Chartered Governance Institute UK & Ireland

**The Chartered Governance Institute UK & Ireland**

Saffron House
6-10 Kirby Street
London EC1N 8TS

+44 (0)20 7584 4741
info@cgi.org.uk
cgi.org.uk

Department for Business, Energy and Industrial Strategy
1st Floor, Victoria 1
1 Victoria Street
London
SW1H 0ET

Email: audit.consultation@beis.gov.uk

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Dear Sirs

**Consultation on Restoring trust in audit and corporate governance**

We welcome the opportunity to comment on the department's consultation on *Restoring trust in audit and corporate governance*.

As you know, The Chartered Governance Institute UK & Ireland is the professional body for governance and the qualifying and membership body for governance professionals across all sectors. Its purpose under Royal Charter is to lead 'effective governance and efficient administration of commerce, industry and public affairs' working with regulators and policy makers to champion high standards of governance and providing qualifications, training and guidance. As a lifelong learning partner, the Institute helps governance professionals to achieve their professional goals, providing recognition, community and the voice of its membership.

One of nine divisions of the global Chartered Governance Institute, which was established 130 years ago, The Chartered Governance Institute UK & Ireland represents members working and studying in the UK and Ireland and in many other countries and regions including the Caribbean, parts of Africa and the Middle East.

As the professional body that qualifies Chartered Secretaries and Chartered Governance Professionals, which includes company secretaries, our members have a uniquely privileged role in companies' governance arrangements including corporate reporting. Our members are therefore well placed to understand the issues raised by this consultation document. In preparing our response we have consulted, amongst others, with members of the Chartered Governance Institute's Company Secretaries Forum, a group of company secretaries from more than 30 large UK listed companies from the FTSE 100 and FTSE 250. However, the views expressed in this response are not necessarily those of any individual members of any of this group, nor of the companies they represent.

Our views on the questions asked in your consultation paper are set out below.

**General comments**

We completely agree with the Government's expressed intention to restore trust in audit and corporate governance, but believe that this is more necessary in the former than the latter area where we believe that the UK enjoys an international reputation for high-quality governance and that trust is not as fractured as some may suggest. The issue of audit quality is fundamental here.

In all the recent reviews of the audit market and its regulation – Sir John Kingman's review of the Financial Reporting Council (FRC), which reported in December 2018; the BEIS Committee's report on the future of audit and the Competition and Market Authority(CMA)'s Market Study of the audit market, both in April 2019; and Sir Donald Brydon's review of the quality and effectiveness of audit, which reported in December 2019, we have maintained a consistent line in our responses that there are three key issues that need to be addressed in order to improve audit quality. These are the expectation gap, the delivery gap and what we have termed 'the Challenger challenge'.

***The expectation gap***

There is an enormous difference between the political, press and public expectation of the role of audit and what an auditor would perceive it to be as defined in the audit engagement letter. The question is whether it is the role of an audit to demonstrate that a company is not in imminent danger of failure, or simply to check the accuracy of the historical information in the company's accounting records. Accounting and auditing legislation, regulation and standards are very important here. The invitation to comment for the CMA review of the statutory audit market noted (paragraph 2.25) that International Financial Reporting Standards have developed "over time from an approach based on historic cost accounting to that based on fair value accounting. The key principle is that assets and liabilities should be valued on market prices, based on the idea this would make the financial statement more 'useful to users'. Some commentators have argued that fair value accounting has led to greater risk because of the difficulty, and subjective nature, of valuing and auditing certain assets and liabilities."

As we said in our response to that invitation to comment, "We leave the debate over which approach to accounting standards is correct to those better qualified, but we do offer the observation that a number of the 'accounting scandals' that we have seen in recent years have at their heart questions of judgement. Whether particular value could, or should, be regarded as crystallised in the accounts should, in our view, be a question of fact rather than of opinion – either it is the company's money or it isn't. It should not be possible for one accountant to draw up the books for a period and have them audited against current accounting standards and for another to perform the same exercise, for the same period, have it audited by a different auditor or, indeed by other auditors or other specialists in the same firm of auditors, and find many millions of pounds difference so that the accounts have to be restated. We cannot recall a single occasion when such a restatement of accounts has enured to the benefit of shareholders. In our view, a detailed examination of the appropriateness of the use of fair value accounting would be an extremely useful first step in improving the quality of audit and accounting standards revised as necessary to give greater clarity on where judgement has been applied by either the preparer or auditor. Some of these issues are well-handled in the Government's proposals, but others need further work.

***The delivery gap***

As the FRC has consistently reported, the work of auditors, even against the low base of the audit engagement letter, needs to improve. The percentage of audits assessed by the FRC to be of a good standard is, simply, not good enough and it seems to be getting worse. Of the 130 audits inspected directly by the FRC's Audit Quality Review team in its 2019/20 audit inspection cycle, only 62% were assessed "as good or requiring limited improvements. Results for the smaller Challenger firms and for our inspections of local authority audits were poorer than for the company audits inspected at the seven largest firms." This compares with 67% in the previous year.

Not only does the audit process not do what many in our society believe it should, it fails to do properly the bare minimum of what it is actually supposed to do. Much more work is required to foster a greater spirit of professional scepticism among auditors. The proposals in the consultation paper go a long way towards addressing this issue and they have our support. In particular, we support the creation of a separate audit profession and the additional powers and responsibilities being given to the Audit, reporting and Governance Authority (ARGA) as it replaces the FRC. For some years, we have been concerned that the FRC has been expected to control the market to a degree which is beyond its powers. These proposals give it that power and are welcome.

