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Thursday 8 July 2021

Dear BEIS colleagues,

Restoring trust in audit and corporate governance

We welcome the opportunity to respond to your consultation on restoring trust in audit and corporate governance.

The Quoted Companies Alliance has examined the proposals and expresses its response from the viewpoint of small and mid-sized quoted companies.

Overall, we are deeply concerned by some of the proposals presented in the consultation. Our two overarching concerns are centred on expanding the definition of a Public Interest Entity (PIE) and the automatic extension of the scope of the reforms.

In response, we strongly advocate for the following two approaches:

1. That the definition of a PIE should initially incorporate all FTSE 350 companies and then, if considered appropriate following our proposed approach to implementation, could be extended to other large companies (both public and private) with:
    a. over 500 employees; AND
    b. a turnover of more than £500 million; OR
    c. a market capitalisation exceeding £1 billion (on a market agnostic basis).
2. That there is no automatic extension of the scope of the reforms and a four-pronged approach to implementation is taken forward. This would include:
    a. Initial Implementation of the reforms to FTSE 350 companies only.
    b. Impact Analysis of the consequences of the reforms, with adjustments and modifications being made.
    c. Extension Assessment to consider which entities the reforms should be extended to, if any.
    d. Transition Period of at least three years before extending the scope of the requirements.

We look forward to working with you and the FRC to find a path for audit reform and governance that encourages growth with confidence.

Yours sincerely,

Tim Ward
Chief Executive

Executive Summary

The cost of overburdensome regulation is shrinking the public markets

Listing shares on the UK's public equity markets has become less attractive for many companies in recent years. Since 2007, the number of companies quoted on the Main Market and AIM has declined considerably. Burdensome listing requirements and excessive scrutiny are often cited as the main causes.

There is a risk of worsening the situation

Companies and investors believe that implementing the changes, as proposed in the consultation, will inhibit the ability of companies to grow, create jobs and deliver prosperity. This view is reflected in the results from a survey by YouGov for the QCA. A large proportion of the respondents felt the reforms would have a negative impact on growth, the worthwhileness of a company's listing, and the quantity and quality of directors.

The benefits of a thriving small and mid-cap community

It is important to note what is being put at risk from disproportionate regulatory reforms. Small and mid-cap public companies make an essential contribution to the UK economy. The social and economic benefit of these companies is significant, particularly in terms of creating employment, increasing tax returns and their positive contribution to addressing regional inequality and levelling up.

The quality, supply and diversity of directors

Another key concern is the impact of the reforms on company directors. The reforms have the potential to significantly increase the burdens and liability that directors face to the extent that their directorship will simply not be worth the risk and cost. It is likely that groups that are already underrepresented in leadership roles in UK businesses will be most heavily impacted, meaning these reforms will potentially work against the Government's stated aim of increasing diversity of company boards.

We are competing with Europe

It is vital that the UK maintains a competitive advantage over the rest of Europe and is viewed as an attractive listing venue that encourages innovation and growth whilst maintaining high standards and investor protection. Implementing highly costly and burdensome regulation would act as a serious disincentive to companies seeking a listing in London.

The importance of proportionality

It is often assumed that all public companies are large. This leads to a one-size-fits-all approach where measures are targeted at the largest companies, but are applied in a blanket manner to all companies. All regulation must be proportionate and in line with stated Government policy. It is essential that maximising corporate access to capital and extolling the virtues of permanent public equity are achieved.

What is "in the public interest"

We believe that a deeper consideration of why an entity can be deemed to be a Public Interest Entity is needed. We believe that the basis for identifying a PIE should be broken down into three separate pillars. Namely, (P) public interest, (I) investor protection and (E) employee protection.

Following this, we propose that the definition of a PIE should initially incorporate all FTSE 350 companies and then, if considered appropriate following our proposed approach to implementation, could be extended to other large companies (both public and private) with:

- over 500 employees; AND
- a turnover of more than £500 million; OR
- a market capitalisation exceeding £1 billion (on a market agnostic basis).

