



# Restoring trust in audit and corporate governance

A practical guide to the BEIS White Paper for FTSE 350 audit committees



# A practical guide to the BEIS White Paper Prepared for FTSE 350 audit committees

## The Government published its long-awaited White Paper on 'Restoring trust in audit and corporate governance' in March 2021

The indicated objectives of the reform are to:

- restore public trust in the way that the UK's largest companies are run and scrutinised
- ensure that the UK's most significant corporate entities are governed responsibly
- empower investors, creditors, workers and other stakeholders by giving them access to reliable and meaningful information on a company's performance
- keep the UK's legal framework for major businesses at the forefront of international best practice

The White Paper will potentially have a substantial impact on FTSE 350 companies, and especially their audit committees, both as regards to extending their governance, reporting and audit requirements and the strengthening of regulatory sanctions on directors as well as auditors.

In this guide we highlight the main reforms proposed from the perspective of FTSE 350 companies and offer some thoughts on their potential impact on boards and audit committees and how they may respond to them.



# A practical guide to the BEIS White Paper

## Prepared for FTSE 350 audit committees

The key elements of the proposals in so far as they affect FTSE 350 companies are highlighted below. More detail is provided in the Appendix.

### **Expanded scope of PIE definition may involve subsidiaries**

- Companies listed on the Main Market are already PIEs but under the new proposals some subsidiaries may also become PIEs if they meet the thresholds for private companies to be classified as such and this would lead to significant additional regulatory focus on these businesses.

### **Significant new obligations on PIEs**

- Most significantly, being a PIE in the future will lead to substantial additional responsibilities and a more stringent regulatory regime.

### **Directors to confirm effectiveness of financial reporting controls**

- Directors to be responsible for confirming the effectiveness of controls on financial reporting.

### **Directors to disclose realised profits and confirm ability to pay dividends**

- Individual companies, or parents in the case of groups, to disclose their realised profits in their annual report. Confirmation should also be provided that the directors reasonably expect that dividend payments will not threaten the company's solvency over the next two years.

### **New Resilience Statement looking out at least five years**

- A Resilience Statement to be prepared with a mandatory assessment period of five years, rather than the three years typically adopted at present, and to include at least two reverse test scenarios.

### **New three year Audit and Assurance Policy with shareholder advisory vote**

- An Audit and Assurance Policy to be developed at least every three years setting out the form of assurance obtained on various parts of the annual report and to be subject to a shareholder advisory vote in the case of premium listed companies. Companies to be asked to explain what independent assurance, if any, the company plans to obtain in relation to the resilience statement and the effectiveness of their internal control framework.

### **Additional reporting obligations on directors in relation to fraud**

- Directors to report on the steps they have taken to prevent and detect material fraud with additional requirements to be placed on auditors as well in relation to fraud detection.

### **Additional reporting obligations in relation to payment practices**

- The annual reports of certain PIEs to provide a summary of how the company, or group as appropriate, has performed with regard to supplier payments.

### **Whole of annual report to be subject to regulatory review and findings published**

- The whole of the annual report to be subject to periodic review by the regulator who will have the power to require changes to be made and to publish correspondence related to the review and a summary of findings.

### **Mandatory shared audit or sole challenger firm appointment for FTSE 350**

- Managed shared audit to be introduced for all UK-registered FTSE 350 companies with limited exceptions agreed with the regulator or where a challenger firm is appointed as sole auditor. Under the proposed form of shared audit, companies would be required to appoint a challenger firm to audit a meaningful proportion of the group's statutory audits.

### **New sanctions regime for directors**

- A new sanctions regime to be introduced for directors on reporting and audit matters with a graduated range of sanctions including fines and a temporary ban on being a PIE director
- ARGAs to impose additional requirements on audit committees in relation to the appointment and oversight of auditors.

### **AQR findings to be published**

- AQR (audit quality) reports on individual audits to be published by the regulator without the need for consent by the audit firm and audited entity.

