



Financial Reporting Council

# Consultation Document

## Proposed Revisions to the Audit Firm Governance Code

August 2021

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# Section 1: Executive Summary

The Audit Firm Governance Code (“the Code”) is an important part of the UK regulatory framework around audit. The Code was created in 2010 to improve the governance in place at the largest audit firms (“Firms”) with the aim of promoting public confidence in audit. While the Code’s primary purpose is the protection of the audit practice and the promotion of audit quality, the public interest in the Firms’ activities reaches beyond audit. For example, there is a public interest in the activities of the whole Firm and its global network because of their potential to affect the audit practice.

Accordingly, the proposed 2022 Code will continue to focus on governance at the firm-wide level and to pursue broad objectives related to the public interest and market resilience.

Public confidence and trust in audit has been damaged following high-profile corporate collapses, in which the quality of the audit and the role of the auditors have been called into question. Perceptions of conflicts of interest persist, despite prohibitions on the provision of non-audit services to audit clients.

These events led the Department for Business, Energy and Industrial Strategy (“BEIS”) to consult on a package of reforms to restore trust in audit and corporate governance.<sup>1</sup> Operational separation of the audit practice from the other parts of a Firm’s business is a key element of the proposed reforms. Our review of the Code has considered the implications of operational separation and what that means for governance at the firm-wide level and for the Code.

Confidence in audit means having confidence in the Firms’ capabilities and in their commitment to delivering high-quality audit on a consistent basis. Firms that are well governed are more likely to meet expectations for high-quality audit. The Code plays an important role in this by establishing minimum expectations around governance at Firms.

The Code goes beyond legislation and aims to drive good practice at Firms. It draws on the approach to governance in companies as embodied in the UK Corporate Governance Code and tailors this for an audit firm and partnership context. As public appreciation of the role of audit in supporting companies to create long-term value for people and society grows, so the Code must develop to support a focus on the public interest by those Firms. Our review has considered to what extent the Code might evolve to contribute to this broader agenda and help rebuild confidence in audit.

We have approached this review with a view to refreshing and sharpening the Code, clarifying expectations, deepening its focus and strengthening its impact. We encourage Firms to focus on the Principles and how they apply them, and to include a meaningful explanation in their transparency reports where they have not followed a Provision. The proposed 2022 Code adopts Principles and/or Provisions in a number of new areas and will align and integrate the scope of the Code with the rest of the regulatory framework for audit, which is based around public interest entities (“PIEs”).

In terms of which firms should apply the proposed 2022 Code, we propose setting staggered thresholds that will provide stability for firms. We estimate that the proposed thresholds will mean that an additional three firms are expected to apply the proposed 2022 Code.

We are proposing to change the format and structure of the proposed 2022 Code to be clearer and sharper and to align it with the structure of the 2018 UK Corporate Governance Code.

The proposals refine the stated purpose of the Code, retaining a focus on promoting audit quality, while shifting the emphasis more squarely onto the public interest and reframing the third objective around audit firm resilience.

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<sup>1</sup> [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/970673/restoring-trust-in-audit-and-corporate-governance-command-paper.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/970673/restoring-trust-in-audit-and-corporate-governance-command-paper.pdf)

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We have sought to:

1. strengthen the Code in those areas where we have identified gaps in the 2016 Code or weaknesses in firm implementation;
2. provide greater clarity in areas where stakeholders tell us the 2016 Code is insufficiently precise or detailed;
3. reflect recent developments in good governance practice;
4. eliminate or reduce overlap with requirements based in law, regulation or standards;
5. align the Code with the language and intent of the new International Standards on Quality Management (UK); and
6. establish the boundaries between the responsibilities of independent non-executives (INEs) and Audit Non-Executives in firms with operationally-separate audit practices, currently the "Big Four".

We have strengthened the Code in the areas of accountability, culture, sustainability, and resilience. We have added Provisions that the most senior governance body at a firm ("the Board") should be comprised of a majority of partners that do not have significant management roles. We have also clarified and strengthened the role of this Board and introduced a separation between the role of chair and that of the managing / senior partner. A separation of the roles of chair and chief executive is a core element of the UK Corporate Governance Code.

We have incorporated an emphasis on long-term sustainability, people, culture, and employee engagement in line with the UK Corporate Governance Code. The Firms are first and foremost people businesses. We have brought people matters together with values, behaviour, and culture as a way of giving them added prominence and because they are closely connected. We have assigned specific responsibilities to the Board and to INEs in these areas.

The proposed 2022 Code emphasises the financial and operational resilience of Firms and sets expectations around the relationship between a Firm and its INEs with the regulator.

The 2016 Code provided considerable flexibility and Firms each developed their own approaches, leading to significant differences in their governance structures, as well as the positioning and activities of INEs. The proposed 2022 Code seeks to drive more consistency in how INEs are embedded in governance structures. It also provides more clarity on the role and status of INEs and their responsibilities under the Code. Lastly, it establishes the boundary between the responsibilities of INEs and Audit Non-Executives in Firms with operationally-separate audit practices.

We believe these changes will create a Code that will provide a solid foundation for governance at Firms for at least the next five years, dovetailing with operational separation for the 'Big Four'<sup>2</sup> and supporting smaller Firms to raise standards, improving their approach to governance and safeguarding the public interest.

<sup>2</sup> Deloitte LLP, EY LLP, KPMG LLP, PwC LLP

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## Section 2: Introduction

The Code was first introduced in 2010 and updated by the FRC for the first time in 2016. Audit is a statutory function in which there is considerable public interest. The purpose of the Code is to enhance trust and confidence in the value of audit amongst stakeholders and in the capital markets as a whole.

We are revising the Code in 2021/2022 to ensure that it is consistent with regulatory requirements for audit firm governance, including operational separation, to close gaps and address weaknesses identified by our monitoring work in 2020, to provide greater clarity over roles and responsibilities, and to reflect good practice identified by our monitoring work and more recent developments in governance practice in companies.

Since it was first introduced in 2010, the Code has greatly enhanced the approach of the Firms to public interest matters and to governance more broadly. Undoubtedly the most significant change brought about by the Code has been the appointment of INEs.

At the time of its introduction, it was the only Code of its kind and the UK remains one of the few jurisdictions to have a Code and make provision for INEs. The Code is a vital element of the regulatory framework for audit, alongside the various ethical and quality standards that auditors must follow.

The Code is based on a set of Principles, supported by 'comply or explain' Provisions, which aim to promote good governance and ensure Firms have appropriate levels of oversight and are taking account of the public interest in the way they operate. This, in turn, should support the consistent performance of high-quality audits by stable, sustainable, and resilient Firms.

Our review has considered the Code's purpose, its structure and format, who should apply it (its scope), along with the relevance of its content. All existing Principles and Provisions have been reviewed to examine their value considering the forthcoming regulatory changes and the evolving regulatory landscape. The Government has consulted on '*Restoring trust in audit and corporate governance*'. We will keep abreast of any developments and may make consequential changes to the Code, once the outcome of the Government's consultation is known.

Operational separation is being implemented by the 'Big Four' on a voluntary basis in the expectation that legislation will follow. These four Firms have agreed to separate their audit practices from the rest of the business by 2024. In practice, all four will have established separate audit practice governance by October 2021. This will have implications for the role of INEs and governance at the firm-wide level which our review has addressed.

To guide this review the FRC sought input from a broad range of stakeholders via meetings and roundtables. This included existing INEs, Firms and external stakeholders, including audit committee chairs, investors, finance directors, and an academic and former INE, who agreed to join a Stakeholder Advisory Group. Their input has informed the drafting of the proposed 2022 Code. We would like to take this opportunity to thank everyone who has contributed their time and expertise to support this review.

The proposed 2022 Code can be found at Appendix 1. Appendix 2 is a schedule of the proposed 2022 Principles and the rationale behind them. Appendix 3 is a reconciliation of the 2016 Code against the proposed 2022 version.

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The proposed 2022 Code is organised by theme in five sections.

- Sections A-C are directed primarily at Firms applying the Code and deal with the themes of leadership; people, values, and behaviours; and operations and firm resilience.
- Section D is directed primarily at INEs.
- Section E is directed at those firms with operationally-separate audit practices and deals with the respective roles and responsibilities of INEs and the independent members of Audit Boards, known as Audit Non-Executives.<sup>3</sup>

<sup>3</sup> See Appendix 1

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## Section 3: How to Respond

Comments on the questions set out in this consultation document are requested by **18 November 2021**. Responses should be sent by e-mail to [afgcreview@frc.org.uk](mailto:afgcreview@frc.org.uk).

or in writing to:

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Please note that it is advisable to send your response electronically. All responses will be acknowledged.

It is the FRC's policy to publish on its website all responses to formal consultations unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or email addresses) from submissions; therefore only information that you wish to be published should be submitted.

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## Section 4: Purpose of the Code and Application Scope

This section considers overarching issues relevant to the Code, namely its purpose and objectives, which Firms are expected to apply the proposed 2022 Code, when the proposed 2022 Code should take effect, transparency reporting and stakeholder engagement.

### Purpose of the Code

The purpose of the Code and the broader framework for audit firm governance is currently:

1. To promote audit quality.
2. To help the firm secure its reputation more broadly, including its non-audit businesses.
3. To reduce the risk of firm failure, which in relation to the largest firms would be of systemic significance.

Broadly, our outreach found widespread support for this purpose. Stakeholders believe these objectives continue to be relevant and appropriate. With respect to objective three, there was resounding support for reframing it in a more positive way and aligning the purpose with the two overarching objectives of the FRC's monitoring and supervisory regime, namely improving audit quality and promoting audit firm resilience and by extension audit market resilience. We believe that audit firm resilience will be easier to translate into meaningful activity and for INEs to demonstrate how they are working to meet that objective.

There was also some support for a more explicit connection to the public interest in the Code's purpose. This should provide a useful bridge to the role of INEs and could help to raise awareness among stakeholders of the role that they play in ensuring the public interest is a significant driver of the way in which Firms operate.

We therefore propose revising the Code's purpose as follows:

1. To promote audit quality.
2. To ensure firms take account of the public interest in their decision-making, particularly in audit.
3. To safeguard the sustainability and resilience of audit practices and of firms as a whole.

We consider that this refreshed purpose encompasses everything in the current one since a Firm's reputation is critical to sustainability and resilience and would therefore continue to be covered under objective three. Objectives two and three continue to make it clear that the Code is not only relevant for the audit practice but applies to the whole Firm.

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

#### Application Scope

Firms that audit more than 20 listed companies currently fall within the scope of the 2016 Code. Six firms meet the current threshold of 20 listed company audits and two others choose to apply it.

Given that the regulatory framework for audit is based around PIEs, we are proposing that application should in future be linked primarily to the audit of PIEs.

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We consider that stability in application is desirable, so that Firms do not move in and out of scope unless there is a significant shift in either direction in the number of PIEs they audit. We therefore favour setting the threshold for starting to apply the proposed 2022 Code higher than the threshold for stopping.

In addition, we consider that it would be in the public interest for Firms that audit one or more FTSE 350 companies, but otherwise audit few PIEs, to meet minimum standards of governance and attention to the public interest in the way they operate.

Accordingly, we are proposing that Firms should apply the proposed 2022 Code:

*“once they audit 20 or more PIEs or if they audit one or more FTSE 350 companies. Where the number of PIE audits conducted by a firm applying this Code drops below 10 and a firm does not audit any FTSE 350 companies, it may cease to apply this Code.”*

The gap between the two thresholds should help to avoid situations in which Firms move in and out of scope as a result of small changes in the number of PIE audits they undertake. We recognise that companies can move in and out of the FTSE 350, which may lead to some instability in application of the proposed 2022 Code.

We estimate that three firms that audit more than 20 PIEs would be brought into scope if the threshold were set at this level, one of which already chooses to apply the Code. The other two would need to start applying the proposed 2022 Code from 2023. And there is one firm that audits one or more FTSE 350 companies that would also need to start applying it.

