

Private and Confidential

By email
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Dear Sirs

Proposed revisions to the Audit Firm Governance Code

BDO LLP welcomes the opportunity to comment on the FRC's proposed revisions to the Audit Firm Governance Code. At a time of considerable change in audit, corporate governance and financial reporting we are generally supportive of the proposals which aim to enhance trust and confidence in the value of audit amongst stakeholders and in the capital markets as a whole.

We would raise two matters that should flow through all answers to the consultation:

1. There needs to be greater clarity on the definition of "Public Interest". If Firms are to be held to account on the Public Interest then there has to be an ability to set internal guidance based on a clear definition. By not defining Public Interest the ability to apply retrospection to any challenge is unfair on the Firms. The FRC need to define what they understand "Public Interest" to be given in the Consultation Document they refer to themselves as the "proxy of Public Interest".
2. Underlying all aspects of the Code there needs to be an understanding that Firms are not corporate vehicles with a removed ownership structure. As Members of the Limited Liability Partnership (often referred to as Equity Partners) there is a direct connection between ownership and Governance. Therefore a comparison to the corporate environment is not always a good measure.

In relation to our specific responses to the questions raised in the Consultation Document, we set these out below.

Q1. How appropriate do you feel that the revised purpose of the proposed 2022 Code is?

The revised purpose of the proposed 2022 Code feels relevant and we consider that the proposed changes are sensible. We agree that the focus on the whole firm rather than just the audit business is important given the financial and reputational risks affect the whole firm rather than just one business line.

Q2. What are your views on the proposed thresholds for application of the proposed 2022 Code?

We agree with the proposed thresholds for application of the proposed 2022 Code but these will need to align fully with the BEIS PIE definitions when these are finalised in due course.

In relation to the proposed extension of the PIE definitions our preference remains option 1 (consistent with our comments to BEIS). Bringing an additional 1,000 entities into the PIE definition, whilst potentially not widening the number of Firms in scope, does significantly increase the burden on existing in-scope firms in terms of the necessary audit and quality control procedures required for each of these additional PIE audits.

Q3. Should the proposed 2022 Code apply to any firm that audits a FTSE350 company? Please suggest alternatives.

We agree that any firm auditing a FTSE350 company should be required to apply the proposed 2022 Code due to its significance in the capital markets and its level of public interest. This is essential to maintaining market confidence in audit. We would also expect that any firm auditing in this market should have the ambition to audit more than just one PIE otherwise this is just a convenience appointment.

We would also suggest including any AIM50 company as these are equivalent in size to companies in the FTSE250 and therefore attract a similar level of public interest.

We would also expect that the FRC's supervision requirements of firms performing these audits to be consistent given the aim to maintain market confidence in audit.

Q4. What are your views on the proposed effective date of the proposed 2022 Code?

As a firm that already applies the 2016 Code the proposed effective date of the 2022 Code is manageable. However, we do think we need to have more certainty in terms of the BEIS report for the implementation of the 2022 Code to be effective, with complete clarity on the proposed reforms. As a minimum the revised definition of PIE needs to be determined before the 2022 Code is released.

Q5. What are your views on the priorities for engagement with investors, audit committee members and accountability to owners?

Improved quality of engagement is important so that stakeholders are better educated as to the value and purpose of audit and any bias is addressed. There is a clear need to ensure meetings with stakeholders are purposeful. We agree that the best place for encouraging stakeholders to engage is through the UK Stewardship Code. However, we do recognise that it is difficult to force stakeholders to engage if they have no appetite so to do. For challenger firms it is even more difficult to encourage stakeholders to engage. We would welcome the FRC's assistance in facilitating engagement with stakeholders.

Q6. To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?

We are supportive of the changes proposed in the areas of partner oversight and accountability to owners, particularly the roles of senior and managing partner, which we believe should be separate.

We would welcome some clarity or guidance on thresholds that may be used to assess when a partner would be considered to have significant management responsibilities.

Q7. 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 are supportive of the proposals to underpin connectivity with the global network and the monitoring of its potential to impact the UK Firm. Full information about potential risks in the global network should be available to INEs and if decisions are being made at a global level that impact the UK Firm it is important that these are clearly referenced. Connectivity with the global network should be via the Managing and Senior Partners, or those with specific responsibilities, who should formally report to the UK Firm on matters of global influence.

Q8. 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.

We are supportive of the approach taken to people and culture in section B of the proposed 2022 Code. However, we believe that having the right culture has wider relevance than just supporting the consistent performance of high-quality audit and should also support consistently high-quality engagements across the whole firm. All engagements carried out by the firm, whether they are in the audit business or in other business service lines, should be performed with consideration of all stakeholders and to safeguard the long term sustainability of the firm.

Q9. 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?

There are no other matters or suggestions that we can add.

Q10. Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?

We believe that the proposed 2022 Code is clear enough about the role INEs play in the Firms.

We believe that INEs should regard themselves as guardians of the interest of all stakeholders, including employees, partners, suppliers, clients, investors in clients and, of course, the FRC. We are concerned that in considering the FRC to be acting as proxy for the “Public Interest” (and see our earlier comments concerning these words), the INEs become directly accountable to the FRC. We consider that the governance of the firm would suffer if this were to occur and furthermore consider that if this is the intention that INEs should potentially be appointed by the FRC rather than by Firms.

As noted above, we would also welcome the FRC to take more steps to define the “Public Interest” if these are the words that the FRC wishes to continue to use. We think this will assist both Firms and INEs to discharge their roles most effectively and avoid unhelpfully differing interpretations.

Q11. 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.

We are concerned that the proposals for the strengthening the status and role of INEs will significantly increase the burden on INEs and reduce their impact and effectiveness rather than strengthen it.

Firms do differ from corporate entities in that their owners are actively involved in managing the business and therefore the role of INEs is different. We therefore question whether there is a real need to strengthen the role of INEs in the ways proposed.

In a number of areas the suggested involvement of the INEs (eg their involvement in assessing culture and in the review of the effectiveness of the firm's risk management and internal control systems) appear to be executive rather than non-executive activities. The blurring of these executive and non-executive roles should be avoided in the proposed 2022 Code.

Q12. 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.

We are concerned that there may be a duplication of effort between the audit board and governance bodies for the whole firm.

Where audit is a large proportion of a firm's overall business (as it is for our firm) it may be difficult for INEs to have full oversight of the firm if they are not sufficiently involved in oversight of the audit business. If Audit Non-Executives are required to be appointed, there will need to be additional processes and controls to ensure that all the INEs have an appropriate level of oversight over the audit practice. We think that this will at best result in duplication and at worst it will become unclear how the INEs are to exercise their oversight role over the audit practice.

As INEs are independent across the firm's business it is not clear to us why there is a need to have separate Audit Non-Executives. We are also concerned that this role separation creates an inconsistency with the AFGC aim that it should apply across the whole firm.

Additional comments on the proposed 2022 Code

Section E of the proposed 2022 Code covers operational separation of the audit business. We would welcome some clarity in the proposed 2022 Code for firms and also stakeholders as to the thresholds at which a firm would be required to apply operational separation (eg, size, market share of PIEs).

We have shared this letter with our INEs who are in agreement with its contents. If you would like to discuss any of the above, or have any questions relating to it, please contact Matthew White on [REDACTED].

Yours faithfully



BDO LLP