### **New framework for wider aspects of corporate auditing**

- A framework for all 'corporate auditing' to be created covering both the auditing of all financial information and also of wider information, eg culture, ESG, cyber, controls.



# A practical guide to the BEIS White Paper

**It will be helpful for the board and its audit committee to consider how to use the proposals in the White Paper to help it build a more sustainably successful business without necessarily waiting for the legislation. There is the challenge, however, that some of the proposals are expressed in terms that suggest they may be subject to at least some change following the consultation period.**

Ten issues for the board and audit committee to consider:

## **1. How are we currently performing against the expectations of the White Paper?**

The proposals, for example, relating to having strong internal controls; only paying dividends if it does not threaten solvency; and having a clear understanding of the organisation's resilience all represent good business practice and so it will be useful for the board to check how it is doing in these areas and to identify where there is scope for possible improvement.

## **2. How can we best develop a programme to implement the necessary changes?**

It will be helpful for the board to consider the extent of changes that are likely to be necessary. If there is significant work needed, questions include how it could be spread over a period of time, who within senior management should lead in particular areas, reporting lines to the audit committee, what additional resources will be needed and whether these will best be sourced by strengthening staff teams and/or outsourcing?

## **3. Are the new requirements likely to impact the company's ability to pay dividends?**

It will be important for the board to consider whether it has the information to assess its ability to pay dividends under the new requirements and if not whether it should obtain it as a matter of priority and continue to keep it up to date. In disclosing its realised profits it will need to decide whether to calculate and disclose them in full or to state they 'are not less than...'. If applicable, the board will need to pay particular attention to the potential impact of an expected need to change its dividend policy and to how it should prepare its shareholders for any change and the expected impact on how it is perceived relative to its competitors.

## **4. Should the internal audit function be strengthened?**

Although not much discussed in the White Paper, a particular area of focus for audit committees of FTSE 350 companies should be whether there would be merit in strengthening their internal audit function, through recruitment or co-sourcing, given the extra work it is likely to have in providing assurance to the committee on a number of areas covered in the White Paper. It will also be worthwhile considering an assurance mapping exercise to consider how it gets assurance on information reported and whether there are any gaps or overlaps in assurance obtained.

## **5. What additional work will be required for the Resilience Statement?**

In considering the Resilience Statement, the audit committee will need to discuss what are likely to be the additional matters needing to be covered if the period covered goes out to five years in the medium-term section rather than three years, as generally at present, and it will also need to consider the content of its two negative stress test scenarios?

## **6. Which areas will the audit committee cover in its Audit and Assurance Policy?**

The audit committee will need to reflect on which areas, in addition to the statutory audit, which it will have assured and the form it will take in terms of internal or external assurance and, if the latter, whether this should be by the statutory auditor or another assurer. If Managed Shared Audit is introduced, a further question for many FTSE 350 companies will be whether any additional assurance work should be undertaken by the group auditor or the challenger firm involved in the audit.

Areas the audit committee is specifically asked to consider with regards to whether to have external assurance are the directors' statement on financial reporting controls and the Resilience Statement. On financial reporting controls, if the audit committee

plans to have external assurance the amount of additional work required will depend on whether they are already subject to assurance or not, eg due to a dual US listing, and even if so how might any new UK arrangements differ from those it currently applies?

In deciding whether to have assurance in particular areas the audit committee will need to seek the views of its investors but also be conscious of what other leading listed companies are doing. Sustainability is an area where many institutional investors are likely to be pressing for additional assurance.

### **7. How should FTSE 350 audit committees implement Managed Shared Audit (MSA)/ appointment of a challenger firm?**

The White Paper indicates most FTSE 350 companies should introduce Managed Shared Audit subject to limited exceptions to be agreed with the regulator or in situations where a challenger firm is appointed as sole auditor. Some companies, especially in the FTSE 250 may wish to consider whether they would like to explore appointing a challenger firm. For most FTSE 350 companies MSA is the more likely approach and it will be helpful to identify which subsidiaries might provide a meaningful share of the audit for challenger firms both in terms of being important to the business as well as representing a meaningful proportion of the audit fee. Audit committees should also ask themselves whether they know the challenger firms sufficiently well and, if not, how best to improve their understanding of those they are likely to ask to subsequently tender for parts of the audit.

