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Dear Shamima,

Proposed revisions to the 2016 Audit Firm Governance Code

EY welcomes the opportunity to respond to the Financial Reporting Council's (FRC) consultation to revise the 2016 Audit Firm Governance Code (the 'Consultation').

We share the FRC's objective of promoting public confidence in audit and our work to voluntarily implement operational separation of our audit practice is testament to this. However, we believe that there is value in the FRC considering the necessity, timing, clarity and proportionality of key proposals in the Consultation so that the next iteration of the Audit Firm Governance Code (AFGC) stands the test of time.

Our general observations are set out in this covering letter and the Appendix has our responses to the consultation questions. Our Independent Non-Executives ('INEs') have provided their input to this response.

We acknowledge the publication by the FRC of "*What Makes a Good Audit*" on 16 November 2021 which touches on governance and leadership as elements of a good quality audit practice.

Timing and necessity for change

As advocated in our response to the Government's consultation *Restoring trust in audit and corporate governance* (the Government's reform proposals'), it is vital that holistic and proportionate reforms which collectively improve the UK's business ecosystem and make the UK an even more attractive place to do business are taken forward and ones which are unnecessary are abandoned. In a similar vein, we encourage the FRC to re-consider some of the key proposals in the Consultation from the following key perspectives:

- ▶ Changes to the AFGC need to be aligned to the overall outcomes from and timing of the Government's reform proposals - including those related to the powers and duties of Audit Reporting and Governance Authority (ARGA) - and for regulatory change to be sequenced appropriately.
- ▶ Greater consideration must be had for the impact of the FRC's operational separation principles (the 'Op Sep Principles') before further changes are made as their implementation has already resulted in significant changes to the governance of the largest audit firms including EY.
- ▶ The proposals should be framed in the context of the FRC's statutory obligations under the Legislative and Regulatory Reform Act 2006. This provides (among other things) that regulatory activities should be carried out in a manner which is transparent, accountable, proportionate and consistent and targeted where action is most needed. It would be helpful therefore, if greater prominence could be given to the fact that the AFGC constitutes

advice and guidance as to suggested good practice¹ and that there is flexibility through the application of Principles and through complying or explaining against the Provisions, an approach which also aligns to the UK Corporate Governance Code.

Separate codes for operationally separate audit firms and a structure centred on the audit practice

We acknowledge the FRC's desire to have a Code that applies to all audit firms in scope. However, given the specific expectations of the Op Sep Principles and the significant changes implemented by the firms within scope, we believe that to avoid duplication, it is necessary for the AFGC to be restructured to distinguish between those firms subject to the Op Sep Principles, and those which are not.

While this may mean creating a separate Code for those firms that are not currently within scope of the Op Sep Principles, it will provide greater clarity on the additional governance processes and procedures that operationally separate firms have to implement/apply. Other governance codes are also "segmented" in this manner to fit the nature of entities under their scope e.g., there are different codes for premium listed entities vs AIM companies vs large private companies.

Section E of the proposed AFGC focusses on the operationally separate audit practice. In our view, this should be reversed such that the majority of the AFGC is focused on the audit business i.e., its culture, its people management, its risk management, its leadership and governance etc, followed by a specific section dealing with firmwide matters that have the potential to impact the resilience of the audit practice.

Such a structure would be more consistent with and proportionate to the status of the Code as a *"vital element of the regulatory framework for **audit** alongside the various ethical and quality standards that **auditors must follow.**"* (p4 of the Consultation).

It would also help eliminate some unintended consequences in the proposed scope and application. For example, Principle H states that *"The firm should apply policies and procedures for **managing people across the whole firm that support its commitment to the purpose and Principles of this Code.**"* Policies and procedures may vary depending on the needs of and issues facing different parts of the firm in respect of talent management and retention. It is also not appropriate, for example, that the majority of the firm's staff who are outside audit, and who do not provide audit or audit-related services, are managed in such a way as to achieve the purpose and Principles of the AFGC.