***The Challenger challenge***

In its review of the audit market, the Competition and Markets Authority placed much importance on the issue of the market dominance of the 'Big Four' as Deloitte, EY, KPMG and PWC are commonly known, and seemed to attribute to this dominance some of the issues of audit quality. We do not agree with this view. In our view, the issue is more the capacity of the Challenger firms than their existence. Competition in, and the resilience of, the audit market are both very important issues but we believe them to be different from the issue of audit quality. We therefore have doubts about the effectiveness of some of the proposals in this area. Put simply, there is a lack of trust in the capacity of auditors outside the Big Four. The lack of confidence on the part of companies, investors and some regulators in the capacity of smaller auditors to deliver high quality audits of large or complex organisations is an issue of trust and without the accuracy or inaccuracy of this perception being tested by an independent body, any potential misconceptions will continue to abound. It is essential that the validity of any gaps in auditing capability is investigated as the inclusion of Challenger firms in the audit market will not serve to improve that market if those firms genuinely do not have the capability, resource, specialism or expertise to audit more complex organisations. For the avoidance of doubt, we intend here no reflection on the quality of those firms or the individuals working in them, rather a concern about their capacity. The issue of audit gridlock, where companies find that existing relationships with firms can mean that they are conflicted from tendering for the audit, means that companies would be very keen to see more firms in the audit market.

That said, it is with some of the other proposals in the consultation that we have greater concerns. We strongly support the UK corporate governance model of 'comply or explain', which allows companies to put in place the most effective governance arrangements for their particular circumstances, and we would caution against diluting or, in some cases, removing this flexibility. We are concerned that a number of the proposals set out in the consultation document will replace provisions of the UK Corporate Governance Code with set rules. This, combined with the increasing number of internal management

processes that are being put to a shareholder vote at the AGM, risks eroding the UK's system of Corporate Governance.

As an example, we would draw your attention to the advisory vote for shareholders on remuneration policy which was introduced some years ago. We do not believe this has been welcomed by shareholders generally and it has not been a positive development for companies, resulting in many unintended consequences, including an unhelpful polarisation of views, a focus on remuneration in engagement between companies and their investors and an increase in the influence of proxy advisory firms. We therefore caution against adding to this through proposals for additional shareholder voting on internal management processes such as risk and audit. There are already many mechanisms by which investors can signal dissatisfaction with the way in which their appointees – the directors – manage the company, not least the ability to vote against those directors at a general meeting every year. Advisory votes, which have little real impact, simply create an opportunity for those investors who wish to do so to 'virtue signal' by voting 'against', without actually doing anything meaningful like voting against the responsible director or directors personally.

Our members believe that the UK's reputation for corporate governance is very strong. We do not believe that more governance will necessarily increase the UK's reputation. Although there have been some high-profile corporate collapses in recent years, corporate collapse is relatively rare. It is also difficult to argue that the measures proposed would have prevented those collapses. Consequently, we do not believe further increases in regulation and additional corporate governance are necessary and believe it is likely that the proposals will reduce the UK's competitiveness.

As part of the consultation process, we would encourage BEIS to engage directly with some large law firms and investment banks to understand the factors that companies consider when choosing whether to undertake a listing of their company and where to locate their company. We would also encourage BEIS to review the impact of the Sarbanes-Oxley Act on the number of companies in the US and foreign issuers that have subsequently chosen to delist and its effectiveness in preventing corporate failures.

**Answers to specific questions**

**1. Public Interest Entities**

**QUESTION 1: Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.**

Yes. We agree that some large private companies should be included within the definition of a PIE. However, the scope of the new definition is important. Where subsidiaries of large UK entities fall within scope, we believe that it is important that the requirements should be met at a group level rather than at an individual company level – as paragraph 1.3.19 of the consultation notes, "the accounts of the group headed by the company better reflect the commercial reality of the entity." Experience of recent regulatory requirements for increased reporting by subsidiary companies has resulted in duplication of reporting and an increased administrative burden to no benefit.

**QUESTION 2: What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.**

Option 1 seems a simpler test as it reflects the test used to identify those large companies which are already required to include a corporate governance statement in their directors' report under the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 (SI 2008/410), Schedule 7, paragraphs 21 to 30. Option 2 has attractions for some as it brings a smaller body of companies into scope but, on balance, we feel the advantage lies with not creating a new set of thresholds for company reporting.

Whatever threshold is chosen, we believe it important that there be an additional requirement that all organisations within scope have a properly qualified company secretary or governance professional. At present, the requirement that a company has a company secretary applies under s271 only to public companies. Prior to the Companies Act 2006, this requirement applied to all companies. It is the case that there is nothing to stop any organisation having a company secretary or governance professional should it choose to do so but, with the additional focus being placed on governance and reporting, we believe that the statutory obligation should be widened to cover the additional organisations being brought into scope as PIEs.

**QUESTION 3: Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.**

No, not unless they meet other threshold criteria or unless the Government decides, which we would not recommend, that they must be PIEs because their shares are publicly listed. We agree that it may be appropriate to include some AIM listed companies within the definition of a PIE for reasons other than their listing but we do not believe AIM listing alone is sufficient reason for inclusion. The intention of an AIM listing is that companies are subject to a lower level of standards and regulation, so the inclusion of AIM companies in the new definition of a PIE would appear to be disproportionate and to treat AIM as if it were a regulated market, effectively upgrading it.

In particular, we do not believe that it is appropriate to use market capitalisation as a threshold for categorisation as a PIE. A company's market capitalisation is constantly changing and is affected by many factors, some of which are external to the company, including market expectations, the performance of competitors and, in some regrettable cases, market manipulation by speculators. We therefore do not believe this to be an appropriate measure on which to base PIE status.

**QUESTION 4: Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?**

No. We see no merit in, or reason for, such an exemption. Indeed, it could be argued that it is at this stage of its development that a company most needs high audit standards.

**QUESTION 5: Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.**

We have no opinion on this question.

**QUESTION 6: Should the Government seek to include large third sector entities as PIEs beyond those that would already be included in the definitions proposed for large companies? If so, what types of third sector entities do you believe should be included and why?**

Yes, but only where they meet the threshold criteria for a PIE. We see no merit in bringing additional third sector bodies within scope, especially where they already have to meet their own sectoral regulatory requirements.

Where a large third sector entity does meet the threshold criteria for a PIE, ARGA should bear in mind the expertise of the directors who may well be volunteers rather than paid directors, that many of them report that they already have difficulty in securing auditors, and that their finance and administration teams are not staffed to deal with additional complexities of PIE reporting, which would place an additional and disproportionate burden on the entity.