### **8. What will be the impact of subsidiaries becoming PIEs in their own right?**

Boards and audit committees will need to consider whether there will should be an increase in the formalisation of board proceedings for boards that become PIEs in their own right and possibly in the membership of their boards. The impact of specific reporting and audit changes will also need to be considered.

### **9. How should the board and audit committee engage with its shareholders on likely changes arising from the White Paper?**

The board and audit committee should determine how it can best engage with its institutional shareholders in particular, on the likely impact of the changes. A possible forum would be in meetings with their heads of corporate governance.

### **10. How will the structure, composition and behaviour of the board change?**

In considering the appointment of new independent directors in the coming years, in addition to addressing other key issues such as diversity and inclusion and sector or relevant specialist experience, for example with regards to technology, nominations committees are likely to want to have sufficient directors capable of operating successfully in a more heavily regulated environment and with the necessary reporting and audit experience. There may well also be an increase in fees for audit committee members given the extra time commitment that will be needed.

It will also be essential for board members to consider how they can continue to strike the right balance between enterprise and accountability within the new corporate regulatory structure and for the chair, along with all members of the board, to ensure it remains a genuinely unitary board rather than the independent non-executive directors on the audit committee primarily acting in an oversight capacity. Conversely, there is simultaneously a risk that independent directors become too involved in executive decisions in areas such as risk management. Achieving the necessary balance will require particular attention when the board is facing challenging times, for example where there are concerns on the Resilience Statement or on the board's ability to pay dividends.



# Appendix

## Key takeaways for FTSE 350 audit committees

### Contents

- A:** A fluid timetable
- B:** Substantially increasing the number of PIEs
- C:** Major new reporting and related auditing requirements
- D:** Enhancing shareholder engagement with audit
- E:** Managed shared audit and reserve market cap powers for regulator
- F:** A tougher approach to regulation

### A: A fluid timetable

The White Paper says the Government will introduce draft legislation 'when Parliamentary time allows' and that 'there will be choices to make about when the reforms will come into force. Individual measures could be brought in on a specific date, over a period, or there could be power to switch certain reforms on when appropriate'. The White Paper adds that once the law is in effect 'there is often a transition period in which special measures apply' indicating that some of the proposals would apply firstly to premium listed companies and then after two years to all Public Interest Entities (PIEs) and the possibility is raised of excluding emerging growth companies from some of the measures for a period of two years after their Initial Public Offering.

### B: Substantially increasing the number of PIEs

There were 1,945 PIEs in February 2020 and the current definition of a PIE covers:

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

The White Paper proposes to add large private companies to the PIE classification applying one of two options:

- **Option 1** companies with more than 2,000 employees or a balance sheet of more than £2bn (1,960 entities)
- **Option 2** companies with more than 500 employees and a turnover of more than £500m (1,060 entities)

The definition would apply to individual companies or, in the case of a parent company, would be based on the relevant figures in their consolidated financial statements. The Government is also proposing classifying AIM-market listed companies with a capitalisation above 200m euros as PIEs and asking whether Lloyds syndicates and large third sector organisations such as charities, universities and housing associations should be classified as PIEs.

The statutory audits of PIEs and their auditors are currently subject to more stringent regulation than other businesses. The White Paper would significantly increase the additional responsibilities of PIEs, as discussed here:

The Government is 'proposing allowing a significant lead time before activating a new PIE definition'.

# Appendix

## Key takeaways for FTSE 350 audit committees

### C: Major new reporting and related auditing requirements

#### 1. Reporting on controls

Directors to undertake an annual review of the effectiveness of internal controls on financial reporting and to explain whether they consider the controls are operating effectively and the benchmark used in their assessment.

Deficiencies should be disclosed along with the remedial action being taken and the timeframe over which they are being addressed.

The regulator to prepare or endorse guidance reflecting audit committee best practice in this area.

