

Audit Reform and Regulation Team
 Department for Business, Energy & Industrial Strategy
 1st Floor, Victoria 1
 1 Victoria Street
 London, SW1H 0ET

5 June 2019

Email: FRCConsultation@beis.gov.uk

Dear Sir/Madam,

Independent Review of the Financial Reporting Council – Initial consultation on the recommendations

We are supportive of the recommendations raised by Sir John Kingman. We believe the most important factor is how these can enhance the strength and powers of the regulator without impacting the attractiveness of UK markets. As companies, our views are centred on category three recommendations; as such we have not commented on a number of the recommendations but support BEIS taking them forward.

This response provides our high-level views on certain recommendations, which we understand will be subject to further consultation. The recommendations that we have significant views on are:

- **Enforcement regime for directors:** In our view, this should encompass all board members, not just those named in the recommendation. Any regime introduced must complement those already in existence in other jurisdictions and sectors, such as the Financial Conduct Authority (FCA) Senior Managers Regime.
- **Graduated audit findings:** The long-form audit opinion has been well received by investors, provides users with a better understanding of the audit approach and views on key matters. Introducing graduated findings would not be of value unless accompanied by sufficient narrative. Comparability of audit reports provided by different firms is of utmost importance. It is therefore critical that a method to ensure comparability is maintained if graduated findings are introduced.
- **Pre-clearance:** We fully support a pre-clearance procedure being introduced and believe this will have added benefits as discussed with Sir John Kingman. We anticipate pre-clearance would be used on complex matters, as an exception rather than the norm, and therefore should not be a pay-to-use service. A more effective mechanism would be to introduce a set of upfront criteria for using the service and absorb the cost of this in the annual fee paid.
- **Internal control framework:** We would support a review into the current control environments in the UK to identify areas where improvement may be required, before determining whether, and to what extent, the UK control framework needs changing. Any UK control regime should give equivalence to those already adopting US SOX, in order to avoid unnecessary duplication of costs, effort and reporting.

The appendix details our comments on specific recommendations. Prior to further consultation, we would be happy to facilitate discussions between BEIS and our members, if helpful, to share their experiences and views of these recommendations. Please feel free to contact me at brian.gilvary@the100group.co.uk, if you wish to discuss our comments.

Yours sincerely,

Brian Gilvary - Chairman, The 100 Group

Appendix 1: Detailed feedback on recommendations

Recommendation 4: Regulators strategic objective

We are fully supportive of the new regulator having a clearly defined strategic objective. The term “*wider public interest*” needs to be explicitly defined, as without a clear definition it is ambiguous, open to interpretation and therefore harder to fulfil. IFRS already defines a user population in the conceptual framework and the Brydon Review is consulting on who the beneficiaries of audit should be. It would be beneficial for all, if these definitions were aligned.

Recommendation 25: Power to direct changes to accounts rather than having to go to court

We are broadly supportive of the regulator having such power. Our understanding is that in practice, it is very rare for the courts to get involved; as such we would expect the regulator to only exercise the power in extreme circumstances and would not expect there to be an increase in the number of changes as a result of the power moving to the regulator. If taken forward, an independent appeals process should be implemented. This appeal process could be similar to that of the Takeover Panel, where there is an Appeal Board, which hears appeals against rulings. This structure has proved extremely efficient over many years and provides independent challenge when required.

Recommendation 26: CRR findings reported publicly

As outlined in our discussions with Sir John Kingman, we support publication of CRR correspondence and noted that this is already done by the SEC. However, in agreement with the company the SEC redact certain information, which is either commercially or price sensitive, from the published letters. A similar mechanism to prevent disclosure of such information will need to be adopted in the UK publication process.

Recommendation 28: Paid for pre-clearance

We are fully supportive of this recommendation. We believe that a pre-clearance procedure would provide comfort for businesses, the regulator and auditors on the treatment of “*novel and contentious*” matters. Whilst a fee is a useful mechanism to avoid over burdening the new regulator and prevent pre-clearance being sought on trivial matters, or those where guidance already exists, a more effective mechanism would be to introduce a set of criteria for using the service and the associated cost be assumed into the annual fees paid to the regulator.