**QUESTION 7: What threshold for 'incoming resources' would you propose for the definition of 'large' for third sector entities? Is exceeding £100m too high, too low or just right?**

We see no need for additional criteria for third sector entities. Either they meet the 'option 1' or 'option 2' criteria for being treated as a PIE or they don't. However, an assessment of how many third sector entities would be caught under 'option1' or 'option 2' would be helpful.

**QUESTION 8: Should any other types of entity be classed as PIEs? Why should those entities be included?**

We believe that any entity should be classed as a PIE where it meets the established threshold criteria for a PIE, but not otherwise.

**QUESTION 9: How would an increase in the number of PIEs impact on the number of auditors operating in the PIE audit market?**

Much will depend on the success of the Government's efforts to increase competition in the statutory audit market. It could be argued that increase in the number of PIEs, particularly at the smaller end, will mean that Challenger firms will have the opportunity to gain valuable experience in carrying out these statutory audits. At present there is no indication of a willingness of new players to operate in the PIE market; on the contrary we have been told of a trend for the Big Four to reduce the number and type of entities they are willing to audit.

**QUESTION 10: Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?**

Yes, this seems proportionate and reasonable.

**QUESTION 11: Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?**

Yes, this seems proportionate and reasonable. Measures should also be considered for avoiding a 'cliff-edge' where, for example, a company with 1,999 employees is not subject to rules that would apply to a company with 2,000 employees as this is a disincentive to business growth.

**2. Directors' accountability for internal controls, dividends and capital maintenance**

**QUESTION 12: Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?**

We believe that current internal control frameworks generally work well and see no advantage in adding layers of additional requirements on internal controls. However, we believe it would be appropriate to review and strengthen existing requirements in specific areas where they may be needed to be increase effectiveness. We understand that it is not the Government's intention to replicate the US Sarbanes-Oxley regime but would caution against the risk of regulatory creep. Our members' experience of that regime is that it creates a cottage industry, prioritising process over results, with considerable additional cost for the company, particularly in the form of accountancy and advisory services. The consultation document noted (Paragraph 2.1.10) that "Responses from the largest accountancy firms generally supported the introduction of a SOX-style framework provided it was proportionate and reflected the different UK context" - a cynic might suggest a link here.

It is not just an issue of costs for companies, however. A number of our members with experience of reporting in the US contrasted the significant resourcing at the Securities and Exchange Commission with that available to the FRC. If the decision is taken to strengthen the UK internal control framework, we recommend that ARGA look long and hard at the resourcing implications of so doing.

We would also encourage BEIS to review the impact of the Sarbanes-Oxley Act on the number of companies in the US and foreign issuers that have subsequently chosen to delist and its effectiveness in preventing corporate failures. It would be a pity were the Government's efforts to restore trust in audit and corporate governance to make the UK market less competitive and so less attractive for listing.

**QUESTION 13: If the control framework were to be strengthened, would you support the Government's initial preferred option (Table 2)? Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?**

We believe that the Government's initial preferred option, as set out in the consultation document, is generally a reasonable and proportionate approach. In particular, we support the proposal that all directors should be required to acknowledge their responsibility for establishing and maintaining an adequate internal control structure and procedures for financial reporting, rather than merely the executive directors, because we believe that the concept of the unitary board, with collective responsibility, is critically important.

We believe that carrying out a review of the internal control framework on an annual basis would not necessarily be helpful. Twelve months is insufficient time to assess the effectiveness of any new or amended internal control framework.

We would be concerned were it proposed in the future that companies' internal control frameworks become subject to yet another shareholder vote at the annual general meeting. We do not believe the increasing number of matters being put to a shareholder vote is supported by shareholders generally, or that many shareholders are well placed in terms of resource or expertise to understand the details of a company's internal management processes.

**QUESTION 14: If the framework were to be strengthened, which types of company should be within scope of the new requirements?**

Logic would suggest that a strengthened framework should apply to all PIEs.

**QUESTION 15: Should the regulator have stronger responsibilities for defining what should be treated as realised profits and losses for the purposes of section 853 of the Companies Act 2006? Would you support either of the two options identified? Are there other options which should be considered? What should ARGA consider when determining what should be treated as realised profits and losses?**

Yes. This has been an issue for some investors for some time and giving ARGA power to define realised profits and losses for the purposes of section 853 of the Companies Act 2006 is a sensible and proportionate solution. Option 2, offering binding rules, is probably the better one, given the contention that this issue has caused.

**QUESTION 16: Would the proposed new distributable profit reporting requirements provide useful information for investors and other users of accounts? Would the cost of preparing these disclosures be proportionate to the benefits? Should these requirements be limited to listed and AIM companies or extended to all PIEs?**

We do not believe the proposed new distributable profit reporting requirements would provide any information that can not already be inferred from a company's accounts and share the concern captured

in the consultation document (paragraph 2.2.22) that “A statement along the lines proposed could be perceived as unnecessary given that it would cover legal obligations with which directors must already be compliant.”

However, as a company must prepare this information for the board before they can recommend a dividend payment, the marginal cost of reporting distributable profit should be negligible. We see no reason why this requirement should not extend to all PIEs although, of course, the benefit will be mainly in respect of listed companies.

**QUESTION 17: Would an explicit directors’ statement about the legality of dividends and their effect on the future solvency of a company be effective in both ensuring that directors comply with their duties and in building external confidence in compliance with the dividend rules? Should these requirements be limited to listed and AIM companies or extended to all PIEs?**

No. Directors should, and do, consider their duties as directors when recommending or declaring a dividend but we believe existing mechanisms can be used to strengthen the legality of dividends. However, we see no real harm in such a requirement other than that it is yet another piece of data to be reported. We see no reason why this requirement should not extend to all PIEs although, again, the benefit will be mainly in respect of listed companies.