Applying the proposed 2022 Code would create some additional one-off and recurring costs for these Firms, for example as a result of the requirement to appoint INEs. Smaller Firms would be expected to appoint a minimum of two INEs to comply with the Code. There are likely also to be some costs, for example management time, involved in making other adjustments to governance. As the Code operates on a ‘comply or explain’ basis, it would be open to smaller Firms, if they felt the costs were disproportionate, to explain how they had met the expectations of the Code in a different way to the one set out in the Provisions.

These costs must be viewed in the context of the considerable benefits that we believe should result from applying the proposed 2022 Code. First, it should improve governance and, by extension, resilience. Second, it would give access to an external perspective from INEs. Third, it should put firms in a stronger position to take on additional PIE audits in the future, which would support competition in the audit market overall.

#### *Possible Extension of the PIE Definition*

The thresholds we have proposed are based on the current definition of a PIE:

- entities whose transferable securities are admitted to trading on a regulated market;
- credit institutions; or
- insurance undertakings.

The statutory audits and auditors of PIEs are subject to more stringent regulation than those of other entities. There were 1811 PIEs under the current definition as of 30 June 2021, and they are audited by 35 different firms.

The BEIS consultation, *‘Restoring trust in audit and corporate governance’*, proposed extending the UK’s definition of PIEs 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.”<sup>4</sup>

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<sup>4</sup> Page 33, ‘Restoring trust in audit and corporate governance’

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The two options proposed are:

**Option 1:** Large companies which are already required to include a corporate governance statement in their directors' report, which 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.

**Option 2:** Large companies with both: over 500 employees, and a turnover of more than £500 million.

BEIS estimated that Option 1 would mean that approximately 1,960 entities would be brought within the definition of a PIE, whereas option 2 would mean around 1,060 additional entities being caught by the definition. Under both options 114 UK incorporated AIM companies with a market capitalisation greater than €200m would also be brought into scope.

Based on the data currently available we do not believe that either option 1 or option 2 would lead to any additional Firms coming within scope of the proposed 2022 Code. Nevertheless, we cannot rule out the possibility until the outcome of the BEIS consultation is known and updated data is available. If any smaller Firms believe they could be affected based on the scope proposed for the 2022 Code, we would like to hear from them.

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

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

#### **Effective Date of the Proposed 2022 Code**

Subject to the outcome of this consultation, we will aim to publish a final version of the Code in spring 2022. The proposed 2022 Code will take effect from accounting periods beginning on or after 1 January 2023. This will enable Firms applying the Code for the first time to recruit INEs and make other arrangements, and existing Firms to make any necessary adjustments to how their governance operates currently. It will also mean that we should have more certainty over the Government's intentions regarding the definition of PIEs.

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

#### **Transparency Reporting**

Appendix B to the proposed 2022 Code concerns transparency reports.

By law, statutory auditors and auditors of PIEs are required to publish a transparency report on their website within four months of the end of their financial year.

Of the 33 entities required to produce a transparency report, only nine currently apply the 2016 Code, as set out below.<sup>5</sup>

Entities within the expressed scope of the Code	Entities that voluntarily adopt the Code
BDO LLP	Mazars LLP
Deloitte LLP	National Audit Office
Ernst & Young LLP	RSM UK Audit LLP
Grant Thornton UK LLP	
KPMG LLP	
PricewaterhouseCoopers LLP	

The 2016 Code includes a number of reporting provisions. While there is some overlap with the requirements of EU Regulation 537/2014, the 2016 Code provides for additional disclosures that would not otherwise be made.

Our reviews of the transparency reports of the seven largest Firms from 2018, 2019 and 2020 found very few instances where non-compliance was confirmed and an explanation provided. The few explanations identified occurred in respect of Provision C.1.1, where fewer than the required number of INEs were in place.

Common practice for most is to state they have fully complied with the 2016 Code and to include an appendix directing the reader to the relevant section of the transparency report for more information on the various matters covered by the 2016 Code. We have found that it was not always clear whether a particular Provision had been complied with and working this out required the reader to invest considerable time reading and cross-referencing the report.

We have therefore sought to make it clearer in the proposed 2022 Code that Firms should articulate how they have applied the Principles. Where a Firm has not followed a particular Provision, it should explain why, the alternative arrangements in place, how these achieve the desired outcome by different means, and whether the non-compliance is temporary and if so for how long.

#### *Purpose and usefulness of transparency reports*

We are aware that not all stakeholders believe transparency reports are as useful as they could be.

The FRC's 2019 thematic review, 'Transparency Reporting', found that, while they generally provide the information required, the reports "are not being read by the intended beneficiaries, principally investors and Audit Committee Chairs and members." The two main problems identified were:

- a lack of awareness amongst investors and audit committee chairs that the reports exist; and
- for those that are aware of the reports, a view that they are too long and overly positive to be useful. This is unsurprising given that many Firms have seen the reports as a marketing opportunity rather than solely an accountability or compliance document.

<sup>5</sup> Page 4, FRC Thematic Review, 'Transparency Reporting', September 2019

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Transparency reports should provide stakeholders with important information about each Firm's quality processes. Feedback suggests that Firms could improve their transparency reports by making them shorter and sharper, tailoring them to the intended audience and explaining within them the challenges they are facing in seeking to deliver consistently high-quality audits, the actions they are taking to improve quality, along with their assessment of how successful their efforts are at delivering the desired outcomes.

In summary, despite improvements in the reports over time, there is clearly more to be done to convince audit committee chairs, finance directors, investors and other stakeholders to read and discuss these reports with Firms. We believe the most effective way to improve the reports is direct dialogue between stakeholders and Firms.

### **Adoption of provisions in the UK Corporate Governance Code**

Provision E.2.2 of the 2016 Code states:

*"In its transparency report the firm should give details of any additional provisions from the UK Corporate Governance Code which it has adopted within its own governance structure."*

Most firms state in their transparency reports that they have not adopted additional requirements from the UK Corporate Governance Code. Nevertheless, we have found examples of Firms adopting good practice from the UK Corporate Governance Code, in particular the practice of conducting board effectiveness reviews.

Feedback suggests that Provision E.2.2 is difficult to report against. On balance, we consider Provision E.2.2 does not have a significant impact on governance practice and lacks transparency. We have concluded that, if a particular aspect of governance is important, it should be incorporated into the proposed 2022 Code for all Firms to adopt. This would be clearer and simpler, and more likely to drive good practice across the board.

### **Stakeholder Engagement**

Section F of the 2016 Code concerns stakeholder engagement. Principle F.1 deals with firm dialogue with listed companies, their audit committees and shareholders. The Code is aimed at Firms, and Principles F.2 and F.3 are directed at shareholders rather than Firms and their INEs, so therefore do not sit easily in the 2016 Code.

Our 2020 assessment of implementation of the 2016 Code by Firms found that, while executives engage regularly with investors and companies on a range of matters, INE involvement has tended to be limited to engagement with the Company Reporting and Auditing Group and, more recently, the Audit Committee Chairs' Independent Forum. At the 'Big Four', INEs also report taking part in firm-sponsored events and roundtables with investors and audit committee chairs.

Other areas of good practice identified at individual firms included:

- INEs review the Firm's strategy for engagement with investors; and
- INEs regularly review their own plans for engagement with investors and other external stakeholders.

Dialogue on matters of governance with listed companies, their audit committees and shareholders can help build confidence in audit firms and the way they governed and run, while dialogue with INEs is useful for raising awareness of the INE role and the public interest focus at Firms. Nevertheless, anecdotal evidence suggests limited appetite, in particular among investors, for engagement on governance matters with Firms or their INEs.

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While this is an area where firms and INEs could look to increase their efforts, we believe that a coordinated effort across firms, investors and audit committee chairs is likely to be more effective. We therefore propose removing Principles F.2 and F.3 with a view to consulting on tackling this in the next revision of the UK Stewardship Code and the introduction of standards for audit committees. Principle F.1 and Provision F.1.1 have been merged and refocused on INE engagement as we consider that INEs will be more effective if they have opportunities to understand the user experience of audit.

**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 between these groups and INEs?**

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## Section 5: Leadership

Section A of the proposed 2022 Code brings together concepts related to the leadership of a Firm and oversight of senior management by the Firm's partners via its most senior governance body, referred to in the 2016 and proposed 2022 Code as 'the Board'.

The 2016 Code sets expectations that Firms should put in place governance arrangements that ensure:

- i) management is accountable to the firm's owners;
- ii) there are checks and balances on individual power; and
- iii) there is meaningful oversight of the way management is running the firm.

However, the high-level wording in the leadership section of the 2016 Code has provided considerable room for interpretation and led to different practices between firms. Our monitoring work in 2020 found that, at most firms, the role of the Board<sup>6</sup> (usually made up of elected partners who do not hold significant management roles) in overseeing how Management<sup>7</sup> runs the business was underdeveloped and could benefit from being strengthened.

### *Accountability*

The governance of partnerships differs from companies. The interests of owners and those running the firm are more closely aligned in partnerships. Other differences include:

- Better access to information and greater involvement and influence by owners over the running of the business.
- The process of elections for leadership roles.
- Fixed terms for the managing partner and in some cases his/her management team.
- No share prices or associated long-term incentive plans.

This has led some to question why the Code should be concerned with accountability to owners at all. While the public interest in audit is the main consideration for the regulator, it is impossible to separate this from the resilience of a firm as a whole. From a regulatory perspective, stable, sustainable and well-run firms that are able to focus on fulfilling their public interest remit are desirable. We consider that effective accountability to partners (as owners) supports overall firm resilience. Accountability helps mitigate the risk that management becomes detached from partner views or that partners become dissatisfied, destabilising a firm.

### *Partner oversight*

We believe that the proposed 2022 Code should be clearer about the role of the Board in challenging Management and holding them to account for how they run the Firm. It should set clear expectations in areas like board composition and responsibilities. This should help to drive a more consistent minimum standard of oversight across all Firms applying the proposed 2022 Code, for the benefit of partners, regulators and the public interest in well-governed firms. Greater alignment should also make it easier to communicate to external stakeholders about governance.

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<sup>6</sup> A firm's most senior governance body.

<sup>7</sup> A firm's senior executives.

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We are proposing to strengthen partner oversight in the following ways:

1. Placing an explicit responsibility on boards for oversight and challenge of management – Principle B.
2. Specifying in the proposed 2022 Code some critical areas, such as strategy, resilience, culture, and risk, which a firm’s board should oversee. This should include having some things reserved for its decision – Provision 4.
3. Clarifying that a majority of the Board should be partners without significant management responsibilities, i.e. who are remote from the day-to-day management and leadership of the firm – Provision 2.
4. Asking Firms to put in place arrangements for determining the reward and progression of Board members that will support open and robust challenge at the Board and reduce the disincentive to challenge the managing/senior partner. This could help to mitigate concerns among elected Board members that challenging Management could be harmful to their future compensation or career prospects – Provision 5.
5. A new Provision that those charged with governance (Board members and INEs) should have access to the same information as Management (wherever possible) – Provision 8.

### *Unfettered powers of decision*

The 2016 Code is silent on what checks and balances on individual power might look like. In practice the firms use a range of different methods to incorporate checks and balances on managing/senior partner power but there is typically little transparency around these methods, for example:

- Partner votes and powers to call them.
- Managing / Senior Partner Elections (and manifestos).
- Fixed appointment terms.
- Separation of roles.
- Minimum requirements for practicing auditors in board composition.

The UK Corporate Governance Code focuses on a separation between chair and chief executive roles and this is generally accepted as being good practice. In partnerships there are no independent directors and no independent chair to act as a counterweight to the chief executive. But partners elected to a Firm’s Board can act as a check on the power of the managing/senior partner.

The proposed 2022 Code therefore places greater emphasis on the need for checks and balances on individual power in Principle B while Provision 3 requires a separation between the roles of Board chair and managing/senior partner. We also want to encourage genuine reflection at firms on the balance of power so Provision 9 introduces reporting on the safeguards a Firm has in place and how they achieve the desired aim.

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

#### *Global networks*

The Firms are typically part of global networks. The degree of integration with those networks varies between Firms, ranging from relatively loose arrangements to fully integrated global structures.

