



CITY OF LONDON LAW SOCIETY AND LAW SOCIETY RESPONSE TO BEIS CONSULTATION ON “RESTORING TRUST IN AUDIT AND CORPORATE GOVERNANCE”

8 July 2021

To: audit.consultation@beis.gov.uk

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Introduction

The views set out in this response have been prepared by a joint working party of the Company Law Committees of the City of London Law Society (the "**CLLS**") and the Law Society of England and Wales (the "**Law Society**") (together the "**Committees**").

The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

The joint working party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to company law and corporate governance.

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Summary

We strongly support the Government's objective to ensure that audit maintains the highest level of trust and public confidence. There is a clear link between good financial reporting procedures, good audit and good corporate governance, being the behaviours, systems and processes through which a business is run.

However, some of the proposals raise significant problems, many of which have not been addressed in the Consultation. We appreciate it is not the Government's intention to create problems, and in some areas the Consultation acknowledges that further consideration of the proposals is required, but in our view, unless these issues are fully addressed, the overall aims of the Consultation will be undermined and there are likely to be significant adverse (and no doubt unintended) consequences including damage to the attractiveness and competitiveness of the UK as a place to establish and operate businesses. Whilst it is true that there have been some recent high profile corporate failures, these are exceptions, often with complex causes, and, as is often said in legal circles, "hard cases make bad law".

We comment below, as requested, in direct response to those questions posed in the Consultation in respect of which we have specific contributions and observations to make. We do not comment on certain consultation questions in respect of which we have no view or which are better dealt with by others. In addition, we set out in this summary the key issues which are of concern to the Committees, including certain fundamental points of principle.

Impact on the UK economy

- **Destination of choice:** The combination of proposed changes will amount to the most significant change in UK company law since the Companies Act 2006 (the "**Companies Act**"). The Companies Act is part of the corporate governance ecosystem in the UK and its flexibility and consistency is one of the reasons that the UK has historically been a significant destination for foreign investment. In the context of the overall strategy for driving economic growth post-Brexit and post-COVID-19 crisis, it is vital that the various Government initiatives are coordinated and consistent. The Government needs to promote Britain as a place for business to thrive, ensuring that we do not create unnecessary and disproportionate burdens on enterprise. Imposing increased reporting and accountability requirements on companies and directors sometimes raises standards of corporate behaviour, but this is not always the case. Sometimes the impact of the increased burden on companies and directors will fail to serve the Government's broader aim of seeking to ensure that the UK remains an attractive venue as part of being a competitive jurisdiction with high standards.
- **Inconsistencies with Lord Hill's UK Listing Review (the "Listing Review"):** If implemented as set out, the proposals set out in the Consultation will, in our judgment, result in the UK becoming a less attractive jurisdiction in which to establish and list new companies or group holding companies, to the detriment of the UK economy more broadly. It is already known that when put side by side with the listing structure in other jurisdictions with which the UK competes, the premium listing regime is usually seen as incrementally onerous and unattractive in comparison. As the Listing Review noted, there is no point in having a theoretically perfect market if in practice it is not used. Many of the recommendations contained in the Listing Review were aimed at reforming the premium and standard listing segments, including by removing their current characterisation and nomenclature so that there is one Official List which has different routes by which it can be accessed depending on which chapter of the Listing Rules is used by an issuer. The additional obligations that may be placed on premium-listed companies and their boards as a result of the proposals in the Consultation are only likely to compound the relative unattractiveness of the London listing regime, even if all the recommendations made in the Listing Review are implemented. We would urge the Government to pause and adopt an evidence-based approach in considering the recommendations of the Listing Review alongside the feedback to this Consultation and then determining the best way to achieve the desired policy goals without detracting from the UK being an attractive jurisdiction in which to carry on business and to invest.

Impact on companies

- **Proportionality:** It is imperative that any reform adopts a proportionate and practical approach, particularly when compared to the requirements and potential exposure to liability to which companies, and their directors, are subject in other jurisdictions. The jurisdiction of incorporation of a company – and where it is based - is a choice for most businesses. Any reforms should be considered in light of the benefits that they will bring, given what can realistically be expected of companies in-scope, balanced against the significant burden to companies in complying with such reforms (and the resultant impact on the audit market, both in terms of cost, availability, and the timeliness of release of audited information).
- **Duplication:** We also have very serious concerns over a number of the new powers proposed to be conferred on ARGA including, in particular, in areas where there is potential overlap with the existing responsibilities of the FCA in relation to listed companies and of the Courts in relation to directors' duties. In our view, the current framework of duties, responsibilities and attendant liabilities is sufficient to focus the minds and attention of by far the vast majority of directors and additional regulation is unlikely to change the behaviour of any rogue minority. The existing statutory and common law duties and regulatory obligations are currently overseen by the Courts and other regulators pursuant to a system which reflects appropriate checks and balances and which takes account of a considerable bank of case law and precedent. We are concerned that the intention seems to be to allow ARGA to have investigative, prosecutorial and judicial responsibilities without there being any clear framework of necessary checks and balances. In particular, the interpretation and enforcement of directors' duties is something that should be left to the Courts. If the exercise of directors' duties is to be made the subject of a set of "behavioural standards" proposed by ARGA then this should at most be done by way of codes of conduct and best practice guidance, similar to the UK Corporate Governance Code, and should not then be adjudicated upon by a non-judicial body that was the author of the relevant "standards". At the very least, any such new powers granted to ARGA should be subject to judicial review and the principles of natural justice, and arguably should reflect similar sorts of checks and balances as apply to the FCA when it is performing a similar role, in order both to protect against the risk of an arbitrary exercise of powers and to build confidence in any proposed new system.
- **Purpose of audit:** Audit is not, and cannot be, a guarantee of continuing financial viability. Similarly, internal systems and controls can only seek to mitigate, as opposed to eliminate, risk. We are concerned that some public comments suggest an expectation that a company which has received a clean audit of its accounts should never subsequently become insolvent and that should it become so, this inevitably indicates a failure by the directors or auditors or both to meet their responsibilities, without any investigation as to whether they have in fact met the relevant requirements and standards of care. It will never be possible to achieve a situation where no company with an unqualified audit report becomes insolvent and it needs to be made clearer to the public that a company whose accounts have been audited may still become insolvent.
- **Volume of change/cost of compliance:** There have recently been significant corporate governance changes affecting large companies – including the introduction of the Companies (Miscellaneous Reporting) Regulations 2018 ("**Miscellaneous Reporting Regulations**") and the 2018 UK Corporate Governance Code ("**Corporate Governance Code**"), as well as changes to the Listing Rules requiring premium-listed companies to report on climate change in line with the TCFD Recommendations and Recommended Disclosures. Many companies affected by these changes are concerned about the volume of regulation and accompanying guidance with which they are required to comply as these necessitate, among other things, frequent reviews of, and revisions to, their policies and procedures. This imposes a not inconsiderable burden on wider management teams and organisations as a whole at a time when they are also addressing the challenges posed by the COVID-19 pandemic. We suggest that the Government takes the opportunity to review the existing corporate governance and financial and narrative reporting requirements in the round with a view to simplifying the

approach to ensure that companies have clarity and consistency, and to reduce concerns that the burden of meeting any new requirements would be a deterrent to companies establishing themselves or considering listing in the UK.

Impact on boards

- **Loss/cost of talent:** Directors are already subject to numerous and onerous responsibilities and obligations and it will become harder to recruit high quality directors if their responsibilities and obligations are increased in all of the ways proposed in the Consultation. Directors joining boards will have increased expectations on remuneration commensurate with their additional responsibilities, as was recently acknowledged by Sir Jon Thompson.¹ D&O insurance policies have already become more expensive or narrower in scope and the trend is likely to continue in this vein: this may in turn have an impact on director recruitment at a time when companies are seeking – and in most cases succeeding - to improve board quality and diversity. If reforms are not proportionate and evidence-based, there is a significant risk that directors will become overly focused on addressing compliance issues rather than properly evaluating risk and managing that risk as part of driving forward the strategy and success of the company.

Answers to Consultation questions

Chapter 1

The Consultation proposes various obligations which would apply to PIEs, some that would apply to listed companies, some that would apply to FTSE 350 companies, some that would also apply to AIM-traded companies and others that would also apply to large private companies. We assume that changes to the Companies Act and any proposals for companies subject to regulation by ARGA would only apply to companies incorporated in the UK. Listed companies and AIM-traded companies may be incorporated in other jurisdictions. Insofar as the Consultation relates to such companies, we assume they are limited to companies incorporated in the UK. In addition, there are complexities where a PIE's parent is an overseas company and/or listed outside of the UK (with group reporting obligations applying at the parent / listed company level). Additional requirements in the UK could increase the burden on such groups with little benefit. It will be important for ARGAs to work with non-UK regulators in these circumstances to ensure that these groups are not subject to unduly onerous overlapping regimes, given that they are likely to be reporting on a consolidated basis already.

To the extent that obligations will apply to FTSE 350 companies, consideration will need to be given to how appropriate this is, given the potential for membership of this index to change during the course of a year such that some companies may become in-scope only shortly before their financial year end and so may not have had compliance in mind throughout the year in question and equally some companies may “yo-yo” in and out of the index over a period of years – how will comparability be achieved in these circumstances? Furthermore, the goal of proportionality would not, in our view, be achieved simply by applying the obligations to FTSE 350 companies or indeed premium-listed companies, given the vast range of companies this would encompass in terms of their size and capacity to respond to any increased regulatory burden, their market capitalisation and their systemic importance.

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

We accept that to focus the reforms on listed companies incorporated in the UK could be too narrow given that the public interest in having a sound audit and corporate reporting regime does not apply solely to listed companies. We also agree that smaller companies are, generally, unlikely to pose the same systemic risks or risks of prejudice to the public if they fail and may have fewer stakeholders with an interest in their audited accounts. As such, most of the

¹ FT article entitled “*Head of UK’s financial regulator says it was not up to the job*” published on 27 May 2021.

members of the Committees consider that including large private companies incorporated in the UK in the definition of PIE is appropriate. Some disagree and are strongly against bringing any private companies within the scope of these reforms. However, in line with our response to question 2 of the Consultation, we suggest that any large private company that is a subsidiary of a PIE should be exempt from the proposed new reporting requirements to avoid unnecessary duplication and burden.

Whilst we can see the argument for why many of the proposed reforms should apply to premium-listed companies initially, we are concerned that even applying the reforms to this subset will bring a widely differing group of companies within scope. Premium-listed companies vary significantly in their size, capacity to respond to additional regulatory burdens, and in their systemic importance. We believe there are good arguments for allowing for a proportionate approach to the implementation of the reforms with the expectations on companies being proportionate to their ability to adapt and respond within the prescribed timeframe for compliance. In particular, consideration should be given to adopting a trial period approach with the reforms only being extended to other companies once practice has developed in the companies that were initially in-scope, the effectiveness of the reforms has been proven, and it can be demonstrated that other companies and their stakeholders would benefit from the reforms and that it would not be disproportionate to apply them to a wider range of companies. We note that paragraph 1.2.5 of the Consultation suggests that reforms will apply to premium-listed companies initially and then after two years will be extended to all PIEs. In our view, a two-year gap would not be long enough as it would only allow for one year's worth of reporting, and would not give sufficient time to determine whether the reforms were fit for purpose or their cost, to assess if they need to be adjusted before they apply to other PIEs. In other words, we agree with a phased approach to the new reforms, but this should be over a longer period and with a more flexible approach to what constitutes compliance, consistent with the principles of proportionality and practicality. We also note, as is also set out in our response to question 11, that it will be important to ensure that a minimum size or systemic importance criteria applies to ensure that smaller premium-listed companies are not subject to unduly onerous requirements, noting that as at 31 May 2021, the largest company on the FTSE All-Share Index had a market capitalisation of £107,377 million, with the smallest company having a market capitalisation of just £38 million² and that many smaller premium-listed companies do not meet the criteria set out in either Option 1 or Option 2 of the proposed large private company test.

In addition, given that the extension of the definition of PIE will – presumably - bring a number of companies within the scope of existing rules (as opposed to just the proposed reforms) for the first time, the impact of such extension should be considered and those companies will also need time to prepare for compliance with the existing rules. Scope for loss of UK governance controls also needs to be considered, as reincorporation away from the UK upon introduction of these proposals could be a realistic option for many large private companies.