**QUESTION 18: Do you agree that the combination of recently introduced Companies Act section 172(1) reporting requirements along with encouragement from the investment community and ARGA will be enough to ensure that companies are sufficiently transparent about their distribution and capital allocation policies? Should a new reporting requirement be considered?**

We believe that companies are, or will be, sufficiently transparent about their distribution and capital allocation policies and that, consequently, no new reporting requirement is necessary or desirable.

**3. New corporate reporting**

**QUESTION 19: Do you agree that the above matters should be included by all companies in the Resilience Statement? If so, should they be addressed in the short or medium term sections of the Statement, or both? Should any other matters be addressed by all companies in the short and medium term sections of the Resilience Statement?**

We are not convinced by the argument that the proposed Resilience Statement is necessary, although we are pleased to see that the intention is that it replace the Going Concern and Viability Statements rather than being in addition to them – an additional statement would merely be repetitive.

Our chief concern is the expectation that the medium-term section of the Resilience Statement will require companies to look forward over a period of five years, with the long-term section looking even further ahead. It is our members’ experience that reporting tends to become less useful when companies are required to make statements on matters more than three years into the future. If companies attempt to report on a period of five years into the future, reporting tends to become more ‘boiler plate’ with fewer details and with less information specific to the company. This, combined with the proposals to increase

the liability of directors, will result in greater caution in reporting, particularly for companies exposed to US regulation where there is already significant resistance from the companies' US legal advisers to reporting, especially of risks or future speculation, that would be regarded as a basic expectation in the UK. It would be essential for the Government to provide in legislation for a 'safe harbour' for statements made in good faith.

It should also be made explicit that companies cannot and should not be expected to look into a crystal ball that will predict all eventualities. For example, how many companies two or three years ago might reasonably be expected to have foreseen the impact on their businesses of the COVID-19 pandemic.

**QUESTION 20: Should the Resilience Statement be a vehicle for TCFD reporting in whole or part?**

We can see that the short, medium and long-term reporting required under TCFD sits well with the periods for reporting in the Resilience Statement, however please see our comments above in response to question 19 regarding longer-term reporting under the Resilience Statement.

**QUESTION 21: Do you agree with the proposed company coverage for the Resilience Statement, and the proposal to delay the introduction of the Statement in respect of non-premium listed PIEs for two years? Should recently-listed companies be out of scope?**

This approach seems proportionate and reasonable. However, we see no reason why recently-listed companies should be out of scope, although this should be kept under review to ensure that it does not discourage UK listings.

**QUESTION 22: Do you agree with the proposed minimum content for the Audit and Assurance Policy? Should any other matters be addressed in the Policy by all companies in scope?**

The proposed minimum content for the Audit and Assurance Policy seems reasonable and proportionate.

**QUESTION 23: Should the Audit and Assurance Policy be published annually and subject to an annual advisory shareholder vote, or should it be published and voted on at least once every three years?**

No. We do not believe there is any appetite amongst the majority of shareholders for an advisory vote on an Audit and Assurance Policy, nor do we believe that many shareholders have the necessary availability of resource or expertise in this area. We believe that the majority of retail shareholders in particular will not welcome another vote on internal management processes.

As noted above, there are already many mechanisms by which investors can signal dissatisfaction with the way in which their appointees – the directors – manage the company, not least the ability to vote against those directors at a general meeting every year, and they already have access to the board, the audit committee and the audit committee chair should they so wish.

We regularly receive feedback from companies that it is difficult to persuade investors to engage with audit matters and, if this is the Government's wish, it would be better were the provisions of the Stewardship Code strengthened in this regard rather than additional responsibilities placed on companies.

**QUESTION 24: Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?**

The proposed scope of coverage and method for implementing the Audit and Assurance Policy seems reasonable and proportionate.

**QUESTION 25: In order to improve reporting on supplier payments, should larger companies be required to summarise their record on supplier payments over the previous 12 months as part of their annual Strategic Report (applying at a group level in the case of parent companies)? If so, what should the reporting summary include at a minimum? Do you have alternative suggestions on how to improve supplier payments reporting?**

We see no real benefit in companies providing a summary of their record on supplier payments as they already provide this information and we do not believe a summary is necessary or useful.

**QUESTION 26: To which companies should improvements in supplier payments reporting apply: companies which are PIEs and already report under the Payment Practices Reporting Duty, or PIEs with more than 500 employees?**

To avoid onerous duplication of reporting, improvements in supplier payments reporting should only apply to companies which are PIEs and already report under the Payment Practices Reporting Duty

**QUESTION 27: Do you agree with the Government's proposal not to introduce a new statutory requirement at this time for directors to publish an annual public interest statement?**

Yes. We agree with the decision not to introduce a new statutory requirement for a public interest statement.

**4. Supervision of corporate reporting**

**QUESTION 28: Do you have any comments on the Government's proposals for strengthening the regulator's corporate reporting review function set out in this chapter?**

We strongly support the Government's proposals for strengthening the regulator set out in this chapter and elsewhere in the consultation document, but have to remind the Government, as we have done in previous consultation responses, that the regulator's objective to "promote brevity and comprehensibility in company reporting" does not sit well with the Government's tendency in recent years to produce a stream of new reporting requirements, in some cases, it might be argued, in response to small but vociferous lobbies.

We believe that it would generally be better were many reporting requirements required on the company website rather than in the annual report, especially where they are not directly relevant to the business activities of the company. Information provided on websites could be kept up to date and could be more focussed and relevant to the individual company.

As noted in our response to question 29 below, we believe that ARGA should be the only regulator able to initiate action in these areas.

**5. Company directors**

**QUESTION 29: Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?**

We believe that the best approach to overlapping powers would be to give ARGA ultimate responsibility for the supervision of directors duties, including responsibility for audit, and of corporate reporting, with ARGA being able to request the FCA to use its power to apply sanctions where ARGA, as the expert regulator in these areas, believes it necessary. We do not believe that the FCA should have power to act on its own behalf in these areas, although it should be able to refer matters to ARGA for review. In particular the arrangements should guard against the risk of 'double jeopardy' in respect of the same issue.

