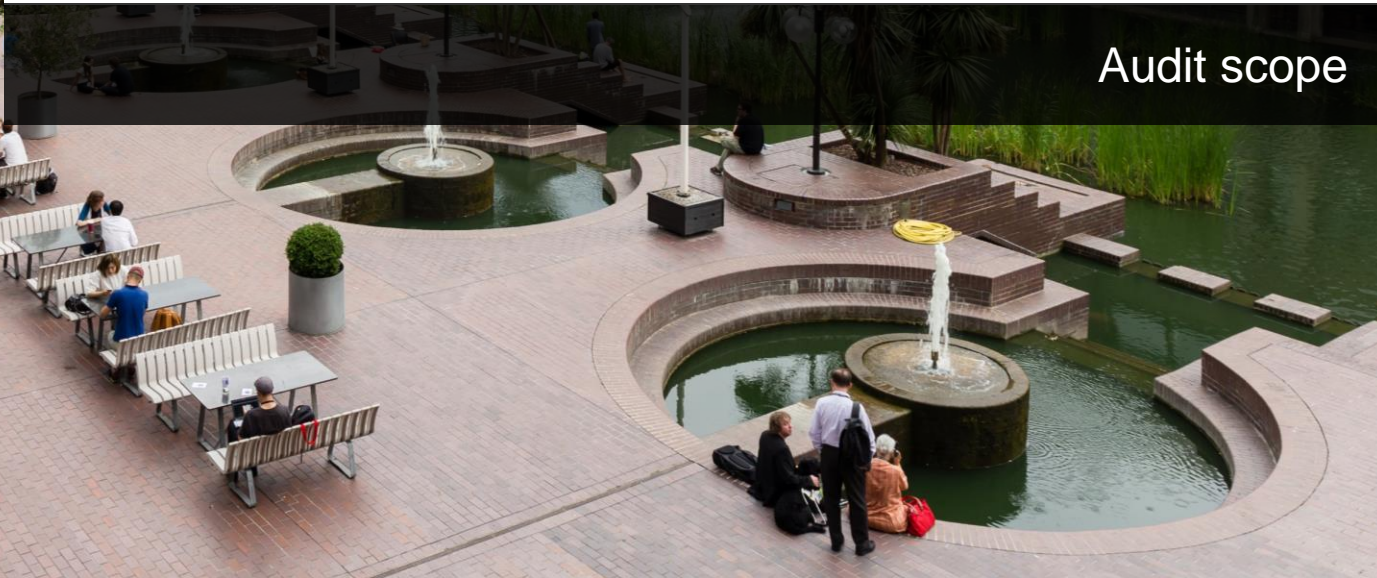




Restoring trust in audit and corporate governance



Restoring trust in audit and corporate governance

- The Department for Business, Energy and Industrial Strategy (BEIS) has published its consultation, 'Restoring trust in audit and corporate governance'.
- This consultation is the next step in the process of reform and a significant milestone towards setting up a new, robust and independent regulator.
- As part of our stakeholder engagement to support BEIS' consultation, we have launched a series of webinars and roundtables so that all stakeholders can engage with and discuss the key themes of the consultation.