We also note that the proposed definition of PIE will capture all credit institutions, regardless of size. Given that these institutions will most likely be regulated by the PRA or FCA, including all credit institutions without any additional test to determine size or appropriateness would be disproportionate.

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

Whilst most members of the Committees support the extension of the definition of PIE, the Committees do not have a strong view on which Option would be preferable. There are complex issues around the appropriateness of both Options 1 and 2 (in particular, whether having an “employee numbers test” is appropriate). The Committees have a slight preference for Option 1 should the Government proceed in extending the PIE definition.

The Committees recognise the potential benefit of choosing a test which reflects existing thresholds under the current legislation, however the Committees note that there are a myriad of tests that now apply to companies in the context of corporate reporting, with different criteria applying to, for example, section 172 reporting, other stakeholder reporting and corporate

² <https://www.ftserussell.com/analytics/factsheets/home/search>

governance reporting under the Miscellaneous Reporting Regulations and Modern Slavery Act reporting, and that are also proposed, for example, in respect of mandatory climate-related financial disclosures. The Committees would therefore strongly encourage the Government to consider, at the same time, whether the existing reporting framework could be simplified (for example, by reference to whether a company is either medium sized, large or a PIE (which would include the largest private companies, AIM-traded companies and main market listed companies which are incorporated in the UK)).

If the Government decides to proceed on the basis of Option 1 or 2, consideration should be given to the meaning of “employees” in this context. We note the wide-ranging definitions of “employee” in existing legislation³ and would welcome consistency and clarity on what “employee” will mean for the purposes of Options 1 and 2.

In addition, it is not clear how the test would apply to corporate groups. We note that paragraph 1.3.19 states “*the thresholds used under either option would apply to all companies in their own right. Additionally, in the case of parent companies, the thresholds would be applied to the group headed by that company. It is proposed that a parent company would therefore qualify and be regulated as a PIE if the relevant thresholds for options 1 and 2 were met when applied to the accounts of the group headed by that company where the parent company is required to file group accounts in the UK*”. How will groups with a non-UK parent, where consolidation occurs at the level of the non-UK parent be treated (if there is no requirement to file UK group accounts, this would presumably exclude many of the large private equity owned businesses in the UK with a non-UK parent company)? We propose that in these circumstances, UK-based subsidiary undertakings of third-country parent companies should have an exemption to certain of the reporting requirements where they are included in their parents' consolidated reports and that report is deemed to be equivalent to UK standards.

We also suggest that where a company that would be captured as a PIE is a subsidiary of another company that is also a PIE, the subsidiary should be exempt from the proposed new reporting requirements. Paragraph 1.3.19 states that the proposed thresholds for the expanded PIE definition would be applied, in the case of parent companies, to groups headed by that company. This is different from the recently enacted corporate governance arrangements disclosure requirements (arising from the Miscellaneous Reporting Regulations) where the same threshold applies but only at an entity level. As mentioned in our preliminary comments, the Consultation affords the opportunity to simplify the corporate governance and reporting framework and we consider that this opportunity should be taken.

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

We assume this only refers to AIM-traded companies incorporated in the UK. We do not see that there is any reason to distinguish AIM-traded companies from large private companies, should the Government proceed to expand the definition. As such, an AIM-traded company should be within scope if it would otherwise fall within the scope of the definition of PIE (as amended). We do though strongly advocate careful review of the application of these reforms to AIM-traded companies, given that it will add a significant burden to AIM listing, potentially making it uncompetitive as compared to other venues, with the risk of driving AIM-traded companies to overseas incorporation and listing.

A market capitalisation test is inappropriate as it could result in companies falling within the regime one year, and outside of it the next. Companies should have certainty as to when they would be brought into, and when they would fall outside, the expanded PIE definition. If an AIM-traded company was within scope one year and outside the next, to the extent that the company did not then voluntarily continue to comply with the new regime, stakeholders would not be able

³ By way of example, in the Equality Act 2010, an employee includes any person working under a contract of employment as well as workers and agency workers and includes employees of a UK company who are based overseas. Under the Miscellaneous Reporting Regulations, employees employed to work wholly or partly outside the UK are excluded from the “employee” definition, and under the Energy Savings Opportunity Scheme, an employee is “any person employed under contracts for service”.

to rely on comparable year on year accounts and assurance processes. A potential solution to address this point would be to require that an AIM-traded company must satisfy the relevant threshold for three consecutive financial years, for example (rather than using a threshold of two out of the last three years, which does not provide a company with sufficient certainty to plan). The issue highlighted here applies equally to the proposal that the reforms should apply first to FTSE 350 companies – see our comments above.

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

Whilst the Committees considered that there were good arguments as to why a temporary exemption may be helpful for companies preparing for an IPO which were not already PIEs in order to minimise the immediate burden from these reforms, the Committees also considered that it may make little difference to a company's decision regarding its listing jurisdiction whether it needed to comply with the new rules upon the date of an IPO or within a short period thereafter. In preparation for an IPO, companies are required to put in place many new systems and controls and so becoming a PIE and being subject to the rules which apply to PIEs from the date of listing would simply become another pre-IPO process. There were also concerns raised about this proposal of an initial period of exemption from an investor perspective, in so far as investors would expect UK listed companies to be subject to the same reporting obligations from the date of listing, if listed on the same segment of the market. This may well lead to "voluntary" adoption of the new requirements notwithstanding the availability of this proposed exemption. On balance therefore, our view is that a temporary exemption is unlikely, in practice, to ease the burden on newly listed companies.

One additional point to note is that where reference is made in the question to "newly listed companies", we assume that the intention is for this to apply to "companies newly admitted to listing / trading on a regulated or a prescribed market".

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

The Committees do not believe that it is appropriate to include Lloyd's Syndicates for the reasons set out in paragraph 1.3.28 of the Consultation.

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

The Committees are concerned that this would be disproportionate given the additional costs involved, with the benefit of third sector entities' inclusion being unclear. It should also be noted that such entities are already subject to an additional layer of regulation, for example, as a charity or a registered provider.

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

The Committees make no comment on this question as we disagree with the proposal.

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

No.

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

The Committees make no comment on this question, other than to note that any material increase in the number of PIEs may place even greater strain on the available pool of auditors – especially given the issues relating to the management of auditor conflicts of interest. See also our response to the questions on Chapter 6, especially question 40.

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

Yes. See response to question 1 above.

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

Yes. The phasing of implementation is imperative. As set out in our response to question 1, there needs to be a pause for reflection on extending the proposals to a wide range of companies that are not currently in-scope for many of the existing reporting requirements, let alone the proposed new ones, to allow any teething problems with the new regime to be addressed, to allow good practice to develop and to ensure that the proposals are fit for purpose. If reforms applying initially to premium-listed PIEs (or some sub-set of them) are implemented by way of legislation (as opposed to amendments to the UK Corporate Governance Code) it will be important to ensure that a minimum size or systemic importance criteria applies to ensure that smaller, non-systemically important, premium-listed companies are not subject to unduly onerous requirements. A potential solution to this problem is to apply the reforms initially only to premium-listed companies which are within scope by virtue of meeting the large private company test.

Chapter 2

12. Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?

As set out in the Committees' responses to the Brydon review (see [here](#)) and BEIS' consultation on the Kingman recommendations (see [here](#)), there are already a number of requirements for boards of UK-incorporated and listed companies to establish procedures to manage and oversee the company's internal controls and to report on their robustness and we do not believe there is a case for strengthening the rules in this area.

Listed companies are already subject to numerous requirements as regards their internal control framework under DTR 7 and Listing Principle 1, and in the case of premium-listed companies, by the requirements imposed on sponsors on IPO and when the company undertakes major transactions, and by the Corporate Governance Code. Whilst premium-listed companies report on a "comply or explain", continuing basis against the Corporate Governance Code, most invariably comply due to a combination of investor pressure and a desire to be seen to be maintaining appropriately high standards of corporate governance. In addition, the vast majority of AIM-traded companies follow the QCA Corporate Governance Code, with a small number following the Corporate Governance Code, the AIC Code or other codes.

Recent reforms have further added to the corporate governance compliance and reporting regime. The Miscellaneous Reporting Regulations require qualifying UK-incorporated companies to provide a statement of their corporate governance arrangements in their directors' report, and since 2019, large private companies have been encouraged to adopt the Wates Corporate Governance Principles, which include principles and supporting guidance relating to the need for the board both to establish an internal control framework and to agree an approach to reporting. The requirement for large private companies to report expressly on their governance arrangements is still relatively new and should be given time to properly bed down before any further major changes are proposed (and for this reason some members of the Committees are not in favour of including private companies in the new definition of PIE proposed).

The Committees note the proposals focus on the impact that high profile corporate failures have on investor confidence, a wide range of stakeholders and the communities within which those corporates operate. However, such failures remain rare, usually flow from unsuccessful business models and good faith choices specific to the company in question, or result from a failure to effectively implement the existing regime rather than a failing in the regime itself. Internal systems and controls can only ever exist to mitigate, as opposed to eliminate, risk – including the risk of financial failure. To our knowledge, there is no evidence of a lack of investor confidence in the current UK regime regarding disclosures and governance – in our view, the problem to be fixed is limited and the proposed remedies need to be kept in proportion.

If the Government considers that further measures are required in this area, the Committees suggest that the Government should ask the FRC/ARGA to consider amending provision 29 of the Corporate Governance Code to require premium-listed companies to report on how the board considers the internal financial controls to be effective. The Committees consider that this would be an appropriate and proportionate measure to encourage better reporting in this area (we note that the reference in paragraph 3.2.9 to the “*effectiveness of the company’s internal controls framework*” should be a reference to the “*internal controls over financial reporting*” as set out in Table 2 of Chapter 2, as an extension of reporting beyond financial controls would lack proportionality and be unduly onerous for companies). As regards non-premium-listed PIEs, the Committees suggest, as set out in our response to question 14, that any reforms in this area should only follow once their effectiveness has been proven and it can be demonstrated that other companies would benefit from the reforms.

Any proposals in this area which the Government takes forward must not: (i) impose a disproportionate cost and regulatory burden on UK companies, in particular relative to the US in Sarbanes-Oxley Act (“**SOX**”) requirements; or (ii) depending on how it is intended that the declaration/attestation is framed, undermine the balance between collective board responsibility and individual director responsibility for their own particular duties (if the proposal for the responsibility statement only to be given by certain directors is pursued). Any changes to the current regime must be both proportionate and risk-based, having regard to the size and resources of those being regulated. Equally, it is important to consider whether adopting aspects of the SOX regime would in fact improve auditing standards and accountability in a meaningful way, rather than simply resulting in greater costs and administrative burden as well as detracting from the attractiveness of the UK as a listing destination. Exceeding the SOX regime in any way should be avoided or the competitiveness of UK listings risks being adversely impacted.

13. If the control framework were to be strengthened, would you support the Government’s initial preferred option (Table 2)? Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?

If the Government determines that it is necessary to strengthen the control framework, then we consider that it will be very important for there to be flexibility in how directors are able to report on internal financial controls (as is currently the case) and that companies are provided with clear and effective guidance to help support the preparation of their disclosures. As set out above, we would support an amendment to provision 29 of the UK Corporate Governance Code to require premium-listed companies to report on how the board considers the internal financial controls to be adequate and effective. If this measure leads to improved reporting and increased investor confidence, then it could be extended to non-premium-listed PIEs through legislation.

Most members of the Committees consider that, depending on how it is framed, the directors’ responsibility statement acknowledging their responsibility for establishing and maintaining adequate internal control structures and procedures for financial reporting should be given by or on behalf of the board as a whole, not just the CEO and CFO personally, in order to remain consistent with the principle of collective board responsibility and the requirements for financial reporting under the Companies Act.

We note however that requiring the board to give such a statement risks a dilution of the distinction between the responsibilities of executive directors and non-executive directors and

so we suggest that it is important that the form of attestation given acknowledges the supervisory role of non-executive directors, who are not typically involved in the day-to-day management of the company. It must be recognised in formulating the statement that the duties of a non-executive and executive director, and of individual directors, in this area differ, depending on their roles and expertise. In exercising all due care and skill as required, different types of directors take on different roles in relation to the financial reports of a company (for example, non-executive directors test and challenge executive directors, but are not (and should not) be involved in the day-to-day management of the business and the operation of its financial procedures). There is a significant risk that these reforms will result in directors becoming overly focused on compliance issues rather than evaluating and managing risk, as part of pursuing the strategy and success of the company.

