

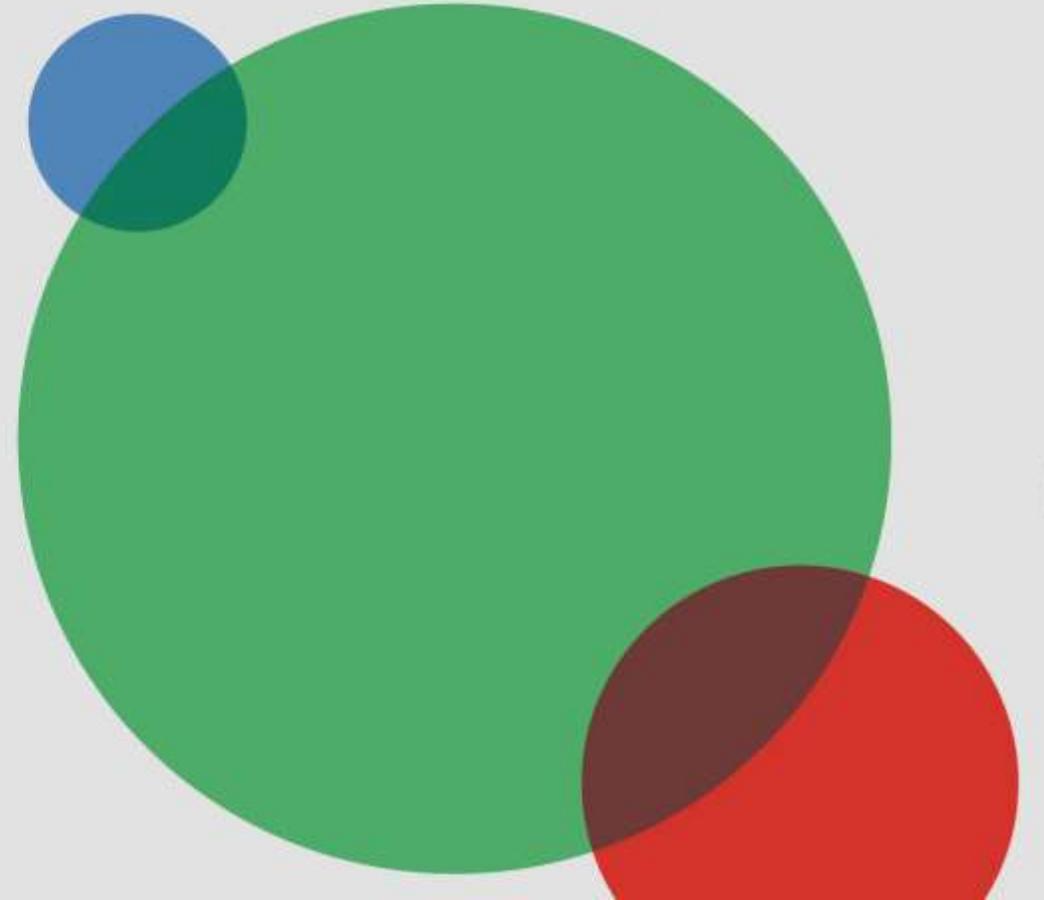


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ABAF

Restoring trust in audit and corporate governance

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# Main audit reviews in the UK

- Sir John Kingman's Independent Review of the Financial Reporting Council (FRC);
- CMA's Statutory Audit Services Market Study; and
- Sir Donald Brydon's Independent Review of the Quality and Effectiveness of Audit.

# BEIS Consultation: Restoring trust in audit and corporate governance

- The UK Government's response to the recommendations from Kingman, the CMA and Brydon Reviews was issued on 18 March 2021
- 232 pages long - 11 sections with 98 consultation questions
- Consultation closed on 8 July 2021
- Proposed changes primarily initially aimed at public interest entities

# Key proposed areas

- 1 Establishment of ARGGA
- 2 Definition of a PIE
- 3 Enhanced director accountability, (including internal controls)
- 4 Enhanced transparency
- 5 Market concentration and choice

# 1 Establishment of ARGA

- ARGA has the ability to recalibrate the corporate ecosystem and rebuild public trust, by encouraging higher standards of corporate governance, corporate reporting and audit.
- It can help address the audit expectation gap and also help address the directors' expectation gap, in terms of the public's understanding of what directors are responsible for, and hold them accountable.
- This would require a substantive change of emphasis for its work programme and resources, compared with its predecessor, the FRC.

