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Dear Secretary of State

### **Smarter regulation and the regulatory landscape: Call for Evidence**

Mazars is an internationally integrated partnership specialising in audit, accountancy, advisory, tax and legal services. Operating in over 90 countries and territories around the world, we draw on the expertise of 47,000 professionals – 30,000+ in the Mazars integrated partnership and 17,000+ via the Mazars North America Alliance. In the UK, Mazars has approximately 160 partners and over 2,900 employees, and is ranked one of the top 10 firms nationally.

We are pleased to have this opportunity to provide evidence in relation to smarter regulation and the UK regulatory landscape. As a professional services firm our main regulator is the Financial Reporting Council ('FRC'). We set out herein our comments on the general regulatory landscape, with a focus on the role of the FRC. We have not responded to the detailed questions in the call for evidence as most of them are not relevant.

#### ***Overview of regulatory landscape***

As set out in the call for evidence, we agree that regulation plays a "vital role in protecting customers, the environment and setting the right framework for business to thrive", when such regulation is delivered effectively. We further agree that it is important that smarter regulation focusses on proportionate, future-proofed regulation.

Regarding the three pillars of the Smarter Regulation programme we agree that the current regulatory landscape is complex with companies subject to the activities of multiple regulators. As such, we understand the rationale for mitigating the regulatory burden. However, we believe that the government needs to balance the need for streamlining the regulatory landscape and mitigating the regulatory burden on business, to support competition and growth, with the need to ensure that

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robust, but proportionate, regulation provides proper oversight and enables confidence in corporate governance in UK businesses in the public interest. In supporting competition, regulators should pay particular interest to parts of the market in which there is, or risk of, excessive concentration.

A coordinated review of the regulatory landscape, assessing how the different regulators/regulations operate and coordinate their activities is necessary, including consideration of whether, in totality, the regulatory regime is achieving its overall aims. This review should include all regulators, including those reporting to other government departments, in particular the financial regulators which report to HM Treasury given their significant role in corporate reporting and corporate governance.

### ***Alignment with international regulation***

Although we appreciate that it is not always appropriate or possible to align with international regulations, the legislative differences between the UK and European Union (for example) are not helpful for companies operating in Europe, especially given the extra-territoriality of some of those regulations. We believe that regulatory alignment with the UK's most important partners is critical to remaining competitive and urge the Government to consider how it can best ensure such alignment where it is in the interest of UK companies.

### ***Characteristics of an effective regulator***

The Regulators Code, published in 2014, embodies the requirements of regulators. In broad terms these can be summarised as requiring regulators to:

- Support those they regulate to comply and grow
- Engage with those they regulate (and other stakeholders) and hear their views
- Apply a risk-based approach to regulation
- Share information about compliance and risk
- Provide clear information, guidance and advice
- Ensure the regulatory approach is transparent

We believe that these broad principles remain appropriate but would also suggest the following additional characteristics in an effective regulatory approach:

- Accountability – regulators should be clearly accountable to the relevant government department and other stakeholders with thorough periodic public external reviews of their effectiveness.
- Clarity of purpose – setting out what the regulator is intending to achieve and how it will get there, particularly where the regulator has a range of responsibilities which it has to balance
- Proportionality – regulators should be proportionate in all of their activities, such that the requirements and actions taken are fair, balanced and reasonable with the overall benefits exceeding the costs.
- Enforcement powers are increasingly important to regulators, but these must be applied in a balanced, fair and proportionate manner. Regulators should have enforcement powers over all parties that can influence their relevant activities.
- Best practice – regulators should focus equally on sharing good practices, as well as identifying deficiencies in those they regulate to enable improvement.

***What makes a strong effective regulator - with a focus on the FRC****Stable legislative underpinning*

We are disappointed with the continuing delays in the progress with audit and corporate governance reform following the reviews completed in recent years. It is imperative that proper regulation is underpinned by a stable legislative framework to provide both regulators and those they regulate with certainty.

