



Restoring trust in audit and corporate governance



Quality and competition in the audit market

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



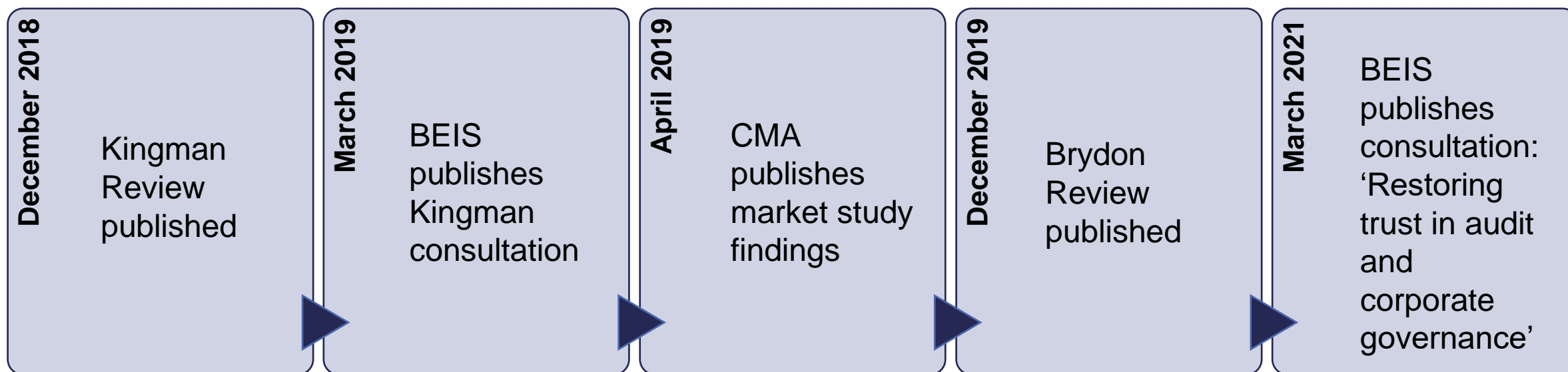
Reform objectives

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



Jen Sisson

Deputy Director of
Stakeholder
Engagement



Claire Lindridge

Director of Audit
Market Supervision



Laura Warren

Head of Competition
Policy

Quality and competition in the audit market

Operational separation

Managed shared audits

Audit committee oversight



Operational separation

What is this section about:

- The Government shares the concerns raised by the CMA that the multidisciplinary structure within large firms has resulted in behavioural and financial incentives that sometimes lead to poor quality audits.
- It has therefore brought forward the CMA's central recommendation to use operational separation to strengthen the oversight of audit practice.
- The Government's central proposal is to give ARGA powers to strengthen the governance of audit practices, building on the FRC's principles published in July 2020.

Operational separation

In line with the Principles of Operational Separation the FRC agreed with the larger firms last year, the Government proposes to require:



The strengthening of governance within audit practices through the creation of Independent Audit Boards within firms



Audit Boards to have oversight of audit partner remuneration and ensure it is linked to audit quality



The publication of a separate profit and loss account for the audit practice, accounting for cross subsidies between the audit practice and the rest of the firm through arm's-length transfer pricing



Regulatory oversight of the remuneration of audit partners, with a view to support policies and practices that reward high-quality audits

Operational separation

Some further details

- The Government envisages that the measures proposed will apply initially to audit firms who carry out statutory audits of 15% or more of the FTSE 350 by audit fees.
- The Government intends to take appropriate powers to enable the regulator to deliver a full structural separation in future, subject to consultation and Parliamentary scrutiny. This is based on the CMA's proposal to revisit the option to require a full structural split once its recommendations have been implemented and had time to take effect.



Managed shared audits

What is this section about:

- The Government agrees with the CMA's conclusion that the market would benefit from increased participation from a wider range of firms.
- It therefore proposes that managed shared audit applies to all UK-registered FTSE 350 companies.
- Limited exceptions apply to:
 - those who appoint a Challenger firm as their sole audit firm
 - those that have not been a FTSE 350 company for at least half of the annual accounting period prior to the audit appointment and are not a FTSE 350 company when the audit tender process begins.

Managed shared audits

Some more details about the proposals

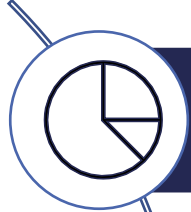
- Managed shared audit would require companies to identify a meaningful proportion of the audits of statutory entities within the group for bids from Challenger firms only

(by Challenger, it means a firm that provides statutory audits to PIEs and whose audit revenue did not represent more than 15% of the FTSE 350 statutory audit market by fees in either of the previous two years).

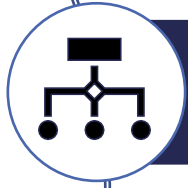
- The Government believes that this will increase choice and support new entrants to the FTSE 350 audit market in an effective, efficient and proportionate way.
- This is instead of the CMA's proposed joint audit regime, with which the Government had a number of concerns.