We believe that strong global networks can have a positive impact on audit quality and on the resilience of Firms. At the same time, there are risks from having decision-making and governance arrangements for UK-based firms conducting UK statutory audits taking place in other jurisdictions. For example, a conflict between global strategic priorities and the priorities of the UK firm could pose risks to the public interest in the UK.

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The proposed 2022 Code therefore includes several additions aimed at global networks. These are spread across sections C and D.<sup>8</sup> We consider 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.

UK INEs already have a seat on a relevant global governance body at some Firms, where these exist. At other Firms, interaction with the global network is less formalised, may be less regular and more targeted on audit. We are therefore adding a Provision<sup>9</sup> to ensure that INEs have access to what is happening at the global level and are in a position to assess the potential impact on the UK Firm. In general, we also consider that strong connectivity between the audit practice and the global firm is helpful and can ensure that the global leadership is aware of what is happening in the UK.

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

<sup>8</sup> See Provisions 28, 30 and 32

<sup>9</sup> See Provision 32

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## Section 6: People, Values And Behaviour

Section B of the proposed 2022 Code brings together in one place the various people- and conduct-related matters that are spread across sections B and D in the 2016 Code, including values, culture, whistleblowing and people management.

We have incorporated into section B of the proposed 2022 Code an emphasis on long-term sustainability, culture, and employee engagement in line with the UK Corporate Governance Code.

Our monitoring work in 2020 found that people management responsibilities under the 2016 Code needed a more concentrated focus across all Firms. To give this more prominence we have integrated people management with the closely related topics of values, behaviour, and culture in a single section and assigned specific responsibilities to the Board and to INEs in these areas.

Provision 10 places a joint responsibility on a Firm's Board and Management for establishing purpose and values and ensuring that culture is aligned.

Provision 15 introduces a requirement for Firms and INEs to assess and monitor culture in line with the UK Corporate Governance Code. We envisage that both Management and the Board would be involved in culture monitoring as it is crucial to meeting the expectations under Provision 10.

The Firms are first and foremost people businesses, therefore it is critical that they pay close attention to these areas as part of a strategy for attracting and retaining talent. Maintaining the attractiveness of audit as a profession is a concern for Firms, audited entities and the FRC. Firms also play an important role in training well-rounded finance and accounting professionals, some of whom go on to senior finance roles in PIEs. The proposed 2022 Code therefore places specific emphasis on people management in Principle H and Provision 17, although the whole section is intended to drive a focus on people.

Provision 16 introduces a requirement for a Firm to establish mechanisms for engaging with its people. For example, some Firms have already set up mechanisms such as shadow boards and/or workforce advisory groups. These mechanisms should also help to contribute, alongside other initiatives, to meeting the expectations in Principle G and Provision 13. Provision 16 also covers whistleblowing mechanisms, which we envisage would exist alongside broader engagement with the workforce on a range of topics.

Provision 18 clarifies that INEs should rely on both data and two-way dialogue with a Firm's people. Our monitoring work has found that INEs are already connecting with workforce advisory groups where these exist and are taking an increasingly proactive approach. In keeping with the UK Corporate Governance Code, Provision 18 also stipulates that one INE should be designated as having primary responsibility for ensuring this engagement happens.

Provision 17 places specific emphasis on remuneration and incentive structures. Remuneration is a key driver of behaviour. We would expect INEs to have a close eye on whether the right behaviours are being incentivised in the audit practice in particular, and to seek evidence of the correlation between quality and remuneration outcomes to ensure that the public interest is protected and the Code's purpose is being achieved.

Provision 19 asks Firms to report on people engagement and how their talent management and culture promote the purpose of the Code, for example, how the culture of the audit practice supports high-quality audit.

**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.**

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## Section 7: Operations And Firm Resilience

Section C covers many of the operational and financial matters included in the 2016 Code and is central to Firms' resilience. These include the important functions of risk management and internal control, as well as financial reporting.

We have removed some elements of sections C and E of the 2016 Code. These matters are still important but are already required by law, regulation or standards. Appendix 3 reconciles the 2016 Code against our proposals.

This section also deals with the relationship between a Firm and the regulator. We expect Management to be committed to a positive attitude to working with the FRC and its successor bodies. Principle K and Provision 20 set out our expectations in this area.

The importance of effective information to support management and boards is addressed in Provision 22. Better quality management information can help Firms to identify issues and take corrective action before they become a threat to audit quality or Firm resilience. The FRC's work to identify Audit Quality Indicators,<sup>10</sup> published in 2020, is an example of one area where we are working with Firms to improve the quality of the data they collect, utilise and publish.

Provision 28 brings together reporting on a range of important matters relevant to Firm resilience. Feedback from external stakeholders suggests they are concerned with how well developed the global networks are and how joined up they are. Other things of interest include anything that could give rise to a call on capital and put a strain on the UK Firm, understanding how conflicts are managed and understanding the dynamics of inbound work and its impact.

Provision 28 therefore also introduces a new reporting element. It asks that a Firm describes in its transparency report, how it interacts with the network, the benefits and risks posed by the network and any mitigation in place. An example might be how a conflict or competing priority is being managed.

Over the past few years, several Firms have established a partner-led audit quality committee to oversee initiatives to improve audit quality. We consider this to be a positive step in supporting audit quality as an alternative to an independent Audit Board. We would welcome views on whether the proposed 2022 Code should encourage Firms that do not have operationally-separate audit practices to adopt this approach.

**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?**

<sup>10</sup> [https://www.frc.org.uk/getattachment/f116f7d7-94d8-4c82-94b2-ba24e3b195eb/AQTR\\_AQI\\_Final.pdf](https://www.frc.org.uk/getattachment/f116f7d7-94d8-4c82-94b2-ba24e3b195eb/AQTR_AQI_Final.pdf)

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## Section 8: Independent Non-Executives

Section D of the proposed 2022 Code deals with INEs and builds on section C of the 2016 Code. In the proposed 2022 Code we have sought to provide greater clarity over the expectations for the appointment, positioning, and role of INEs, with more explicit reference to the public interest and specific areas of INE responsibility.

### *INE positioning*

Key to being an effective INE is timely access to information, and the ability to challenge senior leaders and influence decision-making. Accordingly, Principle M places an expectation on firms that they will position INEs in such a way as to facilitate this and ensure they are well connected to the senior leadership, while Principle P gives INEs rights to information and people so that they can be well informed about what is happening in the Firm.

Our monitoring work in 2020 found that Firms are increasingly giving INEs a participating observer role on governance committees, particularly in the areas of audit quality, people matters, remuneration and risk. This is welcome as it gives INEs a better window on the work of the Firm and increases their visibility among executives.

Regular attendance by INEs at the board and/or committees provides independent challenge and can improve INEs' understanding of the business, the flow of information between different parts of the Firm and how the Firm operates. It also gives them early sight of important information and initiatives and additional opportunity to influence outcomes. INEs usually attend and may contribute to the debate but do not take part in decision-making.

As discussed in section 5, partners can be dependent on the support of the managing/senior partner for pay and career progression, so a strong, independent voice at the Board is important. There is also some evidence to suggest that it might embolden the partners on the Board and encourage them to be more robust in their own challenge.

We have therefore concluded that, as well as being members of a public interest body, INEs should have a formal right to attend Board and committee meetings and to participate in discussions without taking part in decision-making. Provision 29 therefore strengthens the wording in the 2016 Code. Going forward all Firms will have a public interest body, with a majority of INEs and chaired by an INE. This enables INEs to set the meeting agendas. In addition, they will need also to embed INEs in other governance structures.

INEs need access to the Firm's senior leaders and should be able to request the attendance of the managing / senior partner at meetings of the public interest body where they are not already a member. Attending the public interest body demonstrates a commitment to the public interest on the part of senior leaders and sends a signal to the rest of the firm.

### *INE numbers*

Given the increasing demands on INE time and the complexity of the largest Firms, we consider that three INEs is unlikely to be enough at these Firms going forward. However, we have decided against increasing the minimum requirement of three INEs in the Code because:

- the largest Firms either already have more than three INEs or are in the process of appointing Audit Non-Executives which will bolster the level of independent resource in those firms; and
- the revised scope we are proposing will mean some smaller Firms will be expected to start applying the Code for the first time. Although the Code operates on a comply or explain basis, we want to encourage those Firms to embrace INEs and the benefits they bring and do not consider it would be appropriate to raise the bar at the present time.

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### *INE role and responsibilities*

Our outreach with stakeholders found considerable support for more clarity in the Code over the nature of the INE role and specific INE responsibilities. Principle N articulates at a high level the role that INEs are expected to play in the Firms. As the introduction to the proposed 2022 Code describes, there is no single definition of the public interest. INEs must reflect and form their own view of the public interest in the different contexts that they encounter in the Firm. Specific areas of INE responsibility are spread across sections B, C and D of the proposed 2022 Code. Provision 30 seeks to draw together in one place the various matters that INEs should be involved with. This should be read in conjunction with those Provisions in sections B and C which confer a responsibility on INEs. Provision 30 also makes clear that INEs operate across the whole firm and are not restricted to audit.

### *INE independence and accountability*

Principle O places stronger emphasis on the importance of INEs maintaining objectivity and an independent mindset throughout their tenure. INEs must avoid aligning themselves too closely with the views of management or becoming champions for the Firm. Their role is to help the Firm identify where the public interest is engaged and make sure the Firm is taking that into account in its decision making. To support INE independence, Provision 35 introduces a maximum tenure for INEs of nine years.

In terms of INE accountability, we do not consider that INEs should be accountable to the Firms, beyond a duty of care. It is not their role to represent the views of the partnership or to help Firms commercially.

Nor are INEs formally accountable to the regulator, which does not appoint them. However, given the alignment between the interests of the regulator and those of INEs, we expect an open relationship and for INEs to alert us to concerns in certain circumstances. Principle Q, supported by Provision 38, sets expectations regarding the nature of the relationship for the first time, including a duty to alert the regulator in the circumstances stipulated. Examples might include if the INEs felt the Firm was not providing them with access to information or people, was putting them under undue influence or was not listening to them. This mirrors the approach taken in financial services regulation, where non-executive directors of regulated financial services entities are expected to have similarly open dialogue with the PRA and FCA.

### *INE appointments*

Our monitoring work in 2020 found that it was not clear at all Firms where responsibility lay for assessing the composition of the public interest body and identifying gaps in INE skillsets. Often the managing / senior partner had a decisive role in appointments. We consider that regular assessment of the continuing relevance of the skills of INEs should feed into succession planning and inform INE reappointment and recruitment decisions. Provision 31 therefore asks Firms to establish a nomination committee, including INE involvement, to lead such processes and decisions going forward. We consider that this measure will support INE independence. The nomination committee would also manage independent appointments to the Audit Board in Firms with operationally-separate audit practices.

INE workloads have increased over time at all Firms. We found that, at many of the Firms, INE workload was heavier than expected at the outset. We consider that a large gap between initial expectations and actual workload could lead to INEs resigning from their roles early or being unable to fulfil the demands of the role. It is therefore desirable for Firms to narrow the gap between expected and actual workload so that they can have a meaningful discussion with prospective applicants about the time commitment involved. The nomination committee would be responsible for this.<sup>11</sup>

### *Dealing with disagreement*

Provision 37 addresses arrangements for dealing with disagreements between INEs and the Firm. Such disagreements should be unusual but circumstances could arise in which an INE believes a Firm is acting against the public interest. INEs need a formal mechanism to escalate their concerns in such a situation in order to try to resolve the disagreement.

<sup>11</sup> See Provision 31

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Our monitoring work in 2020 found that some, but not all, Firms had procedures in place which set out a clear, multi-step escalation route for the INEs to follow, ending in public resignation in the event no satisfactory resolution could be found. These procedures should also be available to Audit Non-Executives at Firms with operationally-separate audit practices. We expect all Firms to develop a clear and transparent escalation procedure and to ensure all INEs (and Audit Non-Executives) are aware of it. Involving INEs in the development process may be helpful in achieving these aims.

**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.**

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## Section 9: Operational Separation

Section E of the proposed 2022 Code is relevant only for Firms with operationally-separate audit practices, at present Deloitte LLP, EY LLP, KPMG LLP and PwC LLP.