Proposed approach to ensuring less damage

Taking all of the above into consideration, a more sensible, supportive and pragmatic approach to introducing the reforms would be to adopt a four-pronged approach to implementation. Rather than an automatic extension, this approach would ensure that the reforms are targeted appropriately at those fully able to comply and truly within the public interest. A successful four-pronged approach would consist of the following:

1. **Initial Implementation** of the reforms to FTSE 350 companies only.
2. **Impact Analysis** of the consequences of the reforms after two years, with adjustments and modifications being made.
3. **Extension Assessment** to consider which entities the reforms should be extended to, if any.
4. **Transition Period** of at least three years before extending the scope of the requirements.

The need for transparency, accountability and scrutiny

On the basis of the above, it is essential that the impact of the proposed reforms and the performance of the new regulator are scrutinised and held to account in a transparent manner. The appropriate Minister from BEIS should be required to provide an annual statement on audit and corporate governance reform to the Chancellor for inclusion in their State of the City statement. This should include a clear statement on the effectiveness of ARGA.

Introduction: Putting the Proposed Reforms into Context

Shrinking public markets

In our response, we concentrate primarily on the proposals set out in the consultation. However, we believe that it is important to consider the current state of the UK's equity markets in order to better understand the context in which the proposed reforms will be implemented.

It is generally accepted that listing shares on the UK's public equity markets has become less attractive. For the past twenty years, the total number of listed companies in the UK has fallen consistently. Increasingly overburdensome regulation (particularly compared to private companies of equivalent size), the significant costs of compliance and the growth of private equity (in part due to significant tax advantages) have contributed to the decline in listings.

Since 2007, the number of companies quoted on the Main Market has declined by 25% and the number of companies quoted on AIM has declined by 49%[1]. Studies, such as the *QCA/Peel Hunt Mid and Small-Cap Survey*, indicate the reasons for this decline, with 60% of respondents attributing this to overly burdensome requirements and excessive scrutiny[2]. Appendices 2 to 5 reveal the extent of decline in the number of companies on the Main Market and AIM and the decline in number of companies coming to these markets. These companies are arguably the cornerstone of the UK's position as a global financial centre. The Government should seek to encourage growth of these markets and prevent the erosion of their competitiveness. Of course, this should not come at a cost of appropriate governance, but the UK is generally regarded for having very high standards, particularly as it is now widely accepted and recognised that business models can reach a degree of maturity in a much shorter time frame than has been the case historically.

UK Listing Review and the need for positive reform

In light of the above, the QCA has been encouraged by the focus, timing and findings of Lord Hill's UK Listing Review, and welcomes the steps taken by HM Treasury and the Financial Conduct Authority (FCA) to take forward the recommendations. The review recognised the need to reform our markets in light of the recent decline, acknowledging that positive change is necessary to ensure the UK has a continuum of attractive equity markets for growth companies. This will help to ensure that companies of all sizes are able to raise finance, create intellectual property, generate jobs, increase tax take, and distribute wealth across the UK.

Many of the reforms proposed in this consultation are a direct contrast to creating the aforementioned positive changes; many are anti-business and anti-growth. They will undoubtedly reduce the attractiveness of the UK's public equity markets, leading to fewer companies listing, resulting in less choice for investors and ultimately impact the growth of the UK economy and high-quality employment and tax take for the Exchequer.

[1] Report by Hardman & Co and the QCA of May 2020: *Are the public markets closing to smaller companies – The evidence from the past 20 years in London*

[2] QCA/Peel Hunt Mid and Small Cap Survey, conducted by YouGov: *To be or not to be….a public company – the growing de-equitisation crisis.*

The current COVID-19 pandemic and the UK's withdrawal from the European Union (EU) necessitates the importance of alleviating unnecessary burdens, improving productivity and providing opportunities and growth for UK PLC. For the UK to cement its place as a global financial centre, particularly in the post-Brexit era, the Government should not be imposing more burdens and substantial costs on companies. It is imperative that the UK is seen as having an open, innovative, disruptive and generative environment for companies seeking to raise capital in order to enhance the attractiveness of UK markets for companies and investors by giving them greater choice and flexibility.