We agree that the directors' responsibility statement should only apply to internal controls over financial reporting (rather than covering all aspects of the company's internal control and risk management procedures) and further we consider that it is important that the form of attestation does not go beyond that which is required under SOX for executive directors.

We think that mandatory external audit and assurance in relation to internal financial controls would be disproportionate, and so agree that this should be for boards and individual audit committees to consider as part of the proposed Audit and Assurance Policy. We note however that, as a practical matter and particularly in light of the proposed enforcement regime, it is likely that many boards or individual directors will require some form of external assurance in order to give the responsibility statement on internal financial controls in the first place. This is therefore likely to lead to additional costs for companies irrespective of whether external assurance is mandatory or not. If the Government determines that mandatory external assurance is required, we believe that this would likely lead to more prescriptiveness in the content of the disclosures (as standards for assurance would need to be introduced), which may in turn lead to more "boilerplate" disclosures in this area.

We are deeply concerned about the proposed enforcement arrangements set out in Table 2, which would allow ARGAs to investigate the accuracy and completeness of the directors' internal control disclosures and, if necessary, order amendments or recommend an external audit of the internal controls. If companies could be required to have their internal controls assured by an external auditor in limited circumstances (which we do support), we think ARGAs should be required to publish guidance to set out how it will determine if it believes there has been a serious and demonstrable failure of internal controls or that material control weaknesses have persisted over several years. ARGAs should be required to engage with a company before reaching any such decision, consistent with the principles of natural justice.

The Consultation draws a comparison with the FCA's "skilled person" review framework under sections 166 and 166A of the Financial Services and Markets Act 2000. Extending a process that was designed for application in the most highly and extensively regulated business sector to all large businesses is not proportionate and not justified by any evidence. This power is currently only exercisable by the FCA in respect of a regulated firm and is generally used sparingly. Should the proposed enforcement arrangements be adopted, appropriate safeguards will need to be put in place to avoid the risk that the mere instigating of a review has the effect of undermining investor and other stakeholder confidence in the relevant company, thereby precipitating the very outcome that the regime is intended to avoid.

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

In line with our response to question 1 of the Consultation, any reforms in this area should initially apply only to premium-listed companies (or an appropriate sub-set) and should only be extended to other PIEs once their effectiveness has been proven and it can be demonstrated that other companies would benefit from the reforms.

The question of which companies are within scope will of course largely be linked to the approach taken to implementation. If, as we consider most appropriate, the Government introduces the requirements on a phased basis through a change to the Corporate Governance Code, then only premium-listed companies (or possibly some subset of these) would be within scope initially. If instead the Government determines that it wishes to proceed via the legislative

route, then presumably this would involve a change to the Companies Act and therefore the requirements could initially apply to quoted companies or traded companies and then be expanded to the wider definition of PIEs at a later stage if there is real evidence that the new requirements lead to improved reporting and increased investor confidence without disproportionate cost and competitive harm. In our view it is critically important that any changes are implemented on a basis that is proportionate and flexible such that the practical effect is not to over-burden companies and/or directors or to detract from the attractiveness of the UK as a place to list and/or establish businesses and does not make more difficult the recruitment of suitable board candidates.

Any proposals in this area need to be considered in the context of the Listing Review and the longer-term aspiration of that Review that the premium and standard listing categories should be collapsed into one Official List that simply has different routes to listing.

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

As the Committees stated in our response to the BEIS Select Committee inquiry last year (see [here](#)), the legal and accounting issues relating to dividends and maintenance of capital are complex and we would welcome a separate expert review that could consider and develop proposals that would both simplify some of the complexity and give new emphasis to the existing duty to consider a company's ability to pay its creditors. It would not be appropriate to proceed with making changes to important corporate laws absent such a review.

The Committees consider that the ICAEW/ICAS guidance on distributable profits has been helpful to support the statutory provisions but we consider the fact that the statutory provisions on distributable profits require 170 pages of technical guidance (aspects of which have given rise to technical disagreements between the respective Institutes and the Committees) demonstrates that it would be appropriate to consider whether the law could be simplified. We do not think that the regime is one which can be easily or comprehensively understood by many directors. An alternative would be to clarify and/or restate the law in a manner which does not require 170 pages of technical guidance as to its interpretation and application.

If the Government determines that it is appropriate to retain the current "realised profit and loss" approach, the Committees are comfortable with responsibility for developing guidance to assist with determining what amounts to realised profit and loss being transferred to ARGA, provided that: (i) ARGA undertakes a full consultation before finalising the guidance (as the Consultation proposes); (ii) the vast body of experience and knowledge that has been built up by ICAEW and ICAS in this area, including its technical guidance, is not lost; (iii) ARGA has the necessary skills and expertise to maintain that guidance going forward (and ICAEW and ICAS are comfortable that this is the case); (iv) ARGA consults appropriately on any proposed future changes and updates to the guidance; and (v) any guidance is ultimately subject to the primacy of the Companies Act, the Courts and the law and should not have the effect of changing the law or restricting the role of the Courts.

We are strongly of the view that it would be more appropriate for ARGA to adopt guidance rather than binding rules. In addition, the Committees note that whilst "realised profit and loss" is an accounting concept, what constitutes a distribution and whether or not a distribution can be made or not, is a question of law. Questions of law are matters for lawyers to advise on and for the Courts to determine. Neither ARGA, nor any person other than the Courts should be responsible for determining such matters of law. As has previously been noted in our correspondence with BEIS and without diminishing the immense value of TECH 02/17 and the body of work which supports it, TECH 02/17 does include certain statements as to what

amounts to a distribution which are not supported by the Committees and do not, in our opinion, reflect the law.⁴

In light of the complexities of this area of law and as outlined above, the Committees consider that a separate review with the objective of simplification of the current law would be preferable to leaving ARGAs to determine what is a realised profit or loss. In particular, the Committees would welcome consideration of whether a move away from a test based on distributable reserves to a solvency-based test, as is the case in a number of other jurisdictions, would be more appropriate, noting that Brexit has made such a change legally possible (this solvency-based test could be introduced alongside the existing net assets test which currently also applies to public companies).

Whilst there is currently no explicit statutory requirement, section 851 of the Companies Act preserves the common law duties on directors to act prudently when considering distributions and to be satisfied that the company will, after payment of the dividend, continue to be able to meet its obligations as they fall due. A "two year" solvency confirmation statement, when added to the existing distributable reserves test, is not appropriate or proportionate and adds further confusion as it is not clear how that statement fits with this existing common law requirement and so we strongly oppose this proposal. In the Committees' view, layering a new and different requirement on top of an already complex regime is not the right approach. There is no basis for the proposed two year period when, for example, a private company can return capital to shareholders using a solvency statement which is only required to consider a one year period and other "going concern" type assessments also address a similar one year period. We consider that, if it were to be adopted, the proposed approach would be problematic, unclear and at odds with the Government having consistently argued for greater competitiveness and flexibility in relation to reforms relating to capital (for example through changes implemented in the Companies Act).

A new two year period and the need for express confirmations with the risk of liability and/or sanction would likely encourage the increased use of share buybacks (which often in practice do not directly benefit retail shareholders – particularly those holding via disintermediated structures) in circumstances where otherwise a dividend from profits would have been made. In addition, a two year period is likely to be challenging in a takeover scenario where a dividend is contemplated as it is likely that the whole board of directors will change, and so the board of directors at the time of declaration of the dividend may not know what the plans and/or actions of the new directors will be.

Creation of this test may also force companies within scope to reduce leverage in ways not required by law in other jurisdictions, which may encourage businesses affected to look for alternative options for incorporation where the law is more flexible and certain.

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

Yes. We understand that investor bodies have been in favour of including a disclosure of this nature for some time and we also support this proposal in principle. It should help investors better understand the potential scope for a company to pay dividends.

Our view is that rather than it becoming a new Companies Act reporting requirement, it would be preferable for there to be a new accounting standard requiring the disclosure to be made as

⁴ See Joint Working Party of the Company Law Committee of the Law Society of England and the Company Law and Financial Committees of the City of London Law Society, '[Guarantees and Distributions](#)' (5 June 2018) at paragraph 4; and Joint Working Party of the Company Law Committee of the Law Society of England and the Company Law and Financial Committees of the City of London Law Society, '[Intragroup Loans and Distributions](#)' (5 June 2018) at paragraphs 4 and 21.

a note to the accounts. This approach would allow sufficient flexibility for the requirement to be adapted depending on investor needs going forward.

In respect of corporate groups, and as the Consultation acknowledges, there may be some challenges in determining what the content of the narrative disclosure should be and presenting it in a way that is not misleading as to the availability of distributable profits to the parent company. We also think that some companies may have difficulties in giving precise details of their distributable and non-distributable reserves and we therefore support the proposal of the inclusion of a “not less than” figure. If instead companies were required to report a definitive figure, this could create an expensive and time-consuming process, with little obvious benefit.

However, we think it is important to bear in mind that the amount of distributable reserves and non-distributable reserves will change (positively or negatively), including as a result of events (which may or may not be within the company's control) and the information provided in the accounts is only a snap shot of those reserves as at the balance sheet date. Currently, to comply with their duties as directors and to ensure the company does not make an unlawful return of capital at common law, the directors have to have regard to the position at the time the dividend payment or other distribution is proposed to be made, and not just rely on the level of distributable reserves as at the last accounts date. Therefore, we think that including a distributable reserves figure in the accounts might, without some further explanation, lead investors to expect a future level of dividends which the directors might decide is not appropriate. We therefore consider that the guidance proposed in paragraphs 2.2.18 and 2.2.24 should ensure that this point is addressed.

We think that the additional costs of preparing the disclosures on a “not less than” basis are unlikely to be significant, as listed companies already perform this analysis in practice (regardless of whether they report on it).

Whilst we consider that the benefits of the disclosure on a “not less than” basis are of most relevance to external investors, and therefore to those who hold shares in listed companies, as the Consultation suggests, we do not see a material downside to this disclosure being applied to all PIEs which are not wholly-owned subsidiaries. This would have the benefit of ensuring a level playing field in this area.

The Committees also note that the proposed reporting requirements would need to be made each time a dividend is paid, which could be twice a year for many companies, and more frequently for some. As such, some disclosures would not form part of the annual reporting cycle and would not benefit from the safe harbour provisions under section 463 of the Companies Act. In order to avoid exposing directors to a disproportionate level of liability, we suggest that the Government considers how these safe harbours could be extended to cover all of the proposed new disclosures set out in the Consultation to the extent that they may not be included in the company's Strategic Report.

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

As mentioned above, we would welcome a separate review of the law on dividends and maintenance of capital with a view to simplifying the law in this area, rather than adding an additional layer of complexity to an already complex regime. Directors already have multiple duties in relation to dividends and we do not believe evidence has been shown of a compliance problem or lack of accountability under the current law. See our response to question 15 of the Consultation above, which in large part applies equally to the response to this question.

In the absence of any such simplification, as we have already stated, the two year look forward period for the solvency test is not appropriate or proportionate, and we are not clear how it interacts with the existing common law solvency principle relating to dividends, i.e. that the

directors must be satisfied that the company will, after payment of the dividend, continue to be able to meet its obligations as they fall due. Under the current requirements, the statutory rules apply a balance sheet test that has regard only to the distributable reserves of the company making the distribution. There is no explicit statutory requirement as part of the provisions on making distributions to consider cash flow solvency - it is unnecessary as many duties cover this. In addition, in our experience directors do consider solvency, including cash flow solvency, when making distribution decisions. Solvency law and the directors' duty to promote the company's success already require them to consider the effect of the dividend on the company's ability to pay its debts.

As noted above, when considering whether to propose and/or pay a dividend and, if so, in what amount, directors already take into account the level of reserves that are available for distribution and the impact of the dividend on the ability of the company to meet its debts as they fall due. In light of this, we do not think it would be helpful to require directors to make a new public statement that they have had regard to their section 172(1) duties and their wider common law and fiduciary duties. If this was to be required then it is likely in practice that additional narrative disclosure would need to be made in order to ensure that any express comfort provided to the market and stakeholders and any associated risk and uncertainties are properly understood in order to avoid any undue expectation that the relevant confirmation amounts to a guarantee that the company will not encounter financial difficulties following payment of the dividend. Accordingly, if this proposal were to be pursued, then it would be necessary for guidance to be provided as to which common law and fiduciary duties are being referred to in this context. We also think that it would be necessary to provide guidance as to what sort of risk analysis a company would have to undertake for the directors to show that their expectation is reasonable. This would likely create boilerplate disclosures with little value. We are not clear to what extent, if any, directors would be required to take account of contingent and prospective liabilities in the relevant period, which is a complex issue already addressed in case law. If, despite our views on this area, the Government determines that directors will be required to make such a statement, we think it should apply to any dividend or other distribution, whenever made. As noted in our response to question 16, any such disclosure should also benefit from safe harbour provisions set out in section 463 of the Companies Act.