# 1 Establishment of ARGGA (cont'd)

- ARGGA has the potential to become a globally respected improvement regulator.
- The establishment of a stronger regulator is obviously important but there also needs to be sufficient safeguards in the system. (Judge and jury?)
- The associated costs and their allocation must be proportionate and cannot be allowed to spiral out of control. There needs to be an appropriate balance.

## 2 Definition of a PIE

Current UK (EU) definition –

- entities whose transferable securities are admitted to trading on a regulated market
- credit institutions; or
- insurance undertakings.

Implications of being a PIE – e.g. enhanced NAS restrictions, mandatory audit firm rotation, additional corporate reporting requirements, FRC audit inspection

(Approx. currently around 2,000 PIEs in the UK)

## 2 Definition of a PIE (cont'd)

- To ensure there is a more level playing field between listed entities and private companies, the proposed extension of the scope of the definition of a PIE to cover certain large private companies appears sensible.
- Again, this has to be proportionate. Two options were put forward by BEIS.

## 2 Definition of a PIE (cont'd)

- Large private companies (Size is a factor). Option 1 would add 2,000 (approx.) and option 2 (1,000 approx.) more PIEs. Option 2 is favoured by BEIS.

Option 1	Option 2
more than 2,000 employees; or a turnover of more than £200 million and a balance sheet of more than £2 billion	over 500 employees, and a turnover of more than £500 million.

## 2 Definition of a PIE (cont'd)

Also, possibly:

- Certain AIM companies (market cap > 200m euros) (Sensible)
- Lloyds Syndicates (Leave for FRC to decide)
- Third sector entities – e.g. charities (incoming resources > £100m) (Contentious – mixed views)

## 2 Definition of a PIE (cont'd)

### Impact on PIE audit market

- More or less audit firms in this space?
- Opportunity versus enhanced regulatory and market scrutiny

### 3 Enhanced director accountability

- There is a need for the roles and responsibilities of directors to be better understood, and for greater accountability of directors.
- ARGAs should have the necessary powers to take enforcement action against all directors of PIEs, for this is an important aspect of addressing regulatory fairness.
- Currently professional accountants who are in senior roles in a PIE are at a regulatory disadvantage.

### 3 Enhanced director accountability (cont'd)

- ICAS welcomes government's proposal to enhance requirements on internal controls over financial reporting which would appear to represent the introduction of a proportionate version of US SOX which would help place greater focus on director accountability.
- Need for mandated assurance? On balance, no, but many corporates may choose to get external assurance.

# 4 Enhanced Transparency

## Enhanced transparency – corporate resilience

- ICAS welcomes the proposed resilience Statement that incorporates and builds on going concern and viability
- Statements will greatly improve transparency and seek to mitigate the risk of surprise failures
- However, there is a need to recognise that there is a wide spectrum of companies who will now need to prepare a Resilience Statement, and there will be a need for flexibility to allow corporates to determine:
  - (i) the key matters to be addressed;
  - (ii) the most appropriate place in the statement to reflect them; and
  - (iii) the timeframe

## 4 Enhanced Transparency (con't)

### Enhanced transparency – audit and assurance policy

- The introduction of an audit and assurance policy will help to create greater transparency as to where a board of directors obtains the necessary assurance on key areas of the business and its reporting
- Investors will need to engage.

## 5 Market concentration and choice

### Managed Shared Audit

- ICAS recognises that the PIE audit market would benefit from increased choice and hence reduced concentration.
- However, there is no silver bullet in this regard.
- Managed shared audit may lead to more firms being active in the PIE audit market
- However, would it ultimately lead over time to those firms having the capacity to undertake the audit of their own accord?

## Next Steps

- UK Government to publish feedback paper on consultation.
- Subject to considerable delay.

## Next Steps – what we expect

- Expect something on legislation to establish ARGAs
- Widened scope of PIE definition
- Unlikely to be any new requirements on internal controls (business lobbying)
- Expect something on mandatory managed shared audit.

## Next Steps – what we expect

- Other areas may be taken forward by FRC/ARGA.
- Corporates are also taking steps on a voluntary basis e.g. audit and assurance policy statements.

# Concluding remarks

- It has been a long process.
- This has not been helped by events which have required the Government's attention e.g. Covid-19, the war in Ukraine, fuel supply and costs.