Our primary focus is the protection of the audit practice and the work of auditors within the wider Firm. This includes ensuring incentives are aligned with audit quality, that Firms are investing in audit, and that they have access to the necessary skills and talent. However, the audit practice cannot be viewed in isolation as it is part of the same legal entity, even where it is operationally separate from the rest of the Firm. Other parts of the Firm, for example the tax or consulting practice, as well as the global network have the potential to undermine the sustainability of the audit practice.

Principle R, supported by Provisions 40 and 41, establishes the boundary between the responsibilities of INEs and those of Audit Non-Executives. Detailed oversight of the audit practice will be the responsibility of the Audit Board and its Audit Non-Executives, while the INEs will continue to pursue the Code's purpose, including promoting audit quality, in the context of the wider Firm and the Firm's network.

In practice, INEs in these Firms will have a somewhat adjusted focus but will continue to do many of the things they do currently. Participation in firm-wide committees will continue to be the preserve of INEs. INEs will focus on firm-wide matters, such as client acceptance and continuance, financial resilience, risk management, global initiatives, culture and people matters. And they will monitor the activities of the wider Firm and the global network for their potential to disrupt the audit practice, taking action in the public interest as they deem appropriate.

We do not believe, however, that it would be productive for a Firm's public interest body to be shadowing the work of the Audit Board or impeding its independence. Principle S therefore establishes the concept of mutual reliance between INEs and Audit Non-Executives and Provision 42 envisages an open dialogue between the two where their responsibilities intersect. Consequently, the public interest body will need to collaborate with the Audit Non-Executives to the extent that the INEs need to understand what is happening in the audit practice.

In practice, some of the Audit Non-Executives might also be INEs and members of both the Audit Board and the public interest body. These individuals will provide a helpful bridge between the two and help to ensure things are joined up where they need to be. The terms of reference of the respective bodies will help give clarity about their respective responsibilities and how they interact.

**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.**

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# Summary of Consultation Questions

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

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

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

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

**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?**

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

**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?**

**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.**

**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?**

**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.**

**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.**



Financial Reporting Council

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# Appendix 1 - 2022 Audit Firm Governance Code

## Introduction

The Audit Firm Governance Code (“the Code”) was first developed by an independent working group chaired by Norman Murray (then chair of Cairn Energy plc) and published jointly by the ICAEW and FRC in January 2010. It operated on a ‘comply or explain’ basis and applied to firms auditing 20 or more listed companies. It introduced for the first time the concept of independent non-executives in the largest audit firms. Independent non-executives are now well established in many of these firms.

The Code was first updated by the FRC in 2016 following a high-level review of its implementation by those audit firms within its scope. It has been updated again in 2022 to take account of the introduction of operational separation of audit practices at the largest audit firms and findings from the FRC’s review of firm implementation against the 2016 Code. The threshold for application of the 2022 Code has been aligned with the rest of the regulatory regime for audit which is based on the audit of public interest entities (“PIEs”) rather than listed companies.

The Code applies to the firm as a whole, not purely the audit practice. It continues to apply in its entirety in firms where the audit practice is operationally-separate from the rest of the firm.<sup>1</sup>

The Code makes the following assumptions:

- that all firms within its scope are subject to the International Standards of Quality Management (UK) ; and
- that all firms within its scope are established under the Limited Liability Partnerships Act (2000) or under the Companies Act (2006) and are subject to the associated statutory requirements.

## Purpose of the Code

Audit is a statutory function in which there is considerable public interest. High-quality, reliable audit depends on well-governed, stable and resilient firms consistently delivering high-quality work. This Code is intended to enhance trust and confidence in audit amongst stakeholders and across the market as a whole.

The Code provides a framework for good governance practice against which firms that audit PIEs can be assessed and report. Its principal objectives are:

- to promote audit quality;
- to ensure firms take account of the public interest in their decision-making, particularly in audit; and
- to safeguard the sustainability and resilience of audit practices and of firms as a whole.

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<sup>1</sup> As required by statute or agreed voluntarily with the FRC or its successor bodies.

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The Code is intended to benefit stakeholders with an interest in the reliable performance of high-quality audit, including:

- investors and shareholders in PIEs;
- audited entities, particularly PIEs, and their partners, employees, suppliers and customers;
- directors, particularly audit committee members, with responsibilities for the appointment of auditors and the effectiveness of audit; and
- regulators.

### Application Scope

The scope of this Code is firms that audit PIEs.<sup>2</sup> The FRC encourages all such firms to adopt this Code voluntarily and expects firms to apply it once they audit 20 or more PIEs or if they audit one or more FTSE 350 companies. Where the number of PIE audits conducted by a firm applying this Code drops below 10 and a firm does not audit any FTSE 350 companies, it may cease to apply this Code. Firms that do not meet these thresholds and who apply the Code, may choose to apply it in a manner proportionate to their size and the nature of the entities they audit.

### Structure of the Code

The 2022 Code operates on a 'comply or explain' basis. Firms are required to apply the Principles and should describe how they have done so in their transparency reports. Firms should comply with the Code's Provisions or explain in their transparency reports why they have not, the alternative arrangements in place and how these work to achieve the desired outcome and the purpose of this Code. For example, smaller firms might choose to apply some Provisions in a way that is proportionate to their size and resources. The way in which a firm applies this Code, can demonstrate its commitment to good governance that enhances the firm's long-term sustainability and resilience and helps it to achieve the purpose of this Code.

This Code is organised by theme in five sections, as follows:

- Sections A-C are directed primarily at firms applying the Code and deal with the themes of leadership; people, values and behaviours; and operations and firm resilience.
- Section D is directed primarily at independent non-executives.
- Section E is directed at those firms with operationally separate audit practices and deals with the respective roles and responsibilities of independent non-executives and the independent members of Audit Boards, known as Audit Non-Executives.

### Operational Separation of Audit Practices

The CMA Review of 2019<sup>3</sup> recommended an operational split between the audit and non-audit practices of the largest audit firms in the UK. The Government consulted on proposals to implement operational separation in March 2021 as part of its wider consultation on *Restoring Trust in Audit and Corporate Governance*. It will apply initially only to the four largest audit firms: Deloitte LLP, EY LLP, KPMG LLP and PwC LLP.

These four firms are working with the FRC to implement operational separation on a voluntary basis ahead of legislation, if implemented. They have submitted proposals for applying the FRC's Principles of Operational Separation.<sup>4</sup> Principles 1-10 set out the requirements for the governance of operationally-separate audit practices. These require the firms to establish a separate Audit Board, with a majority of independent Audit Non-Executives, to oversee audit quality

<sup>2</sup> As defined in the Statutory Auditors and Third Country Auditors Regulations 2016

<sup>3</sup> [https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit\\_final\\_report\\_02.pdf](https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit_final_report_02.pdf)

<sup>4</sup> See Appendix C

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and the activities of the audit practice. In practice all four firms will have established separate audit practice governance by October 2021.

The Principles of Operational Separation sit alongside this Code in setting a framework for governance and oversight at those firms which are required to apply them.

The creation of Audit Boards with an independent majority will lead to consequential changes to other aspects of firm governance, particularly the role of INEs. This is dealt with in section E.

### **The Public Interest**

The public interest is an abstract concept for which there is no single definition. Its meaning depends on the context. The public interest can be described as being about putting the common good and wellbeing of society above the interests of an individual or a small group of individuals. This meaning resonates across a range of different contexts.

In the context of audit, the consistent performance of high-quality audits is in the public interest because they promote the efficient functioning of capital markets in the UK, lowering the cost of capital. Reliable corporate reporting allows market discipline to work. More broadly, it underpins public trust and confidence in the market economy. Whether or not audit firms are operating in a manner which supports the consistent performance of high-quality audits is therefore a matter of public interest. Other matters of public interest in this context include the ability of companies to find an auditor able to deliver high-quality audit services and the resilience of the audit market as a whole.

Independent non-executives have a unique role. They are not directors of the business or responsible for its strategy or performance. Independent non-executives represent the public interest and provide counsel and challenge in respect of a firm's activities from that perspective. This means acting for the benefit of the common good, not necessarily in the interests of the firm's owners (the partners), although those interests may often be aligned. Independent non-executives generally do not have voting rights or make decisions.

An integral part of the role of independent non-executives is to reflect and form views on what the public interest means in the context of audit and the activities of the firm as a whole. It is their job to help the firms to identify where the public interest in its activities is engaged and to ensure the firm is taking the public interest into account in its decision-making and how it operates.

Additional context on independent non-executives and their independence can be found in Appendix A.

Information about transparency reporting and 'comply or explain' can be found in Appendix B.

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# A Leadership

- A. A firm's Management<sup>5</sup> and governance structures should promote the long-term sustainability of the firm. To this end, the Management of a firm should be accountable to the firm's owners.
- B. A firm's governance arrangements should provide checks and balances on individual power and support effective challenge of Management. There should be a clear division of responsibilities between a firm's governance structures and its executive Management. No one individual or small group of individuals should have unfettered powers of decision.
- C. A firm's Management should demonstrate its commitment to the public interest through their pursuit of the purpose of this Code and regular dialogue with the independent non-executives. Management should embrace the input and challenge from the independent non-executives.
- D. The members of a firm's Management and governance structures should have appropriate experience, knowledge, influence and authority within the firm, and sufficient time, to fulfil their assigned responsibilities.
- E. The Management of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.

## Provisions

1. A firm should establish a Board<sup>6</sup> or equivalent governance structure to oversee the activities of Management.
2. At least half a firm's Board should be selected from among partners who do not have significant management responsibilities within the firm.
3. The chair of the Board should not also chair parts of the management structure or be the managing partner.
4. A firm's Management and Board should have a clear understanding of their authority, accountabilities and responsibilities. The Board should have clearly defined terms of reference, with matters specifically reserved for its decision, detailing in particular its role in relation to firm strategy, risk, culture and other matters relating to the purpose of this Code. Management should have terms of reference that include clear authority over the whole firm and matters relating to the purpose of this Code. Terms of reference should be disclosed on the firm's website. Terms of reference for international management and governance structures taking decisions that apply to the UK should be disclosed on the UK firm's website in the same way as for UK-based structures.
5. A firm should establish arrangements for determining remuneration and progression matters for members of the Board which support and promote effective challenge of Management.
6. The individual members of a firm's governance structures and Management should be subject to formal, rigorous and ongoing performance evaluation and, at regular intervals, members should be subject to re-election or re-selection.
7. There should be a formal annual evaluation of the performance of the Board and any committees, including the public interest body.<sup>7</sup> A firm should consider having a regular externally-facilitated board evaluation at least every three years.

<sup>5</sup> A firm's most senior executives, responsible for running the business.

<sup>6</sup> A firm's most senior governance body.

<sup>7</sup> See Provision 29.

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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.
  9. A firm should disclose in its annual transparency report:
    - a) the names and job titles of all members of the firm's governance structures and its Management;
    - b) a description of how they are elected or appointed and their terms, length of service, meeting attendance in the year, and relevant<sup>8</sup> biographical details;
    - c) a description of how its governance structures and Management operate, their duties, the types of decisions they take and how they contribute to achieving the Code's purpose. If elements of the Management and/or governance of the firm rest at an international level and decisions are taken outside the UK, it should specifically set out how management and oversight is undertaken at that level and the Code's purpose achieved in the UK; and
    - d) an explanation of the controls it has in place on individual powers of decision and to support effective challenge by Board members, how these are intended to operate and how they work in practice.

<sup>8</sup> Relevant being judged by reference as to the Code's purpose.

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## B People, Values and Behaviour

### Principles

- F. A firm is responsible for its purpose and values and for establishing and promoting an appropriate culture,<sup>9</sup> that supports the consistent performance of high-quality audit, the firm's role in serving the public interest and the long-term sustainability of the firm.
- G. A firm should foster and maintain a culture of openness which encourages people to consult, challenge, contribute ideas and share problems, knowledge and experience in order to achieve quality work in a way that takes the public interest into consideration.
- H. A 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.