We also consider that a 12-month look forward period would be more appropriate, in line with both the existing obligations for premium-listed companies under provision 30 of the UK Corporate Governance Code as regards the "going concern" statement and the solvency statement look forward period for a reduction of capital by a private company under section 643 of the Companies Act.

We note that in paragraph 2.2.21 there is also a proposal that the directors' statement should include confirmation that "*the dividend is consistent with the Resilience Statement*". However, paragraph 3.1.13 includes the "*sustainability of the company's dividend and wider distribution policy*" as one of the specific disclosures which the Government is considering for the Resilience Statement. There is additional overlap in the reporting proposals in that the first bullet of paragraph 2.2.21 requires the directors to confirm that they have had regard to section 172 (including the need to have regard to the likely consequences of any decision in the long term) whereas the sustainability of the dividend policy addressed in the Resilience Statement also appears to be based on the long term perspective. We consider that the disclosures in the Resilience Statement would negate the need for a directors' confirmation in the directors' statement as set out in paragraph 2.2.21, not least as it would add further confusion to the law on dividends if a further ill-defined sustainability test was added over and above the existing requirements and proposals in relation to the effect of the dividend on the company's future solvency.

In line with our response to question 16, we see no reason why this requirement should be determined by reference to whether a company is listed or not given that many large private companies have multiple shareholders and so support the requirement being extended to all PIEs which are not wholly-owned subsidiaries.

18. Do you agree that the combination of recently introduced Companies Act section 172(1) reporting requirements along with encouragement from the investment community and ARGA will be enough to ensure that companies are sufficiently

transparent about their distribution and capital allocation policies? Should a new reporting requirement be considered?

Yes. We agree with this and do not consider that an additional reporting requirement is necessary. This point has been considered by the investment community – including the Investment Association, who have been considering expanding their guidance on the point, and the International Corporate Governance Network which has issued guidance on capital allocation reporting.

Chapter 3

19. Do you agree that the above matters should be included by all companies in the Resilience Statement? If so, should they be addressed in the short or medium term sections of the Statement, or both? Should any other matters be addressed by all companies in the short and medium term sections of the Resilience Statement?

No. It would be preferable for companies to be afforded more flexibility in how they approach the Resilience Statement disclosures. We are supportive of a statutory framework for reporting on the Resilience Statement being adopted but would suggest that the disclosure requirements set out in paragraph 3.1.13 (as well as any others) would be better addressed in guidance which is developed by ARGA. Importantly, this would allow for the requirements to evolve over time to meet investor needs. ARGA could be given the authority to make regulatory rules in the future with regard to the content of the Resilience Statement if it considered that this was necessary because the approach of a statutory framework supported by guidance was not working.

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

The recently introduced Listing Rule 9.8.6(8)R and related guidance require premium-listed companies to report on the basis of the TCFD framework on a “comply or explain” basis, with flexibility being afforded as to the location of the disclosures in the annual report. Whilst we acknowledge that the Government’s consultation on requiring mandatory climate-related financial disclosures by large companies proposes that TCFD disclosures be included in the non-financial information statement set out in the Strategic Report (and we consider that this is the best location for the disclosures as they would benefit from the safe harbour for directors under section 463 of the Companies Act), we suggest that the flexibility afforded to companies in the Listing Rules as to where the disclosures should be located is more appropriate at the moment given that these are extensive new reporting obligations, which overlap with other environmental reporting obligations. We also refer the Government to the CLLS/Law Society joint response to BEIS’ consultation on requiring mandatory climate-related financial disclosures (see [here](#)).

As such we are supportive of flexibility for the time being to allow time for market practice to develop. We consider that the Resilience Statement as articulated in Chapter 3 of the Consultation is an unlikely vehicle for TCFD reporting given the degree of specificity required under TCFD, and that it is more appropriate for TCFD reporting to sit alongside the existing ESG reporting requirements in the Strategic Report. If the Government considers that the Resilience Statement is an appropriate place for TCFD reporting, then it will be important to ensure that the Resilience Statement will benefit from the safe harbour protections for directors under section 463 of the Companies Act.

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

No. We consider that the Resilience Statement requirement should apply to premium-listed companies (or only a sub-set of them) and should only extend to other companies once its effectiveness has been proven and it can be demonstrated that there is good reason why other companies should be required to prepare such a statement.

We are also concerned that the Consultation proposes that the Resilience Statement will be a statutory requirement, but is silent as to the enforcement and safe harbour regime that will apply to it. This is particularly important given that the information in the Resilience Statement is forward-looking. The safe harbour provisions set out in section 463 of the Companies Act, which apply to information contained in the Strategic Report, should also apply to the Resilience Statement.

See our response to question 4 regarding recently-listed companies.

22. Do you agree with the proposed minimum content for the Audit and Assurance Policy? Should any other matters be addressed in the Policy by all companies in scope?

No. In line with our comments on the Resilience Statement disclosures, companies should be afforded flexibility in how they approach the Audit and Assurance Policy disclosures. We are supportive of a statutory framework for reporting on the Audit and Assurance Policy being adopted but would suggest that any requirements set out in paragraph 3.2.9 which are adopted would be better addressed in guidance which is developed by ARGA and which would allow for the requirements to evolve over time. ARGA could be given the authority to make regulatory rules in the future with regard to the content of the Audit and Assurance Policy if it considered that this was necessary because the approach of a statutory framework supported by guidance was not working.

In relation to the proposed minimum content set out in paragraph 3.2.9, we note the following:

(i) it is unclear what is meant by “independent assurance” in this context. Does this mean external / third party review or might it also include, for example, a review by the internal audit team? External assurances will generally come at a greater cost and so it would be preferable if companies had the option to obtain external or internal assurances;

(ii) the reference to the “*effectiveness of the company’s internal controls framework*” should presumably be a reference to the “*internal controls over financial reporting*” as set out in Table 2 of Chapter 2, as an extension of reporting beyond financial controls would lack proportionality and be unduly onerous for companies; and

(iii) given that the policy will be voted on by shareholders, we do not think that the additional requirement for a company to explain how shareholder views have been taken into account is required.

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

We do not have a strong view on this question and consider that other organisations are better placed to comment, however if the Government determines that a shareholder vote is required, we consider that the Audit and Assurance Policy should be voted on at least every three years (in line with the current practice for the Directors’ Remuneration Policy) and not annually. An annual advisory vote would be disproportionate to achieve the aim of the Audit and Assurance Policy, which is to provide a flexible means for companies to explain whether, and if so, how, they are obtaining assurance on any company reporting beyond that which is required by the annual company audit. Annual votes are more likely to become boilerplate and standardised, making them burdensome and ineffectual.

We are, however, aware that the experience of many listed companies is that shareholders often do not engage with companies generally on many issues and certainly not on audit and assurance matters and so if the Government determines that a shareholder vote is appropriate, we suggest that the Stewardship Code could be strengthened to encourage engagement on this topic.

We do not consider that, following the extension of the proposals to non-premium-listed company PIEs, there is any rationale for large private companies to be treated differently as regards the need for a shareholder vote as suggested in paragraph 3.2.14 of the Consultation.

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

No. We agree that these proposals should apply first to premium-listed companies (or some sub-set of them), and that the initially in-scope companies should have at least a full reporting cycle after the proposals become effective in order to prepare and publish their first Audit and Assurance Policy. We also agree that the proposals should only extend to other companies once their effectiveness, relative to cost, has been proven and it can be demonstrated that there would be a benefit of other companies being subject to the same reforms.

We note that, as with the existing Directors' Remuneration Policy, the Government considers that the Audit and Assurance Policy should become a new Companies Act requirement. We support this proposal, but caution against including the proposed minimum disclosures set out in paragraph 3.2.9 in the statutory requirements. We consider that it would be preferable to allow flexibility and market practice to evolve over time and as such, in line with our comments on the Resilience Statement, we consider that the content requirements would be best addressed in guidance.

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

We agree that, in light of the Government's concerns about poor payment practices, a requirement to report on payment practices would be helpful not only to seek to improve supplier payment practices, but also to give shareholders and other stakeholders better visibility on how a company's directors are meeting their section 172(1) duties. In line with our comments on the Resilience Statement, we would be in favour of companies having flexibility in how they approach the required reporting summary, with the preferred content for the summary being addressed in guidance developed by ARGAs. This would allow for the disclosure requirements to evolve over time. ARGAs could be given the authority to make regulatory rules in the future as to the prescribed content of the reporting summary if, having allowed companies time to prepare such summaries and investors and other stakeholders to assess the utility of them, it considered that this was necessary.

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

With reference to our response to question 2, we note that there is a myriad of tests which apply across the various current reporting requirements to determine whether a company is in scope and we would be in favour of simplifying the tests. If Option 2 is chosen as the basis for the extension of the PIE definition, then all PIEs would be in scope under the Government's proposal. If instead Option 1 is chosen, then there may be companies that meet the turnover and balance sheet tests but that do not have 500 or more employees. As such, these companies would be out of scope and it is not clear to us why this new reporting requirement would be any less relevant to them - there is no obvious correlation between supplier payment practices and the number of employees employed by a company. We consider it would be better for this requirement to apply to all PIEs (whatever test is chosen).

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

Yes. We agree and consider that the section 172 reporting requirements are sufficient to allow wider stakeholder constituencies to form a view on how a company's activities are having an impact on matters of public interest.

Chapter 4

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

We suggest that the Government considers the points set out below with regard to the implementation of the proposals set out in chapter 4. Further consultation in this area once the detail of the proposals has been developed is critical given the significant issues the proposals will give rise to as currently framed in the Consultation.

(i) As we outlined in our previous response to BEIS' consultation on the Kingman recommendations, any change to the formal procedure by which directors can be required to revise accounts needs to contain appropriate checks and balances. The current procedure for the revision of defective accounts and reports is set out in Chapter 11 of Part 15 of the Companies Act. Sections 455 and 456 of the Companies Act first require the Secretary of State to give notice to the directors indicating the respects in which the accounts or reports do not appear to comply with the requirements of the Act, specifying a time of not less than one month for the directors to provide an explanation of the accounts or reports or prepare revised accounts or reports. After this time, if it appears to the Secretary of State that the directors have not provided a satisfactory explanation or revised the relevant documents so as to comply with the Companies Act requirements, then the Secretary of State may apply to the Court for a declaration that the accounts or report do not comply with the requirements of the Act and requiring the directors to revise them. Section 457 of the Companies Act also permits the Secretary of State to make an order authorising other persons to apply to the Court under section 456. The Conduct Committee of the FRC is so authorised and must exercise its authority pursuant to its published operating procedures.

This process ensures that directors and companies producing accounts and reports are subject to a clear, transparent and proportionate regime should the Secretary of State believe that the accounts or reports in question are defective in some way. We strongly oppose ARGA having the power to direct changes to reports and accounts without the need to seek a Court order. This would fundamentally change the law in ways which have not been properly considered, creating uncertainty for companies and their directors.

First, the requirement for the Secretary of State to seek a Court order to revise defective reports or accounts where the directors in question are regarded as not having taken appropriate action ensures that there is a careful and independent assessment of the circumstances by the Court. The removal of any such "check and balance" would be a retrograde step and, to the extent that the power to direct that reports or accounts are corrected is to be given to ARGAs, it will be important to ensure that ARGAs' statutory powers and objectives are clear and transparent and that there is an obligation on ARGAs to act in a manner which is proportionate to its stated objectives and is fair to the companies concerned. Normal principles of natural justice should apply and we would urge the Government to reconsider the proposed removal of the requirement to seek a Court order or at least to ensure that a clear framework of safeguards are in place to protect against the risk of an arbitrary exercise of powers based on the benefit of hindsight given the nature of the judgements that are entailed in signing off a set of accounts as being "fair, balanced and understandable" as at a particular moment in time.

Second, we also think that there should be a clear process of appeal for a company to use so that it is able to challenge ARGAs' decisions (in the same way as a company could appeal against a Court ruling). Is it proposed that any regulatory rules will include a provision equivalent to section 457 (Other persons authorised to apply to Court)?