The Government must fully understand the implications that these reforms could potentially have on the businesses listed on the UK's exchanges. In our survey with YouGov[3], nearly two thirds of companies said that they would be likely to re-evaluate the worthwhileness of their company's listing. Investors were asked whether they believed the companies they invested in would re-evaluate their listing, with 63% stating that they believed companies would. This demonstrates a fear amongst both companies and investors that the burdens of a listing on a UK public exchange could become too great to warrant it. This could have severe implications for the number of companies on UK exchanges and resulting job creation.

In terms of job creation more specifically, the table below highlights the percentage increase in number of jobs for companies with a market capitalisation below £1 billion a year after their IPO. With an average percentage increase of between 17.9% and 32.3%, and some newly listed companies increasing their employment by as much as 200%, the ability of public companies to create employment opportunities must not be underestimated. A potential reduction in the number of companies on public exchanges, as well as companies seeking a listing, as a result of these reforms, would be hugely damaging to the UK economy.

Year on year changes	**2016**	**2017**	**2018**	**2019**
Largest increase	202.9%	87.5%	72.1%	128.6%
Smallest increase	0.0%	-4.7%	29.8%	1.6%
Average % change 12m after IPO	32.3%	23.1%	17.9%	30.2%
Median	13.6%	15.7%	14.7%	22.5%

[4]

The EU and competitive advantage

Following the UK's withdrawal from the EU, the UK must maintain a competitive advantage over the rest of Europe. The UK has to be viewed as an attractive listing venue that encourages innovation and growth whilst maintaining high standards and appropriate levels of investor protection.

Recently, the European Commission's Technical Expert Stakeholder Group (TESG) published a report on Small and Medium-sized Enterprises (SMEs)[5]. As part of this, the TESG has proposed a recalibration of the concept of a SME, stating that "the SME definition currently established in EU law (more concretely in financial legislation, which applies an additional definition based on a market capitalisation criterion of less than EUR

[3] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[4] QCA/Hardman & Co. Research, 2021 (forthcoming report)
[5] European Commission, 2021, Technical Expert Stakeholder Group (TESG) report on SMEs: *Empowering EU Capital Markets – Making Listing Cool Again*, available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/210525-report-tesg-cmu-smes_en.pdf

QUOTED COMPANIES ALLIANCE

200 million) is no longer valid"[6]. The basis for this argument is that this market capitalisation threshold is no longer commensurate with market realities.

The QCA agrees with this.

The historic €200 million market capitalisation threshold is no longer appropriate as it fails to reflect the maturing of, and developments within, the SME ecosystem in recent years. Average market capitalisation has increased sharply in recent years, and with that, so has the nature of what can be considered an SME.

In light of this realisation, the TESG has followed in the footsteps of the European Commission's High-Level Forum on the Capital Markets Union[7] to recommend that the outdated SME definition should be remoulded into a new concept entitled "Small and Medium Capitalisation Companies (SMCs)". SMCs would include "all publicly listed companies on any type of market whose market capitalisation is lower than 1 billion euros"[8].

It is a commonly held view that, when compared to the EU, the UK typically has higher levels and standards of corporate governance, both in terms of their form and substance. It is often considered that UK organisations adopt the spirit of the standards as well as their theoretical framework. It should also be noted that the UK's exchanges are larger in size and, arguably, more developed than the exchanges of our European counterparts. Despite this, the EU appears to be committed to creating more space and flexibility for smaller quoted companies to allow them to flourish and grow without being overburdened by disproportionate regulation that is targeted at the largest companies, but is often applied in a blanket manner to smaller companies.

This could seriously inhibit the UK's standing against the EU's and create a competitive disadvantage, as well as limit the UK's attractiveness as a listing venue. Significantly, only 4% of companies and 15% of investors believe that there would be a significant increase in the level of confidence that the UK is an attractive listing venue as a result of these proposals[9]. Furthermore, 78% of companies and 54% of investors believe that the reforms will provide either no change or decrease the attractiveness of the UK[10]. It is concerning that these numbers are so high, in particular amongst the investment community. Given that there is significant emphasis on the reforms providing greater levels of protections for investors, it is worrying that so many believe the reforms would not have a positive impact, with some going further to suggest it would have a detrimental impact. We therefore believe that there should be a wholesale re-think on the positioning of the reforms.