### Provisions

- 10. A firm's Board and Management should establish the firm's purpose and values and satisfy themselves that its purpose, values and culture are aligned. 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 and the ability to tailor the output for the UK.
- 11. A firm should have a code of conduct which it discloses on its website and requires everyone in the firm to apply. The Board and independent non-executives should oversee compliance with it.
- 12. A firm should promote the desired culture and a commitment to quality work, professional judgement and values, serving the public interest and compliance with professional standards<sup>10</sup> and applicable legal and regulatory requirements, in particular through the right tone at the top and the firm's policies and procedures.
- 13. A firm should establish policies and procedures to promote inclusion and encourage people to speak up and challenge without fear of reprisal, particularly on matters relating to this Code and the firm's values and culture.
- 14. A firm should introduce meaningful key performance indicators on the performance of its governance system, and report on performance against these in its transparency reports.
- 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 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.
- 16. A firm should establish mechanisms for delivering meaningful engagement with its people. This should include arrangements for people to raise concerns in confidence and anonymously and to report, without fear, concerns about the firm's culture, commitment to quality work, the public interest and/or professional judgement and values. 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.
- 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

<sup>9</sup> Consistent with the requirements of Provision A.1.1 of the 2019 Revised Ethical Standard for Auditors.

<sup>10</sup> Including ethical and technical standards, and the fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour

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development activities, and diversity and inclusion, to ensure that the public interest is protected. They should monitor the firm's success at attracting and managing talent, particularly in the audit practice.

18. Independent non-executives should use a range of data and engagement mechanisms to understand the views of colleagues throughout the firm and to communicate about their own roles and the purpose of this Code. One independent non-executive should be designated as having primary responsibility for engaging with the firm's people.
19. A firm should disclose in its annual transparency report:
  - a) a description of how it engages with its people and how the interests of its people have been taken into account in decision-making; and
  - b) a description of how opportunities and risks to the future success of the business have been considered and addressed, its approach to attracting and managing talent, the sustainability of the firm's business model and how its culture, in particular in the audit practice, contributes to meeting the purpose of this Code.

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# C Operations and Resilience

## Principles

- 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.
- J. A firm should establish policies and procedures to identify, assess and manage risk, embed the internal control framework and determine the nature and extent of the principal risks the firm is willing to take while working to meet the purpose of this Code.
- K. A firm should communicate with its regulators in an open, co-operative and transparent manner
- L. A firm should establish policies and procedures to ensure the independence and effectiveness of internal and external audit activities and to monitor the quality of external reporting.

## Provisions

- 20. A firm should assist the FRC and its successor bodies to discharge its duties by sharing information openly.
- 21. A firm should take action to address areas of concern identified by regulators in relation to the firm's audit work, leadership and governance, culture, management information, risk management and internal control systems.
- 22. A firm should develop robust datasets and effective management information to support monitoring of the effectiveness of its activities, including by independent non-executives, and its ability to furnish the regulator with information.
- 23. A firm should establish an audit committee and disclose on its website its terms of reference and information on its membership. Its terms of reference should set out clearly its authority and duties, including its duties in relation to the appointment and independence of the firm's auditors. Where a firm's audit committee sits at an international level, information about the committee and its work should be disclosed by the UK firm as if it were based in the UK.
- 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 cover all significant controls, including financial, operational and compliance controls and risk management systems.
- 25. A firm should carry out a robust assessment of the principal risks facing it, including those that would threaten its business model, future performance, solvency or liquidity. This should reference specifically the sustainability of the audit practice in the UK. Independent non-executives should be involved in this assessment.
- 26. A firm should publicly report how it has applied in practice each of the Principles of this Code and make a statement on its compliance with its Provisions or give a detailed explanation for any non-compliance.
- 27. A firm should explain who is responsible for preparing the financial statements and the firm's auditors should make a statement about their reporting responsibilities in the form of an extended audit report as required by International Auditing Standards (UK) 700/701.

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28. The transparency report should be fair, balanced and understandable in its entirety. A firm should disclose in its transparency report:
- a) a commentary on its performance, position and prospects;
  - b) how it has worked to meet the legal and regulatory framework within which it operates;
  - c) a description of the work of the firm's audit committee and how it has discharged its duties;
  - d) confirmation that it has performed a review of the effectiveness of the system of internal control, a summary of the process it has applied and the necessary actions that have been or are being taken to remedy any significant failings or weaknesses identified from that review;
  - e) a description of the process it has applied to deal with material internal control aspects of any significant problems disclosed in its financial statements or management commentary;
  - f) an assessment of the principal risks facing the firm and explanation of how they are being managed or mitigated; and
  - g) a description of how it interacts with the firm's global network, and the benefits and risks of these arrangements, with reference to the purpose of this Code. This should include an assessment of any risks to the resilience of the UK firm arising from the network and any action taken to mitigate those risks.

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## D Independent Non-executives

### Principles

- M. A firm should appoint independent non-executives to the governance structure who through their involvement collectively enhance the firm's performance in meeting the purpose of this Code. Independent non-executives should be positioned so that they can observe, challenge and influence decision-making in the firm.
- N. Independent non-executives should provide constructive challenge and specialist advice with a focus on the public interest. They should assess and promote the public interest in firm operations and activities as they relate to the purpose of this Code, forming their own views on where the public interest lies.
- O. Independent non-executives should maintain and demonstrate objectivity and an independent mindset throughout their tenure. Collectively they should enhance public confidence by virtue of their independence, number, stature, diverse skillsets, backgrounds, experience and expertise. They should have a combination of relevant skills, knowledge and experience, including of audit and a regulated sector. They owe a duty of care to the firm and should command the respect of the firm's owners.
- P. Independent non-executives should have sufficient time to meet their responsibilities. Independent non-executives should have rights consistent with discharging their responsibilities effectively, including a right of access to relevant information and people to the extent permitted by law or regulation, and a right, individually or collectively, to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive resigns, to report this resignation publicly.
- Q. Independent non-executives should have an open dialogue with the regulator.

### Provisions

- 29. Independent non-executives should number at least three, be in the majority on a body chaired by an independent non-executive that oversees public interest matters and be embedded in other relevant governance structures within the firm as members or formal attendees with participation rights. If a firm considers that having three independent non-executives is unnecessary given its size or the number of public interest entities it audits, it should explain this in its transparency report and ensure a minimum of two at all times. At least one independent non-executive should have competence in accounting and/or auditing, gained for example from a role on an audit committee, in a company's finance function or at an audit firm. Independent non-executives should meet regularly as a private group to discuss matters relating to their remit. Where a firm adopts an international approach to its management and/or governance it should have at least three INEs with specific responsibility and relevant experience to focus on the UK business and to take part in governance arrangements for this jurisdiction. The firm should disclose on its website the terms of reference and composition of any governance structures whose membership includes independent non-executives, whether in the UK or another jurisdiction.
- 30. 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<sup>11</sup> including client management processes, and global network initiatives on the firm and the audit practice in particular. 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.

<sup>11</sup> See also Provisions 11, 15, 16, 17, 18, 24, 25, 32 and 33

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31. A firm should establish a nomination committee, with participation from at least one independent non-executive, to lead the process for appointments and re-appointments of independent non-executives (and Audit Non-Executives), to conduct a regular assessment of gaps in the diversity of their skills and experience and to ensure a succession plan is in place. The nomination committee should assess the time commitment for the role and, when making new appointments, should take into account other demands on independent non-executives' time. Prior to appointment, significant commitments should be disclosed with an indication of the time involved. Additional external appointments should not be undertaken without prior consultation with the nomination committee.
  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.
  33. Independent non-executives should have regular contact with the Ethics Partner, who should under the ethical standards have direct access to them.<sup>12</sup>
  34. Independent non-executives should have dialogue with audit committees and investors to build their understanding of the user experience of audit and to develop a collective view of the way in which their firm operates in practice.
  35. Firms should agree with each independent non-executive a contract for services setting out their rights and duties. Independent non-executives should be appointed for specific terms and have a maximum tenure of nine years in total.
  36. The firm should provide each independent non-executive with the resources necessary to undertake their duties including appropriate induction, training and development, indemnity insurance and access to independent professional advice at the firm's expense where an independent non-executive judges such advice necessary to discharge their duties.
  37. The firm should establish, and disclose on its website, well defined and clear escalation procedures compatible with Principle P, for dealing with any fundamental disagreement that cannot otherwise be resolved between the independent non-executives and members of the firm's Management and/or governance structures.
  38. An independent non-executive should alert the regulator as soon as possible to their concerns in the following circumstances:
    - the independent non-executive believes the firm is acting contrary to the public interest; or
    - the independent non-executive believes the firm is endangering the objectives of this Code; or
    - the independent non-executive initiates the procedure for fundamental disagreements.

<sup>12</sup> Paragraph 1.14 of the FRC's 2019 Ethical Standard for Auditors

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39. A firm should disclose in its annual transparency report:

- a) information about the appointment, retirement and resignation of independent non-executives; their remuneration; their duties and the arrangements by which they discharge those duties; and the obligations of the firm to support them. The firm should report on why it has chosen to position its independent non-executives in the way it has; and
- b) its criteria for assessing whether independent non-executives are: i) independent from the firm and its owners; and ii) independent from its audited entities.

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# E Operational Separation

## Principles

- R. Where a firm applies the Principles for Operational Separation,<sup>13</sup> has established an Audit Board with a majority of Audit Non-Executives<sup>14</sup> and is subject to regulatory monitoring of these arrangements, Audit Non-Executives will fulfil the responsibilities of independent non-executives under this Code in so far as these relate to the audit practice. A firm's independent non-executives will focus on representing the public interest in high quality audit at the firm-wide level as well as on the public interest in firm activities in non-audit parts of the business and the risks posed by these non-audit activities to the audit practice.
- S. Independent non-executives should rely on Audit Non-Executives to provide independent oversight of audit quality plans, audit strategy and remuneration in the audit practice. Audit Non-Executives should rely on the independent non-executives to monitor activities at the firm-wide and network levels for their potential impact on the audit practice.
40. Audit Non-Executives should have the same obligations regarding time commitment, independence and objectivity, and the same overarching rights and responsibilities under this Code as independent non-executives. They should focus their attention on the audit practice in accordance with the Principles for Operational Separation.<sup>15</sup> The Audit Board should have the authority to act independently of the firm-wide public interest body.
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.
42. Independent non-executives and Audit Non-Executives should maintain open dialogue, consult on matters of public interest and share information with one another to the extent this is relevant for the audit board's oversight of the audit practice and/or the effective discharge of the independent non-executives' responsibilities at the firm-wide level. They should inform one another in the event they invoke the procedure for fundamental disagreements.

<sup>13</sup> See Appendix C

<sup>14</sup> As required by Principle 3 of the Principles for Operational Separation

<sup>15</sup> As required by Principle 1 of the Principles for Operational Separation

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# Appendix A

## Independent Non-Executives

### *Status and Accountability of Independent Non-Executives (INEs)*

All of the largest audit firms in the UK are limited liability partnerships (LLPs). They are owned, managed and run by the firm's partners (although each firm has slightly different arrangements). LLPs do not have shareholders and they do not have boards of directors, including non-executive directors, in the same way as public companies. As owner-managed businesses, the potential for conflicts of interest between the owners and managers of the business is lower than at public companies. Conversely, there is a higher risk that they do not adequately consider the needs of their stakeholders.

Legally, only partners can hold certain offices or carry out certain functions, including making key decisions about firm strategy and direction. INEs are not directors and do not have fiduciary duties to the firm's partners. Nor are they accountable for the performance of the business or responsible for setting strategy. INEs are therefore not the same as the independent non-executive directors on a public company board.

INEs are selected, appointed and remunerated by their firm. The Code states that INEs owe a duty of care to the firm. This means they must act in good faith and with reasonable care and diligence in exercising their responsibilities. While we do not believe that INEs should answer to the partnership in each and every other respect, a duty of care is appropriate and compatible with their public interest remit.

INEs (and Audit Non-Executives) should regard themselves as being accountable to the public interest. To the extent that the regulator acts as a proxy for the public interest, there should be an expectation of openness, cooperation and candour in the relationship between INEs and the regulator for mutual benefit. INEs play an important role as an additional lens into the firms while recourse to the regulator can reinforce the influence of INEs with senior management. The Code seeks to clarify this relationship in Principle Q and Provision 38.