Third, is the intention that the current provisions of the Companies Act regarding revision of defective accounts and reports will be removed from the Companies Act and incorporated in a

new rulebook published by ARGA? We presume not, as these provisions need to apply to all companies. If so, what will be the status of the relevant rules as a matter of law? Is it proposed that the power in section 454 for directors to prepare revised accounts or reports on a voluntary basis will remain in the Companies Act? The proposals assume that accounts are a matter of accounting policy and therefore within ARGA's expertise, but accounts are first a matter for the Companies Act, in which the Courts have deep expertise. A shift away from the Courts would mean a shift away from legal certainty to a regime overseen by an untested new regulator, with accounting but not legal expertise.

(ii) The Consultation recommends the publication of summary findings and, if necessary, full correspondence between ARGA and the relevant company following a CRR review. We consider that ARGA should not have the power to publish the full correspondence but only relevant extracts (and always subject to existing legal principles around confidentiality and privilege). We consider that in view of our comments above regarding the process of appeal, it will be important that that correspondence is not published until the relevant appeal procedure has been completed. In addition, the Consultation says that *"it will ensure that there are safeguards in the legislation regarding the publication of information which a company regards as commercially confidential"*. We think it will be important to ensure that there is clarity on what these safeguards will be and how they will operate in practice. They need not only to address commercial confidentiality and privilege but also the risk of false allegations and inaccurate assertions in correspondence. We are sceptical that a well conducted review's findings should require this further disclosure.

(iii) We note that paragraph 4.2.10 provides that the pre-clearance service will be a matter for ARGA to consider following completion of a pilot study. We agree that this is a sensible approach in view of the apparent lack of demand. It will be important for companies to understand how the pre-clearance service operates (and particularly the timeframes involved) and that there would be a benefit in ARGA publishing on an anonymised basis the outcomes of issues addressed through the pre-clearance procedure to provide an information bank for companies going forward. In addition, we consider that the points made in (ii) above regarding confidentiality and appropriate safeguards are also important to ensure that the information published is sufficiently anonymised so as to protect the identity of the company in question.

(iv) We further note that paragraphs 4.3.6 and 4.3.7 reference that the FRC will undertake a pilot study of preliminary results and investor presentations, working with the FCA to establish the extent of any inconsistencies between this information and the subsequent annual report and accounts. We agree that the pilot study approach is a preferable approach. In our view, the FRC/ARGA should focus its efforts on improving annual reporting before turning to investor communications outside of the annual report which are already monitored by the FCA. In our view, giving ARGA jurisdiction to review investor presentations would be duplicative of existing FCA powers.

(v) We agree that if ARGA's remit is to extend to the entire annual report, then it is appropriate for its CRR function to be extended in parallel. We assume that this is not intended to detract from the comply or explain approach to corporate governance that is a general and well established feature of the UK market, but we query what ARGA's role will be in assessing compliance with, for example, the Corporate Governance Code? Will ARGA have any responsibility for determining the quality of any explanation given? How will this fit with the FCA's powers under the Listing Rules, which impose reporting requirements in relation to the Corporate Governance Code? These questions reveal the duplication and resultant increased costs of extending ARGA's remit to the entire annual report and reflect the unnecessary levels of duplication inherent in ARGA moving from being a regulator of audit and accountants to becoming a regulator of directors, without there having first been a detailed analysis of the gaps and the need for any improvements, as was previously prompted by BEIS (see the August 2017 BEIS Response to the Corporate Governance Green paper at Chapters 3 and 4).

(vi) With reference to point (v) above, does the power to direct changes to reports apply to corporate governance reporting / any other reporting that is currently not a mandatory Companies Act or FCA requirement? We do not believe that it should be extended in this way.

Chapter 5

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

We have serious concerns around the proposal that ARGA will be able to impose civil sanctions for breach of directors' Companies Act duties. See our response to question 32 for further details.

This proposal should be reconsidered following a proper analysis of duplication, existing enforcement mechanisms and, in particular, consideration of the role and value of the Courts in providing accountability for director breaches. These proposals risk the UK becoming a jurisdiction in which being a director is overly regulated without adequate justification or proportionality.

We welcome the Government's decision not to introduce an authorisation scheme for company directors. We understand that the FRC and FCA are already cooperating in respect of various areas and whilst a degree of overlap will be inevitable, the benefit of this is that where the FCA considers that a particular case is not appropriate for the FCA, it can pass it over to the FRC and vice versa.

The acknowledged extent of duplication with the FCA is disproportionate and unnecessary. The case for such duplication (with resultant bureaucracy, costs and negative competitive impact) has not been established. Other jurisdictions do not duplicate for the same issues. For example, in the US, only the SEC regulates disclosures. Such regulatory overreach is not needed, justified or in the UK's competitive interest. We agree that there may be gaps in regulatory enforcement, not least in cases where no insolvency has occurred, for non-listed companies outside of the FCA's remit. We note that BEIS does not use its powers to appoint inspectors into companies where unlawful activity may have occurred and there may well be a case for ARGA helping to fill that gap. But that is not the proposal set out in the Consultation. The cases cited as justifying the extension of powers, such as Carillion, are still subject to regulatory and legal enforcement proceedings, with significant accountability under consideration. In our view, the mere fact that the FRC as the regulator of accountants may have jurisdiction over some directors but not others, is not an appropriate rationale for giving ARGA jurisdiction to take similar action against all PIE directors, absent real gaps being identified, not just asserted.

We are very concerned by the statement in paragraph 5.1.14 of the Consultation that ARGA's new civil enforcement regime will not replace existing arrangements for taking action against directors for offences under the Companies Act. We agree that the FCA should remain responsible for enforcing its (separate) rules regarding company accounts and reports. We also agree that the Insolvency Service should continue to take the lead in relation to director disqualification proceedings under the Company Directors Disqualification Act 1986. We note that the Government already proposes to give HM Revenue & Customs a direct route to bring disqualification proceedings. In our view, it will be both highly problematic and disproportionate to have different authorities be responsible for criminal and civil offences in respect of failures to comply with the same Companies Act requirements. We support a single point of enforcement/prosecution of claims, and that effective enforcement action is taken by properly funded agencies.

Our concerns are especially acute regarding offences where accounts and reports do not satisfy all of the Companies Act content requirements. These requirements are detailed and need to be interpreted and applied consistently. This is harder if multiple authorities are responsible for enforcing non-compliance (please see our response to question 33 which flags some potential problems in the context of directors' duties).

The proportionality principle referred to in paragraph 5.1.19 is very important in ensuring that potential directors (particularly non-executive directors and those from non-financial backgrounds) are not deterred from agreeing to become directors based on a concern that they will be subject to enhanced standards. The impact of the proposed increased responsibilities

and liabilities for directors are likely to have an adverse impact on the ability of in-scope companies (particularly those that are publicly listed or traded) to attract directors with the appropriate range of skills required to achieve an effective balance of skills and experience on the board, especially against a backdrop of also seeking to improve board diversity. If the Government proceeds with this aspect of the proposals, which we do not support, as a minimum ARGA should set out how the proportionality principle will apply in practice – for example, to set out that ARGA will take account of companies of different complexity, and with regard to directors that ARGA will take into consideration whether a director is an executive director or not and whether the director has particular financial expertise (i.e. to adopt an approach that is reflective of the existing law relating to a director’s duty of skill and care). However, the case for change has not been established and, in our view, the right answer is to leave this to the Courts, with their decades of expertise of exactly these issues.

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

No. If the Government proceeds with this aspect of the proposals, which we do not support, we consider that ARGA’s enforcement powers should be limited to the duties identified in paragraph 5.1.21. If it is proposed to introduce into the statutory regime new statutory duties for directors and for ARGA to have enforcement powers in relation to those duties, then these should be subject to consultation at the time (rather than ARGA being given a power now that will extend to such new duties).

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

We agree with the statement in paragraph 5.1.23 that the statutory duties set out in paragraph 5.1.21 are not designed for regulatory enforcement and so should remain within the remit of the Courts. If this was to change – and in our view there is no case for such a change – then greater clarity would be required to give certainty to directors on what these duties entail and the circumstances in which civil enforcement action would be taken. We agree that ARGA should provide more detailed but clear, focused and proportionate guidance as to its interpretation of how these statutory duties are to be met (particularly in respect of those directors who sit on audit committees) to address this specific issue, taking into account the wide range of companies that are subject to these duties, the differing complexity of the companies’ business and the range of directors subject to the duty, some of whom may be closely involved in management of the business and others who may be non-executive directors, all with varying degrees of financial competency.

If the Government is concerned that there is an enforcement “gap” either in terms of powers or timing, given that in practice, the Secretary of State via the Insolvency Service only gets involved in the disqualification of directors post-insolvency, an alternative the Government could explore is ARGA having powers to act to pursue/prosecute before the Courts’ disqualification in situations other than insolvency. Alongside the statutory standards for disqualification and criminal prosecution that already exist, new procedures would need to be created, and additional delegation to ARGA granted for decision taking on enforcement. It would be vital that the Courts decide findings, not ARGA’s tribunals. Otherwise the UK’s well-established and trusted company law will no longer be the test for directors, with significant negative cost implications and a loss of competitive appeal for the UK’s corporate law ecosystem (which is a major asset for our highly successful legal profession, generating substantial revenues for the UK).

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

No. Without clarity on what the “behavioural standards” would be, and how they would fit into the existing framework of directors’ duties, it is difficult for the Committees to meaningfully

comment in this area beyond setting out significant reservations. We set out our high-level concerns below.

Directors are currently required to comply with their duties to their company. Certain of these are codified in the Companies Act and some additional fiduciary duties apply under common law. In particular, all directors (both *de facto* or otherwise) are required to act with honesty and integrity – many other regulatory and statutory obligations build on these core principles. There is also a long-established body of case law that assists directors and advisers in assessing what is required of a director or of a board collectively in order to discharge their duties effectively. Ultimately, the Courts determine whether a director is in breach of his/her fiduciary and statutory duties. Certain regulators also define fiduciary standards (for example, the FCA's regulatory regime contains conflicts of interest requirements for directors of regulated entities). We understand that the proposed new regime of behavioural standards is intended to work alongside the existing regime of directors' duties, but there is no detail in the Consultation as to how this would happen in practice. Paragraph 5.1.17 references a memorandum of understanding between the FCA and FRC which could in theory address the approach as between these two bodies but should not need to if duplication is avoided: that is the right route. In addition to these two regulators, the Insolvency Service, CMA and SFO also have enforcement powers which will overlap.

There is also the potential for ARGA to set behavioural standards that conflict with directors' other duties. That would leave, at least in theory, directors in a position whereby they could face enforcement action by ARGA or an adverse decision of the Courts, depending on what action they took or refrained from taking. The extent of the conflict of course depends on what the behavioural standards are. If, for example, the behavioural standards are confined to "acting with honesty and integrity", then there is unlikely to be a conflict. If the behavioural standards are broader than this, then ARGA would need to provide clear guidance as to how and when they would take action based on a breach of a behavioural standard when another more specific requirement has been complied with. We suggest that if the Government proceeds with these proposals, that there should be further broad consultation on the details in due course.

In light of the potential for overlapping and / or conflicting responsibilities and given that directors are already subject to statutory and fiduciary duties, and, in the case of listed companies, expectations set by the UK Corporate Governance Code, we are strongly against additional statutory behavioural standards being introduced and would instead be in favour of any such standards being in the form of guidance. If they are to be introduced on a statutory basis, it is imperative that the behavioural standards are carefully considered in light of the existing directors' duties regime and are subject to enforcement before the Courts, not ARGA.

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

No. The Consultation is not clear on whether it is proposed that the enforcement powers are to be limited to those duties for which ARGA is the regulator, namely the duties referred to in paragraph 5.1.21 or whether the enforcement powers are to be made available in respect of breaches of directors' duties more broadly. If the Government proceeds with this aspect of the proposals despite the view of the Committees, we consider that any enforcement powers should be limited to the duties set out in paragraph 5.1.21.

As stated above, we are very concerned that if ARGA is able to make enforcement decisions in respect of directors' duties, it and the Courts could arrive at conflicting views in respect of the same facts. For example, ARGA may decide that a director is in breach of the duty to approve accounts only if they give a true and fair view, but a court may decide that the director has met the standard of care required under section 174 of the Companies Act. Any such potential for irreconcilable decisions would be unworkable and would lead to considerable uncertainty for other directors' future actions. This in turn may deter well qualified candidates from being prepared to become directors, particularly of publicly listed or traded companies.