Recommendation 36 - 37: Enforcement regime for relevant directors and non-member directors

There is already collective responsibility amongst boards in relation to their duties to prepare and approve annual accounts. In our experience, as the UK is a renowned leader in Corporate Governance, all board members understand their responsibilities and diligently fulfil their duties in this respect. As such any new regime should extend to and, hold to account, the entire board, not just those roles named (CEO, CFO, chair, and audit committee chair).

Care should be given to ensure that where existing regimes may overlap with the new regulators scope, be it through secondary listings or sector specific regulations, they are complementary.

Recommendation 45: Duty of alert for auditors to report viability or other concerns

If this recommendation is taken forward, there needs to be an appropriate and clear process for auditors to follow, including prior discussion with the company and its board on the matter prior to escalation. It would not be appropriate for the auditor to report anything directly without first providing the business the opportunity to review, explain and work through any concerns with the auditor. In the event that there is no response, or a resolution cannot be reached, escalation may be appropriate, but we would expect this to be in limited circumstances.

Current regulations require companies to inform shareholders of market impacting information, using mechanisms such as profit warnings and market updates. Auditors have the same ability through the

use of emphasis of matter paragraphs or qualifications to audit reports. We would be supportive of the auditor pre-warning the regulator of the contents of their audit report. We would have concerns about them reporting any company information which may provide the regulator with potentially market sensitive information above and beyond, or in addition to, that issued by the company to shareholders.

Recommendation 46: Regulator should be able to act quickly and require rapid explanations from companies

We are fully supportive of this recommendation, which will undoubtedly give rise to a much stronger, more robust and challenging regulator. It is imperative that the regulator is resourced sufficiently with staff of the right calibre and experience so that the regulator can respond equally as quickly. As, in our experience, delays are more often than not due to the regulator.

Recommendation 47 - 50: Commission a skilled person review, have the power to publish the skilled person's report and have powers to act on findings of the report

The commissioning of a skilled person review in exceptional circumstances would be an appropriate power for the regulator to have, and we note that this already exists within the PRA and FCA. As with the PRA and FCA reports, we do not think it would be appropriate for these reviews to be published as given the level of detail the reviews will go into, any report would contain significant amounts of highly sensitive commercial information.

Recommendation 51: Strengthened framework around internal controls in the UK

We would support a review into the current control environments in the UK to identify areas where improvement may be required, before determining whether, and to what extent, the UK control framework needs changing. Any UK control regime should give equivalence to companies already adopting US SOX, in order to avoid unnecessary duplication of costs, effort and reporting.

Our members that apply US SOX note that the additional time and cost it places on a business is extremely high and this should not be underestimated when compared to the benefits that a new control environment may bring.

Recommendation 52: Viability statements should be reviewed and reformed, or abolished

We acknowledge that the quality of viability statements varies across the FTSE as a whole and therefore are supportive of them being reviewed and reformed to enhance consistency. We do not believe that, as currently used, viability statements provide users of accounts with the information they expected and we question the value they add.

If reforming viability statements is not sufficient to meet the demands of users, we would support abolishing them and focusing instead on greater clarity, including expectations, of the going concern statement and its coverage period. For example these could include reasonable worst case scenarios to be deployed and assessed, or reverse stress testing to model different scenarios.

We also believe this an example of the expectation gap, as there is confusion as to whether viability statements are subject to audit. Investors are also unsure how they interrelate with going concern statements and query the timeframes covered. Understanding of the limiting factors to the reports and analysis of the skills needed to provide assurance should be sought prior to further consultation.

Recommendation 53: Independent Auditor's Report to include "graduated" audit findings

The recently introduced long-form audit opinion has been well received by investors and we are therefore supportive of further reviews to enhance the insight for shareholders. Greater narrative in audit reports provides users with a better understanding of the audit approach and the auditor's views on significant matters.

Introducing graduated findings would not be of value unless accompanied by sufficient narrative in the audit report. Comparability of audit reports provided by different audit firms is of the utmost importance. It is therefore critical that a method to ensure comparability of audit reports is maintained if graduated findings are introduced.