In practice, since 2019, the FRC has met with INEs in their firm groups on a regular basis as part of its firm supervisory activity. It also has an opportunity to meet the preferred candidates for INE roles prior to appointment.

INE accountability to the public interest also means ensuring there is high quality public transparency over their activities and related outcomes, so that they can be questioned and challenged by external stakeholders. This is achieved through stakeholder engagement and transparency reporting.

### *An independent mindset*

An overarching requirement for an effective INE is having an independent mindset and demonstrable objectivity in discharging the role. INEs should not become advocates or champions for the firm. Their role is as guardians of the public interest.

The risks that, over time, an independent non-executive might become less independently minded are not easy to address in a Code. Nevertheless, Principle O seeks to emphasise the importance of these characteristics, while Provision 35 sets a maximum tenure of 9 years to guard against threats to independence.

### *Independence*

Independence is a characteristic which the FRC believes enhances stakeholder confidence in the way audit firms are governed and run.

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Principle O and Provision 39 deal with the independence of INEs (and Audit Non-Executives). Firms are expected to establish and publish criteria, against which an INE's (or an Audit Non-Executive's) independence will be assessed. These criteria must cover two separate and distinct independence issues, namely, whether an INE is independent from the firm itself; and whether they are independent from the firm's audited entities.

Accordingly, a firm will need to disclose in its transparency report the relationships with the firm itself and with its audited entities that it considers would compromise INE independence, including by reference to requirements from UK and overseas regulators and the International Code of Ethics. It should also disclose any other measures it has in place to safeguard INE independence, for example limits on INE tenure.

A 'covered person' is defined in the UK Ethical Standard for Auditors as *"a person in a position to influence the conduct or outcome of the engagement"*. The definition goes on to state that *"An independent non-executive appointed by a firm to act in a public interest role on a governance or oversight body of the firm is not a covered person"*. Thus, INEs (and Audit Non-Executives) are not 'covered persons' for the purposes of UK audits and are not subject to the full range of restrictions, for example on their investments, that apply to an audit partner.

INEs (and Audit Non-Executives) can therefore oversee a firm's processes – for example by sitting on a remuneration committee – provided that they are unable to determine the compensation of any individual and/or recuse themselves from any situations where this might arise.

In developing criteria, a firm is expected to reflect the views of an objective, reasonable and informed third party.<sup>16</sup> For example, a current partner or employee should never be considered independent for these purposes and a proposal to appoint a former partner or employee would need to be subject to careful consideration. A firm should think carefully about possible situations in which a conflict of interest might arise in order to reach a view on whether an individual would be truly independent but should not exclude individuals from consideration as potential INEs simply on the basis that independence issues might arise in the future.

Once appointed, INEs will need to be sensitive to potential conflicts of interest, report them and ensure that they exclude themselves from any related decisions. For example, an INE who also sits on the board of a company which is considering appointing the audit firm as auditor, should recuse themselves from any involvement in the tender process.

INEs will also need to comply with relevant requirements, such as insider dealing legislation, in relation to information that they might become aware of through their involvement with a firm.

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<sup>16</sup> Firms may refer to the third party test in I14 of the 2019 Ethical Standard for Auditors.

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# Appendix B

## Transparency Reporting

Transparency is key to improving trust and confidence in audit. All firms which audit PIEs are required by regulation to produce annual transparency reports containing, inter alia, information about the operation of this Code within that firm. However, these reports are not widely read and have been described as both compliance and marketing documents of limited interest to stakeholders. At well over 100 pages, reading the reports is also time-consuming.

Our 2019 thematic review into transparency reporting<sup>17</sup> found that, while they generally provide the information required, the reports “are not being read by the intended beneficiaries, principally investors and audit committee chairs and members”. The two main problems identified were:

- a lack of awareness amongst these groups that the reports exist; and
- for those that are aware of the reports, a view that they are too long and overly positive to be useful.

Reporting enhances accountability and drives behaviour, helping ensure leadership focus on the key governance and performance issues which the Code covers. Alongside the FRC’s firm reports on audit quality, transparency reports should provide stakeholders with important information about each firm’s quality processes and initiatives to improve audit quality. Clearly there is more to be done to tailor the reports to the audience and convince audit committee members, finance directors and investors to read and discuss these reports with the firms. Dialogue between stakeholders and the firms is likely to be the most effective way to improve the reports.

### *Applying the Principles and ‘Comply or Explain’*

Reporting against this Code should focus on describing how a firm has applied the Principles, in a manner that would enable stakeholders to evaluate how the firm has met purpose of the Code and achieved the desired outcomes. Reporting should cover this in the context of the particular circumstances of the firm.

It is important to report meaningfully when discussing the application of the Principles and to avoid boiler-plate reporting. A firm should articulate what action has been taken and the resulting outcomes. High-quality reporting will include signposting and cross-referencing to those parts of the transparency report that describe how the Principles have been applied. This will help stakeholders with their evaluation of firm policies and procedures.

The effective application of the Principles should be supported by high-quality reporting on the Provisions. These operate on a ‘comply or explain’ basis and firms should avoid a ‘tick-box approach’. An alternative to complying with a Provision may be justified in particular circumstances based on a range of factors, including the size, service lines, history, network and ownership structure of a firm. Explanations should set out the background, provide a clear rationale for the action the firm is taking and explain the impact that the action has had. Where a departure from a Provision is intended to be limited in time, the explanation should indicate when the firm expects to conform to the Provision. Explanations are a positive opportunity to communicate with stakeholders.

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<sup>17</sup> FRC Thematic Review, ‘Transparency Reporting’

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# Appendix C

## Principles For Operational Separation

### *Objectives, Outcomes and Regulation*

#### FRC Objectives:

- Objective 1: Improve audit quality by ensuring that people in the audit practice are focused above all on delivery of high-quality audits in the public interest.
- Objective 2: Improve audit market resilience by ensuring that no material, structural cross subsidy persists between the audit practice and the rest of the firm.

In pursuing these objectives, we will seek to ensure that audit remains an attractive and reputable profession and increases deserved confidence in audit.

#### Desired outcomes:

- Audit practice governance prioritises audit quality and protects auditors from influences from the rest of the firm that could divert their focus away from audit quality.
- The total amount of profits distributed to the partners in the audit practice should not persistently exceed the contribution to profits of the audit practice.
- Individual audit partner remuneration is determined above all by contribution to audit quality, taking account of the degree of difficulty and risk of the audits.
- Audit practice financial reporting is transparent to the regulator and public, allowing effective monitoring of audit practice performance and financial resilience.
- The culture of the audit practice supports audit quality and the public interest by encouraging ethical behaviour, openness, teamwork, challenge and professional scepticism/judgement.
- Auditors should act in the public interest and work for the benefit of shareholders of audited entities and wider society; they are not accountable to audited entities' executive management and are not (nor viewed as or considered to be) consultants.

#### Regulation:

- Firms will need to demonstrate to the FRC that they are delivering these outcomes, consistent with these principles.
- Firms should provide regular management information for the audit practice to FRC, including financial statements, audit quality indicators and other information which indicates whether these outcomes are being delivered.
- FRC will publish annually an assessment of whether firms are delivering these objectives and outcomes.
- FRC will seek backstop powers to require firms to deliver these outcomes as part of the forthcoming audit reform legislation.

## Principles

### Governance

#### Audit board purpose

- P1 The Audit Board should be responsible for providing independent oversight of the audit practice, with a focus on the pursuit of Objective 1.

The firm's most senior governance body should be responsible for providing oversight with a focus on the pursuit of Objective 2.

- P2 The Audit Board and the management of the audit practice should establish and promote a culture supportive of the public interest.

#### Audit Board composition

- P3 The Audit Board should be chaired by and have a majority of Audit Non-Executives (ANEs).

#### Independence of Audit Board from the firm

- P4 At least one of the ANEs should not be a firm INE ('doubly independent'). The Chair of the Audit Board should be an ANE and may also be a firm INE but should not chair any other governance body in the firm.

#### Skills of Audit Board

- P5 At least one ANE on the Audit Board should have experience of audit at an appropriate level of seniority, either as a former auditor or consumer of audit services.

#### Audit Board oversight of Audit CEO and Audit Strategy

- P6 The Audit Board should oversee the firm's audit strategy to ensure that it is consistent with pursuit of the objectives and outcomes set out above. It should be able to require changes where it considers that the strategy is not consistent.
- P7 The Audit Board shall be consulted by the Senior Partner of the firm with respect to the appointment of the CEO of Audit and have the opportunity to object to the appointment. The Audit Board may seek the removal of the Audit CEO.

#### Audit Board oversight of partner promotion and remuneration

- P8 Remuneration of audit partners and audit partner promotion should be overseen by a sub-committee of the Audit Board comprising ANEs only. Admissions of partners will remain a partnership responsibility and subject to the governance procedures of the partnership. However, the selection of candidates to be admitted to the partnership to practice as audit partners will be overseen by the Audit Board.

#### Other governance matters

- P9 Appointments of individuals to the Audit Board should be subject to a formal, rigorous and transparent procedure.
- P10 The Audit Board should have the authority to commission reviews from Internal Audit to support their oversight role.

## Principles

### *Scope of the separate practice*

#### Services within the "ring-fence"

- P11 Statutory audit should be provided by the audit practice. The audit practice may also provide:
- permitted audit-related and non-audit services to PIE entities audited by the firm;
  - audit-related and non-audit services to non-PIE entities audited by the firm which are not prohibited; and
  - services to other entities not audited by the firm that are either:
    - included on the "white-list" in paragraph 5.40 of the Ethical Standard 2019, and are commissioned by those charged with governance at the entity, or
    - are non-audit assurance engagements where the recipient of the assurance is a third party (e.g. a regulator, government or lender) separate from the client of the audit firm. These assurance engagements should be performed in accordance with a recognised assurance standard (e.g. ISAE 3000, ISAE 3402, SOC1 etc).

#### Specialists supporting audit

- P12 Specialists supporting audit (and other permitted services provided by the audit practice) can be located elsewhere in the firm provided their services are supplied and charged to the audit practice on an arms-length basis.

#### Other ring-fence matters

- P13 Partners and staff in the audit practice should spend the majority of their time on work in the audit practice. This does not preclude the secondment of staff to other areas of the business (in either direction) or the appointment of audit partners to firmwide leadership roles.
- P14 Revenues from audit work should make up at least 75% of the revenue of the audit practice.

### *Financial*

- P15 Transactions between the audit practice and the rest of the firm should be conducted and priced on an 'arms-length' basis. The audit practice should not receive fees for introducing business to other parts of the firm.
- P16 The audit practice should produce a separate profit and loss account with overhead absorption on an equitable basis.
- P17 As part of its annual assessment of whether firms are delivering these objectives and outcomes, the FRC will assess whether the overall distribution of profits to the partners in the audit practice and to those in the rest of the firm is consistent with their respective contributions to firm profits, with no material, structural cross subsidy persisting in either direction.

This assessment will take account of any non-recurring items and investment to improve audit quality. If the FRC's assessment is that a material, structural cross subsidy persists, the firm should produce an action plan to remove the subsidy over a period to be agreed with the FRC.

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## Principles

### *Remuneration of partners*

- P18 Remuneration policies and practices for partners in the audit practice should be designed to reward primarily high-quality work and positive leadership behaviours. The firm should have measures in place to reduce reward in cases of poor-quality work. Partners and staff in the audit practice should not be incentivised for sales passed to other parts of the firm.

### *Transparency*

- P19 Firms should publish information about the governance of the audit practice and the terms on which transactions occur between the audit and non-audit business and the nature of these transactions.
- P20 Firms should produce annually a separate profit and loss account for the audit practice to a level which is consistent with the firm's own published statutory financial statements. This profit and loss account should be assured by the firm's auditors. Firms should submit more detailed financial information supporting the profit and loss account to the FRC no later than four months after the financial year end.

After an agreed transition period, firms should publish the audit practice's profit and loss account described above in their Transparency Reports.

Firms should provide to the FRC their budget for the audit practice and sensitivities for the coming year.