Making enforcement powers available to ARGA in respect of breaches of directors' duties would be a significant unwelcome change to the existing legal framework and we do not believe that

the case for such a change had been established. Directors and those involved in compliance and enforcement rely on the long-standing approach taken by the Courts and the checks and balances which exist within the legal system. The FCA has developed a sophisticated regime for enforcement of the Listing Rules, Disclosure Guidance and Transparency Rules and the UK Market Abuse Regulation but with significant responsibility and accountability being placed on the FCA. Whilst there may be a case for giving ARGAs broader powers to bring enforcement actions, the determination of whether or not a director has fallen short of what is required of him or her in a particular set of circumstances should remain with the Courts. Any change to this approach would introduce unnecessary uncertainty over the process to be followed and would require detailed and sophisticated procedures commensurate with the responsibility and accountability proposed to be conferred on ARGAs in this area.

It is very important that all directors who would be subject to these powers have a clear understanding of the expectations that will be placed on them and the circumstances in which any new enforcement powers would be exercised (this is particularly relevant given the proposed expansion of the role of the audit committee, as directors who sit on the audit committee will be more closely involved in the annual accounts process relative to directors who are not members of the audit committee, and it will be particularly relevant for those directors from a non-financial background). In practice, we do not consider that this is tenable and would urge the Government not to proceed with this proposal.

The Committees do not think it appropriate for ARGAs to be given the power to temporarily ban individuals from being directors. It is a major infraction of someone's human rights to ban them from working (the potential impact for most directors of such a step) without having been through a proper Court process. In practice, commencement of an enforcement process has a huge negative impact on individuals, who may in fact have done nothing wrong. No case has been made to justify such a change. It would be inconsistent with all other regulatory and legal processes on fitness for roles for such a step not to be subject to an appropriate judicial process.

The Government must publish more detail on how these proposals will apply in practice before it takes any further steps in this area, taking into account the comments above, and we would be happy to engage further on these proposals once more detail is available either privately or publicly.

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

We have several concerns with the proposals in paragraph 5.2 which we have set out below.

First, given the significant difference in ease of enforceability between malus and clawback arrangements (malus being easier to enforce from a practical and legal perspective than clawback), we think it is important to be clear on which is being referred to, as section 5.2 uses those terms interchangeably in some places, which does not always make sense, especially as regards to specifying time periods. Paragraph 5.2.4 refers to a period of "two years from an award being made" – does this mean the grant of an award or the vesting / payment of an award? If it means two years from grant for example, for an LTIP this is likely to be in the pre-vesting period and therefore malus (and not clawback) is relevant. We consider that this should be clarified to avoid confusion and unintended impact on how bonuses and LTIPs are structured. Furthermore, to ensure full enforceability under employment legislation, the consent of those subject to malus and clawback arrangements is required and we are therefore unclear on what the Government proposes on ensuring full enforceability.

Second, the sort of ill-defined triggers proposed in the reforms are not appropriate tests for malus and clawback if the UK is to remain a globally competitive business jurisdiction. See further below.

Third, paragraph 5.2.3 suggests that if the provisions are broadly drawn, they can become difficult to enforce. We do not agree that this accords with companies' practical experience and would urge the Government to look at the practice that has developed within the financial services sector. These powers are discretionary, and it seems appropriate to give the remuneration committee wide discretion in this area. This is a separate point to enforceability, which is whether a remuneration committee acts appropriately in exercising its discretion. Investors have a significant range of opportunities to engage with companies and the remuneration committees in order to hold them to account as is regularly witnessed during the PLC AGM season.

Fourth, we note that the proposed triggers in paragraph 5.2.5 are different to (and more extensive than) the triggers which the FCA applies to financial services businesses, namely:

- material employee misbehaviour or material error;
- material downturn in financial performance (firm or business unit) – (malus only); and
- material failure of risk management (firm or business unit).

The extension is not justified in our view as it involves a “one size fits all” approach beyond even the way the UK financial sector (our most heavily regulated sector) is governed. The list proposed in paragraph 5.3.5 contains many areas of potential overlap, for example misconduct / conduct leading to financial loss. In addition, the list is not specific about which triggers require individual fault and which are more general. For example, a business unit might suffer “reputational damage” or “financial loss” but it may be difficult to point to company-wide damage. We also consider that “misconduct” is extremely broad and, for it to be workable in practice, we would expect it to be qualified (for example serious misconduct, or misconduct leading to financial loss / reputational damage).

The proposal to include “failure to protect the interests of employees and customers” is very unclear. It not only goes beyond the section 172 duty to “have regard to the interests of” these stakeholders, but we think it would also be unwise to have a trigger event which solely looks at the interest of those two classes of stakeholders. In addition, we think it would be hard to apply the test in practice. For example, would the test apply if a company had made some employees redundant but paid redundancy pay in accordance with statutory and contractual entitlements? How would the test apply in dealing with employees outside the UK - would it be enough to meet the relevant legislative requirements of a particular country or would companies be expected to meet standards proposed, for example, by the UN or other international bodies if those are higher? How would the test work if, for example, some employees were arguably detrimentally affected by a decision with other employees being treated better as a result?

In light of the concerns and uncertainties highlighted above, we believe that whilst regulatory guidance would be helpful, there is a strong case for giving remuneration committees discretion over establishing appropriate triggers for these malus and clawback provisions.

Chapter 6

35. Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government’s aims to see audit become more trusted, more informative and hence more valuable to the UK?

Yes. We agree that, in theory at least, the quality of a company’s audit could potentially be improved if auditors were required to consider a wider range of information which is relevant to an assessment of whether the accounts provide a true and fair view. We consider that a new statutory requirement would help, but that detailed guidance would be required on what is included in the perimeter of “wider information”, and that this should be very clearly defined. We are also concerned about how this obligation would apply to forward-looking statements (for example, the Resilience Statement) and that the breadth of information which the auditors are required to review could add significant increased costs (and time) to the statutory audit. Auditors cannot be seen as a fix to all corporate risks and they need specific responsibilities not generic ones.

As already noted above and as reflected in our response to question 36 of the Consultation, we are concerned that these additional requirements create an expectation gap as to what an audit can realistically be expected to achieve and that, in particular, it cannot be a guarantee that a company will not subsequently fail.

36. In addition to any new statutory requirement on auditors to consider wider information, should a new purpose of audit be adopted by the regulator, or otherwise? How would you expect this to work?

We think that the proposal to have a non-binding purpose statement that could evolve over time would be preferable to having a binding statement at this stage which does not provide any flexibility.

In line with our response to the Brydon review, we are concerned that some public comments suggest an expectation that a company which has received a clean audit of its accounts should never become insolvent and that the fact that it has become so inevitably indicates a failure by the directors or auditors or both to meet their responsibilities, without any investigation as to whether they have met the relevant requirements and standards of care. It will never be possible to achieve a situation where no company with audited accounts becomes insolvent and it needs to be understood that a company whose accounts have been audited may still become insolvent. We suggest it would be worth considering the inclusion of a statement in all audited accounts that the preparation of accounts and their audit is not (and cannot be) a guarantee that the company will continue to be a viable business. It should also be made clear – possibly through an express statement to this effect in annual accounts – that viability statements and/or going concern statements in their current form and Resilience Statements in their proposed form are equally not a guarantee that the company will remain solvent should circumstances change.

37. Do you agree with the Government's approach of defining the wider auditing services which are subject to some oversight by the regulator via the Audit and Assurance Policy?

Yes. We consider that this is sensible to ensure there is clarity on what is within (and what is outside) the scope of the corporate audit and what other services are to be subject to oversight by the regulator in this regard.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question but are concerned about the risk of a huge increase in bureaucracy and costs without clear parameters for establishing proportionate value and need.

40. Would establishing new, enforceable principles of corporate auditing help to improve audit quality and achieve the Government's aims for audit? Do you agree that the principles suggested by the Brydon Review would be a good basis for the regulator to start from?

We agree that this is a sensible approach. However, it is important to ensure that there is no inconsistency with the existing obligations of auditors.

In addition, we note that one of the audit principles suggested by the Brydon Review is that “*auditors act in the public interest and have regard to the interests of the users of their report beyond solely those of shareholders*”. This principle is very broad and it is important that, if this principle is adopted, the need to “have regard to” the interests of non-shareholders does not extend auditors’ existing duty of care or accountability to all stakeholders who reasonably rely on their audit work and their published auditor’s report (noting that the Courts have considered and ruled on the extent of an auditor’s liability and the principle should not change that legal position). The number of stakeholders who might come into this category is very high and the purposes for which they may rely on the auditor’s report may be very different. The auditor will not know the identity of all these stakeholders or the purposes for which they will use the auditor’s report. If liability were extended in this way, it seems unlikely that auditors would be able to obtain insurance against the potential liability for a reasonable premium. If auditors are unable to obtain insurance at a reasonable premium the cost of audit could become very high and some audit firms might be driven out of the market, reducing competition and choice for companies.

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

Yes. We consider that this proposal is sensible provided that the set of principles are appropriate and that they are not inconsistent with the underlying standards or requirements.

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

Yes. We agree with the principle behind the proposed package of reforms. We note however that no matter what actions the directors or the auditors take in relation to fraud detection and prevention, they will always be at risk of being judged not to have done enough, whether by media commentators or those who are the victims of fraud, and so it is important that the obligations and expectations are very clearly articulated.

Simply increasing the volume of regulation will not stop companies failing or individuals in companies making mistakes or misjudgements, or at times breaching their duties. We also note that there are likely to be cost implications for companies given the increased scope of work for auditors, and that the audit firms will need to train their teams, both in the UK and, for audits of multinational groups, in other jurisdictions, to enable them to comply with these obligations and to be able to sign off on accounts, taking into account the risks involved in doing so. Professional indemnity insurance costs are also likely to rise. We consider that there is a risk that the new disclosures will become boilerplate on the basis of the outcomes of a specific and potentially narrowly focused diligence process designed to allow the disclosure to be made. This may in turn reduce the effectiveness of the proposed reform.

We also note that the increased work required by the company and the auditors may have timing implications for publishing audited results. We query whether BEIS’ recent consultation on improving the quality and value of financial information on the UK companies register (see [here](#)) which proposes to reduce filing deadlines for private and public companies and encourage the publication of accounts more quickly following a year end, has been considered, in light of the increased work for companies and auditors in this area.

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

We assume the “proposed duty” referred to in the question is that set out in paragraph 6.1.10 (and referred to in paragraph 6.5.5), namely a statutory duty “to consider relevant director conduct and wider financial or other information in reaching their judgements”. Such a statutory duty would require auditors to look beyond the description of directors’ conduct in the section

172 statement and to “wider ... information”. If “relevant director conduct” and “wider ... information” are not clearly defined and delineated then we do not see how it would be possible for the auditors to determine what information is relevant to the audit, and, in turn, obtaining that information may be very onerous.

The section 172 statement is a relatively new and separate reporting obligation for companies, and it is not directly relevant to the current audit framework. This question appears misconceived as it suggests that auditor consideration of how the directors have acted in line with section 172 will inform the quality of the directors’ section 172 statement. Whilst the auditor’s consideration of these issues may provide some degree of “check and balance” as against the directors’ own section 172 statement, improvements in section 172 reporting are more likely to come about through market practice and guidance issued by the FRC. We would be interested to hear if the FRC considers that section 172 reporting has improved this year following the FRC Lab Tips (October 2020) and also the FRC’s November 2020 review of Corporate Governance Code reporting. Our view is that section 172 reporting has improved, raising questions of the value of imposing a new burden in this regard so soon after the commencement of this reporting.

The Brydon Review recommended that the auditor should be required to state whether the directors’ section 172 statement is based on “*observed reality, on the basis of the auditors’ knowledge of the company and its processes*”. It is not clear from paragraph 6.5.5 whether the Government is planning to adopt this Brydon Review proposal, or instead whether this will form part of the separate FRC consultation referred to in paragraph 6.5.6. If the Government is proposing to adopt this proposal, we do not see how an auditor could state that the section 172 statement is based on “observed reality” unless the auditor attends all or a significant proportion of the relevant board meetings and is also able to observe the directors’ behaviour more generally when discharging their duties outside of board meetings. This is not a proportionate requirement, nor does it reflect a realistic expectation of what can be achieved in practice. Auditors are already subject to obligations under section 496 of the Companies Act to state whether the strategic report and the directors’ report have been prepared in accordance with applicable legal requirements, and so we suggest that legislation already requires auditors to consider section 172 as part of their review.