The importance of growth in small and mid-sized quoted companies

The UK should seek to celebrate and encourage the role of public companies and their significant contribution, both regionally and nationally, to the UK economy. There are approximately 1,250 small and

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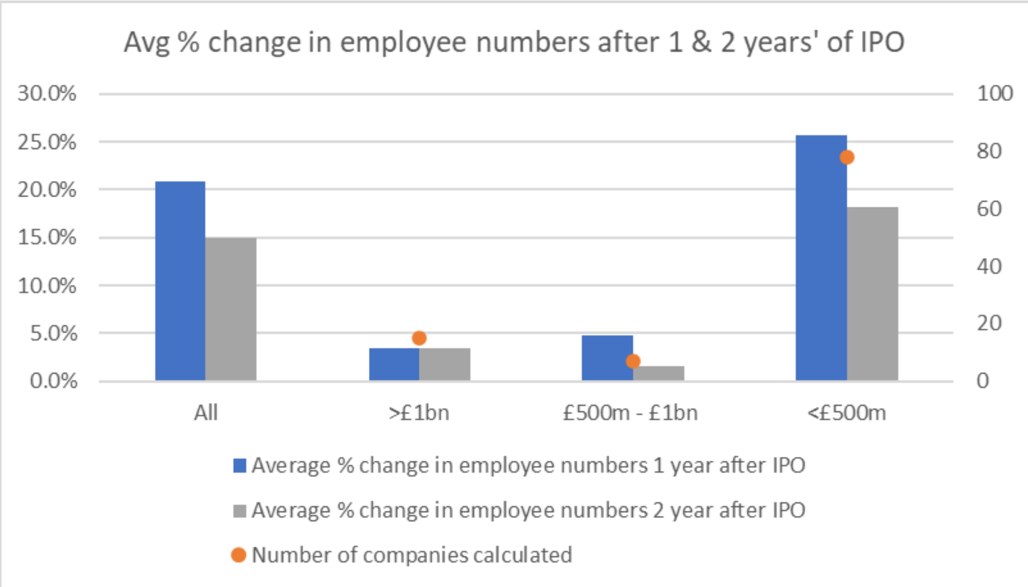
[6] Ibid, page 19
[7] European Commission, 2020, Final Report of the High Level Forum on the Capital Markets Union, available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf
[8] Ibid, page 66
[9] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[10] Ibid.

mid-sized quoted companies in the UK, representing 93% of all quoted companies[11]. They employ approximately 3 million people (or 11 per cent of private sector employment), and contribute over £26.5 billion in taxes on an annual basis[12].

It is estimated that the small and mid-sized quoted company community alone directly employs nearly 1.5 million people outside London and across the UK's nations and regions[13]. This demonstrates their importance in addressing regional inequality.

Implementing these changes, as proposed within the consultation, will inhibit the ability of companies to overtake and challenge the existing top companies on the UK's exchanges. It will also not allow companies to grow, create jobs and deliver prosperity and increased tax returns for the Exchequer.

To this end, and in order to quantify the contribution that newly listed companies make to employment, we analysed the number of jobs created following a company's IPO. The diagram below highlights the positive correlation between companies conducting an IPO and job creation. The percentage of job creation is particularly pronounced for smaller quoted companies with market capitalisations below £500 million, with an average increase of 25.7% after the first year and an 18.2% increase in the second year.



[14]

This reiterates the importance of ensuring that smaller companies have the ability to grow, without being constrained by disproportionate, overburdensome and costly regulation, which would reduce job growth and cause companies to direct resources elsewhere.

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[11] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf

[12] Ibid.

[13] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf

[14] QCA/Hardman & Co. Research, 2021 (forthcoming report)

We acknowledge that the Government intends to reduce the number of jobs lost as a result of implementing these reforms. However, an important balance needs to be struck. The Government should not prioritise protecting moribund companies over encouraging growth through new IPOs.

Furthermore, the opportunity costs companies will incur should also be considered. In our survey with YouGov[15], we asked companies how much time they currently spend on compliance/governance matters compared with business/growth/future planning matters. The mean time spent on compliance is 32%, with a mean time spent on growth matters of 68%. Therefore, there already appears to be a considerable proportion of a board's time spent on compliance. However, when we asked how much time companies perceived they would spend on these matters following the implementation of the reforms, the figures changed to almost equal time spent on compliance matters and growth matters. These reforms, therefore, raise significant questions about the impact that they would have on restricting the growth of companies, and ultimately, the UK economy, particularly given the significant amount of time already spent on compliance.