In the case of the FRC, the lack of legislation establishing the new Audit, Reporting and Governance Authority (ARGA) is frustrating. Such powers are needed to enable the FRC to effectively regulate all parties in the corporate reporting ecosystem, including company directors, and address the present asymmetrical regulation and enforcement, where the focus is primarily on auditors. In the Financial Services sector, the presence of the Financial Conduct Authority as regulator of the corporate entity, strengthens the overall regulatory framework. For example, where the auditor has concerns that may not impact their audit opinion, they are able to refer these concerns to the regulator which can then address the issue directly with management of the entity.

Furthermore, one of the key objectives of ARGA will be to drive competition and choice in the audit market not least in order to strengthen market resilience. It is difficult for potential new entrants to the PIE audit market to make the significant financial commitments to enable a successful transition in an uncertain regulatory environment.

*Accountability and clarity of purpose*

We often hear the phrase “Who audits the auditor?”. Perhaps we should also ask “Who regulates the regulator?”. The legislative framework should provide the clarity of purpose and overall objectives of the regulator and the arrangements by which they demonstrate that they are having a positive impact and with regards to which they should be held accountable.

There should be clear objectives set by the Government with open, transparent reporting of performance by the regulator to the relevant department and the public to demonstrate how the regulator is achieving its overall purpose and objectives. Regulators should be held accountable by the Government in the achievement of their objectives and achieving improvement in the entities which they regulate.

Given the wide range of responsibilities which ARGA will have, when it is formally established, it is important that it is held accountable for achieving its multiple aims. It is important that the FRC (ARGA) effectively manages, and is held accountable for, its range of powers, covering competition, choice and market resilience, regulation, enforcement and market supervision which need to be carefully balanced if the optimum outcomes are to be achieved. Clarity should be provided over the purpose of the FRC, whether it is to protect the market or individual shareholders, or both.

There is evidence, for example, of the FRC’s regulatory and supervisory functions impacting challenger firm decisions on entering and/or growing their presence in the PIE audit space, whilst ARGA’s responsibilities for competition and choice will require new market entrants and expansion in existing audit providers. Achieving its competition and quality goals simultaneously will undoubtedly require a proportionate and improvement orientated approach by the new regulator and one in which it works effectively with the various other stakeholders in the FTSE350 and wider PIE markets.

Accountability of regulators should extend to setting and reporting achievement of targets. As an example, in relation to market competition, the Government could set targets over a five-year period on the reduction in market concentration in the FTSE100 and FTSE350. Annual progress made towards the goals set should be published together with an indication of additional measures to be taken if targets are not being achieved. A minimum reasonable goal would be for the collective market share, by audit fee, of the challenger firms to at least be equal to the average market share of each of the Big 4 at the end of that period, namely 20% whereas between 2019 and 2022 it only rose from 1% of FTSE350 audit fees to 2%.

We also believe a review of how the Audit Quality Review is undertaken and how its results are reported would be beneficial covering the number of files selected for firms of different sizes to consider whether it is proportionate to their share of the PIE market, the structure of AQR reviews and, in particular, how the results of reviews are reported. The way results are reported seems different to the approach adopted in other professions and could potentially be open to misinterpretation.

#### *Improvement focus and ex-ante regulation*

We believe that regulation should not just be a process for identifying where things have gone wrong but, equally importantly, a focus on improvement is critical for a strong and effective regulator to enable a “right first time” outcome. This can be achieved by providing clear guidance and advice, and sharing of best practice. Similarly, it should track and help market players respond effectively to emerging trends.

We are pleased to note steps taken in recent years by the FRC to move towards being what it often refers to as an “improvement regulator” and encourage the FRC to continue its efforts in this direction under its new leadership. However, we believe that it is important that the regulator is able to monitor the impact of its actions in this regard. As examples, the effectiveness of initiatives such as roundtables, sand boxes and the challenger firm scale box must be assessed, and their positive impact demonstrated.

Furthermore, we encourage the FRC to take more of an “ex-ante” and participative approach to its regulatory activities where appropriate. This would entail the FRC being more open to consultation and discussion prior to decisions and actions being taken by auditors and others rather than merely acting as a judge after the event. Such an approach would help to ensure that the right outcomes are achieved in the public interest.