Restoring trust in audit and corporate governance

Consultation on the government's proposals

March 2021

Closing date: 8 July 2021

CP 382



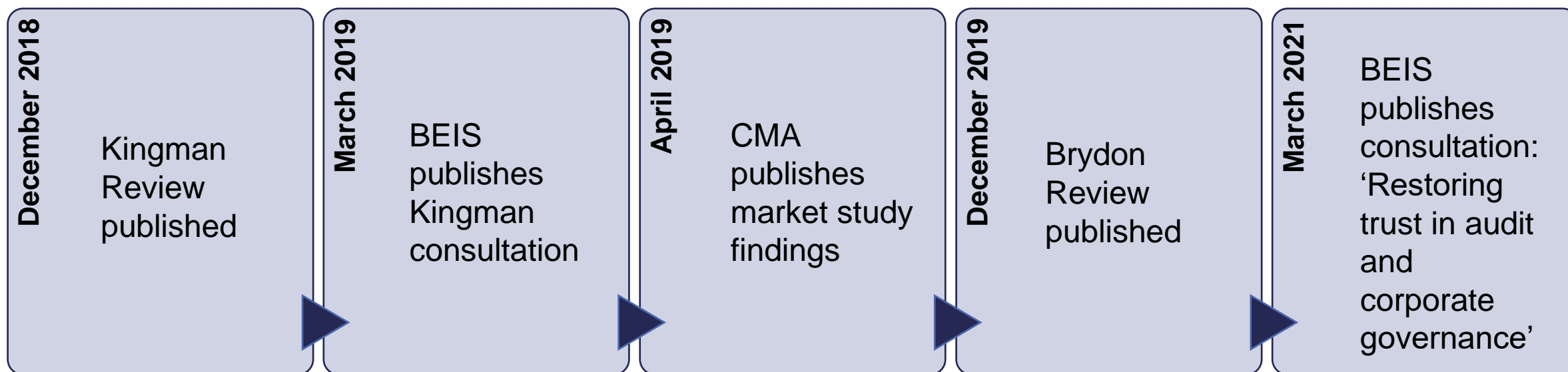
Reform objectives

The proposals aim to:

- Restore public trust in the way that the UK's largest companies are run and scrutinised
- Ensure that the UK's most significant corporate entities are governed responsibly
- Empower investors, creditors, workers and other stakeholders by giving them access to reliable and meaningful information on a company's performance
- Keep the UK's legal frameworks for major businesses at the forefront of international best practice

The journey so far

A timeline of key events



Key engagement themes

We are focusing on six key themes across our engagement and today will be focusing on:



Speakers



Miranda Craig

Director of Strategy
and Change



Claire Lindridge

Director of Audit
Market Supervision



James Ferris

Head of UK Auditing
Standards

Audit scope

Purpose and scope of audit

The new profession

Auditor reporting



Purpose and scope of audit

What is this section about:

- The Government agrees that audit needs to change along the broad lines proposed by the Brydon Review.
- This results in a two key areas of focus:
 - Giving auditors a specific responsibility to consider relevant director conduct and wider financial or other information in reaching their judgements. This would be a statutory requirement of auditors.
 - Adopting the Brydon Review's proposed purpose of audit as a broad ambition for its own programme of reforms, and to ask the new regulator to incorporate that ambition across the relevant parts of its work.

Purpose and scope of audit

The Government's position

- The Government also agrees with the Brydon Review that it should generally be for companies and their shareholders to decide the scope of the external auditing which is obtained beyond the statutory audit of the financial statements.
- The Government agrees with the Brydon Review that overarching requirements should be placed on auditors in order to direct the profession towards a stronger ethos of scepticism, challenge and informativeness.
- The Government proposes to do this through a set of binding principles to be determined and enforced by the regulator.

Purpose and scope of audit

- Brydon's suggested purpose is:

“To help establish and maintain deserved confidence in a company, in its directors and in the information for which they have responsibility to report, including the financial statements.”

- The consultation explains that the external auditing which a company chooses to obtain via its Audit and Assurance Policy should be subject to oversight by the regulator.
- For the auditing of additional information to have the benefits of increased confidence identified by the Review, it will need to be clear to users of company reporting what level of assurance, if any, has been obtained in respect of that information.

Purpose and scope of audit

What is the Government proposing?

Introduce a regulatory framework to cover both audits of financial statements (referred to as statutory audit) and other types of information which companies decide to have audited via the Audit and Assurance Policy process (“wider audit”).

The new regulator should oversee the provision of these wider audit services, including through the creation of a framework for all “corporate auditing”, covering both the auditing of financial statements and the auditing of this wider information.

To give the regulator some functions in relation to all corporate auditors (i.e. statutory auditors and those providing wider audit services via the AAP), including settling and enforcing standards applicable to corporate auditing as a whole.