Directors and investors normally to agree whether directors' effectiveness statement to be subject to external assurance but assurance to be required where serious failures have occurred or where there have been weaknesses over a number of years.

The Regulator to have power to sanction directors where they have failed to maintain effective internal controls on financial reporting.

The new requirements to be introduced in legislation.

The new requirements would initially be applicable to premium listed companies, with possible temporary exemptions for smaller newly listed companies, and applied to other PIEs after two years.

#### 2. Capital maintenance and dividends

Individual companies, or the parent company in the case of groups, should disclose their realised profits in their annual report. The new regulator will provide guidance on the extent to which their profits and losses are realised thereby determining the amount available for distribution. Where the exact figure cannot be determined, it will be acceptable to indicate the distributable profits are 'not less than...'.<sup>1</sup>

The parent company should estimate and disclose the amount of potential distributable profits across the group that could be passed to the parent company for paying future dividends, with the parent company able to select on a reasonable basis which group companies to include in the calculation. Narrative disclosures would explain any major constraints on the ability of subsidiaries to pay their distributable profits to the parent company.

Confirmation should be provided that it is the directors' reasonable expectation that payment of the dividend will not threaten the solvency of the company over the next two years in the light of the risk analysis and company position when the dividend is proposed.

The disclosures above on realised and distributable profits would be in the financial statements and so subject to audit.

The Government envisages the requirement applying to listed and AIM companies only but is asking whether they should be extended to all PIEs.

# Appendix

## Key takeaways for FTSE 350 audit committees

### 3. Resilience statement

The resilience statement would have short, medium and long-term resilience sections.

The short-term section would incorporate companies' existing going concern statements including disclosure of any potential material uncertainties subsequently determined not to be material after the use of significant judgement and/or the introduction of mitigating action.

The medium-term section would incorporate the existing viability statement to provide an assessment of the company's prospects and resilience and to address matters which may threaten its ability to continue in operation and meet its financial liabilities as they fall due.

Companies would be asked to include at least two reverse stress test scenarios in their resilience statements. Future specific disclosures would be required in the short and medium-term resilience statements which might cover threats to liquidity, company solvency and business continuity, supply chain issues, digital security, business investment need, sustainability and climate change risk.

The mandatory assessment period should be five years (rather than the three years currently normally adopted by companies).

Content in the long-term section of the resilience statement would not be prescribed.

The preferred implementation route would be to implement the need for a Resilience Statement through legislation as a new section of the Strategic Report.

The new requirements would initially be applicable to Premium Listed Companies and after two years to all PIEs.

### 4. Audit and Assurance Policy

The White Paper proposes a new framework to enable companies to set out more clearly the extent to which the annual report and other disclosures are scrutinised by the external auditor or someone else.

The Audit and Assurance Policy would be agreed for a three-year period and be subject to an advisory shareholder vote. It would be introduced by legislation amending the Companies Act, 2006.

The White Paper is inviting views on whether the policy should include the following new disclosures:

- the assurance, if any, the company intends to obtain in the next three years in relation to the annual report and other disclosures beyond that required by statutory audit. The statement should include an explanation of what independent assurance, if any, the company plans to obtain in relation to the resilience statement and the effectiveness of the internal control framework.
- a description of the company's internal audit and assurance processes including how the company is planning to strengthen its internal audit and assurance capabilities over the coming three years.
- a description of what policies the company may have in relation to the tendering of external audit services, for example whether the company will allow the external auditor to provide permitted non-audit services.
- an explanation of whether, and if so how, shareholders and employees' views have been taken into account in formulating the audit and assurance policy.

The requirements would initially apply to Premium Listed Companies which would be given a year after the requirement came into force to develop their Audit and Assurance Policy and to have the advisory shareholder vote on it. It would apply to other PIEs two years later.



# Appendix

## Key takeaways for FTSE 350 audit committees

### 5. Tackling fraud

The Government proposes to legislate to require directors to report on the steps they have taken to prevent and detect material fraud and to require auditors to report on the steps they in turn took to detect any material fraud and assess the effectiveness of relevant controls.

