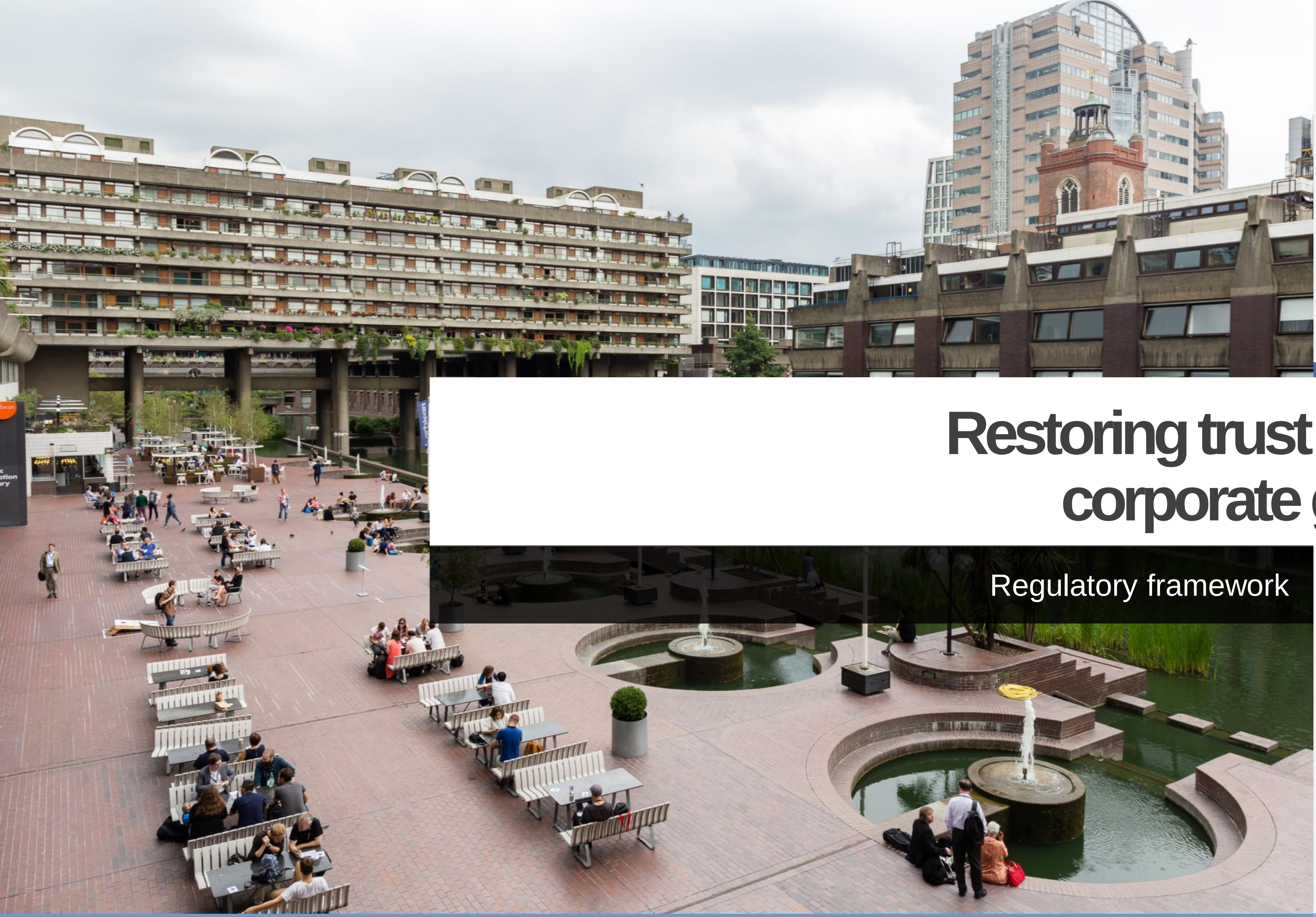