This is reinforced when companies were asked about the perceived impact of the reforms on their company's growth, with 59% of companies believing that their growth would be negatively impacted by the reforms[16].

Finally, we note that the Prime Minister recently established the Taskforce on Innovation, Growth and Regulatory Reform (TIGRR), which clearly demonstrates his commitment to, and recognition of the importance of, growth. In a recent report issued by the TIGRR, there is a specific recommendation to "mandate a new Proportionality Principle"[17]. The Proportionality Principle is described as absolutely vital to a new framework, with "one of the longstanding issues with traditional regulation is that it has a disproportionate negative impact on smaller businesses"[18].

In his letter in response to the report, the Prime Minister specifically states that the UK "can lead the world in the economy of the future, creating new opportunities and greater prosperity", but that this can only be achieved "if we clear a path through the thicket of burdensome and restrictive regulation that has grown up around our industries"[19].

We agree with the Prime Minister and the "Proportionality Principle" proposed in the TIGRR's paper. It is essential that any new regulatory or legislative action is proportionate in its approach, having regard to the smaller size and more limited resources of these companies, as well as balancing the subsequent costs and benefits of these developments.

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[15] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[16] Ibid.
[17] Taskforce on Innovation, Growth and Regulatory Reform, May 2021, page 17, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT__1_.pdf
[18] Ibid.
[19] The Prime Minister's letter to the TIGRR, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994141/Iain_Duncan_Smith_Theresa_Villiers_George_Freeman_signed_letter.pdf

To this end, we also note that both Sir John Kingman, in the Independent Review of the Financial Reporting Council[20], and Sir Donald Brydon, in the Independent Review into the Quality and Effectiveness of Audit[21], stressed, on multiple occasions, the need for proportionality. The former recommended a reconditioning of the FRC's approach to place proportionality at the heart of the regulator and any subsequent regulation, whilst the latter expressed his commitment to ensuring a proportionate audit regime, highlighted his mindfulness of proportionality towards the introduction of a strengthened regime on internal controls and emphasised the need to take into account the size and complexity of companies.

We do not believe the reforms proposed in this consultation have been taken forward in the spirit of proportionality.

The role of non-executive directors in growth companies

The role of non-executive directors in growth companies differs from that at a more established, larger company. Typically, it is not a static role where an individual is principally an Audit Committee chair, for example. In a recent report by Henley Business School[22] it was highlighted that the role is more dynamic and more about enabling rather than monitoring. The report states that:

"It is generally recognised that the greatest contribution of NEDs in growth companies is to add value through engaged stewardship and support for the company's ambitions. The basic level of good governance consists of strong internal controls and financial discipline, but the distinct NED contribution lies in the mentoring and stewardship of the CEO, the top team and/or the company as a whole, by bringing to bear their experience, their specific and general business skills, and even their links to stakeholders."

The findings of the report suggest that the focus of the role of the NED in a large listed company[23], "according to the [UK] Code, is one of monitoring and control: over the robustness and appropriateness of strategy, over culture and management remuneration, and providing assurance about the integrity of accounts."

Market capitalisation distribution

It is also important to address the common misconceptions that surround the perceived size of companies on the UK's public equity markets. During the QCA's discussions throughout the consultation period, it became apparent that policymakers are making incorrect assumptions about the size of public companies,