### *Accountability*

- P21 Firms should appoint one individual (or a small number of individuals with clearly defined and non-overlapping responsibilities) from the Senior Management team to be responsible and accountable for ensuring the outcomes and principles for operational separation are delivered, embedded and monitored.

### *Transitional Arrangements*

- P22 Firms should provide a transition timetable to ensure that each of these principles is implemented as soon as practicable and they are met implemented in full by 30 September 2024 at the latest (exact date dependent on each firms' year-end). An implementation plan should be submitted to FRC by 23 October 2020. The FRC will agree a transition timetable including a medium-term plan with a firm.

In the first year of submission, the profit and loss account may be done on a 'best efforts' basis.

Firms will not be required to publish the profit and loss account during an agreed transition period ending not later than 30 September 2024 (exact date dependent on each firms' year-end).



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## Appendix 2 - Schedule of Principles in the Proposed 2022 Audit Firm Governance Code

Principles 2022	Status	Rationale/Objective
A. A firm's Management and governance structures should promote the long-term sustainability of the firm. To this end, the Management of a firm should be accountable to the firm's owners.	Replaces A.1	To encourage a focus on long-term sustainability and on accountability to the wider partnership.
B. A firm's governance arrangements should provide checks and balances on individual power and support effective challenge of Management. There should be a clear division of responsibilities between a firm's governance structures and its executive management. No one individual or small group of individuals should have unfettered powers of decision.	New	To guard against unfettered power and provide checks and balances thereby improving firm resilience.
C. A firm's Management should demonstrate its commitment to the public interest through their pursuit of the purpose of this Code and regular dialogue with the independent non-executives.	New	To create senior management accountability for pursuit of the objectives of the Code.
D. The members of a firm's Management and governance structures should have appropriate skills, experience, knowledge, influence and authority within the firm, and sufficient time, to fulfil their assigned responsibilities.	New	To support ISQM1 and introduce a similar expectation to the one that exists for INEs, namely that Management and Board members should be suitably qualified for their roles and have enough time to fulfil them.

Principles 2022	Status	Rationale/Objective
E. The Management of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.	Replaces E.1	To ensure that INEs and Board Members have access to information in a manner which enables them to fulfil their roles.
F. A firm is responsible for its purpose and values and for establishing and promoting an appropriate culture, that supports the consistent performance of high-quality audit, the firm's role in serving the public interest and the long-term sustainability of the firm.	Replaces B.1 and B.1.1	To focus firms on long-term sustainability and embedding a culture that is aligned with the purpose of the Code.
G. A firm should foster and maintain a culture of openness which encourages people to consult, contribute ideas and share problems, knowledge and experience in order to achieve quality work in a way that properly takes the public interest into consideration.	Replaces B.3	To ensure firms pay attention to openness and inclusiveness and encourage all their people to speak up and reach their potential.
H. A firm should apply policies and practices for managing people across the whole firm that support its commitment to the purpose and Principles of this Code.	Replaces D.3 - reworded	To drive a focus on people and to sure that a firm's people management is targeted in such a way as to support the purpose of the Code.
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.	New	To promote a focus on collecting and using data and sophisticated management information that will enhance the ability of firms to achieve the purpose of the Code.
J. A firm should establish procedures to identify, assess and manage risk, embed the internal control framework and determine the nature and extent of the principal risks the firm is willing to take while working to meet the purpose of this Code	Replaces D.2 - reworded	To ensure firms continue to focus on the firm-wide risk and control framework.

Principles 2022	Status	Rationale/Objective
K. A firm should communicate with its regulators in an open, cooperative and transparent manner.	New	To set an expectation that firms will be open and cooperate with the regulator.
L. A firm should establish policies and procedures to ensure the independence and effectiveness of internal and external audit activities and to monitor the quality of external reporting	Replaces E.4 - reworded	To ensure firms continue to focus on the quality of internal and external audit arrangements.
M. A firm should appoint independent non-executives to the governance structure who through their involvement collectively enhance the firm's performance in meeting the purpose of this Code. Independent non-executives should be positioned so that they have the opportunity to observe debate, to challenge and to influence decision-making in the firm.	Replaces C.1 - reworded	To require firms to appoint INEs and to make clear they should be given the access they need to make an impact through challenge and influence.
N. Independent non-executives should provide constructive challenge and specialist advice with a focus on the public interest. They should assess and promote the public interest in firm-wide operations and activities as they relate to the purpose of this Code, forming their own views on where the public interest lies.	New	To clarify the role of INEs within the firms and to establish that their role is a firm-wide role and not an audit only role.
O. Independent non-executives should maintain and demonstrate objectivity and an independent mindset throughout their tenure. Collectively they should enhance shareholder and public confidence by virtue of their independence, number, stature, diverse skillsets, backgrounds, experience and expertise. They should have a combination of relevant skills and experience including of audit and a regulated sector. They owe a duty of care to the firm and should command the respect of the firm's owners.	Replaces C.2 - reworded	To focus INEs on the importance of maintaining an independent mindset throughout their tenure. To introduce expectations of the diversity of characteristics and areas of expertise INEs should possess.

Principles 2022	Status	Rationale/Objective
P. Independent non-executives should have sufficient time to meet their responsibilities. Independent non-executives should have rights consistent with discharging their responsibilities effectively, including a right of access to relevant information and people to the extent permitted by law or regulation, and a right, individually or collectively, to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive, to report this resignation publicly.	Replaces C.3	To establish expectations regarding INE commitment, their rights of access and to introduce a mechanism for resolving disagreements.
Q. Independent non-executives should have an open dialogue with the regulator	New	To set expectations about the nature of the relationship between INEs and the regulator.
R. Where a firm applies the Principles for Operational Separation, has established an Audit Board with a majority of Audit Non-Executives and is subject to regulatory monitoring of these arrangements, Audit Non-Executives will fulfil the responsibilities of independent non-executives under this Code in so far as these relate to the audit practice. A firm's independent non-executives should focus on representing the public interest in high quality audit at the firm-wide level as well as on the public interest in firm activities in non-audit parts of the business and the risks posed by these non-audit activities to the audit practice.	New	To establish the boundaries between the roles of INEs and Audit-Non-Executives in firms with an operationally-separate audit practice, in respect of promoting audit quality and firm-wide matters.
S. Independent non-executives should rely on Audit Non-Executives to provide independent oversight of audit quality plans, audit strategy and remuneration in the audit practice. Audit Non-Executives should rely on the independent non-executives to monitor activities at the firm-wide level for their potential impact on the audit practice.	New	To establish a principle of mutual reliance between INEs and Audit Non-Executives with a view to avoiding duplication.



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## Appendix 3 - Reconciliation of the 2016 Audit Firm Governance Code against the Proposed 2022 Version

The Principles and Provisions in the 2016 Code are detailed in the left-hand column. The right-hand column shows where they have been incorporated into the 2022 version or deleted.

2016 Audit Firm Governance Code	Proposed location in 2022 Version
<p><b>Owner accountability principle</b></p> <p>Main Principle A.1</p> <p>The management of a firm should be accountable to the firm’s owners and no individual should have unfettered powers of decision.</p>	<p>Retained and reworded – see Principles A and B</p>
<p>Provision A.1.1</p> <p>The firm should establish a board or equivalent governance structure, with matters specifically reserved for its decision, to oversee the activities of the management team.</p>	<p>Retained and reworded – see Provisions 1 and 4</p>
<p>Provision A.1.2</p> <p>The firm should state in its transparency report how its governance structures and management operate, their duties and the types of decisions they take. In doing so the firm should explain how its governance structure provides oversight of both the audit practice and the firm as a whole with a focus on ensuring the Code’s purpose, is achieved. If the management and/or governance of the firm rests at an international level it should specifically set out how management and oversight of audit, is undertaken and the Code’s purpose achieved in the UK.</p>	<p>Retained, slightly reworded – see Provision 9</p>

2016 Audit Firm Governance Code	Proposed location in 2022 Version
<p>Provision A.1.3</p> <p>The firm should state in its transparency report the names and job titles of all members of the firm’s governance structures and its management, how they are elected or appointed and their terms, length of service, meeting attendance in the year, and relevant biographical details.</p>	Retained – see Provision 9
<p>Provision A.1.4</p> <p>The members of a firm’s governance structures and management should be subject to formal, rigorous and ongoing performance evaluation and, at regular intervals, members should be subject to re-election or re-selection.</p>	Retained – see Provision 6
<p><b>Management principle</b></p> <p>Main Principle A.2</p> <p>A firm should have effective management which has responsibility and clear authority for running the firm.</p>	Deleted – stating the obvious and not adding anything.
<p>Provision A.2.1</p> <p>Management should have terms of reference that include clear authority over the whole firm including its non-audit businesses and these should be disclosed on the firm’s website.</p>	Retained – see Provision 4
<p><b>Professionalism principle</b></p> <p>Main Principle B.1</p> <p>A firm should perform quality work by exercising judgement and upholding values of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour in a way that properly takes the public interest into consideration and meets auditing and ethical standards.</p>	Incorporated into Principle F and Provision 12
<p>Provision B.1.1</p> <p>The firm’s governance structures and management should establish and promote throughout the firm an appropriate culture, supportive of the firm’s public interest role and long term sustainability. This should be achieved in particular through the right tone from the top, through the firm’s policies and practices and by management publicly committing themselves and the whole firm to quality work, the public interest and professional judgement and values.</p>	Incorporated into Principle F and Provision 12

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision B.1.2</p> <p>Firms should introduce KPIs on the performance of their governance system, and report on performance against these in their transparency reports.</p>	<p>Retained and slightly reworded – see Provision 14</p>
<p>Provision B.1.3</p> <p>The firm should have a code of conduct which it discloses on its website and requires everyone in the firm to apply. The Board and independent non-executives should oversee compliance with it.</p>	<p>Retained – see Provision 11</p>
<p><b>Governance principle</b></p> <p>Main Principle B.2</p> <p>A firm should publicly commit itself to this Audit Firm Governance Code.</p>	<p>Deleted – reporting against the Code demonstrates this commitment.</p>
<p>Provision B.2.1</p> <p>The firm should incorporate the principles of this Audit Firm Governance Code into an internal code of conduct.</p>	<p>Deleted – duplication. This is implicit in creating an appropriate culture, covered elsewhere in the Code.</p>
<p><b>Openness principle</b></p> <p>Main Principle B.3</p> <p>A firm should maintain a culture of openness which encourages people to consult and share problems, knowledge and experience in order to achieve quality work in a way that properly takes the public interest into consideration.</p>	<p>Retained – see Principle G</p>
<p><b>Involvement of independent non-executives principle</b></p> <p>Main Principle C.1</p> <p>A firm should appoint independent non-executives to the governance structure who through their involvement collectively enhance the firm’s performance in meeting the purpose of the Code.</p>	<p>Retained – see Principle M</p>

**2016 AFGC****Proposed location in 2021 AFGC**

## Provision C.1.1

Retained and reworded - see Provision 29

Independent non-executives should number at least three and be in the majority on a body that oversees public interest matters; and/or be members of other relevant governance structures within the firm. They should also meet as a separate group to discuss matters relating to their remit. They should have full visibility of the entirety of the business but should pay particular attention to and report on risks to audit quality and how they are addressed. If a firm considers that having three INEs is inappropriate given its size or number of public company clients, it should explain this in its transparency report and ensure a minimum of two at all times. Where the firm adopts an international approach to its management it should have at least three INEs with specific responsibility and relevant experience to focus on the UK business and to take part in governance arrangements for this market; or explain why it regards a smaller number to be more appropriate, in which event there should be a minimum of two.

## Provision C.1.2

Retained – see Provision 39

The firm should disclose on its website and in its transparency report information about the appointment, retirement and resignation of independent non-executives; their remuneration; their duties and the arrangements by which they discharge those duties; and the obligations of the firm to support them. The firm should report on why it has chosen to position its independent non-executives in the way it has (for example, as members of the main Board or on a public interest committee). The firm should also disclose on its website the terms of reference and composition of any governance structures whose membership includes independent non-executives.