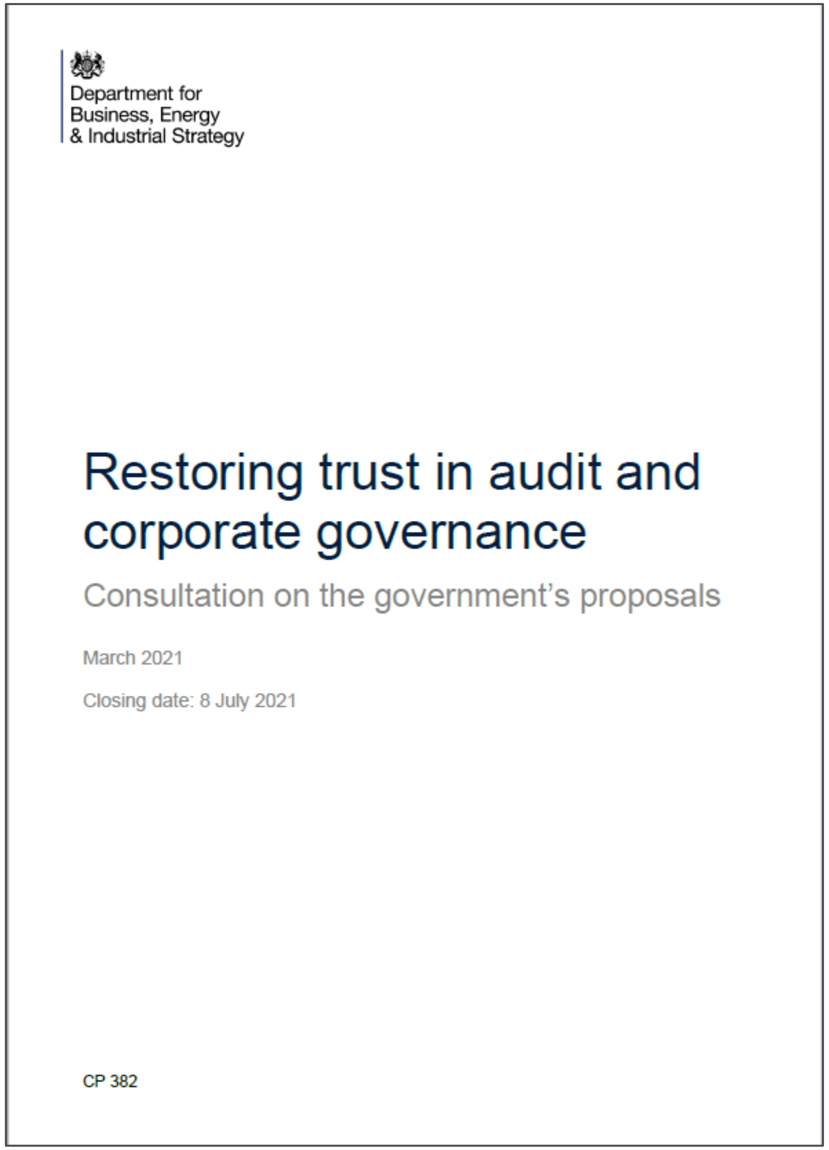