The Government would welcome views as to what powers and duties should be given to ARGA. For example, would it be necessary to require the regulator’s inspection regime for PIE audits (equivalent to the FRC’s Audit Quality Review) to cover all corporate auditing, or could that be left to the regulator’s discretion if given powers for that purpose?

Purpose and scope of audit

Audit Principles suggested by the Brydon Review (para 6.4.2 of the Review):

- Auditors act with integrity, fulfilling their responsibilities with honesty, fairness, candour, courage and confidentiality;
- Auditors are appropriately qualified and exercise professional judgment and appropriate scepticism or suspicion throughout their work;
- Auditors act in the public interest and have regard to the interests of the users of their report beyond solely those of shareholders;
- Auditors maintain independence from the entity and its officers on whom they are engaged to report;
- Auditors are objective and provide findings and opinions unaffected by bias, prejudice, compromise and personal or corporate conflicts of interest;
- Auditors work to verify and encourage openness and honesty in financial and other company reporting;
- Auditors ask the directors to report any material information that may legitimately be disclosed to assist the understanding of users of an audit report, and, if necessary, disclose it themselves;
- Auditors provide appropriate challenge to management, assessing critically information and explanations received for signs of over-optimism, judgmental bias or possible fraud;
- Auditors' reports contain clear findings and expressions of opinion setting out all information necessary for a proper understanding of the opinion and its basis; and
- Auditors' reports give transparency to any differences of view with management and how they were resolved.



The new profession

What is this section about:

- The Brydon Review identified that there is currently no separate professional body for external auditors.
- Corporate auditing, with a new ethos and wider scope, will require tomorrow's auditors to include individuals with different skillsets.
- A new professional body for auditors of all corporate information could also help to elevate the status of auditors and reinforce their ethical and public interest obligations.

The new profession

- The Government proposes to put an appropriate framework in place to facilitate the establishment of a new professional body for external auditors of all types of corporate information.
- The consultation sets out some of the options for setting up a new profession and asks for views on what might work most effectively.
- The Government believes that a new, distinct professional body for corporate auditors should be created to help create a climate for wider audit and enable good audit practice to thrive across corporate audit disciplines.

The new profession

Some more details about the proposals

- The expansion of audit to corporate auditing is a significant change and is likely to require significant change to the current professional arrangements for audit.
- Auditors have to be members of, and obtain qualifications from, professional accountancy bodies formally recognised by the regulator in order to perform statutory audits of a company's accounts. It would be possible to achieve some of the benefits of reform by requiring in legislation that the regulator only 'recognise' bodies which have certain rules in place (for example, adoption of a set of audit principles with which their members must comply when carrying out corporate audits).
- However, simply enforcing compliance with the principles might not lead to bodies promoting the benefits of the 'wider audit' discussed above or developing the training needed to underpin higher standards of audit (though the latter could potentially also be made a requirement).

The new profession

The establishment of a distinct professional body therefore has potential to do more.

Another way to address the issue of reliance on the accountancy professional bodies would be to require separation as between the functions of those bodies in relation to auditors and their functions relating to other members.

However, there are risks that effecting the functional separation of these bodies might not create the cultural and other separation that the Review saw as essential to delivering the intended benefits of reform.

There is also a risk that professional bodies could simply opt to cease supervising and providing qualification to statutory auditors, which would not be an acceptable outcome unless there were appropriate alternative supervision and qualification arrangements.



Auditor reporting

What is this section about:

- The Government believes, in the light of the Brydon and FRC Reviews, that auditors should provide users with more meaningful and useful opinions and information.
- Auditors should seek to report in a clear, concise and transparent manner to increase the value of their reports to shareholders and other users.
- The consultation talks about how to do this, including by enhancing auditor reporting and including graduated findings.