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

Yes. In our response to the BEIS Select Committee inquiry into delivering audit reform (see [here](#)), we reiterated our view that it is important that the “true and fair” view wording should not be changed. In forming the “true and fair” opinion, the proposal is that wider disclosures may be required, and that the “true and fair override” which currently exists should be retained. We consider that this is a sensible and proportionate approach.

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

The Committees make no comment on this question.

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

We understand that there are several reasons for this, including: (i) a reluctance on the part of company directors to support proposals which would require shareholder approval; (ii) the fact that the US Securities Exchange Committee does not permit liability limitation agreements (which will be relevant to some of the largest companies); and (iii) the approach of institutional

investor bodies who have been opposed to these for some time. We understand therefore that the Big Four firms have not been actively seeking to agree LLAs.

We suspect the possibility of significant liability for both the Big Four and Challenger firms acts as a disincentive to compete for PIE audits, particularly given that this may impact the cost of their insurance premiums. We cannot have an outcome whereby firms will be reluctant to audit businesses with greater risks. One potential solution to this issue might be a reform of the law, so that an auditor is only liable for its proportionate share of the liability (rather than a firm being at risk for all of the liability and having to bring contribution proceedings against others who are also liable).

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

Auditors and companies are better placed to comment on this, but litigation risks and regulatory enforcement risk by FRC/ARGA are major considerations for auditors and it seems likely that further exposure would increase risk aversion and innovation.

- 48. Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.**

The Committees make no comment on this question.

- 49. What would be the best way of establishing a new professional body for corporate auditors that helps deliver the Government's objectives for audit? What transitional arrangements would be needed for the new professional body to be successful?**

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

Yes. It would make no sense, if pursued, to duplicate audit regulations.

Chapter 7

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

No. That would involve dictating how directors fulfil their duties in an overly prescriptive way. Paragraph 7.1.15 states that the additional requirements will cover "*the need for audit committees to continuously monitor audit quality, and consistently demand challenge and scepticism from auditors*", and further that "*it will be for ARGA to consider how the new requirements it develops will fit alongside the existing obligations which apply to audit committees*". However, there is no further detail on what the requirements will entail, and we are keen to understand (and comment on) the requirements in due course. In particular it is not clear what might be required of non-executive directors sitting on the audit committee in terms of "continuously monitoring audit quality".

We do however support the power for ARGA to issue non-legally binding guidance in this area.

We previously questioned, in our response to the CMA Review, whether more regulation is the best means of dealing with the issues identified by the CMA. Regulation can be inflexible, requires legislative time, can have unintended consequences and can increase bureaucracy. Our view was (and remains) that it would be preferable to build on the acknowledged success of the UK's corporate governance regime and for ARGA to issue guidance covering the areas of concern. Audit committees might then be required to confirm the extent to which they have complied with the guidance, and, where they have not, to explain the reasons why not. Experience in other areas of corporate governance suggests that, with a "comply or explain" regime, reported levels of compliance are very high (because few companies wish to be forced to admit publicly that they do not comply) and that examples of best practice are soon adopted more widely. We remain unconvinced that making standards/requirements legally enforceable necessarily leads to better or higher levels of compliance (particularly with regard to the spirit as opposed to the letter of the requirement in question) or better outcomes for relevant stakeholders. As such, we would encourage the Government to provide that ARGA implements the additional requirements by updating the existing FRC guidance for audit committees and providing examples of best practice as appropriate.

If the Government determines that additional requirements need to be imposed by ARGA as regulatory rules, it is very important that they are clearly articulated, proportionate and consistent with other relevant regimes. We are very concerned that if the enacted proposals go much beyond the current scope of regulation and practice in other comparable regimes, the attractiveness of the UK as a place to establish companies and to carry on business may be adversely affected.

We note that it is proposed that the requirements should apply to FTSE 350 audit committees. There can be a significant variation between a FTSE 100 company and a FTSE 350 company, and any requirements should be proportional and take account of this.

See also our response to question 53 of the Consultation.

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

As noted above, no detail has been provided on what the requirements will be and so without the detail of the requirements, it is not possible to provide an appropriately considered response to a question relating to compliance. We would urge the Government to publish the detail as part of a further consultation. As a general comment, proportionality will be extremely important. The reforms proposed would represent a considerable extra burden on audit committees, while the expected benefit as yet remains unclear. We are seriously concerned that these powers would impact on the principle of collective board responsibility, and could also deter the best talent from agreeing to become a member of the audit committee of a publicly listed or traded company in light of the additional burden they will impose and the attendant risks of liability and/or reputational damage given the lack of clarity over what is required of them.

We do not believe it is necessary or desirable for ARGA to have the right to place an observer on an audit committee. In practice, the presence of an outsider, particularly one from a regulator, is likely to have an artificial and potentially chilling effect on any meeting and will not necessarily give the observer a true understanding of the committee, its members or the business it is transacting. The presence of the regulator on an ad hoc basis is in practice likely to inhibit a full and frank exchange of views which will always be critical for an audit committee, particularly when it is meeting the company's auditors, and may result in a "tick box" mentality and approach. An observer is also unlikely to have sufficient information on the company's business and audit process, including past audit decisions, to be able to make a fully informed assessment of the audit committee and its compliance with any new requirements. We are not clear, in any event, what powers it is intended the observer or ARGA would have as a consequence of an adverse assessment or indeed the circumstances in which ARGA would be able to exercise the power to appoint an observer in the first place.

We note that ARGA would have the power to take remedial steps publicly and we are concerned about how this power would be exercised in practice, and in particular how the need to ensure that appropriate safeguards are put in place (including in relation to commercially sensitive information) will be dealt with. We also think it will be critically important that the company will have an opportunity to dispute any steps ARGA requires or proposes and is able to follow an appeal process before ARGA issues a public notice. Otherwise, ARGA's power to issue a public notice could in practice mean that a company would be forced to follow ARGA's proposal even if it believes this is inappropriate or that ARGA has misunderstood the position and would likely feel compelled to state this publicly in order to discharge other aspects of its responsibilities whilst following the course of action required of it by ARGA.

In addition, we note the proposal in paragraph 7.1.18 that ARGA would give the audit committee the opportunity to address any issues of regulatory concern before taking remedial steps publicly. In addition to our comments above regarding taking these steps, it would be inappropriate for ARGA to take any steps prior to engaging with the rest of the board of directors, and at the very least, the chair of the board. We suggest that any correspondence between ARGA and the audit committee should also be copied to the chair of the board.

We are also concerned by the scale of the task that might be given to ARGA in relation to audit committees. The proposals will require ARGA to have skilled staff who are able to apply the new regulations and to monitor compliance, and there will be associated costs. Thought needs to be given to where these resources are to come from, not just for ARGA, but it will also be necessary to ensure that there is the availability of sufficient resource (monetary or personnel) within companies (particularly smaller ones) to comply with extensive new regulation.

We also have concerns about the reference to making direct statements to shareholders. Again, we think it is important that much more detail is given about the circumstances in which this would happen, what the statements would cover and how these would fit with the company's obligations under the Listing Rules or other regulatory requirements.

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

No. We agree with the Government that it is not appropriate to give ARGA independent powers of appointment. It would be a significant and, in our view, disproportionate step to compel auditors to act and we consider that the right of appointment would only work effectively if combined with an ability to compel auditors to act in this circumstance. We also do not think it would be appropriate to provide flexibility now for ARGA to be given such powers in the future. We think it would be better to consult on such powers at a later stage if it is felt that there is sufficient evidence to justify them.

In particular, we consider that there is already a process set out in provision 4 of the Corporate Governance Code to deal with the circumstance where 20 per cent. or more votes are cast against an auditor appointment. We do not consider that any further interim step is required between auditors not being appointed (i.e. as a vote of greater than 50 per cent. against their appointment has been cast) and the current process set out in provision 4 which also requires an update on shareholder views and actions taken to be published within six months of that vote being cast.

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

See our response to question 54.

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

See our response to question 54.

If the Government decides that ARGA will have the power to appoint an auditor, there will need to be robust information barriers in place to ensure that there are no conflicts of interest in ARGA's regulatory oversight role versus its appointment role.

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

The Committees make no comment on this question.

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

Yes. We are broadly supportive of these proposals if they are brought in by way of a change to the UK Corporate Governance Code and/or associated guidance on audit committees. However, we also note the intention set out in paragraph 7.3.7 that ARGA will be "invited to consult on these changes" and we are not sure if that suggests that more than a change to the Corporate Governance Code is contemplated. As such, we would welcome further clarity on the proposals themselves, as well as on the proposed implementation plan.

We are supportive in principle of the proposal that the board engages with shareholders on the audit plan, and for the audit committee to report on which shareholder suggestions put forward for consideration have been accepted or rejected by the auditor. We consider that it is important that the views are sought by the board of directors (and not the audit committee, as a committee of the board). This is to ensure that the relationship established by company law between (i) shareholders and directors (ii) the board's collective responsibility for decision-making and (iii) the relationship between directors and other stakeholders is not compromised.

We also consider that it is very important that the shareholder views are advisory only in nature given the existing courses of action open to shareholders who wish to raise issues at a shareholder meeting. Under the Companies Act, and subject to certain thresholds, shareholders already have the ability to propose a resolution at a shareholder meeting (which could relate to matters to be covered in the audit) and to have a statement circulated in advance of the meeting and, if the company is a traded company, to include something in the business to be dealt with at the AGM.

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

Yes. We agree with the proposal that ARGA should revise its guidance to audit committees to encourage questions from shareholders at the AGM about the company audit, and to encourage attendance by the audit committee chair and senior auditor. We would however note that such attendance at the AGM is already commonplace – particularly among larger listed companies.

We note that the FRC in particular has been very focused on the importance of shareholder engagement at AGMs. However, our experience to date (this year in particular, where many companies have offered virtual engagement options) is that meaningful engagement with

shareholders does not typically happen at an AGM but rather in ongoing dialogue throughout the year. As such, we also consider that revising the Stewardship Code to promote greater engagement from investors on matters relating to audit quality is a sensible approach.

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

We note that paragraph 7.3.13 states that it was found to be very rare for the auditor's statement to go into any significant detail about their reasons for ceasing to hold office and that generally the existing process was thought not to serve to inform shareholders in practice. Whilst we consider that the existing legal framework is not deficient, we agree that practice is mixed and that auditors may benefit from clearer guidance on the level of information to be provided to shareholders and ARGA when they resign or are removed.

Chapter 8

General comments on this chapter

We believe that high quality audits should remain the pre-eminent aim of the reforms in this area. We note the aims of the reforms are to "*increase choice, competition and resilience in the audit market*". Whilst we agree these aims are important, they are secondary to the aim of high-quality audits. Audit committees (and shareholders) should be permitted to select the auditor they believe will be best able to deliver a high-quality audit. They should not be shackled in achieving that aim by being forced to appoint a lead auditor and a Challenger firm as part of an education exercise to improve audit competition in the future. It is inconsistent on the one hand to seek to impose more regulation on audit committees with the aim of achieving higher quality audits, but on the other to force them to appoint additional auditors where they may not consider that such an appointment will deliver that quality. The recent FRC sanctions against Haysmacintyre underline the concerns about Challenger firms' capabilities to act on complex audits. We also note that the concern about the systemic risk of having a concentrated number of auditors is not unique to the UK – this problem exists elsewhere (including in the US) and yet we are not aware of other jurisdictions proposing such radical reforms to increase competition in the audit market.

In response to BEIS' consultation on the CMA recommendations, we considered that a better proposal would be to use peer reviews targeted to particular companies where there are doubts about the efficacy or quality of a particular audit. In addition, every FTSE 350 company might be required to undergo a peer review on a periodic basis (say, every five years). Such reviews would ensure high quality audits and, if carried out by a capable Challenger firm, would also serve the CMA's purpose of providing experience of more complex audit issues. We continue to consider that this would be the best approach to solving the issues in this area in preference to the proposed managed shared audit regime.