However, whilst we agree that it is sensible that ARGA be empowered to take action against any and all directors in breach of their directors' duties, we believe that it is inappropriate that ARGA act as standard setter, regulator, prosecutor, judge, jury and executioner. See our suggestion in our response to question 33 below.

It is important that the any future legislation is carefully drawn to ensure that the maximum benefit is obtained from its relationship with the work currently being undertaken to modernise the law relating to the role of Companies House and, in particular, its future role in 'vetting' potential directors.

**QUESTION 30: Are there any additional duties that you think should be in scope of the regulator's enforcement powers?**

Yes. There are a number of statutory duties under the Companies Act where it is, to say the least, unclear as to by whom action should be taken. For example in the case of breaches of duties under s172 it is unclear how directors can be held to account other than by shareholders, and it may not be in their interests to take such action. It would be helpful were ARGA to have a reserve power to take action in the rare event of any breach of directors statutory or regulatory duties where shareholders are unable or unwilling to do so or where ARGA is best suited to apply sanctions in respect of filings with Companies House.

**QUESTION 31: Are there any existing or proposed directors' duties relating to corporate reporting and audit that you think should be specifically included or excluded from further elaboration for the purposes of the directors' enforcement regime?**

No.

**QUESTION 32: Should directors of public interest entities be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audits? Should those standards be set by the regulator? What standards should directors have to meet in this context?**

No. Directors are already subject to a wide range of duties which cover a comprehensive set of circumstances. We have concerns that the increasing level of duties and responsibilities being imposed on directors is making the UK an unattractive place for business – particularly to entrepreneurs. We believe the focus should be on the enforcement of existing duties and responsibilities rather than adding to directors' duties and we support the proposals for increasing the powers of the new regulator ARGA with regard to enforcement.

**QUESTION 33: Should the Government's proposed enforcement powers be made available to the regulator in respect of breaches of directors' duties?**

Yes. We agree that there is currently an anomaly in that the FRC is only able to take action against a director who is in breach of their directors' duties if the director is also a member of one of the accounting bodies. We believe that ARGA should be able to take action against any and all directors in such circumstances.

We also agree that there should be a range of sanctions available to the regulator, including lower level sanctions such as a private or public reprimand in appropriate cases.

However, whilst we agree that it is sensible that ARGA be empowered to take action against any and all directors in breach of their directors' duties, we believe that it is inappropriate that ARGA act as standard setter, regulator, prosecutor, judge, jury and executioner.

We are confident that the Government will put an appropriate independent appeals process in place, but when considering some of the circumstances in which the FRC has been criticised for its response, we believe that, when taking action against directors, ARGA should bear the following principles in mind:

- Action should be both prompt and proportionate with a 'statute of limitations' for regulatory action;
- Action should not be retrospective in the sense of applying hindsight to what may have seemed perfectly reasonable decisions at the time. The Courts have been historically reluctant, and rightly so, to second-guess directors judgement;
- Enforcement should be in respect of neglect of duties, rather than mistakes;
- Enforcement should not assume that all directors are experts – this would have an impact on the diversity of skills and age on boards.

**QUESTION 34: Are there other conditions that should be considered for the proposed minimum list of malus and clawback conditions? What legal and other considerations need to be taken into account to ensure that these conditions can be enforced in practice?**

No. We believe the current clawback and malus provisions are working efficiently. We are concerned that any further tightening of clawback and malus would make becoming a director of a listed company an unattractive choice for potential directors. Potential directors would be more attracted to working for private companies or those listed in other jurisdictions.

We were also struck by the condition for 'reputational damage'. It is entirely possible that reputational damage may arise from decisions or actions that were, at the time, completely reasonable and the condition should contain a safe harbour for such cases.

Our members with international businesses, particularly those with large US interests, are already reporting difficulties in both executive and non-executive recruitment, with the UK being perceived as over-regulated, especially in relation to remuneration, and unattractive to business.

**6. Audit purpose and scope**

**QUESTION 35: Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?**

We are not convinced that this would be helpful, necessary or proportionate.

**QUESTION 36: In addition to any new statutory requirement on auditors to consider wider information, should a new purpose of audit be adopted by the regulator, or otherwise? How would you expect this to work?**

As noted above, we disagree with the Brydon review's position that the 'expectations gap' and 'delivery gap' are "a distraction"; on the contrary, we see them as fundamental to the underlying issue that the Brydon review rightly identifies: "Either audit is helping to reinforce deserved confidence in business or it is not". In the interests of closing the 'expectations gap', we believe that a new definition of the purpose of audit should be adopted by the regulator.

**QUESTION 37: Do you agree with the Government's approach of defining the wider auditing services which are subject to some oversight by the regulator via the Audit and Assurance Policy?**

This would seem proportionate and reasonable.

**QUESTION 38: Should the regulator's quality inspection regime for PIE audits be extended to corporate auditing? If not, how else should compliance with rules for wider audit services be assessed?**

This would seem proportionate and reasonable.

**QUESTION 39: What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?**

We have no response to this question.

**QUESTION 40: Would establishing new, enforceable principles of corporate auditing help to improve audit quality and achieve the Government's aims for audit? Do you agree that the principles suggested by the Brydon Review would be a good basis for the regulator to start from?**

Yes. As noted above, the 'delivery gap' is a significant challenge in the audit market and this will help to address it. This will also be supported by the development of an audit profession noted below. In our view one of the key benefits will be increasing the knowledge and, particularly, experience of auditors. A number of companies have expressed a concern that, although the audit team may have the necessary technical knowledge, it is not always clear that they have developed the experience to be sufficiently challenging.

**QUESTION 41: Do you agree that new principles for all corporate auditors should be set by the regulator and that other applicable standards or requirements should be subject to those principles? What alternatives, mitigations or downsides should the Government consider?**

Yes. We agree.

**QUESTION 42: Do you agree with the Government's proposed response to the package of reforms relating to fraud recommended by the Brydon Review? Please explain why.**

Generally yes, although we would caution that it is unreasonable to expect that either directors or auditors will be able to prevent or even detect every fraud. With this in mind, ARGA should ensure that the steps taken by auditors to detect fraud are proportionate.

