes may affect other types of entity. For example, consideration should be given as to how any reforms will impact on the small and medium-sized sector, in order to avoid any unintended consequences.

Question 14: What further comments do you wish to make?

154. Proportionality must lie at the heart of these reforms, in order to avoid unintended consequences and costs to smaller companies and smaller auditor firms. Firms which undertake only a handful of PIE audits may find the increased costs of work too burdensome and may exit the market. This may have the unintended consequence of reducing competition at a time when increased competition in the sector is viewed as a priority.

155. Increasing PIE regulation is also likely to restrict the growth of firms seeking to enter the PIE market, as the first PIE audit a firm undertakes generally already has a disproportionate cost, due to the enhanced requirements. We anticipate the reforms will cause practitioners to pause and potentially reconsider entering into this market segment.