Other key comments

Other key comments and concerns are detailed in our responses to the Consultation questions in the Appendix, and relate to the following matters:

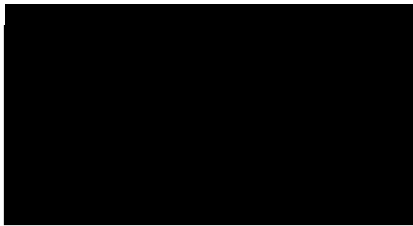
- ▶ The revised purpose of the Code and the lack of definition and guidance around the concept of public interest particularly in light of its proposed application beyond the audit practice (see response to Q1).
- ▶ The proportionality of the changes for private partnerships in which the agency issue present in listed companies is not applicable (see response to Q6).
- ▶ The practicality and proportionality of proposals as regards global networks (see response to Q7).
- ▶ Clarity on the remit of INEs and the practicality of proposals regarding their work (see response to Q10 and 11).

¹ The Regulators' Code to which the FRC is subject, provides that "Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply." Further at 5.1, it states that legal requirements should be distinguished from good practice and the advice or guidance should not impose unnecessary burdens.

We recognise the global leadership that the UK and the FRC have shown since the development of the world's first AFGC in 2010. There has been precedence for the rest of the world to follow suite, so it is important that the proposals in this Consultation are duly deliberated such that the right outcomes are achieved, and action is targeted where it is most needed.

We therefore value the opportunity provided by the FRC to share our perspectives and hope you find our suggestions useful. We would be happy to discuss any aspect of our response with you.

Yours sincerely



Christabel Cowling
EY UK Partner, Head of Regulatory and Public Policy

Appendix: Responses to specific consultation questions

Q.1: How appropriate do you feel that the revised purpose of the proposed 2022 Code is?

We agree with the FRC's position that "*The public interest is an abstract concept for which there is no single definition*". Moreover, in any given scenario, there may be differing and even conflicting views of what is in the public interest.

Given the various duties of firms and the INEs referred to in the Consultation in respect of public interest, including that firms should demonstrate commitment to it (Principle C), that INEs should assess and promote the public interest in firm operations and activities as they relate to the purpose of the AFGC (Principle N) and that INEs should alert the regulator if they believe the firm is acting contrary to the public interest (Provision 38), we have concerns about its scope and the consistency of its application especially in the absence of a definition and guidance.

Three examples of public interest matters are cited in the Consultation on p26: (i) consistent performance of high-quality audit; (ii) the ability of companies to find an auditor; and (iii) resilience of the audit market as a whole. We note that (i) and (iii) align to ARGAs proposed statutory objectives² regarding audit quality and competition. These two points are also expressly reflected in the Objectives of the Op Sep Principles, which creates duplication.

Implicit in the present formulation i.e., "*to ensure firms take account of the public interest in their decision-making, **particularly in audit***" is the need to consider public interest beyond audit. This is too widely drawn, and our view is that it should be framed in the context of and limited to the audit practice. We also believe that the concept of 'securing firms' reputations' in the purpose of the 2016 AFGC is much clearer in scope and application and therefore recommend that is retained.

As such if reference to "public interest" is retained in the AFGC:

- ▶ Reference in the 2016 AFGC to reputational considerations should be preserved and the concept framed in the context of and limited to the audit practice i.e., "*To ensure firms take account of the public interest in their decision-making **with regard to audit and to help them secure their reputation more broadly, including their non-audit businesses***".
- ▶ Clear guidance which includes case studies on the application of the concept and on which both firms and INEs can build on, should be published. This is needed to avoid the public expectation gap widening even further and will help with the consistency of decision making across the profession. This approach is also used in the UK Corporate Governance Code, where the FRC publish separate guidance on judgemental areas, for example, its *Guidance on Board Effectiveness*.

Q.2: What are your views on the proposed thresholds for application of the proposed 2022 Code?

We have no comments on this question.

Q.3: Should the proposed 2022 Code apply to any firm that audits a FTSE 350 company? Please suggest alternatives.

In light of the potential introduction of mandatory managed shared audits (MMSA) under the

² The Government's consultation, *Restoring trust in audit and corporate governance*, proposed ARGAs statutory objectives and regulatory principles as follows: "*The regulator will be required to advance either or both of its quality objective and competition objective when it is carrying out its policy-making functions.*"

- *Quality objective: To promote high quality audit, corporate reporting, corporate governance, accounting and actuarial work.*
- *Competition objective: To promote effective competition in the market for statutory audit work.*

Government's reform proposals, the AFGC should apply to any audit firm that audits any part of a FTSE 350 company including as part of a MMSA. This is another reason why the sequencing of regulatory change that we note in our response to Q4 below is important.