The requirements related to fraud would apply to PIEs.

### 6. Reporting on payment practices

The White Paper indicates an option is being considered to require the annual reports of certain PIEs to provide a summary of how the company, or group in the case of a parent company, has performed with regard to supplier payments over the previous reporting year and to comment on how this compares to the year before that.

Companies could be required to include the necessary information in their Strategic Report which might comprise:

- the company's supplier payments policy, including the standard payment terms and the shortest and longest standard payment periods
- the percentage of the company's supplier payments that met its standard terms and, where the figure is less than 80%, an explanation of why this occurred and what actions the company plans to take to improve its payment record
- when such an explanation was required in the previous year, an update in the following year's report on the actions that were taken to improve the payments record

It is said a natural approach would be for this to apply to PIEs that are large companies for reporting purposes. An alternative would be to apply this to PIEs with more than 500 employees which are the companies currently required to include a non-financial information statement in their annual report.



# Appendix

## Key takeaways for FTSE 350 audit committees

### D: Enhancing shareholder engagement with audit

#### 1. Consulting with shareholders on the Audit and Assurance Policy

The Government considers that a formal mechanism should be established to enable audit committees to gather shareholder views on the Audit and Assurance Policy but recognises that they should be purely advisory in nature and supplementary to the auditors to ensure the audit retains its autonomy.

The Government agrees that shareholders would benefit from having access to the latest risk assessment but considers that the audit committee should only be expected to make additional disclosures if there has been a material change to the principal risks facing the company since those disclosed in the last annual or interim report.

ARGA will be asked to consider further in liaison with audit committees, auditors and shareholder bodies how the engagement would work in practice, but it would need to include consideration of the following:

- the timing and methods of engagement with shareholders
- how the updated risk assessment will be communicated to shareholders, and
- the types of shareholder requests which should require formal consideration, eg could be related to size of shareholdings or a materiality test

The Government considers that the proposal should be implemented through a change to the UK Corporate Governance Code.

The Government is also proposing to encourage better engagement with the auditor at the AGM by inviting the regulator to review its guidelines to audit committees in order to encourage questions from shareholders about the company's audit.

The proposals would initially apply only to the audit committees of Premium Listed Companies.

#### 2. Shareholder engagement on auditor removal or resignation

The Government considers that the existing Companies Act provisions which apply when an auditor ceases to hold office are generally failing to provide meaningful information to shareholders and the regulator as regards the reasons for the auditor's departure in terms of disclosures lacking appropriate specificity. The Government will decide whether to have a follow up on these matters.

Any new requirements would presumably, in principle, apply to all companies subject to audit.



# Appendix

## Key takeaways for FTSE 350 audit committees

### **E: Managed shared audit and reserve market cap powers for regulator**

#### **1. Managed shared audit**

##### **Overall approach**

The Government is proposing a managed shared audit requirement for all UK-registered FTSE 350 companies with limited exceptions. This form of shared audit would see an audit firm appointed to lead the group audit. When tendering for statutory audits of entities in the group, companies would be required to appoint a challenger firm to audit a meaningful proportion of the statutory audits. Companies would act through the audit committee when audits are retendered rather than at an annual reappointment.

##### **How managed shared audit would work**

Detailed and binding requirements for managed shared audits would be issued, supported by guidance. The extent to which requirements could be set out in regulations or in rules made by the regulator remains under consideration. It is currently proposed the requirements would include:

- a challenger firm to be appointed to carry out a meaningful proportion of the group's statutory audits (eg a subsidiary or collective of subsidiaries). Meaningful would be defined by one or more of the following: total audit fee for the group (in the prior year); group revenue; and profit and assets of the company, with the challenger's proportion to be no less than 10% of these criteria and probably closer to 30%. It is recognised that the challenger firm's proportion is likely to be at the lower end of the range for the largest and most complex FTSE 350 companies, at least at the outset.
- the audit committee could identify through its audit tender planning the subsidiaries that could be audited by a challenger firm. The tender process could see the audit committee appoint the group and challenger auditor independently with no joint bidding permitted. It is expected that the group and other audit engagements could be tendered at the same time.
- there would be merit in the subsidiaries the challenger audits being rotated during the audit contract to provide the challenger with greater experience of the company. The regulator would encourage but not require it. The auditor of the subsidiaries would, as a minimum, be subject to the same periodic rotation required of the group auditor.
- any work performed by the challenger firm would fall within the scope of the regulator's audit quality review regime.
- the challenger firm would have access to, and engagement with, the FTSE 350 main group audit committee.

##### **Exemptions from managed shared audit**

Managed shared audit will not apply to companies that:

- have appointed a challenger firm as the sole auditor, or
- have not been in the FTSE 350 for at least half of the annual accounting period prior to the auditor's appointment and are not a FTSE 350 company when the tender process begins

The Government does not propose a blanket exemption for the requirements set out above for the largest and most complex companies. The Government, however, plans to provide exemptions to companies from the managed shared audit requirements in exceptional circumstances and to give the regulator the power to assess when such circumstances have been met. The use of the power would be subject to further consultation and limited by criteria to ensure its use was exceptional. The Government proposes exceptional circumstances could cover situations where companies do not receive bids or bids of sufficient quality.



# Appendix

## Key takeaways for FTSE 350 audit committees

If a company implementing managed shared audit stopped being classified as a FTSE 350 company, it would continue to use managed shared audit until it next retendered its audit unless it ceased to trade in its current form, the company was delisted from the London Main Market or was acquired by an overseas company not subject to the managed shared audit requirement.

### **Regulator's powers and responsibilities in relation to managed shared audit**

The regulator would monitor compliance with the managed shared audit requirements. To do this it would have powers to request information from, and engagement with, FTSE 350 companies. It is also proposed the regulator would have enforcement and sanctioning powers against companies that do not comply with the requirements.

The regulator would have a responsibility to monitor the effectiveness of managed shared audit. The metrics by which the effectiveness of managed shared audit would be assessed would be subject to further consultation and would be likely to include the trend in the challenger firms' FTSE 350 market share as sole and shared auditor. Indicative modelling for BEIS indicates market share could be between 9.1 and 12% of market share after 10 years, in line with CMA's modelling for joint audit.

The regulator would publish an annual report from the first full year after managed shared audit was introduced.

As discussed above, the managed shared audit/sole challenger firm appointment requirements would apply to FTSE 350 companies.

## **2. Reserve power for regulator for market share cap**

### **Overall approach**

The Government also proposes a reserve power for the Secretary of State to allow the regulator to introduce a market share cap. This would be operated following a joint review by BEIS and the regulator if mandatory shared audits do not bring about the desired changes to the FTSE 350 audit market within a reasonable period of time. The Government considers a market share cap would be particularly relevant if, despite the challenger firms investing in capacity and capabilities, the firms were only securing a very limited proportion of the FTSE 350 annual audit market. The reserve powers could also be activated in the event of an audit firm's collapse.

The market share cap would be a temporary measure, with its removal contingent on progress towards the objective of increased choice in the FTSE 350 audit market. Periodic reviews of the market opening measures would continue. Given the length of the audit tender cycle, it is likely that the cap would need to be in place for a number of years.

### **Possible features of a market cap**

The Government would undertake further consultation on the detailed design of the market share cap before the measure was introduced. The Government currently, however, considers that the following principles could feature:

- the measure would apply to all UK-registered FTSE 350 companies, although in practice only a proportion would be directly affected by it.
- there would not be a single numerical or percentage market share cap applied to any single audit firm or group of audit firms. Instead, the regulator would review the pipeline of FTSE 350 audit tenders for an upcoming period and reserve a proportion of them for challenger firms (restricted tenders).