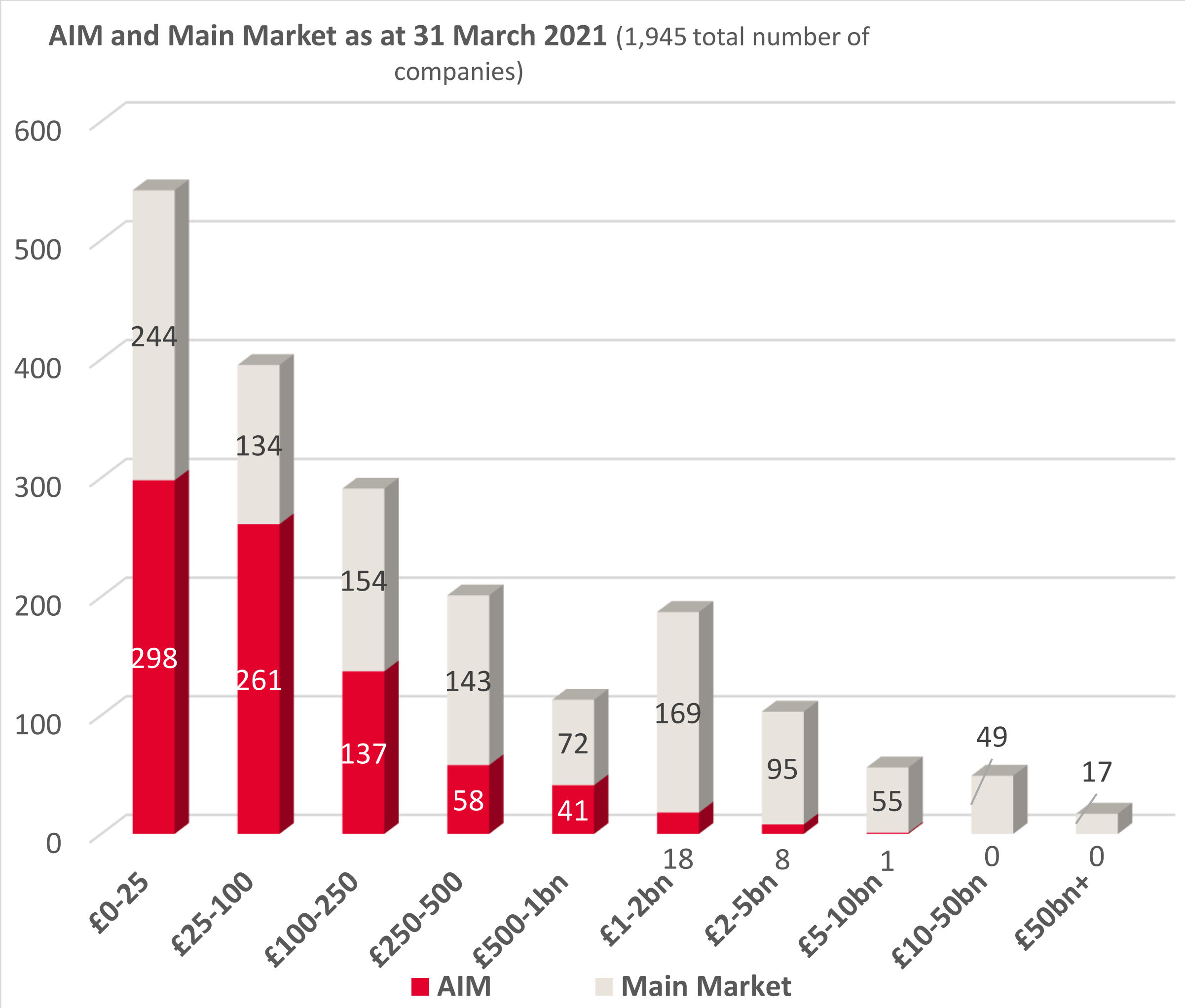
[20] Sir John Kingman, Independent Review of the Financial Reporting Council, December 2018, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

[21] Sir Donald Brydon, Report of the Independent Review into the Quality and Effectiveness of Audit, December 2019, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf

[22] Henley Business School, The Role of Non-Executive Directors in Growth Companies, September 2019, page 4, available at: https://assets.henley.ac.uk/defaultUploads/research/Research-Report-The-Role-of-Non-Executive-Directors-in-Growth-Companies.pdf?mtime%3D20190904142950

[23] Henley Business School, The Role of Non-Executive Directors in Growth Companies, September 2019, page 7, available at: https://assets.henley.ac.uk/defaultUploads/research/Research-Report-The-Role-of-Non-Executive-Directors-in-Growth-Companies.pdf?mtime%3D20190904142950

namely: (i) that, due to their inherent nature, all public companies were assumed to be "large"; (ii) that Main Market companies are significantly bigger than AIM-quoted companies; and (iii) that Main Market companies are not "small" and are all in the "public interest" due to this. The graph below reveals the distribution of the different sizes of companies on the Main Market and AIM by their market capitalisation.