**QUESTION 43: Will the proposed duty to consider wider information be sufficient to encourage the more detailed consideration of i) risks and ii) director conduct, as set out in the section 172 statement? Please explain your answer.**

We remain to be convinced that such 'more detailed consideration' would be helpful or necessary. There has been a considerable focus on s172 obligations and reporting and although it is fair to say, as the FRC has done, that this reporting could be improved, it is our members' experience that this is more a failure of reporting than of director consideration.

**QUESTION 44: Do you agree that auditors' judgements regarding the appropriateness of any departure from the financial reporting framework proposed by the directors should be informed by the proposed Principles of Corporate Auditing? What impact might this have on how both directors and auditors assess whether financial statements give a true and fair view?**

Yes. This will bring some much needed clarity to the position. However, it will be essential that ARGA establishes clear definitions and consistency of terminology to ensure that directors can be clear on their responsibilities in this regard and, for those in regulated sectors, the relationship between the 'true and fair view' and the requirement for accounts to be 'fair, balanced and understandable'.

**QUESTION 45: Do you agree that the need for specific assurance on APMs or KPIs, beyond the scope of the statutory audit, should be decided by companies and shareholders through the Audit and Assurance Policy process?**

Yes.

**QUESTION 46: Why have companies generally not agreed LLAs with their statutory auditor? Have directors been concerned about being judged to be in breach of their duties by recommending an LLA? Or have other factors been more significant considerations for directors?**

We have not been able to identify any benefit to the company, its shareholders, its directors or, indeed, anyone other than the statutory auditor of an agreed LLA. We think it likely that this may constitute a breach of directors' duties and in any event do not believe companies would find it acceptable to agree an LLA with their statutory auditor, nor do we believe such an agreement would be acceptable to shareholders.

**QUESTION 47: Are auditors' concerns about their exposure to litigation likely to constrain audit innovation, such as more informative auditor reporting, the level of competition in the audit market (including new entrants) or auditors' willingness to embrace other proposals discussed in this consultation? If so, in what way and how might such obstacles be overcome?**

On the contrary, we would have thought that better auditing and more informative audit reporting would be a differentiating factor in the choice of auditor. Auditors concerns about exposure are already constraining the level of competition in the audit market.

**QUESTION 48: Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.**

Yes. We naturally believe that a professional body always drives up the quality of a profession. The Institute would be happy to support ARGA in the development of a new professional body.

**QUESTION 49: What would be the best way of establishing a new professional body for corporate auditors that helps deliver the Government's objectives for audit? What transitional arrangements would be needed for the new professional body to be successful?**

We have no view on this question.

**QUESTION 50: Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?**

We would have thought that it would not matter from whom the qualification was obtained, provided it was of an appropriate standard.

**QUESTION 51: Do you agree that a new audit professional body should cover all corporate auditors, not just PIE auditors?**

Yes.

## 7. Audit Committee Oversight and Engagement with Shareholders

**QUESTION 52: Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?**

Yes, provided such requirements are subject to appropriate consultation and, in the same way as the rest of the UK Corporate Governance Code, introduced on a 'comply or explain' basis. If such requirements are to be mandatory, they should be subject to Parliamentary oversight in the normal way.

We do not believe that it would be appropriate for ARGA to have an observer at audit committee meetings as our members indicate that decisions made by the audit committee are often set in context by the deliberations of the board as a whole and an observer will not have a full understanding of the background to decisions made.

**QUESTION 53: Would the proposed powers for ARGA go far enough to ensure effective compliance with these requirements? Is there anything further the Government would need to consider in taking forward this proposal?**

Yes.

**QUESTION 54: Do you agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors in specific, limited circumstances (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?**

We are not convinced that a case has been made for the need for such a power.

**QUESTION 55: To work in practice, ARGA's power to appoint an auditor may need to be accompanied by a further power to require an auditor to take on an audit. What do you think the impact of this would be?**

We have no strong view on this question, but it does seem that this would need to be carefully managed – how might ARGA require an auditor to take on an audit were that auditor to claim no capacity to do so or that it would be conflicted owing to other, perhaps non-public, services provided to the company? It would also seem sensible that the process be appropriately indemnified, or undertaken on a 'no liability' basis, similar to some of the arrangements for the audit of insolvent businesses.

**QUESTION 56: What processes should be put in place to ensure that ARGA can continue to undertake its normal regulatory oversight of an audit firm, when ARGA has appointed the auditor?**

We have no view on this question other than to observe that it creates scope for a conflict of interest.

**QUESTION 57: What other regulatory tools might be useful when a company has failed to find an auditor or in the circumstances described by Sir John Kingman (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?**

We have no view on this question.

**QUESTION 58: Do you agree with the proposals and implementation method for giving shareholders a formal opportunity to engage with risk and audit planning? Are there further practical issues connected with the implementation of these proposals which should be considered?**

No. Our members experience is that most shareholders are less inclined to engage around audit issues in comparison with, for example, remuneration matters and many do not have the resource or expertise to do so. They appoint directors to represent shareholder interests and it is the (non-executive) members of the audit committee who have primary responsibility for oversight of risk and audit planning. Shareholders have access to the chair and non-executive directors, including the chair of the audit committee, throughout the year and although some of our investor members indicate that they would like greater access, feedback from corporate members is that this is a minority and it can be difficult to engage effectively with shareholders on audit issues. They advise us that many investors are not usually in a position to understand the detail of internal management processes and cannot therefore engage meaningfully with the detailed process of risk and audit planning. Furthermore, were investment managers to be required to enhance such expertise, this would require a significant infrastructure cost which they would be likely to pass on to their clients.

We suggest that BEIS establish the level of interest from shareholders as a whole, rather than from a vocal minority, and their ability to provide sufficient resource to engage on these matters before placing an additional cost and resource burden on companies.

**QUESTION 59: Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?**

No. The board, including the audit committee chair, is available to answer questions at the AGM. In our experience the lead audit partner is often also in attendance and there would be no reason why they could not be asked to speak to the auditors report. Indeed, some of our more experienced members indicate that this used to be the custom.