Q.4: What are your views on the proposed effective date of the proposed 2022 Code?

The response to this question should be read in conjunction with the points made in our covering letter.

Significant changes have been introduced by the largest audit firms in response to the Op Sep Principles. Principle 22 of the Op Sep Principles requires that the principles are *"implemented in full by 30 September 2024 at the latest"*. Accordingly, we believe that it would be more effective for the FRC to consider amendments to the AFGC after this date. This would allow a genuine assessment (by the firms and the FRC) of:

- ▶ how the Op Sep Principles have worked in practice; and
- ▶ what outcomes have been achieved from operational separation and how far these contribute both to the purpose of the AFGC and the Op Sep Principles which were designed by the FRC to achieve its objectives to improve audit quality and audit market resilience.

Consideration can then be given to what (if any) further changes are needed to the AFGC. Such an exercise will also help clarify what the proposals to revise the AFGC are seeking to address so that any further changes are proportionate and targeted only in areas where action is needed.

Secondly, the proposed timetable should be aligned to the timeline to implement the Government's reform proposals to ensure that changes to the capital markets ecosystem are considered holistically and in the right sequence i.e., first establishing the new regulator and providing clarity and certainty on its statutory powers, enhancing directors' duties and roles in relation to corporate reporting and audit, clarifying the scope of audit and how it will be executed and finally clarifying the scope of and enhancing the AFGC (if needed).

In summary, it seems premature to consult on the AFGC at a time when the new regulator and its powers are yet to be established and its current governance is in transition.

Q.5: What are your views on the priorities for engagement with investors, audit committee members and other external stakeholders and how could we encourage interaction with INEs?

The suggestions we make below are centred on the overall premise that such engagement needs to be meaningful for all participants, with a focus on outcomes, and all parties involved need to have an incentive and/or obligation to engage.

- ▶ In certain circumstances, engagement may be best undertaken by management and staff of the firm rather than the INEs. For example, in the earlier part of the COVID-19 pandemic, investors were interested in finding out on how the firms had changed their audit procedures in relation to going concern and viability. This engagement was best conducted by staff and management in the firms' quality and professional practices teams (with INEs in attendance to observe). There should be enough flexibility in the wording of Provision 34 to allow for this.
- ▶ The FRC acknowledges the limited appetite among investors (particularly) to engage with INEs. The obligation to "have dialogue" cannot operate effectively as it falls only on one party - the INEs. We suggest Provision 34 is amended as follows: *"... Independent non-executives should seek **feedback from** audit committees and investors to build their understanding of user experience of audit..."*

- ▶ An annual stakeholder meeting organised by the firm and attended by the INEs with an open invitation to investors, audit committee members, key regulators and policy makers should help achieve the objective of Provision 34. This meeting could include a private INE session with no executive management present.
- ▶ Industry bodies such as The Investment Association, The Investor Forum and the Audit Committee Chairs Independent Forum (ACCIF), should help facilitate meaningful collective engagement with the firms and their INEs. Ideally if these bodies were able to engage with their members to collate the issues of interest (within the scope of the AFGC) in advance of meetings with a firm and its INEs, the engagement would be outcome focused and efficient. The topics could also form the subject of a stakeholder meeting described above.
- ▶ In our view, it would also be efficient and effective for the FRC to take a lead in convening and facilitating engagement with investors and audit committees on an individual firm basis and/or cross-firm basis.

Q.6: To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?

We note that the revisions to the AFGC are proposed to achieve greater alignment to the UK Corporate Governance Code (p.2 of the Consultation). Whilst we agree that it is of benefit in any system to compare and borrow good practice, we also believe that this should be proportionate, outcome focused and stakeholder centric.

In that regard, we believe that it is important to recognise the differences in the scopes and purposes of the two Codes. As noted in the introduction to the UK Corporate Governance Code, its main focus concerns the relationship between the company and its shareholders. However, p13 of the Consultation recognises that the agency problem that is present in listed companies is not present in partnerships. A partnership is privately owned and the relationship between the partners (owners), is addressed in the relevant partnership agreement. Therefore, we do not believe that the proposals on owner accountability are proportionate in the context of a private partnership where partners (owners) are not remote, but in fact play an active part in the business.