Regarding the first assumption, public companies are not always "large"; in fact, more often than not, public companies can be categorised as smaller, growth companies. Nearly 80 per cent of public companies (Main Market and AIM) have a market capitalisation below £1bn. Moreover, over 27.5 per cent of companies have a market capitalisation under £25m, and almost one in every two companies have a market capitalisation below £100m. This clearly demonstrates that many of the companies that operate on our public markets should be considered smaller entities.

In relation to the second assumption, and as plainly displayed by the graph, the companies on the Main Market, whilst larger in terms of total market capitalisation, can often be of a similar size to AIM companies. For instance, of the 80 per cent of companies that have a market capitalisation below £1 billion collectively across both markets, 51 per cent of these companies are on AIM, with 49 per cent on the Main Market.

In terms of the third assumption, the belief that all Main Market companies are not small and are in the public interest is entirely wrong. There are 244 companies on this market with a market capitalisation of less than £25m and nearly 400 with a market capitalisation below £100m.

Furthermore, as at 31 May 2021, the largest company on the FTSE All-Share Index had a market capitalisation of £107,377 million, with the smallest company having a market capitalisation of just £38 million[24]. This means that the smallest company is 0.03% of the size of the largest, or 2,825 times smaller. It simply cannot be considered that these two companies have the same level "of public interest", nor can it be deemed that the proposals in the consultation are fair or proportionate.

The need for investors to play their part in these reforms

The QCA recognises that some instances of recent high-profile failings of both public and private companies indicated that a review of the audit, corporate reporting and corporate governance landscape in the UK is needed. Protecting jobs, reducing uncertainty and improving the accuracy, reliability and quality of information that investors, stakeholders and the financial market system as a whole rely on is essential. Making appropriately considered improvements will increase confidence and trust between stakeholders (including investors) and companies in the UK, although many of the reforms in this consultation do not fit within this context of being appropriately considered.

The largest companies in the UK, which are of systemic importance, should be required to take on additional measures due to their size and the significant impact that a potential failure would have on stakeholders. Implementing strengthened requirements for these companies would help to protect their more substantial number of stakeholders, such as employees, customers, suppliers and investors, as well as those impacted by their operations, and this would facilitate increased trust and confidence.

In addition to the largest companies taking on additional responsibilities, we believe that a key sign of effective and enduring public markets is well-functioning systems of communication and feedback from investors. Whilst investors have discussions around buying and selling decisions, they should also have conversations with their investee companies around more nuanced topics about where reporting can be improved, risk appetite, remuneration levels and extent of assurance, amongst other issues.

In many instances, market failures are as much to do with the practices of investors who do not appropriately engage with investee companies, as they are to do with the failures associated with directors, who, due to a lack of feedback, believe that investors are comfortable with their strategy and direction. This can ultimately lead to a situation of continuing poor practice until the business failure occurs.

Therefore, rather than implementing yet more regulation directed at companies to effect change, the Government should seek to build on structures within the investment community, such as the FRC's Stewardship Code, and work with other organisations, such as the Investment Association and Investor Forum, to improve their output with a view to identify and disseminate good practice. As part of this, investors need to have input into accounting standards, as it is their information needs that these structures are trying to identify and fulfil.

[24] FTSE Russell website, FTSE Factsheets, FTSE All-Share Indexes, available at: https://www.ftserussell.com/analytics/factsheets/home/search

At present, the Government is solely focussed on implementing new regulation in an already overly regulated space without any consideration or suggestion of implementing regulation for the investment community in order to make sure they are participating and fulfilling their duties.

A more equal playing field, whereby companies and investors both have requirements and responsibilities to follow as part of a mutually beneficial relationship will enhance the attractiveness of the UK significantly. This would help to avoid situations of excessive regulation and improve investor participation, thus increasing confidence in the market.

