



Financial Reporting Council

Restoring trust in audit and corporate governance

The FRC's approach and next steps

July 2022

Speakers



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Restoring trust in audit and corporate governance

Government Response

- The Department for Business, Energy and Industrial Strategy (BEIS) published its consultation, *Restoring trust in audit and corporate governance*, in March 2021.
- BEIS received over 600 responses from stakeholders and began reviewing them when the consultation closed in July 2021.
- The Government Response to the consultation was published in May 2022, and includes:
 - which proposals BEIS intends to take forward
 - which proposals it has amended or dropped
 - how the changes will be implemented



Restoring trust in audit and corporate governance

Government Response

What's in and what's out – key changes



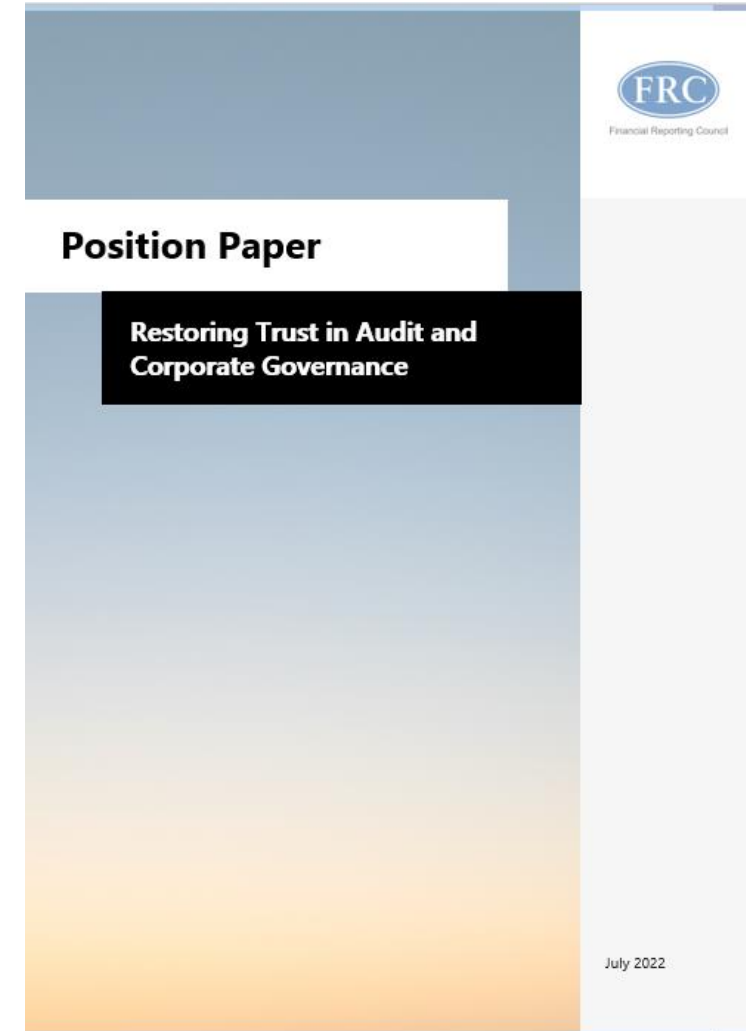
Audit and corporate governance reform

FRC Position Paper

We have just published our Position Paper, providing clarity on how the FRC will address issues in the Government Response which fall within our remit.

It allows our stakeholders to understand how that work will be delivered by building on the 'what' in the Government Response, and explaining 'how' and over what period.

Our ongoing stakeholder engagement will also allow us to ensure that the reforms do not cause unforeseen consequences, and ultimately that they can be delivered by those we regulate in a way that meets legitimate public expectations but without disproportionate cost or burden.