# Appendix

## Key takeaways for FTSE 350 audit committees

- the regulator's determination of what upcoming tenders would be restricted tenders would take into consideration challenger firms' capacity and capability to carry out the audits and whether the FTSE 350 company would be able to comply with the prevailing tendering and audit requirements if it ran a challenger firm only audit tender. The regulator would not identify a particular challenger firm that could carry out the audit but rather consider whether the cohort of challenger firms included sufficient capability to undertake the audit.
- the market share cap would not remove the FTSE 350 company's obligation to run a competitive tender process or to hold a shareholder vote on the auditor appointment.
- the market share cap would not restrict FTSE 350 companies affected from appointing a Big 4 firm to carry out a proportion of the audit, as long as a challenger firm was appointed as group auditor.

The approach seeks to preserve choice and competition between the largest audit firms by not setting individual market share caps and to ensure there is independent regulatory oversight and supervision of which FTSE 350 audits are reserved for challenger firms.

As for market share cap/sole challenger firm appointment requirements, the reserve market share cap would apply to FTSE 350 companies.

### **F: A tougher approach to regulation**

#### **1. Key features of the Audit, Reporting and Governance Authority (ARGA)**

##### Overview of ARGA's objectives and regulatory principles

###### General objective

- to protect and promote the interests of investors, other users of corporate reporting and the wider public interest.

###### Quality objective

- to promote high quality audit, corporate reporting, corporate governance, accounting and actuarial work.

###### Competition objective

- to promote effective competition in the market for statutory audit work.

###### Regulatory principles for ARGA to 'have regard' to:

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

The regulator will be required to advance either or both of its quality and competition objectives when it is carrying out its policy-making functions.

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

# Appendix

## Key takeaways for FTSE 350 audit committees

### 2. Supervision of corporate reporting

#### Power for regulator to direct changes to reports and accounts

The regulator will be given power to direct changes be made to reports and accounts rather than having to seek a Court Order to do so. It will also have the power to instigate an expert review into the underlying reasons for an accounting application and to assess what changes may be required.

#### Power for regulator to publish information on individual CRR reviews

The regulator will have powers to allow it to publish correspondence entered into in the course of a Corporate Reporting Review (CRR) review as well as summary findings. As an interim step, the regulator intends to publish summaries of CRR reviews.

#### CRR review to cover the whole of the annual report

When undertaking reviews, the regulator has been checking the Directors' Report, Strategic Report and Annual Reports of companies within its scope for compliance with the Companies Act, 2006 and applicable reporting standards. It also keeps under review periodic accounts and reports that are produced by issuers of transferable securities and assesses whether they comply with any accounting requirements imposed by FRC rules. The White Paper proposes that the entire content of the annual report should be brought within the scope of the CRR process. The Government will extend both the existing power to request information from companies and the new power to direct changes to accounts to cover the entire content of the annual report. Ahead of legislation, the Government has asked the FRC to extend the CRR scrutiny to all elements of the annual report.

#### Extension of volume of CRR activity with main focus of work on PIEs

The Government supports an expansion of the volume of the regulator's CRR activity. The CRR's scope extends to approximately 15,000 companies in total including all large private companies as well as UK listed and AIM-quoted companies. All LLPs are also covered though the Government agrees that the new regulator should focus most of its pro-active CRR work on PIEs but should retain its current powers to investigate reporting by non-PIE companies.

#### Consideration to be given to pre-clearance service

The Government will ensure that ARGAs has the necessary powers to provide a pre-clearance service, including a statutory exemption from liability where it offers this service. The decision on whether and when to offer a pre-clearance service, and whether it should be preceded by a pilot, should be determined by the regulator.

As discussed above, the CRR process applies to public and large private companies but with a primary focus on the pro-active work on PIEs.

### 3. Sanctions against directors

#### A new sanctions system for PIE directors on reporting and audit

The Government intends to legislate to provide ARGAs with the necessary powers to investigate and sanction PIE directors for breaches of corporate reporting and audit related responsibilities. It is not proposing an authorisation scheme for company directors as exists in financial services.

The new enforcement regime would supplement rather than replace the existing arrangements for taking actions against company directors. All PIE company directors would be in scope for the new civil law enforcement regime and the scope of the regulator's enforcement powers would apply to PIEs which are not companies.