The directors represent the interests of shareholders in board meetings and it is the role of the non-executive audit committee, including the chair, to question the auditor. The feedback that we received was that this is, perhaps, symptomatic of a wider problem with AGMs, on which we know the FRC are engaged, and that this proposal seeks to solve a problem that doesn't exist.

**QUESTION 60: Do you believe that the existing Companies Act provisions covering the departure of an auditor from a PIE ensure adequate information is provided to shareholders about an auditor's departure? If you believe those provisions are inadequate, do you think that the Brydon Review recommendations will address concerns in this area? What else could be done to keep shareholders informed?**

Yes. We believe the existing Companies Act provisions provide adequate information to shareholders on the departure of the auditor. We do not agree with the Brydon review that any further provisions are necessary or desirable.

## 8. Competition, choice and resilience in the audit market

**QUESTION 61: Should the 'meaningful proportion' envisaged to be carried out by a Challenger be based on legal subsidiaries? How should the proportion be measured and what minimum percentage should be chosen under managed shared audit to encourage the most effective participation of Challenger firms and best increase choice?**

We would encourage BEIS to speak to Challenger audit firms to establish whether there is any appetite for the proposals to increase competition, choice and resilience in the audit market.

Those of our members with experience of shared audits have indicated the significant additional cost entailed and the difficulties for the company in reconciling the often conflicting requirements of two auditors whose capability levels and audit processes may be very different. Some of our members with longer memories reminded us that, thirty or so years ago, many large public companies had joint or shared audits in that different audit firms audited different divisions or subsidiaries, and/or different geographical divisions. Their recollection was that these were, effectively, banned at the instance of government and regulators to ensure that there was commonality of standards, accuracy and process, although some also mentioned an inflationary pressure on audit fees.

As noted above, we believe that the issue is more the perceived capacity – in terms of scope, capability, resource, specialism or expertise to audit more complex organisations (because the issue is complexity

rather than size) - of the Challenger firms than their existence. Put simply, there is a lack of trust in the capacity of auditors outside the Big Four. The lack of confidence on the part of companies, investors and some regulators in the capacity of smaller auditors to deliver high quality audits of large or complex organisations is an issue of trust and without the accuracy or inaccuracy of this perception being tested by an independent body, any potential misconceptions will continue to abound. It is essential that the validity of any perception of gaps in auditing capability is independently investigated as the inclusion of Challenger firms in the audit market will not serve to improve that market if those firms genuinely do not have the capability, resource, specialism or expertise to audit more complex organisations.

We have yet to see any evidence to support the view that Challenger firms would have the capacity to share the audit of a large or complex FTSE 350 company – indeed the exemption proposed in the consultation suggests that the Government shares this concern – and we would recommend that the Government and/or ARGA first direct attention to this capacity review before carrying the proposal for managed shared audit forward. The issue of audit gridlock, where companies find that existing relationships with firms can mean that they are conflicted from tendering for the audit, means that companies would be very keen to see more firms in the audit market.

Of course, much will depend on the final definition of 'meaningful proportion' and some of our members suggested that Challenger firms could be encouraged to develop specific expertise, for example in TCFD disclosures. Others, however, questioned whether this would constitute a 'meaningful proportion'.

**QUESTION 62: How could managed shared audit be designed to incentivise Challenger firms to invest in building their capability and capacity? What, if any, other measures, would be needed?**

We have no answer to this question.

**QUESTION 63: Do you have comments on the possible introduction in future of a managed market share cap, including on the outlined approach and principles? Are there other mechanisms that you think should be considered for introduction at a future date?**

We do not believe that an arbitrary market share cap is an appropriate solution to the challenge of broadening the resilience of the audit market unless it could be demonstrated that the Challenger firms had sufficient capacity. Care will be needed to ensure that such a cap does not, in fact, restrict competition if only a small number of firms have the capacity for – or are eligible to undertake on conflict grounds - that company's audit.

**QUESTION 64: Do you have any further comments on how the operational separation proposals should be designed, codified (in legislation and regulatory rules), and enforced in order to achieve the intended outcome of incentivising higher audit quality?**

No.

**QUESTION 65: The Government proposes to require that all audit firms provide annual reports on their partner remuneration to the regulator. This will include pay, split of profits, and which audited entities they worked on. Do you have any comments on this approach?**

We have no views on this question.

**QUESTION 66: In the event that the Government wishes to go further than the existing operational split proposals in future and implement split profit pools in line with the CMA recommendation, do you have any comments on how these can be made to work effectively?**

We have no views on this question.

**QUESTION 67: The Government believes these proposals will meet its objectives. In the event that they prove insufficient to improve audit quality, and full separation of professional services firms is required, do you have any comments on how to make this work most effectively?**

We have no views on this question.

**QUESTION 68: Do you have comments on the proposed measures? Are there any other measures the Government should consider taking forward to address the lack of resilience in the audit market?**

As noted above, the single most important step that the Government could take to address the lack of resilience in the audit market is that of commissioning an authoritative independent review to address, once and for all, the capacity of the Challenger firms. If this can be demonstrated, then all objections to their appointment will be negated. If not, then steps will need to be taken to encourage the Challenger firms to build their capability and capacity.

## 9. Supervision of audit quality

**QUESTION 69: Do you agree with the Government's approach of allowing the FRC to reclaim the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs?**

Yes.

**QUESTION 70: What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?**

We have no view on this question.

**QUESTION 71: In addition to redacting sensitive information within AQR reports on individual audits, what other safeguards would be required to offer adequate protection to the entity being audited whilst maintaining co-operation with their auditors?**

We have no view on this question.

**QUESTION 72: Do you agree with the Government's approach to component audit work done outside the UK? How could it be improved?**

We have no view on this question.