Audit and corporate governance reform

FRC Position Paper

Our Position Paper sets out how the FRC will support the Government's reforms as we transition into the Audit, Reporting and Governance Authority (ARGA). This focuses on five broad areas:

- Revisions and additions to the existing suite of Codes, Standards and Guidance to implement reforms
- The development of new standards in shadow form to allow for voluntary adoption ahead of legislation e.g. minimum standards for audit committees
- Setting expectations for the markets we regulate to drive behavioural changes ahead of statutory powers, following the successful approach we have taken regarding the Operational Separation of the Audit Practice in the largest UK audit firms
- The development of guidance to address issues set out in the Government Response, subject to that guidance meeting the bar set by Sir John Kingman, that ARGA should be sparing in its issuance of guidance and focused on those areas where it has expertise
- Setting high-level expectations around the future supervision and monitoring activities which will flow from the proposed revisions to existing Codes, Standards and Guidance and the creation of any such new documents

Corporate Governance & Stewardship

Next steps

Corporate Governance & Stewardship

Next steps

The UK Corporate Governance Code

The UK Corporate Governance Code is a highly effective driver of good governance and has been replicated in many other jurisdictions. In our view, it is successful because it is principles-based and flexible.

It is important that, in revising the Code, it is not used as a convenient vehicle to add requirements that diverge from its underlying principles. The focus of revisions to the Code will therefore be:

Providing additional support in the existing Code provisions, where reporting is currently weaker, taking account of issues raised in our recent research and reports

Revising parts of the Code relating to the need for a framework of prudent and effective controls to provide a stronger framework for reporting on and evidencing the effectiveness of internal control around the year end reporting process

Making necessary revisions to reflect the wider responsibilities of the Board and Audit Committee for expanded sustainability and ESG reporting and, where commissioned by the company, appropriate assurance in line with a company's audit and assurance policy

Including a provision for boards to consider how audit tendering undertaken by the company takes account of the need to expand market diversity

Updating the Code to cover proposed changes to legal and regulatory requirements as set out in the Government Response, including strengthening arrangements around reporting on malus and clawback

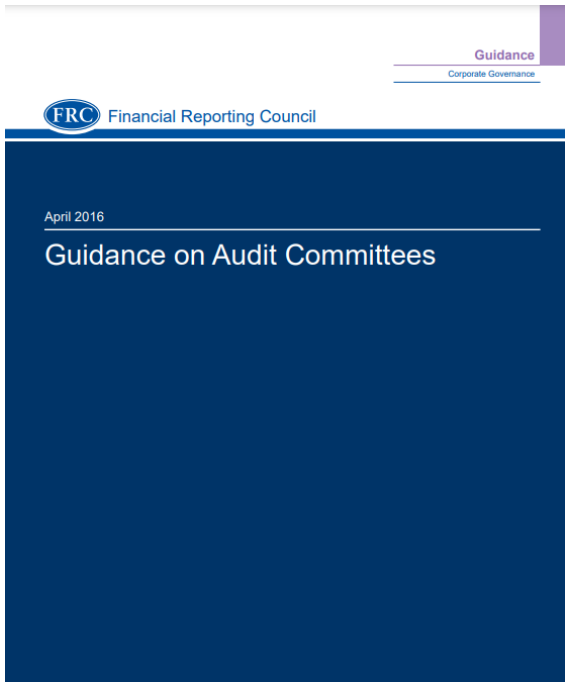
Corporate Governance & Stewardship

Next steps

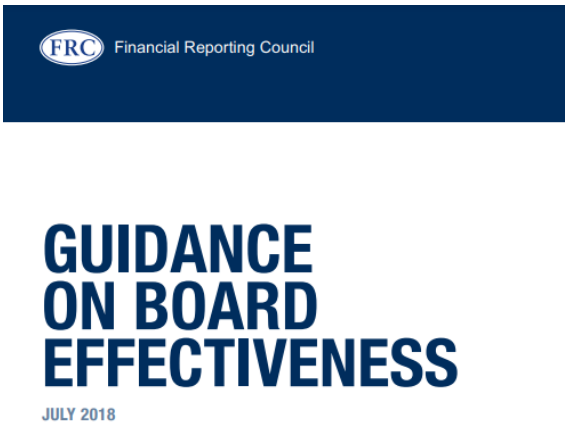
Guidance

The revised Code will be supported by updated guidance to align with the revised Code and to support the reforms in the Government Response, as well as a third guidance update to take account of changes to Principles and Provisions on internal control and its effectiveness:

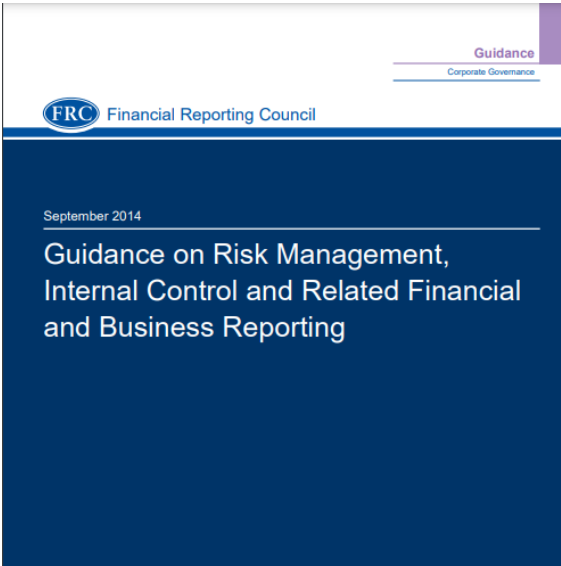
Guidance on Audit Committees



Guidance on Board Effectiveness



Guidance on Risk Management, Internal Control and Related Financial and Business Reporting



Corporate Governance & Stewardship

Next steps

Minimum standards for audit committees

We will develop for use, initially on a voluntary basis, a set of minimum standards for audit committees, setting out expectations on how audit committees should work to address the issues raised in the CMA's report.

Where possible, these standards will consolidate multiple pieces of existing guidance and provide a single source of information.

They will also address how audit committees can support greater market resilience and diversity when tendering for audit services ahead of legislation.

We will look to hold roundtables with stakeholders in the **second half of 2022** to develop these standards, so they are available to Committees for **2023 financial year ends**. Supervision against the standards will commence in **c.2024**.

Supervision

When ARGAs are created, the scope of our Supervision division's Corporate Reporting Review team will extend to the whole annual report and accounts.

While the precise legislative detail regarding the content which will constitute the 'annual report' for these purposes has yet to be published, we expect that corporate governance disclosures will be in scope.

We intend to commence formal inclusion of these disclosures from the first year of Code implementation.

In the meantime, we will continue our inclusion of corporate governance reporting in a sample of routine reviews, initiate a pilot for remuneration reporting, and seek to engage with companies on a voluntary basis.

Corporate Governance & Stewardship

Next steps

UK Stewardship Code

We are not proposing to consider any further revisions to the Stewardship Code in this period.

The Government has confirmed that the FRC – working with the Financial Conduct Authority, the Department of Work and Pensions and the Pensions Regulator – will carry out a review of the regulatory framework for effective stewardship including the operation of the Code in the latter part of 2023, to allow two full years of reporting under the revised Code.

Corporate Reporting

Next steps

Corporate Reporting

Next steps

The changes proposed in the Government Response will require either primary or secondary legislation. In the meantime, we will work to support the reforms by developing implementation guidance for:

- The Resilience Statement
- Fraud Reporting by Directors
- The Audit and Assurance Policy and related disclosure requirements
- Capital maintenance and dividends, including distributable profits, to succeed the existing ICAEW/ICAS guidance

We will also revise our guidance on the Strategic Report in recognition of the significant changes and the expansion in proposed reporting to ensure that the Strategic Report is a source of decision-ready information.

To minimise the need to revisit guidance, we will delay completion of this work until the Government has set out its policy in respect of the use of International Sustainability Disclosure Standards in the UK, so that this can also take account of reporting changes that will be driven by their implementation.

In finalising the timing of this work, we will be informed by our stakeholder engagement and market needs.

Corporate Reporting

Next steps

Reducing regulatory burden

As the Government considers its legislative programme, we will work closely with colleagues at BEIS to propose, for their consideration, ways to reduce the current non-financial reporting burden on companies.

We have already been looking at opportunities to simplify and improve reporting requirements, subject to legislative approval, while making sure the quality of information available to users of corporate reporting including both financial statements and the front half of the annual report is not affected.