Auditor reporting

The Brydon Review made a number of specific recommendations for improvements to auditor reporting. These include auditors being required to report on the following areas:



The extent to which their audit work was informed by external signals of an enhanced risk profile for the company whose financial statements were being audited (Brydon Review paragraph 16.4)



An update on Key Audit Matters reported in the previous two years, along with how the company has responded to deficiencies identified in the prior year's audit (17.3.3)



The reasons for and basis of any sampling techniques used in the audit (24.1.11)



The number of hours spent conducting the audit, analysed by level of seniority (25.2.5)



Any risks omitted from the Risk Report which the auditor considers to be significant (9.1.6)



In the light of the auditor's knowledge of the company and its processes, whether the company's section 172 statement reflects "observed reality" (8.4.3)

Auditor reporting

- The FRC has agreed to consider the recommendations of the Brydon Review and the FRC Review relating to auditor reporting holistically and will consult, as appropriate, on any proposed changes to its standards.
- In doing so, it will seek to balance promoting innovation and competition amongst auditors with the potential benefits, in terms of comparability between companies, of a common framework for enhanced reporting.
- The Brydon Review recommended

“the evolution of graduated findings be left to the marketplace for audit services”

with Boards reflecting their decisions (after taking account of shareholders' views) in their Audit and Assurance Policy.

Auditor reporting

- It suggested that allowing freer form reporting to develop was likely to lead to users being better informed, while requiring a particular type of “graduated findings” to be reported was more likely to lead to a new form of boilerplate.
- It also noted that a choice of product for directors would be good for competition in the audit market. The Review concluded that the proposed Principles of Corporate Auditing, rather than more rules, should inform auditor behaviour in this area.
- The proposed new duty for the auditor to consider wider information (paragraph 6.1.10 above) should encompass assessing external signals of an enhanced risk profile for the company, any significant risks omitted from the Risk Report, and whether the company’s section 172 statement reflects “observed reality”.



Any questions?

What's next?

The next steps in the process

Webinars and roundtables

Details of all other webinars and roundtables across the six workstreams can be found on [our website](#)

Roundtables on audit scope

For investors: Wednesday 26th May, 09:30 – 11:00

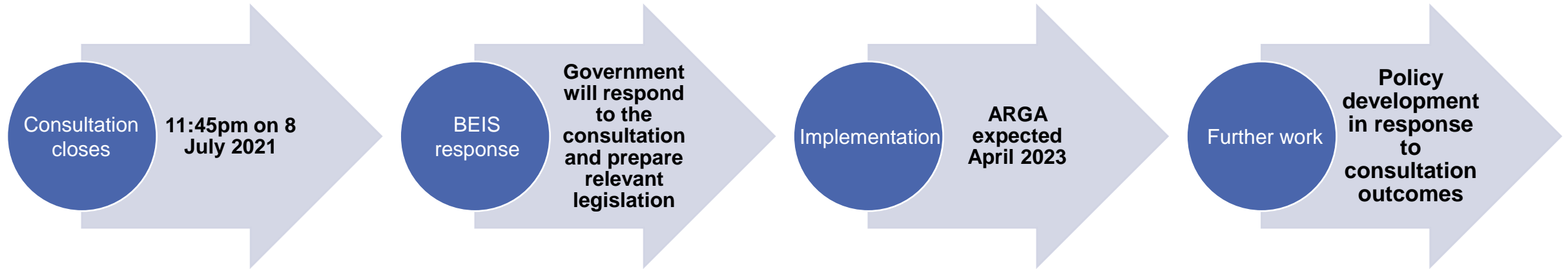
For companies and boards: Tuesday 18th May, 15:00 – 16:30

For auditors, audit firms & professional bodies: Wednesday 19th May, 09:30 – 11:00

For all other interested parties: Tuesday 4th May, 14:00 – 15:30

To register for roundtables, please email stakeholderengagement@frc.org.uk.

Next steps



Responses can be submitted either via the [gov.uk](https://www.gov.uk) website, or by email to audit.consultation@beis.gov.uk.



Thank you