**QUESTION 73: Do you agree that it is problematic if documents that the auditor reviewed as part of the audit are unavailable to the regulator because of the audited entity's legal professional privilege? If so, what could be done to solve or mitigate this issue while respecting the overall principle of legal professional privilege?**

Yes. This is clearly problematic, especially in circumstances where companies claim, as we understand a small minority do, that a significant proportion of their reporting is covered by privilege.

There are legitimate uses of privilege in reporting, for example where advice has been sought on questions of judgement. However, the limited restriction proposed – that legal professional privilege should be waived in respect of documents that the auditor reviewed as part of the audit, seems a reasonable compromise because these will not normally relate to advice obtained in expectation of legal action. However, that waiver should be strictly limited to the role of the regulator in its assessment of audit quality.

We believe that the real problem lies with the scope allowed to legal professional privilege which, in our view should either apply only to advice taken to support existing or immediately contemplated legal action, or should apply to any advice given by any professional adviser in that capacity – not just those advisers who happen to be lawyers. We regularly receive complaints from members who have had to pay for their own advice to the board to be repeated by a lawyer in cases where privilege is felt appropriate.

The practice, if it exists, of claiming privilege where this is inappropriate, should render the directors responsible subject to sanction by ARGA.

**10. A strengthened regulator**

**QUESTION 74: Do you agree with the proposed general objective for ARGA?**

Yes.

**QUESTION 75: Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?**

Yes. Another useful regulatory principle might be to encourage the competitiveness of the UK market.

## 11. Additional changes in the regulator's responsibilities

**QUESTION 76: Should the scope of the regulator's oversight arrangements be initially confined to the chartered bodies and should they be required to comply with the arrangements?**

Yes, and yes.

**QUESTION 77: What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?**

This is a very important question and one that has implications beyond ARGA's responsibilities in regard to the professional accountancy bodies.

As we noted in our response to question 33 above, when we considered ARGA's potential enforcement powers in respect of breaches of directors' duties, whilst we agree that it is sensible that ARGA be empowered to take action against any and all directors in breach of their directors' duties, we believe that it is inappropriate that ARGA act as standard setter, regulator, prosecutor, judge, jury and executioner.

We are confident that the Government will put an appropriate independent appeals process in place, but when considering some of the circumstances in which the FRC has been criticised for its response, we believe that, when taking action against directors, ARGA should bear the following principles in mind:

- Action should be both prompt and proportionate with a 'statute of limitations' for regulatory action;
- Action should not be retrospective in the sense of applying hindsight to what may have seemed perfectly reasonable decisions at the time. The Courts have been historically reluctant, and rightly so, to second-guess directors reasonable judgement, a position recently repeated in the High Court judgement on Kids Company;
- Enforcement should be in respect of neglect of duties, rather than mistakes;
- Enforcement should not assume that all directors are experts – this would have an impact on the diversity of skills and age on boards.

**QUESTION 78: Should the regulator's enforcement powers initially be restricted to members of the professional accountancy bodies? Should the Government have the flexibility to extend the scope of these powers to other accountants, if evidence of an enforcement gap emerges in the future? What are your views on the suggested mechanisms for extending the scope of the enforcement powers to other accountants (if it is appropriate) at a later stage?**

We have no response to this question.

**QUESTION 79: Should the regulator be able to set and enforce a code of ethics which will apply to members of the chartered bodies in the course of professional activities? Should the regulator only be able to take action where a breach gives rise to issues affecting the public interest? What sanctions do you think should be available to the regulator?**

Yes.

**QUESTION 80: Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?**

We have no response to this question.

**QUESTION 81: Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?**

Yes.

**QUESTION 82: Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.**

Yes.

**QUESTION 83: Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?**

We have no response to this question.

**QUESTION 84: Should the regulator continue to be responsible for setting technical standards? Should these standards be legally binding? Should the regulator be responsible for setting technical standards only?**

Yes.

**QUESTION 85: Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?**

Yes.

**QUESTION 86: Should the regulator have the power to request that individuals provide their work in response to a formal request - and to compel them to do so if necessary?**

Yes.

**QUESTION 87: Should the regulator have the power to take appropriate action if work falls below the requirements of the technical standards? What powers should be available to the regulator in these instances?**

Yes.

**QUESTION 88: Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?**

Yes.

**QUESTION 89: Should the regulator's oversight of the IFoA be placed on a statutory basis? What, if any, powers does the regulator require to effectively fulfil this role?**

Yes.

**QUESTION 90: Does the current investigation and discipline regime remain appropriate? Should it be placed on a statutory basis? What, if any, additional powers does the regulator require to fulfil this role?**

Yes.

**QUESTION 91: Do respondents think that the regulator's remit should be extended to actuarial work undertaken by entities? What would be the appropriate features of such a regime, including the appropriate enforcement powers for the regulator?**

We have no response to this question.

**QUESTION 92: Should the regulator's independent investigation and discipline regime for matters that affect the public interest also apply to entities that undertake actuarial work? Should the features of the regime differ for Public Interest Entities?**

Yes and no. The regulator's independent investigation and discipline regime for matters that affect the public interest should also apply to entities that undertake actuarial work, but the features of the regime should not differ for Public Interest Entities.

**QUESTION 93: Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?**

We have no response to this question.

**QUESTION 94: Are there others matters which PIE auditors should have to report to the regulator? Could this duty otherwise be improved to ensure that viability and other serious concerns are disclosed to the regulator in a timely way?**

We have no response to this question.

**QUESTION 95: Should auditors receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator? Would this encourage auditors to report viability and other concerns to the regulator?**

We have no response to this question.

**QUESTION 96: How much time should be given to respond to a request for a rapid explanation?**

We have no response to this question.

**QUESTION 97: Should the regulator be able to publish a summary of the expert reviewer's report where it considers it to be in the public interest?**

Yes.

**QUESTION 98: Are there any additional powers that you think the regulator should have available where an expert review identifies significant non-compliance by a company in relation to its corporate reporting and audits?**

We have no response to this question.

If you would like to discuss any of the above comments in further detail, please contact me.

Yours faithfully

**Peter Swabey**
Policy & Research Director
ICSA: The Chartered Governance Institute

020 7612 7014
pswabey@cgi.org.uk