Supervision timing

Subject to the extension of Corporate Reporting Review powers, we intend to include new reporting disclosures in our review processes from the date at which any new reporting requirements commence. We will pilot the inclusion of some non-financial reporting such as corporate governance disclosures and remuneration reporting ahead of legislation.

We also intend to expand our 'What makes a good...' series to include 'What makes a good annual report'.

We will continue to publish CRR case outcomes on a quarterly basis, including reference to any findings related to non-financial disclosures where appropriate.

Audit

Next steps

Audit

Next steps

The fundamentals of what an audit is will remain unchanged, as the Government has chosen not to expand the scope of an audit.

However, we will consult on changes to address some of the policy points in the Government Response through revisions to standards, including revisions to our Ethical Standard to reflect:

- stakeholder feedback
- evidence gathered through our inspection programme
- our enforcement work

Our intention is that the effective date for changes will align with the effective date for changes to the Code of Ethics, meaning we will consult on a revised standard in **Q1 2023**, with supervision following the respective commencement dates.

Supervision

Our Supervision division will continue to build on its engagement and outreach with Audit Committees, seeking improvement in audit quality incomes.

Significant changes to the Ethical Standard will include:

Revisions to take account of the new proposed framework containing three levels of PIEs: historic; new proposed UK PIEs; and new PIEs caught as a result to the changes to the international definition	Changes to address those situations where the role of Those Charged with Governance is discharged by the Board, in the absence of an Audit Committee
A consultation on whether to exclude sustainability assurance work carried out in accordance with a performance standard adopted by the FRC from the UK aspect of the non-audit services fees cap	Revisions driven by international changes to the fees and non-audit services sections of the Code of Ethics
Consulting on whether to maintain the 'Other Entity of Public Interest' definition	Revisions to simplify and clarify provisions incorporated as a result of European Law in 2016
Necessary revisions to address issues identified as a result of our Supervision and Enforcement work	Any changes necessary to address the expansion of audit-related assurance work driven by sustainability and ESG, and the proposals around an audit and assurance policy

Audit

Next steps

Significant thought has been given in the Government Response to the useability and informativeness of the audit process to stakeholders.

Addressing these issues will require consultations in a number of existing ISAs (UK), with our approach being to minimise divergence between the UK and international standards.

The scope of the revisions will mainly focus on:

- Auditor Reporting Standards – ISAs (UK) 700, 701 and 720
- Auditor Communication Standards – ISAs (UK) 260 and 265
- Auditing Standards covering Law and Regulation and Reporting to Regulators, including Brydon’s recommendations on a ‘duty to report’ – ISAs (UK) 250 sections A and B
- Conforming amendments to other ISAs (UK)
- Necessary updates to Bulletins and Practice Notes in support of revised standards and to provide illustrative reports

Timings

We will consult on proposed guidance in the form of performance standards to support a consistent approach to assuring internal controls reporting and the new resilience statement. We expect the effective date to align with the revised Ethical Standard.

We will develop and consult on a policy paper setting out our approach in respect of the Government’s proposed market resilience/competition objective for ARGAs, and the work we will be doing to prepare ahead of legislation.

Having consulted on a new PIE auditor registration process in Spring 2022, we expect to transition to the new process from **Autumn 2022**.

The Government Response noted that existing professional bodies should make substantial improvements to audit qualification, training and skills. This is not dependent on legislation and our Professional Oversight team will lead engagement including consultation in **late 2022/early 2023** with implementation across **2023 to 2024**.

Actuarial regulation

Next steps

Actuarial regulation

Next steps

The Government has proposed strengthening the actuarial regime by putting it on a statutory footing, similar to other regulated professions, including a risk-based monitoring scheme to assess the quality of actuarial work.

In doing so we are keen to engage with existing regulated actuarial communities and any new stakeholders which will come into scope in preparation for ARGAs.