# Appendix

## Key takeaways for FTSE 350 audit committees

The scope of the enforcement powers would cover:

- the duty to keep adequate accounting records
- the duty to approve accounts only if they give a true and fair view
- the duty to approve and sign the annual accounts
- the duty to approve the directors' report
- the duty to provide a statement as to disclosures to auditors and to provide information or explanation at the request of the auditors

The Government proposes to give the regulator the power to impose more detailed requirements as to how certain statutory duties relating to corporate reporting and audit are to be met by directors.

The regime would operate a 'graduated range' of civil sanctions that could be applied by the regulator where a breach was proven. Proposed sanctions include reprimands, fines, orders to take action to mitigate the effects of a breach or to make declarations of non-compliance, and, in the most serious of cases, temporary prohibitions on acting as a director of a PIE.

New sanctions system applicable to all PIE companies and the Government has indicated all directors will be within scope (not just those in specified roles).

### 4. Audit Committee oversight

The Government proposes to require ARGA to impose additional requirements on audit committees in relation to the appointment and oversight of auditors. They will be required to monitor audit quality continuously and to consistently demand challenge and scepticism from auditors. It will be for ARGAs to consider how its new requirements will sit alongside the existing obligations which apply to audit committees in relation to audit.

The regulator would also continue to issue guidance to assist companies and those serving on audit committees. This might involve examples of good practice to allow companies to build on the experience and expertise of others.

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

The Government further proposes to give ARGAs appropriate powers to take action in relation to breaches of the new audit committee requirements. It is proposed the regulator will take action in proportionate stages and will give the audit committee the opportunity to address any issues of regulatory concern before taking remedial steps publicly.

The additional requirements for audit committees would apply to FTSE 350 audit committees.

# Appendix

## Key takeaways for FTSE 350 audit committees

### 5. Publication of Audit Quality Review reports

The Government intends to legislate to allow AQR (Audit Quality Review) reports on individual audits to be published by the regulator without the need for consent by the audit firm and audited entity. The regulator will be free to decide whether this publication is in full or in summary form. The Government will put in place safeguards to protect the publication of sensitive information about audited entities.

The FRC is already planning to publish the results of all AQR inspections of individual audits, including an assessment of the quality of the audit work, using its revised reporting template, where consent is obtained from both the audited entity and the audit firm. The Government welcomes this initiative but is concerned by the regulator's need to seek consent from the audited entity and the audit firm for publication of its reports in any form.

Issues relating to the publication of audit reports applicable to PIEs.

### 6. Independent appointment of the auditor by the regulator

Whilst the Government is not persuaded that it is appropriate to give ARGAs independent powers to appoint the auditor in certain circumstances at this stage, it is considering whether to legislate to provide flexibility for this to happen in the future. The circumstances where it is considered this may be helpful would be where:

- quality issues have been identified around the company's audit
- a company has parted with its auditor outside the normal rotation cycle
- there has been a meaningful shareholder vote against the auditor's appointment

Any new requirements would presumably, in principle, apply to all companies subject to audit.

### 7. Framework for corporate auditing

The Government is proposing to create a framework for all 'corporate auditing' covering both the auditing of all financial information and also the auditing of wider information, eg culture, ESG, cyber, controls, Alternative Performance Measures (APMs) and Key Performance Indicators (KPIs), and mineral reserves. It believes that a new professional body for corporate auditors should be created to help create a climate for wider audit and to enable good audit practice to thrive across corporate audit disciplines.

The Government is minded to introduce a new legal framework to empower the regulator to set and enforce new principles of auditing that could apply to both statutory auditors and those appointed to provide wider audit services under the Audit and Assurance Policy.

The approach related 'corporate auditing' would be applicable to PIEs.

# Contacts

**Anthony Carey**, Head of Board Practice

T: +44 (0) 20 7063 4411

E: [anthony.carey@mazars.co.uk](mailto:anthony.carey@mazars.co.uk)

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