We agree it is important that management remain attuned to partner views but there are different mechanisms to achieve this. For example, our partner forum has the ability (via representatives) to represent partners' views to the managing partner and the board and is accountable for feeding back to the partners. We also agree that unfettered powers of decision making are contrary to good governance however if there are checks and balances to prevent such unfettered powers in ways other than a separate Chair and CEO, and firms are able to demonstrate what these are and their effect, the AFGC should not seek to mandate governance structures.

Separately, there is a considerable amount of content in the AFGC relating to the operational aspects of how firms should be run rather than their governance - for example, regarding the provision of information to partners/owners, information and data sets that management must develop, skills and knowledge of management, their availability etc. We do not believe the AFGC should mandate how firms are run operationally and while we agree that some of these matters make good business sense, we suggest the FRC extract these operational aspects and include them in a separate guidance document in a similar vein and with similar status to guidance documents such as the FRC's *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* or its *Guidance on Audit Committees* which complement the UK Corporate Governance Code.

Q.7: What are your views on the proposals to underpin connectivity with the global network and monitoring of its potential to impact the UK Firm? Do you have other suggestions for how this could be addressed?

We share the sentiment expressed in the Consultation that “*strong global networks can have a positive impact on audit quality and on the resilience of Firms*”. Audits of the largest companies in our capital markets rely on global cooperation, investments in technology and infrastructure made at scale and initiated and delivered globally and easy transfer of expertise between countries in the wider network.

The Consultation recognises that “*The degree of integration with [global] networks varies between Firms, ranging from relatively loose arrangements to fully integrated global structures.*” and that “*where decisions are made outside the UK firm, the same level of disclosure and transparency should apply as if that body sat at the UK level*”. We believe that is an important clarification – that material/strategic decisions taken outside the UK are relevant only to the extent that they directly bind and/or directly impact the UK firm. In fact, a network may be structured in such a way that material/strategic decisions must always be ratified at local level for implementation purposes. In this case, it is only those local decisions that are relevant for the purposes of the AFGC.

In that regard, we note that Provisions 30 and 32, helpfully recognise the need for an assessment of the impact of global network initiatives on a firm. We note that Provision 41 is similarly drafted by reference to the “*potential to affect audit quality and the resilience of the audit practice*”. What is more challenging from a practical and legal perspective is the proposal for one legal entity to “*provide access*” to the activities of another legal entity. We have provided our suggestions below to clarify the drafting.

AFGC Provisions (emphasis added in bold)	EY comments and drafting suggestions
Provision 30: “ <i>Independent non-executives should have full visibility of the entirety of the business. They should assess the impact of firm strategy, culture, senior appointments, financial performance and position, operational policies and procedures including client management processes, and global network initiatives on the firm and the audit practice in particular.</i> ”	Change proposed for clarity of purpose and to align to the language used in Provision 41: <i>“Independent non-executives should have full visibility of the entirety of the business. They should assess the impact of firm strategy, culture, senior appointments, financial performance and position, operational policies and procedures including client management processes, and global network initiatives to the extent that they have the potential to affect audit quality and the resilience of the audit practice in the UK.</i>
Provision 32: “A firm should provide access for independent non-executives to the activities of the global network such that they can assess global governance standards and the impact of the network on the UK firm and the public interest in the UK.”	Depending on the network structure, it may not be possible for a local firm to unilaterally provide its INEs with such access. Proposed amendment: <i>“A firm should provide information to the independent non-executives in relation to the activities of the global network which are reasonably likely to affect audit quality and the resilience of the audit practice in the UK.</i>

<p>Provision 41: [Independent non-executives] should... i) monitor the activities of the wider firm and global network for their potential to affect audit quality and the resilience of the audit practice...”.</p>	<p>The present drafting suggests that all activities of the global network need to be monitored by the INEs. This would create a disproportionate burden and has practical and legal challenges as noted above.</p> <p>Proposed amendment (in line with proposed amendment of Provision 32):</p> <p>[Independent non-executives] should... j) review and challenge the information provided by management under Provision 32.</p>
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Q.8: How supportive are you of the approach taken to people and culture in section B of the proposed 2022 Code? Please include any suggestions for how we could improve it further.

Overall, we are supportive of the spirit, but have specific suggestions to improve the clarity and flexibility in the drafting of the Provisions.