Pending legislation, we will begin implementing the new regime in time for ARGAs' effective date. This will include:

- Establishing what actuarial work should be considered as being of public interest, and therefore within ARGAs' statutory regulatory scope
- Concluding our post-implementation review of the FRC's Technical Actuarial Standards
- Developing and implementing a risk-based monitoring framework
- Reviewing the actuarial disciplinary scheme and preparing new guidance and operating procedures for ARGAs' actuarial enforcement role
- Setting out the regulatory standards that ARGAs will expect actuarial professional bodies to adhere to
- Preparing Memoranda of Understanding with other sectoral regulators

Local Audit Systems Leader

Next steps

Local Audit Systems Leader

Next steps

ARGA will be the systems leader for local authority financial reporting and audit. We have recruited a director to lead this work, and our priorities are currently:

- Carrying out stakeholder outreach to determine priorities and early action areas for the systems leader
- Working with colleagues in the Department for Levelling Up, Housing and Communities (DLUHC) and the National Audit Office to facilitate the transfer of the Code of Audit Practice, when legislation allows
- Working with the DLUHC, the Treasury and CIPFA LASAAC to determine whether the current complex financial reporting framework for local authorities can be simplified, while still meeting the Treasury's reporting requirements in support of the Whole of Government Accounts
- Building on the success of Practice Note 10 for the Central Government Sector, by consulting on proposals for a specific practice note for local public audit in England

We have issued revised guidance to the Recognised Supervisory Bodies for recognising Key Audit Partners for local audit, which is applicable now.

Our new Director of Local Audit will join in **September 2022**.

Professional oversight

Next steps

Professional oversight

Next steps

The Professional Oversight team will support the transition of the Independent Supervisor role to an appropriate Parliamentary body, working with BEIS to achieve this.

Shadow arrangements have been put in place for the 2021 reporting cycle, and these will continue in 2022.

Progress on reform

What's next?

Progress on reform

What's next?

Implementation support

To further support implementation around corporate reporting, the FRC Lab will carry out a series of projects to assist the development of the new reporting requirements set out in the Government Response (including resilience statements, capital maintenance disclosures and audit and assurance policies).

We also propose to use our newly developed Audit Sandbox to assist with the implementation of new or revised requirements in auditing and ethical standards.

It will provide a safe, regulatory space to allow for auditor-regulator dialogue on audit and competition policy related issues.

Funding

The Government intends to give ARGAs statutory funding so that they can operate on a sustainable and independent basis.

ARGAs will be empowered to make rules requiring that market participants pay a levy to meet the costs of carrying out their regulatory functions.

Implementing a new statutory funding model is a complex exercise, and we intend to invite views this summer on the high-level principles on which ARGAs' funding model should be based.

Legislation and timing

A significant proportion of the proposals contained in the Government Response require legislation to take effect.

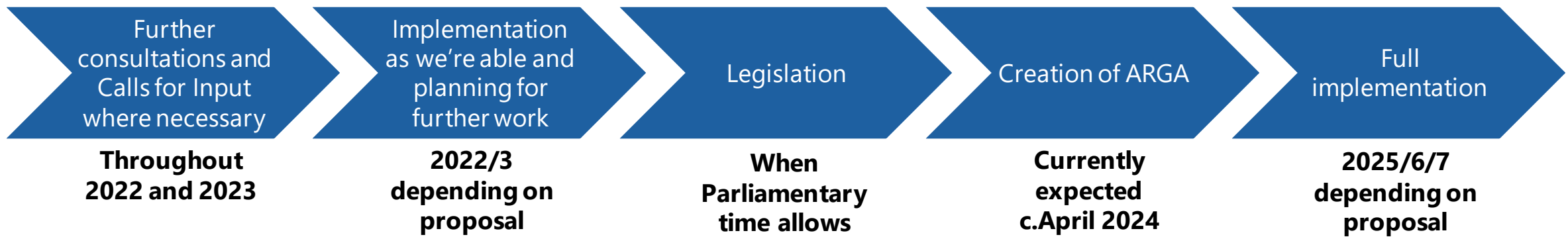
While we intend to undertake work within our existing remit now, some activities are dependent on the timing of secondary legislation which Government has indicated will be brought forward when Parliamentary time allows.

We will use our annual three-year plan and other key publications to provide progress updates as needed and ensure that wherever possible our stakeholders have a reasonable period in which to prepare for future regulatory changes.

Progress on reform

What's next?

What should stakeholders expect to see next?





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