Restoring trust in audit and corporate governance

Regulatory framework

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.



Department for
Business, Energy
& Industrial Strategy

Restoring trust in audit and corporate governance

Consultation on the government’s proposals

March 2021

Closing date: 8 July 2021

CP 382

The journey so far

A timeline of key events

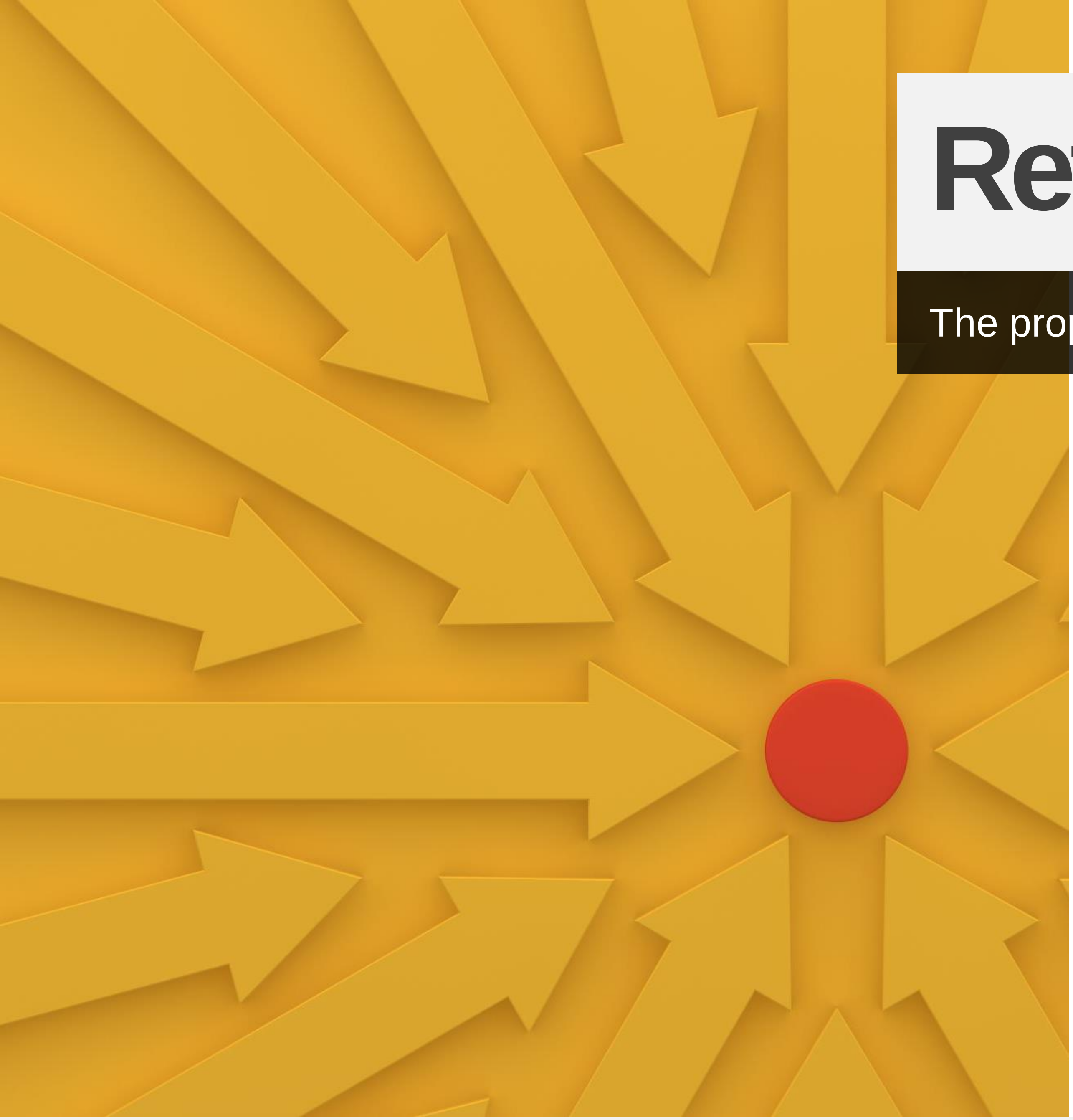
December 2018
Kingman Review published

March 2019
BEIS publishes Kingman consultation

April 2019
CMA publishes market study findings

December 2019
Brydon Review published

March 2021
BEIS publishes consultation: ‘Restoring trust in audit and corporate governance’



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

Key engagement themes

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

Regulatory Framework	Corporate Reporting and Governance	Audit Scope	Quality and Competition in the audit market	Supervision	Enforcement
Definition of PIE	Resilience Statement	Purpose and scope of audit	Operational separation	Scope of Corporate Reporting Review	Enforcement - directors
Internal controls	Audit & Assurance Policy	The new profession	Managed shared audits	Scope of Audit Quality Review	Enforcement - accountants
Set up of ARGA	Capital Maintenance	Auditor reporting	Audit Committee oversight	PIE auditor registration	
	Malus and clawback				

Speakers

Jen Sisson

Deputy Director of Stakeholder Engagement

Phil Fitz-Gerald

Director of the Financial Reporting Lab

Jenny Carter

Director of Accounting & Reporting Policy

Regulatory framework

Definition of PIE

Internal controls

Set up of ARGA

Definition of PIE

What is this section about:

- The consultation proposes to expand the definition of ‘public interest entity’.
- An expanded PIE definition will:
  - Extend the scope of the existing audit and corporate reporting requirements which already apply in relation to PIEs and
  - Generally frame the scope of any new regulatory measures in relation to audit, corporate reporting and corporate governance.