- a. **Provision 10** - The proposed AFGC helpfully recognises that in global organisations, purpose and values could be established at an international level, but adds “where this is the case, the **Firm should ensure it has the ability to influence that decision making process and the ability to tailor the output in the UK**”. As already noted in the Consultation, the degree of integration within networks varies between the firms. As such, whilst it may not be possible for a UK firm to “influence [the] decision-making process” at a global level, provided it had an ability to “tailor the output for the UK” that should suffice. Therefore, we propose the following drafting: “*If a firm’s purpose and values are established at an international level, the firm should ensure it has the ability to influence that decision-making process or the ability to tailor the output for the UK.*” This would therefore task the UK board and management with embedding and promoting the global purpose and values within the local context with consideration for any specific local regulatory requirements.
- b. **Provisions 15 (culture), 16 (whistleblowing) and 17 (review of people management policies by INEs)** - Refer to our responses to Q11 below, where we have provided suggestions to clarify the wording of these Provisions.
- c. **Provision 18, designated INE for people engagement:** This goes beyond and is more restrictive than the equivalent requirement for premium listed companies in the UK Corporate Governance Code. We suggest that the FRC replicate the wording of Provision 5 of the UK Corporate Governance Code as this would allow firms to build on their current approaches in this area and for an alternative if a primary designated INE is not appropriate, including for example, if the responsibility is shared among all INEs.

Q.9: Are there any matters you believe we should include in section C that do not currently feature and/or can you suggest other improvements to how the proposed 2022 Code approaches operational matters and resilience?

What would fundamentally assist this section (as noted in our covering letter) is re-structuring the Code to deal with the audit practice first, with a separate section covering matters related to firmwide matters that have the potential to impact audit quality and the resilience of the audit practice.

Other specific comments we have on this section are as follows:

- a. The new/additional wording in some of the Principles and Provisions in Section C is widely drawn. In particular:
- ▶ Principle I: “A firm should promote a commitment to consistent high-quality audits and firm resilience in the way it operates. To these ends, **a firm should collect and assess management information to evaluate the effectiveness of its policies and procedures** and to enhance its operational decision-making.”
 - ▶ Provision 22: “A firm should develop robust datasets and effective management information (MI) to support monitoring of the **effectiveness of its activities**, including by independent non-executives, and its ability to furnish the regulator with information.”
- It is unclear in what regard effectiveness should be assessed. Some parameters or categories of information, policies, procedures and activities that should be considered at minimum and that clearly link to ARGAs purpose and its proposed statutory objectives on audit quality and competition (see footnote 2) should be provided given that there is a vast amount of information used in operational decision-making. This clarity would also enable firms to report more meaningfully.
- b. We believe that language in Provision 20 and Principle K should be clearly scoped to align to ARGAs purpose and hence we suggest the following drafting:
- ▶ Provision 20: “A firm should assist the FRC and its successor bodies to discharge its duties by sharing information openly **to the extent that such information is relevant and necessary to the regulator’s statutory purpose.**”
- Guidance on this subject, including to distinguish between legal requirements and suggested good practice, would also help firms take a view on the interaction between regulatory expectations and other legal obligations (such as obligations of confidentiality and Data Protection).
- ▶ Principle K: “A firm should communicate with its regulators in an open, co-operative and transparent manner **in respect of matters within the scope of its regulators’ regulatory or statutory purposes and remits.**”
- c. Provision 26 on reporting against the AFGCs Principles and Provisions: This should be addressed upfront as it applies to the whole of the AFGC rather than solely to the matters in Section C.
- In addition, we recognise the FRC has already deleted several Principles and Provisions from the 2016 AFGC (as noted in Appendix 3 of the Consultation) which were separately required by law, regulation or standards, were deemed obvious or that were too high level to report against. It would be beneficial to further review and amend some of the proposed Principles or to provide illustrative examples of good reporting particularly as several of them relate to mindsets and behaviours and may be difficult to report on meaningfully. This is important given the FRC’s own observation that the firms’ Transparency Reports (TR) are not widely read in their current form and the volume of reporting is only likely to increase as a result of the Consultation. Alternatively, each Section of the AFGC should have a reporting sub-section to provide further guidance as to suggested matters to be included in a firm’s TR.
- d. Provision 27 on disclosing responsibility for preparing the financial statements: It is unclear where a firm should provide this explanation (whether in the financial statements themselves or the TR) and also whether this Provision is needed in the AFGC as this should be adequately covered in the legislative framework governing the preparation of the annual report and accounts (ARA).
- e. Provision 28: “A firm should disclose in its transparency report... **a commentary on its performance, position and prospects...**” This new Provision does not take into account