## Provision C.1.3

Reworded and incorporated into Provision 30

The independent non-executives should report in the firm's transparency report on how they have worked to meet the purpose of the Code defined as:

- Promoting audit quality.
- Helping the firm secure its reputation more broadly, including in its non-audit businesses.
- Reducing the risk of firm failure.

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision C.1.4</p> <p>Independent non-executives should have regular contact with the Ethics Partner, who should under the ethical standards have a reporting line to them.</p>	<p>Retained and reworded– see Provision 33</p>
<p><b>Characteristics of independent non-executives principle</b></p> <p>Main Principle C.2</p> <p>The independent non-executives’ duty of care is to the firm. They should command the respect of the firm’s owners and collectively enhance shareholder confidence by virtue of their independence, number, stature, experience and expertise. They should have a balance of relevant skills and experience including of audit and a regulated sector. At least one independent non-executive should have competence in accounting and/or auditing, gained for example from a role on an audit committee, in a company’s finance function, as an investor or at an audit firm.</p>	<p>Retained and reworded – see Principle O</p>
<p>Provision C.2.1</p> <p>The firm should state in its transparency report its criteria for assessing the impact of independent non-executives on the firm’s independence as auditors and their independence from the firm and its owners.</p>	<p>Retained and reworded – see Provision 39</p>
<p><b>Rights and responsibilities of independent non-executives principle</b></p> <p>Main Principle C.3</p> <p>Independent non-executives of a firm should have rights consistent with their role including a right of access to relevant information and people to the extent permitted by law or regulation, and a right to report a fundamental disagreement regarding the firm to its owners and, where ultimately this cannot be resolved and the independent non-executive resigns, to report this resignation publicly.</p>	<p>Retained – See Principle P</p>
<p>Provision C.3.1</p> <p>Each independent non-executive should have a contract for services setting out their rights and duties.</p>	<p>Retained and reworded – see Provision 35</p>

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision C 3.2</p> <p>Independent non-executives should be appointed for specific terms and any term beyond nine years should be subject to particularly rigorous review and explanation.</p>	<p>Retained and reworded – see Provision 35</p>
<p>Provision C.3.3</p> <p>The responsibilities of an independent non-executive should include, but not be limited to, oversight of the firm’s policies and processes for:</p> <ul style="list-style-type: none"> <li>• Promoting audit quality.</li> <li>• Helping the firm secure its reputation more broadly, including in its non-audit businesses.</li> <li>• Reducing the risk of firm failure.</li> </ul>	<p>Deleted but covered by Provision 30</p>
<p>Provision C.3.4</p> <p>The firm should ensure that appropriate indemnity insurance is in place in respect of legal action against any independent non-executive in respect of their work in that role.</p>	<p>Retained and incorporated into Provision 36</p>
<p>Provision C.3.5</p> <p>The firm should provide each independent non-executive with sufficient resources to undertake their duties including having access to independent professional advice at the firm’s expense where an independent non-executive judges such advice necessary to discharge their duties.</p>	<p>Retained – see Provision 36</p>
<p>Provision C.3.6</p> <p>The firm should establish, and disclose on its website, procedures for dealing with any fundamental disagreement that cannot otherwise be resolved between the independent non-executives and members of the firm’s management team and/or governance structures.</p>	<p>Retained and reworded – see Provision 37</p>

2016 AFGC	Proposed location in 2021 AFGC
<p><b>Compliance principle</b></p> <p>Main Principle D.1</p> <p>A firm should comply with professional standards and applicable legal and regulatory requirements. Operations should be conducted in a way that promotes audit quality and the reputation of the firm. The independent non-executives should be involved in the oversight of operations.</p>	<p>Deleted – already a requirement.</p> <p>Partly covered in Principles I and J, and Provisions 24 and 25.</p>
<p>Provision D.1.1</p> <p>The firm should establish policies and procedures for complying with applicable legal and regulatory requirements and international and national standards on auditing, quality control and ethics, including auditor independence.</p>	<p>Deleted – already a requirement of standards.</p>
<p>Provision D.1.2</p> <p>The firm should establish policies and procedures for individuals signing group audit reports to comply with applicable standards on auditing dealing with group audits including reliance on other auditors whether from the same network or otherwise.</p>	<p>Deleted – covered by the standards.</p>
<p>Provision D.1.3</p> <p>The firm should state in its transparency report how it applies policies and procedures for managing potential and actual conflicts of interest.</p>	<p>Deleted – not clear that the disclosures are that useful.</p>
<p>Provision D.1.4</p> <p>The firm should take action to address areas of concern identified by audit regulators in relation to the firm’s audit work.</p>	<p>Retained and broadened to cover all FRC supervisory activity – see Provision 21</p>
<p><b>Risk management principle</b></p> <p>Main Principle D.2</p> <p>A firm should maintain a sound system of internal control and risk management over the operations of the firm as a whole to safeguard the firm and reassure stakeholders.</p>	<p>Retained and reworded – see Principle J</p>

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision D.2.1</p> <p>The firm should, at least annually, conduct a review of the effectiveness of the firm’s system of internal control. Independent non-executives should be involved in the review which should cover all material controls, including financial, operational and compliance controls and risk management systems as well as the promotion of an appropriate culture underpinned by sound values and behaviour within the firm.</p>	<p>Retained and reworded – see Provision 24</p> <p>Culture moved to Provision 15</p>
<p>Provision D.2.2</p> <p>The firm should state in its transparency report that it has performed a review of the effectiveness of the system of internal control, summarise the process it has applied and confirm that necessary actions have been or are being taken to remedy any significant failings or weaknesses identified from that review. It should also disclose the process it has applied to deal with material internal control aspects of any significant problems disclosed in its financial statements or management commentary.</p>	<p>Retained – see Provision 28</p>
<p>Provision D.2.3</p> <p>The firm should carry out a robust assessment of the principal risks facing it, including those that would threaten its business model, future performance, solvency or liquidity. This should reference specifically the sustainability of the audit practice within the UK.</p>	<p>Retained – see Provision 25</p>
<p><b>People management principle</b></p> <p>Main Principle D.3</p> <p>A firm should apply policies and procedures for managing people across the whole firm that support its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code.</p>	<p>Reworded – see Principle H</p>
<p>Provision D.3.1</p> <p>The firm should disclose on its website how it supports its commitment to the professionalism, openness and risk management principles of this Audit Firm Governance Code through recruitment, development activities, objective setting, performance evaluation, remuneration, progression, other forms of recognition, representation and involvement.</p>	<p>Deleted – this is very wide ranging and high-level. It is not clear what kind of website disclosures are expected. These matters are all covered elsewhere in the Code and typically also in transparency reports.</p>

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision D.3.2</p> <p>Independent non-executives should be involved in reviewing people management policies and procedures, including remuneration and incentive structures, to ensure that the public interest is protected.</p>	<p>Retained and expanded – see Provision 17</p>
<p><b>Whistleblowing principle</b></p> <p>Main Principle D.4</p> <p>A firm should establish and apply confidential whistleblowing policies and procedures across the firm which enable people to report, without fear, concerns about the firm’s commitment to quality work and professional judgement and values in a way that properly takes the public interest into consideration. The independent non-executives should be satisfied that there is an effective whistleblowing process in place.</p>	<p>Retained and reworded to mirror the UK Corporate Governance Code – see Provision 16</p>
<p>Provision D.4.1</p> <p>The firm should report to independent non-executives on issues raised under its whistleblowing policies and procedures and disclose those policies and procedures on its website.</p>	<p>Retained in part – see Provision 16</p>
<p><b>Internal reporting principle</b></p> <p>Main Principle E.1</p> <p>The management of a firm should ensure that members of its governance structures, including owners and independent non-executives, are supplied with information in a timely manner and in a form and of a quality appropriate to enable them to discharge their duties.</p>	<p>Retained - see Principle E</p>
<p><b>Governance reporting principle</b></p> <p>Main Principle E.2</p> <p>A firm should publicly report how it has applied in practice each of the principles of the Audit Firm Governance Code and make a statement on its compliance with the Code’s provisions or give a considered explanation for any non-compliance.</p>	<p>Retained – see Provision 26</p>

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<p>Provision E.2.1</p> <p>The firm should publish on its website an annual transparency report containing the disclosures required by Code Provisions A.1.2, A.1.3, B1.2, C.2.1, D.1.3, D.2.2, E.2.2 and E.3.1.</p>	<p>Deleted – the disclosures required are specified in each section of the Code.</p>
<p>Provision E.2.2</p> <p>In its transparency report the firm should give details of any additional provisions from the UK Corporate Governance Code which it has adopted within its own governance structure.</p>	<p>Deleted – matters of sufficient importance to Firm governance have been incorporated into this Code.</p>
<p><b>Transparency principle</b></p> <p>Main Principle E.3</p> <p>A firm should publish on an annual basis in its transparency report a commentary on the firm’s performance, position and prospects.</p>	<p>Retained – see Provision 28</p>
<p>Provision E.3.1</p> <p>The firm should confirm that it has carried out a robust assessment of the principal risks facing the audit firm, including those that would threaten its business model, future performance, solvency or liquidity. The firm should describe those risks and explain how they are being managed or mitigated.</p>	<p>Retained – see Provision 28</p>
<p>Provision E.3.2</p> <p>The transparency report should be fair, balanced and understandable in its entirety.</p>	<p>Retained – see Provision 28</p>
<p><b>Reporting quality principle</b></p> <p>Main Principle E.4</p> <p>A firm should establish formal and transparent arrangements for monitoring the quality of external reporting and for maintaining an appropriate relationship with the firm’s auditors.</p>	<p>Retained and reworded – see Principle L</p>

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision E.4.1</p> <p>The firm should establish an audit committee and disclose on its website information on the committee’s membership and terms of reference which should deal clearly with its authority and duties, including its duties in relation to the appointment and independence of the firm’s auditors. On an annual basis, the audit committee should publish a description of its work and how it has discharged its duties.</p>	<p>Retained – see Provision 23</p>
<p><b>Financial statements principle</b></p> <p>Main Principle E.5</p> <p>A firm should publish audited financial statements prepared in accordance with a recognised financial reporting framework such as International Financial Reporting Standards or UK GAAP, and should be clear and concise.</p>	<p>Deleted – required by law</p>
<p>Provision E.5.1</p> <p>The firm should explain who is responsible for preparing the financial statements and the firm’s auditors should make a statement about their reporting responsibilities, preferably in accordance with the extended audit report standards.</p>	<p>Retained and reworded – see Provision 27</p>
<p>Provision E.5.2</p> <p>The firm should state whether it considers it appropriate to adopt the going concern basis of accounting and identify any material uncertainties to its ability to continue to do so, with supporting assumptions or qualifications as necessary.</p>	<p>Deleted – required by law</p>
<p><b>Firm dialogue principle</b></p> <p>Main Principle F.1</p> <p>A firm should have dialogue with listed company shareholders, as well as listed companies and their audit committees, about matters covered by this Audit Firm Governance Code to enhance mutual communication and understanding and ensure that it keeps in touch with shareholder opinion, issues and concerns.</p>	<p>Deleted – see Provision 34 for INE engagement. Firms engage in a variety of ways with audit committee chairs and investors. Dialogue with these stakeholders will be looked at in the round as the Stewardship Code and standards for audit committees are developed as proposed in section 4 of this consultation document.</p>

2016 AFGC	Proposed location in 2021 AFGC
<p>Provision F.1.1</p> <p>The firm should disclose on its website its policies and procedures, including contact details, for dialogue about matters covered by this Audit Firm Governance Code with listed company shareholders and listed companies. It should also report on the dialogue it has had during the year. These disclosures should cover the nature and extent of the involvement of independent non-executives in such dialogue.</p>	<p>Deleted – consequential to deleting Principle F.1</p>
<p><b>Shareholder dialogue principle</b></p> <p>Main Principle F.2</p> <p>Shareholders should have dialogue with audit firms to enhance mutual communication and understanding.</p>	<p>Deleted – directed at shareholders</p>
<p><b>Informed voting principle</b></p> <p>Main Principle F.3</p> <p>Shareholders should have dialogue with listed companies on the process of recommending the appointment and re-appointment of auditors and should make considered use of votes in relation to such recommendations.</p>	<p>Deleted – directed at shareholders</p>



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