Definition of PIE

- The Government proposes to extend the UK's PIE definition to include large companies within certain limits regardless of whether they are admitted to trading on a regulated market. This will, for example, ensure that certain large private companies are now included within the definition of a PIE.
- The consultation lays out two alternative approaches which could be used to identify the large companies which ought to be added to the PIE definition on the basis of their size:

Option 1: adopt the test used to identify those large companies which are already required to include a corporate governance statement in their directors' report.	**Option 2**: a narrower test which incorporates the threshold for additional non-financial reporting requirements for existing PIEs.
• This provision covers all companies with either: • More than 2,000 employees; or • A turnover of more than £200 million and a balance sheet of more than £2 billion.	• This would mean the definition of a PIE was only extended to large companies with both: • Over 500 employees and • A turnover of more than £500 million.

- The Government intends that any new definition of PIE should also include companies on the exchange-regulated AIM market with market capitalisations above €200 million.

Internal controls framework

What is this section about:

- The section on internal controls frameworks talks about the introduction of a UK version of a Sarbanes-Oxley (‘SOX’) style regime.
- The consultation proposes a number of options about how that new internal controls framework might operate, including its preferred option which aims to achieve a proportionate strengthening of the internal control framework which builds on and develops the UK’s existing provisions.
- The consultation asks a number of questions on this topic and we expect there to be quite a range of views in the responses.

Internal controls framework

The consultation lays out three main options for how the new internal controls framework might operate:

Option A

Require an explicit directors' statement about the effectiveness of the internal control and risk management systems

Option B

Require auditors to report more about their views on the effectiveness of companies' internal control systems

Option C

Require auditors to express a formal opinion on the directors' assessment of the effectiveness of the internal control systems

Internal controls framework

The Government's initial preferred options:

Directors' responsibility statement

- Directors should be required to acknowledge their responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting.

Annual review of internal control effectiveness and new disclosures

- Directors should be required to:
  - Carry out an annual review of the effectiveness of the company's internal controls over financial reporting;
  - Explain – as part of the annual report and accounts – the outcome of the annual review, and make a statement as to whether they consider the systems to have operated effectively;
  - Disclose the benchmark system that has been used to make the assessment; and
  - Explain how they have assured themselves that it is appropriate to make the statement.
- If deficiencies have been identified, these should be disclosed and the directors should set out the remedial action that is being taken over what timeframe.

Internal controls framework

The Government's initial preferred options:

Principles and guidance

- In deciding on the approach to be taken to the internal control effectiveness statement, directors should be guided by principles and guidance developed or endorsed by the regulator reflecting audit committee best practice.

External audit and assurance

- Decisions about whether the internal control effectiveness statement should be subject to external audit and assurance should usually be a matter for audit committees and shareholders. Decisions should be based on judgements about the strength of companies' systems and controls and whether extra assurance would be proportionate. This should be considered as part of the proposed Audit and Assurance Policy (covered in Chapter 3).

- Companies should be required to have their internal controls assured by an external auditor in limited circumstances (e.g. where there has been a serious and demonstrable failure of internal controls or whether material control weaknesses have persisted over several years).

Internal controls framework

The Government's initial preferred options:

Enforcement

- The regulator should have powers 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.
- There should be effective powers to sanction directors where they have failed to establish and maintain an adequate internal control structure and procedures for financial reporting.

Scope

- The requirements should be set out in legislation and phased in over a period of time.
- They should apply initially to premium listed companies who are already familiar with the concept of an annual review (with possible temporary exemptions for newly listed companies where gross revenues remain below a specific threshold) and extended to other PIEs after two years.