the requirement in the Op Sep Principles (Principles 16 and 20) to prepare financial information for the operationally separate audit practice. Also, the ARA already contains financial information related to the firm and the TR provides a conclusion on its viability. The FRC may wish to revisit the necessity of this Provision or have a carve out for firms with operationally separate audit practices. We would encourage the FRC not to add further disclosure requirements to the TR which as noted above it already considers to be too long and not well read.

Q.10: Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?

Q.11: What are your views on the proposals for strengthening the status and role of INEs? Please include any suggestions for other ways to increase their impact and effectiveness.

The response below covers Q10 and Q11 and has had input from our INEs regarding the clarity, proportionality and practicality of the proposals.

Appendix A of the Consultation usefully contextualises the role of INEs i.e., they are not directors, not responsible for the strategy or performance of the business, not in the chain of command. unable to make decisions and do not owe a duty of care to the regulator but only the firm.

The drafting of the proposals on new responsibilities of INEs should bear in mind the following:

- ▶ INEs may not be best placed to undertake some of the newly proposed responsibilities (as explained in our response to Q5).
- ▶ Some of the proposals risk drawing INEs into management’s and/or directors’ responsibilities with a consequential impact on their independence.

Furthermore, in our experience, investors do not appreciate the important nuances in the role of INEs versus independent non-executive directors on corporate boards and hence their expectations are not aligned. We believe that there is merit in the FRC raising this awareness. In light of the Op Sep Principles, which have introduced separate roles for audit non-executives (ANEs), now is an opportune moment for the FRC to engage with the investor community to do this.

We have detailed in the table below specific drafting issues, with suggestions for the FRC’s consideration. Key to our suggestions is ensuring that there is sufficient distinction between the roles of INEs and the firm’s management such that INEs’ oversight role is maintained.

AFGC Provisions (emphasis added in bold)	EY comments and drafting suggestions
8: “Management should ensure that, wherever possible and so far as the law allows, members of governance structures and independent non-executives have access to the same information available to Management. ”	This goes beyond what is required under the UK Corporate Governance Code and also has practical implications. INEs should have the rights to request the information they need to discharge their duties under the AFGC effectively and executive management the obligation to explain reasons (if any) why any such requests were denied.
15: “A firm should assess and monitor culture. It should conduct a regular review of the effectiveness of the firm’s system for the promotion and embedding of an appropriate culture	If the firm’s role is to “undertake a regular review of effectiveness of its system for promoting and embedding an appropriate culture...”, it is not appropriate for the INEs to be “involved in this [same] review” given the general principle that

<p>underpinned by sound values and behaviour across the firm, and in audit in particular. Independent non-executives should be involved in this review. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the purpose of this Code, it should take corrective action.”</p>	<p>INEs are expected to exercise independent oversight over management.</p> <p>INEs should receive the results of such a review (conducted by management) and be responsible for reviewing the analysis and challenging its findings including the rationale for gaps between desired and actual culture and overseeing the actions management are taking/ plan to take to address/close these gaps.</p> <p>Additionally, as noted in our covering letter, the focus should be on culture in the audit practice as this is key to audit quality, rather than firmwide culture. This is within the remit of the Audit Board in operationally separate firms.</p>
<p>16: “The independent non-executives should be satisfied that there is an effective whistleblowing policy and procedure in place and should monitor issues raised under that process.”</p>	<p>INEs should receive reporting from the monitoring performed by the responsible officer in the firm and they should monitor whether the whistleblowing policy has been followed, the procedures are effective and that management is taking appropriate action.</p>
<p>17: “Independent non-executives should be involved in reviewing people management policies and procedures, including remuneration and incentive structures, recruitment and promotion processes, training and development activities, and diversity and inclusion...”</p>	<p>Such policies should be reviewed by the responsible officer for people/talent management and in line with their oversight and monitoring role, INEs should:</p> <ul style="list-style-type: none"> ▶ get assurance from management that material/key people related policies in the areas mentioned are current and that they are in operation, and ▶ review the key outcomes of policies and procedures including where appropriate, with supporting data points.
<p>24: “A firm should monitor its risk management and internal control systems, and, at least annually, conduct a review of their effectiveness. Independent non-executives should be involved in the review which should...”</p>	<p>In the same vein as Provision 15, INEs should receive the results of the review of the effectiveness of risk management and internal control systems, conducted by management rather than be involved in the same review.</p> <p>Their role should be to understand and challenge the findings and the actions that management plan to take to improve the effectiveness of risk management and internal control systems and follow up periodically on progress.</p>
<p>25: “A firm should carry out a robust assessment of the principal risks facing it, including those that would threaten its business model... Independent non-executives should be involved in this assessment.”</p>	<p>INEs should be appraised of the firm’s assessment, be given the opportunity to input to this assessment in light of their skills and experience, and challenge the scenarios modelled and their key assumptions.</p>