#### *Proportionality – Auditing standards*

We noted with interest the letter from the Secretary of State to the FRC in November setting out the additional emphasis in its duty to promote competition and growth in the UK economy and, in particular the requirement for the FRC to consider the proportionality of its rules, both existing and for any new proposals.

Recent developments in auditing standards, both at international and UK level, have increasingly focused on the challenges relating to public interest entity audits and have become increasingly onerous. Whilst these enhancements are generally appropriate for the PIE market, they are increasingly disproportionate to the audits of small and medium sized entities, which are the heart of the UK economy and hence clear differentiation between different parts of the market in standard-setting and monitoring/enforcement is necessary.

The audit standard setting process in the UK currently lacks transparency, compared to international standard setting activities which are carried out in public. Furthermore, consultations are generally supported only by roundtable discussions and written responses, and ultimately lead to very limited amendments to the draft standards proposed by the FRC.

We believe that the audit standard setting process in the UK should be more transparent and there should be a greater focus on the proportionality of requirements to SME audits, including consideration as to whether the new international standard for audits of less complex entities may be appropriate for adoption in the UK.

#### *Proportionality – Corporate reporting*

The FRC's Corporate Reporting Review is held in high regard. However, the FRC continues to set expectations which are then regarded by the market as requirements, leading to indirect "gold-plating" of reporting requirements, impacting the proportionality and scalability of the outcomes with limited regard to the requirements of smaller listed entities compared to the largest, an important issue for the London market's competitiveness given the wide range of listed companies on it relative to many other jurisdictions.

#### *Proportionality – Enforcement*

Enforcement powers must be applied consistently, fairly and in a proportionate manner. The bar for enforcement action against auditors appears to be much lower than that for other professions and it is not clear that the FRC's enforcement are always proportionate to the public interest associated with the matters being investigated. The FRC should demonstrate more transparency in its decision making as to why matters proceed to enforcement. Furthermore, regulators should have enforcement powers over all parties that can influence their relevant activities.

In the case of the FRC, as noted above, its current enforcement activity is focussed primarily on one player in the ecosystem (auditors), and it is important that it is granted the powers to regulate and enforce against other parties such as company directors whether or not they are professional accountants.

It is important that the wider powers available to the FRC/ARGA, transparent and independent appeal mechanisms will be important to ensure that regulation is acting in the public interest.

#### *Post implementation effectiveness reviews*

Regulators should undertake post-implementation effectiveness reviews of any new standards or regulatory actions. This is brought into focus by the Secretary of State's comments in her letter to the FRC when stating that "[...] it is also important to look actively at where rules and guidance are no longer proportionate and can be removed or streamlined." It is important for the FRC to undertake post-implementation reviews in an appropriate timeframe after introduction of new proposals (such as auditing standards and requirements like the corporate governance code) to ensure that they are proportionate and effective. Furthermore, when making recommendations arising from thematic reviews and corporate reporting reviews, the FRC should consider the proportionality of such recommendations when considering their implementation in subsequent periods. As part of this process robust impact assessments should be carefully carried out with costs and benefits assessed in consultation with all relevant market players with expertise in the area.

*Balancing competitiveness with protection of public interest – consideration of market structure / CMA*

In considering the balance between competitiveness of the economy, deregulation and the public interest, the Government may wish to consider how best to address competition in the audit market. At present, market structure sits with the Competition and Markets Authority (CMA) while the FRC is awaiting powers to enhance competition and choice. There is a risk of overlap, and hence potentially of discord, in how the regulatory objectives of the two bodies are advanced.

The Government may also wish to consider whether the Listing Rules, which are currently maintained by the Financial Conduct Authority (FCA) may be more appropriately managed by the FRC (ARGA) which already regulates and enforces corporate reporting requirements.

**Further discussion**

If you would find it helpful to discuss any issues in this letter, please contact David Herbinet, Global Head of Audit ([david.herbinet@mazars.co.uk](mailto:david.herbinet@mazars.co.uk)) or Paul Winrow, Partner, Public Policy & Regulation ([paul.winrow@mazars.co.uk](mailto:paul.winrow@mazars.co.uk)).

Yours faithfully

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