Set up of ARGA

What is this section about:

- The Government intends to introduce legislation to create the stronger regulator recommended by the FRC Review as soon as Parliamentary time allows.
- This new regulator will be named the Audit, Reporting and Governance Authority (ARGA).

Set up of ARGA

ARGA will be:

- Established as a company limited by guarantee
- Given clear statutory objectives and functions
- Governed by a new, smaller board to improve effectiveness and responsiveness
- Given strategic direction by Government and accountable to Parliament
- Funded by a statutory levy

Set up of ARGA

- ARGA will be established as a company limited by guarantee by adopting the existing legal corporate entity used by the FRC.
- The Government intends to legislate to give ARGA the general objective:

To protect and promote the interests of investors, other users of corporate reporting and the wider public interest

- There will also be two operational objectives:

To promote quality

To promote effective competition in the market for statutory audit work

- ARGA will be able to choose whether to advance this or its quality objective (or both) when carrying out its policy-making functions.

Set up of ARGA

- The Government intends to require that ARGA has regard to certain regulatory principles when carrying out its policy-making functions. Based on those proposed by the FRC Review, these should at a minimum include:

  - Promoting innovation in statutory audit work, corporate reporting and corporate governance
  - Promoting brevity, clarity and usefulness in corporate reporting
  - Working closely with other regulators from the UK and internationally
  - Anticipating emerging corporate governance, reporting or audit risks by being forward-looking and acting proactively where possible

- The Government intends to legislate to require ARGA to produce an annual report that is submitted to the Secretary of State and laid before Parliament. The annual report will include reporting on the regulator's broader regulatory activities, including performance of the regulator's enforcement function, to enable greater Parliamentary scrutiny of the regulator's work and performance.

Set up of ARGA

- At the moment, the costs incurred by the FRC in carrying out its regulatory activities relating to audit, corporate reporting and corporate governance are mainly met by the professional bodies and preparers of accounts.

- Around half of these costs are met by the audit and accountancy professional bodies who either have a statutory obligation to meet them or do so under contractual arrangements. The remaining half is voluntarily met by “preparers of accounts”; these include companies listed on the London Stock Exchange, large private companies and public sector organisations.

- The Government will take forward legislation to enable the regulator to raise a levy so that it has a sustainable and independent basis to carry out its regulatory activities.

- The regulator will be given the power to make rules requiring that market participants pay a levy to meet the regulator’s costs of carrying out its regulatory functions.

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 regulatory framework

For investors: Tuesday 27th April, 14:00 – 15:30

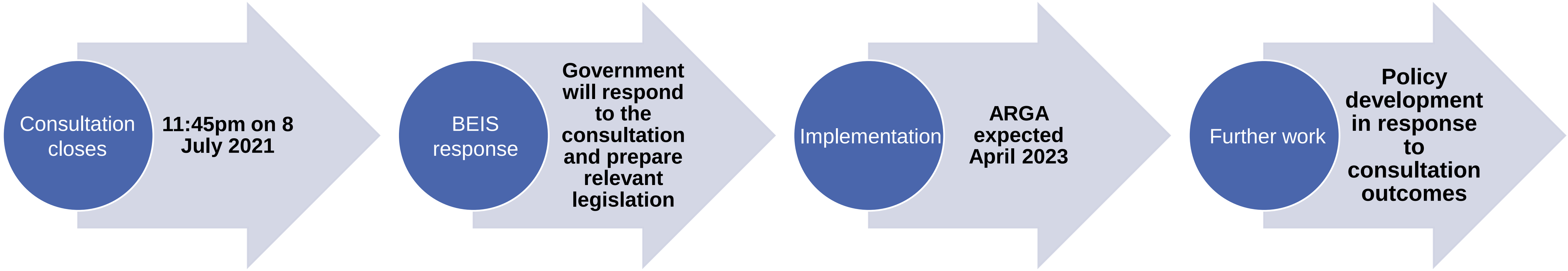
For companies and boards: Wednesday 5th May, 15:00 – 16:30

For auditors, audit firms & professional bodies: Wednesday 12th May, 15:00 – 16:30

For all other interested parties: Tuesday 11th 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 website, or by email to audit.consultation@beis.gov.uk.

Thank you