<p>29: “Independent non-executives should ... be embedded in other relevant governance structures within the firm as members or formal attendees with participation rights.”</p>	<p>We request the FRC clarify the phrase “embedded in other relevant governance structures” as it is ambiguous and the impact on the remit of INEs (which is to provide independent oversight rather than make decisions) is unclear.</p>
<p>30: “Independent non-executives should have full visibility of the entirety of the business.</p> <p>They should assess the impact of firm strategy, culture, senior appointments, financial performance and position, operational policies and procedures including client management processes, and global network initiatives on the firm and the audit practice in particular.</p> <p>They should pay particular attention to and report in the transparency report on how they have worked to address: risks to audit quality; the public interest in a firm’s activities and how it is taken into account; and risks to the operational and financial resilience of the firm.”</p>	<p>We have proposed an amendment to the language of Provision 30 in response to Q7 above.</p> <p>Separately we consider it is more appropriate for management to present to the INEs its assessment of the impacts of the aforementioned matters with regard to audit quality and the resilience of the audit practice and the actions it intends to take in response to the findings from this analysis (rather than INEs performing an assessment). The INEs should have the opportunity to query the analysis and challenge the proposed response.</p> <p>The wording “how they have worked to address” implies a management role. The INEs’ role should be to report how they have overseen the firm’s work in these areas including their challenges to management.</p>
<p>Provision 41: “Independent non-executives should participate in governance structures operating across the entirety of the firm and pursue the purpose of this Code at the firm-wide level. They should: i) monitor the activities of the wider firm and global network for their potential to affect audit quality and the resilience of the audit practice; and ii) ensure the firm takes account of the public interest in its wider decision making”</p>	<p>We are unclear as to the meaning of “participate in a governance structure” particularly given the INEs are not part of the decision making. There is also overlap with Provision 29 which stipulates that INEs “should ... be embedded in other relevant governance structures within the firm”.</p> <p>In respect of global network arrangements, see our response to Q7 above.</p>

Q.12: What are your views on the proposed boundaries between the responsibilities of INEs and Audit Non-Executives? Please give examples of any potential difficulties you foresee with what is proposed.

In line with the view expressed in our covering letter that the AFGC should take fuller account of the impact of operational separation, and that it should be structured to focus on the audit practice, greater clarity should be provided in respect of the overlapping responsibilities of INEs and ANEs. This is particularly so for audit quality which predominantly falls within the oversight remit of the ANEs and is the responsibility of the Audit Board. We suggest that the FRC re-consider Principle M of the AFGC which states that INEs should “*collectively enhance the firm’s*

performance in meeting the purpose of this Code”, of which the first “principal objective” is “to promote audit quality”. Other examples of overlapping responsibilities include:

- ▶ Provision 17: “They [the INEs] should monitor the firm’s success at attracting and managing talent, particularly in the audit practice.” This should be a specific role for the ANEs.
- ▶ Provision 15 on INEs’ role in assessing and monitoring culture: we believe that ANE’s should specifically review the culture in the audit practice which could be different (validly) to the rest of the firm.

As noted in our response to Q4 on the timeline proposed by the Consultation, we believe that this is an area where, in time, the FRC would better be able to clarify the boundaries between INEs and ANEs as they would have the benefit of assessing the effectiveness of governance processes (including the role of ANEs) in the operationally separate firms.

<ENDS>