However, if the Government decides to proceed with the managed shared audit regime, the following risks will need to be addressed:

(i) paragraph 8.1.12 notes that the audit firm appointed to lead the group audit will bear "overall liability" in situations where a Challenger firm has conducted a "*meaningful proportion of statutory audits*". As the lead firm will need sufficient comfort on the Challenger firm's audit of subsidiaries before assuming this liability, the proposal will lead to duplication of work and therefore significantly increased fees for companies. Is it reasonable and proportionate for the lead firm to bear liability for the Challenger firm's work?;

(ii) the requirement for the lead firm to assume overall liability also appears to run counter to the concerns set out in paragraph 8.3.18 about risks to audit firm resilience arising from legal

liability, and the consequential impact on choice for FTSE 350 companies should a large audit firm fail. The proposal exacerbates these concerns; and

(iii) paragraph 8.1.17 suggests that the company will be required to appoint the group and Challenger firms independently with no joint bidding. Given that companies will bear increased costs as a result of these proposals, audit committees should be allowed to take steps to ensure the two firms will work efficiently and effectively together to maintain robust audit quality and reduce the impact on overall fees. In addition, we wonder whether the impact of these proposals would be mitigated if audit committees were permitted to engage with both firms on these issues during the tender process.

One practical step which could be taken to mitigate the difficulties outlined above would be to allow the lead audit firms to “partner” with a small number of Challenger firms to build relationships over time, share knowhow and gain comfort as to each other’s capabilities and processes.

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

Please see our general comments above on this chapter.

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

One step (as mentioned in our general comments on this chapter above) would be to allow lead firms to partner with one or a small number of Challenger firms to help build relationships and capability. This would have the benefit of allowing the lead firm to gain some degree of comfort vis-à-vis quality assurance and managing liability risk on audits and might help Challenger firms build capability/skills etc. more effectively.

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

The introduction of a managed market share cap would be a highly interventionist and complex remedy that would be difficult to design and enforce. In addition, the company is likely to bear increased risks and possibly higher or duplicated costs as result of being required to appoint a Challenger firm where that firm is not its first choice (e.g. in terms of experience, capabilities (whether technical, sectorial or international) and cost) and/or may be constrained in its ability to conduct audits within certain industry sectors or across international groups etc. We consider that this proposal may be practically difficult to implement given existing capacity constraints within the audit market and is disproportionate at this stage.

64. Do you have any further comments on how the operational separation proposals should be designed, codified (in legislation and regulatory rules), and enforced in order to achieve the intended outcome of incentivising higher audit quality?

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

- 67. The Government believes these proposals will meet its objectives. In the event that they prove insufficient to improve audit quality, and full separation of professional services firms is required, do you have any comments on how to make this work most effectively?**

The Committees make no comment on this question.

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

The Committees make no comment on this question.

Chapter 9

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

No. Legal professional privilege ("LPP") is a long-established and fundamental common law right and a human right under English law. LPP is a right, not of lawyers, but of clients, whether individuals or corporates. It is a necessary corollary of every person's right to seek legal advice and, as such plays a crucial role in the proper administration of our justice system. The

protection that LPP affords to legal advice is also an essential component of an effectively governed company operating within a well-ordered and functioning legal system. It is of paramount importance that companies, and especially public companies, take legal advice whenever it is prudent to do so in order to act in accordance with their legal and regulatory obligations to all stakeholders and can be confident that this advice is appropriately protected by LPP.

LPP, as a fundamental right, must take primacy over other considerations, including the manner in which regulators, including ARGA, exercise their oversight functions. To adopt an extreme example to emphasise the point, even a person on a murder charge is unable to avail themselves of another's privileged material in order to seek to establish their innocence (*R v Derby Magistrates' Court* [1995] 4 All ER 526). Similarly, criminal prosecutors exercising their statutory function of bringing criminal conduct to justice are not entitled to compel disclosure of communications protected by LPP. In our view, it would therefore clearly be disproportionate and inappropriate to allow an exception in the context of audit regulation. In any event, it is not as if any case has been made to the effect that the ability to properly regulate in this area has in any way consistently and seriously been hampered by an inability to access another's privileged material, an inability which has long applied to all regulatory (and criminal justice) agencies in the pursuit of their statutory functions.

In circumstances where a company holds material protected by privilege which its auditor requests to see, it is open to that company either to: (i) provide the material pursuant to a limited waiver of privilege to the auditor for the sole purpose of the audit only and share on a confidential basis (and in circumstances where the auditor agrees to receive the material on that basis); or (ii) seek to provide the auditor with the information it requires via the sharing of alternative, non-privileged information; and/or (iii) refuse to provide any such information (as enshrined under section 499(4) of the Companies Act). If privileged material is not disclosed, that material should equally be protected as privileged in the hands of the audited entity. It remains open to the auditor to issue a qualified audit opinion if the auditor has, ultimately, been unable to obtain the requisite audit evidence.

If a company does provide to its auditor material that is protected by LPP, provided it does so pursuant to an effective limited waiver of privilege, that material should be protected from disclosure by the auditor to any third party (including any regulator). Furthermore, the provision of such material, including to a regulator, risks the complete waiver of privilege in respect of that material, particularly if the regulator may bring that information into the public domain in exercising its functions. The practical effect of compelling auditors to disclose privileged materials to any regulator would inevitably be a swift and increasing reluctance for companies to share privileged materials with their auditors. Any such trend could be detrimental to the quality of audit and not assist with the enhancing of it.

The risk to companies of the potential waiver of legal advice must not be under-stated: in some situations the wider disclosure of privileged material could lead to collateral litigation and investigations bringing with it a very extreme threat to the company (especially bearing in mind also that the litigation risk for a company is not limited to claims before the UK Courts). It is easy to foresee that any incursion into the sanctity of the legal advice received could lead to a reluctance to seek (sometimes much needed) legal advice at all. Put simply, in many cases the risk of wider disclosure would be too great.

Chapter 10

General comment on this chapter

We note that paragraph 10.1.29 states that "*ARGA will also have a range of broader functions to which its objectives will not necessarily apply, for example, when exercising its enforcement functions in relation to competition*". We would welcome clarity on what this range of broader functions will be as there does not seem to be any detail included on this in the Consultation. We would also welcome further clarity generally on ARGA's operating procedures, policies, checks and balances, all of which will be relevant to understanding how the proportionality principle will be respected and the reasonableness of the regime for which ARGA is responsible.

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

No. We consider that the revised general objective is too broad as it is not clearly confined to the areas of responsibility which ARGA will have. In addition, it is not grammatically correct as drafted. We suggest that the “general objective” and the “quality objective” be brought together, for example: *“To promote high quality audit, corporate reporting, corporate governance, accounting and actuarial work in order to protect the interests of investors, other users of corporate reporting and the public”*.

In addition, paragraph 10.1.19 of the Consultation suggests that ARGA’s competition and quality objectives are given equal priority. We query how ARGA will exercise its functions whilst avoiding a conflict between its duties (as steps to improve quality will not necessarily advance competition and vice versa). We consider that it would not be appropriate for two potentially conflicting duties to be given equal weight and so suggest that in cases of conflict the quality objective should take priority over the competition objective.

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

We have the following comments on the regulatory principles:

(i) we do not consider that “promoting innovation” is an appropriate regulatory principle, and suggest that this is redrafted as “advances quality improvements, including through the use of innovation”;

(ii) we suggest that “Promoting brevity, clarity and usefulness in corporate reporting” is redrafted to say “Promoting concise, clear and useful corporate reporting” as the inclusion of “brevity” would arguably mean that the principle is compromised every time a new reporting obligation is introduced; and

(iii) we also consider that ARGA should have the same principle as applies to the FCA and PRA under section 3B of the Financial Services and Markets Act 2000, namely “the desirability of sustainable growth in the economy of the UK” (see section 3B(c) of FSMA 2000).

Chapter 11

76. Should the scope of the regulator’s oversight arrangements be initially confined to the chartered bodies and should they be required to comply with the arrangements?

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

- 79. Should the regulator be able to set and enforce a code of ethics which will apply to members of the chartered bodies in the course of professional activities? Should the regulator only be able to take action where a breach gives rise to issues affecting the public interest? What sanctions do you think should be available to the regulator?**

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

The Committees make no comment on this question.

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

We consider that it is important that auditors provide disclosures to ARGA where this is required. However, without statutory protection in respect of breach of duty claims, we are concerned that auditors would be less likely to disclose.

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

We welcome the Government's decision that any new powers to address serious concerns in PIEs should be limited to corporate reporting and audit. Companies will need to have the benefit of clear policy and guidelines on how these powers will be exercised.

The length of time required to reply to a request will depend on the complexity of the query. For example, if ARGAs queries the amount the company has stated as being its distributable profits and the company needs to check the calculations that were done, this might take some time, depending on the complexity of the group's arrangements. We do not think it would be possible for ARGAs to set one time period that would apply to all the different explanations it might require. We suggest therefore that there should be a default minimum period of at least four weeks in which an initial response is to be provided with as much detail as is practical within that timeframe, but with a requirement for ARGAs to assess the appropriateness of that period and to have the power to extend it or grant an additional follow-up period at its discretion (acting

reasonably and proportionately). In making this assessment, ARGA should have regard to the volume of information, the complexity of the issues, any submissions received from the company and its advisers, and any other applicable circumstances. If, as the Committees suggest, the default minimum period is set at four weeks and the request involves a relatively simple issue, the company may be able to respond within that timeframe, and may well be motivated to do so in order to resolve the issue promptly.

A default minimum period with scope for extension would provide companies with a degree of certainty as to how long they might have to respond, whilst also incorporating flexibility to ensure that, where ARGA requires an explanation which the company believes it will not be able to provide (or provide in full) within the prescribed time period then the company would be able to approach ARGA and outline when it thinks it will be able to give the explanation, with a description of the work it thinks it needs to do to provide the explanation requested etc. and ARGA would have the flexibility to allow for an extended period. In practice many issues are likely to require an iterative process with interaction between the company and ARGA in any event.

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

We consider that if ARGA has the power to commission an expert review, it will be important for companies to understand clearly the circumstances in which an expert review may be requested (not least, because the company will be paying for it). In particular, we note that the Government considers that ARGA should have "significant discretion" as to when it would be appropriate to commission an expert review. We consider that any decision to commission an expert review must be based on reasonable evidence and the scope of the review must be reasonable, taking account of the potential problem identified, its importance to the company and its shareholders and the expected cost of the review to identify and address the problems.

Before these proposals are implemented we would welcome the opportunity to review the detailed implementation plan, and in particular to understand more fully what checks and balances would be put in place to ensure that the powers are used appropriately and that the principle of proportionality is respected. In addition, we suggest that the proposed power to require an expert review where ARGA has identified concerns as to whether a PIE's corporate reporting and audits comply with any requirements enforced by ARGA should make it clear (as the Consultation does) that the purpose of the skilled person review is to identify and address concerns relating to the corporate reporting and audit.

As regards the ability to publish an expert report, the Committees note the following:

(i) It is unclear whether the tests referred to in paragraph 11.4.33 as to when ARGA could publish a report are cumulative or not. In our view, giving ARGA power to publish a report could, without appropriate checks and balances, mean that in practice companies will agree to ARGA's proposals even if they think they are disproportionate in order to avoid publication. We therefore consider that there should be an appeal process for companies prior to ARGA having the ability to publish a report.

(ii) As the Government has pointed out, the FCA and the PRA do not publish their reports. We consider that if ARGA has the power to publish a summary of the expert report, then it is very important that the ramifications of this are considered in the context of other regulatory requirements and any other litigation or regulatory proceedings which might be ongoing or instigated in the future. In addition, we consider that this power should be a way of improving standards rather than undermining confidence, and so should be used on an exceptional basis only. We therefore consider that ARGA will need to publish guidance as to how it will weigh a decision on whether publication of a summary report is in the public interest or not. We can envisage cases where ARGA may believe there is a public interest in publication that goes beyond the interests of the company (for example, because of the subject matter dealt with). In such cases, we wonder if it would be better for ARGA to include information in its annual report without identifying the company in question, or that ARGA's right to publish a summary on a named basis only applies where it is in the interests of the company and its shareholders for this to happen.

(iii) The publication of summaries of reports on a named (or identifiable) basis would likely trigger disclosure obligations on the part of a listed company. Ensuring that any such disclosure, when read together with the summary report, is fair, balanced and not misleading may be challenging in the circumstances, particularly if there are other ongoing litigations or regulatory proceedings.

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

We do not consider that additional powers are required. If however, the Government determines that there should be additional powers, we consider that it is very important that there is clarity as to what constitutes "significant non-compliance", and what the consequences of this might be.