Managed shared audits

Detailed and binding requirements would be issued; it is currently proposed that these would include:



A Challenger firm to be appointed to carry out a meaningful proportion of the group's statutory audits



The company's audit committee identifying through its audit tender planning subsidiaries that could be audited by a Challenger



The Challenger being liable for its audit of the relevant subsidiaries (but not for the group audit)




The Challenger firm having access to and engagement with the FTSE 350 company's main (group) audit committee

The Government also suggests that there could be merit in the Challenger subsidiaries being rotated during the term of the audit contract to provide the Challengers with greater exposure to the company.

Managed shared audits

Regulation and phasing

- This requirement would be phased in by requiring companies, acting through their audit committees, to adopt Managed Shared Audit when their audit contract is re-tendered, rather than at an actual reappointment.
- The Government does not propose a blanket exemption for the largest and most complex FTSE 100 companies.
- The expectation is that the regulator would monitor companies' compliance with the managed shared audit requirements, and would therefore have powers to request information from, and engagement with, FTSE 350 companies and audit firms.
- The regulator would also have enforcement and sanctioning powers against companies that do not comply with the requirements.
- The Government also proposes a reserve power for the Secretary of State to allow the regulator to introduce a market share cap. This would be operated following joint review by BEIS and the regulator, should mandatory shared audits not bring about the desired change to the FTSE 350 audit market in a reasonable time frame.



Audit committee oversight

What is this section about:

- Both the CMA and Kingman Reviews noted that the commercial relationship between a company's audit committee and its chosen auditor could result in a lack of professional scepticism being exercised by both parties.
- The Government therefore proposes to give ARGA powers to set additional requirements as to the audit committee's role in the appointment and oversight of auditors.
- ARGA's proposed powers will ensure that the audit committee acts effectively as an independent body responsible for safeguarding the interests of shareholders and other users of accountants.

Audit committee oversight

What are the Government's proposals?

Require ARGA to impose additional requirements on audit committees in relation to the appointment and oversight of audits.

These requirements will cover the need for audit committees to continuously monitor audit quality, and consistently demand challenge and scepticism from auditors.

Regulatory powers for ARGA where problems exist, such as when an auditor resigns, when a PIE is unable to find an auditor, or when a persistent issue with audit quality identified.

ARGA will consider how the new requirements it develops will fit alongside the existing obligations which apply to audit committees, and it would also continue to issue guidance to assist companies and those serving on audit committees.

Audit committee oversight

What are the Government's proposals?

Any new requirements imposed by ARGAs should allow for audit committees to exercise discretion and professional judgement and for innovative best practice to develop.

Impose a duty on ARGAs to monitor compliance with the new audit committee requirements, including through a power to require information and/or reports from audit committees, and a power to place an observer on audit committees if necessary.

Give ARGAs the ability to take action against company directors and/or the audit committee for breaching the new audit committee requirements, with the regulator taking action in proportionate stages and giving the audit committee the opportunity to address any issues of regulatory concern before taking remedial steps publicly.



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 quality and competition in the audit market

For investors: Thursday 13th May, 13:30 – 15:00

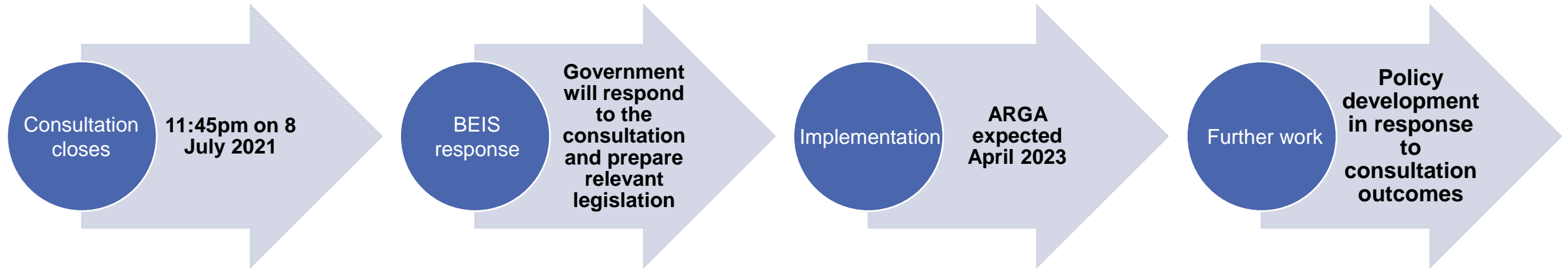
For companies and boards: Monday 10th May, 14:00 – 15:30

For auditors, audit firms & professional bodies: Monday 26th April, 10:30 – 12:00

For all other interested parties: Monday 17th May, 15:00 – 16:30

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