The correct positioning and implementation of the reforms

Taking all of the above into consideration, a more sensible, supportive and pragmatic approach to introducing the reforms proposed in the consultation would be a four-pronged implementation. Rather than an automatic extension to a new intake of PIEs, this approach would ensure that the reforms are targeted appropriately at those truly within the public interest (and fully able to comply).

In the survey conducted by YouGov[25], we asked respondents for their views on whether the phased introduction should be paused for a comprehensive analysis of the impact of the reforms. There was overwhelming support for this, with 95% of company and 83% of investor respondents agreeing that a review was needed before consideration was given to extending the scope of the requirements to other entities. This is a strong body of opinion from both sides of the market against the automatic extension of the Government's proposals.

It should be recognised that the definition of a PIE is currently drawn from the Audit Reform regulations implemented in 2006 through EU legislation. As we have now left the EU, it is important that we do not blindly follow historic EU thinking and we should seek to design a system that suits the needs and objectives of the UK for the present time and in an increasingly competitive and agile global economy.

It is also likely that the PIE definition, once set in legislation, will be applied in many more circumstances beyond audit and corporate governance reform. As such, it is important to do this once, and get it right as the unintended consequences could be great, and have a seriously deleterious impact on the small and mid-sized quoted companies we rely upon to innovate, grow, increase tax contribution and create jobs and wealth across the UK.

As described in greater detail in our response to Q1 below, we believe that a deeper consideration of why an entity is deemed "of public interest" is needed. We believe that the basis for identifying a PIE should be broken down into three separate pillars. Namely, (P) public interest, (I) investor protection and (E) employee protection.

Following this, we propose that the definition of a PIE should initially incorporate all FTSE 350 companies and then, if considered appropriate following our proposed approach to implementation, could be extended to other large companies (both public and private) with:

- over 500 employees; AND

[25] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

- a turnover of more than £500 million; OR
- a market capitalisation exceeding £1 billion (on a market agnostic basis).

In light of this proposed definition, a successful four-pronged approach would consist of the following:

1. **Initial Implementation**

The initial stage should include implementation of the resulting reforms for companies who are constituents of the FTSE 350 only.

Given the wide-ranging and largely unpredictable nature of the impact of the reforms, an initial implementation at the FTSE 350 level is highly advantageous. Not only will it capture the entities of most systemic importance and of greatest public interest, but would also ensure that, due to their larger size, capacity and level of available resources, it captures entities who can comply fully. Implementing changes that companies are unable to comply with could produce significant consequences for the wider market.

It is essential that the new rules are appropriately targeted at the entities who have the ability to comply in full and that companies are not overwhelmed by the enormous cost and burden that these proposals would impose. A blanket approach to all Premium List companies, such as that currently contained in the consultation, could engender huge amounts of financial stress and, ultimately, could lead to delisting or failure, particularly of entities at the smaller end of the Premium List. If the intention of these reforms is to increase the attractiveness of markets and minimise the potential for corporate failure, then implementing the reforms as proposed could worsen the situation rather than improve it.

The costs of listing for small and mid-sized entities are already disproportionately high. Further regulation will make UK public markets unwelcoming and open mainly to the larger entities that can bear these costs. The reforms should, therefore, be targeted initially at FTSE 350 entities only. Whilst a few of these companies may be below our proposed thresholds for the PIE definition, they are included within mainstream indices, where there is a high number of passive investors using Exchange Traded Funds (ETFs) and other trackers, which naturally increases the level of public interest in these companies.

2. **Impact Analysis**

Two years after the initial implementation of the reforms to the constituents of the FTSE 350, the second stage should include a thorough analysis of the impact of the reforms on these entities. This analysis would be used to consider which aspects of the reforms work, and which do not. This will allow the Government and regulator to make modifications, adjustments, or remove certain requirements if they are proven to be unsuccessful in achieving their objectives and/or are too onerous and burdensome.

As a starting point, the Impact Analysis should include, amongst other things, an examination of:

i. Whether the reforms have been successful in producing the benefits they were set out to achieve, and that this success is meaningful. This includes:
    a. More accurate financial information;
    b. More effective decision-making;
    c. Greater market confidence;
    d. More efficient allocation of investment across the market;

   e. Evidence of decreased incidence of fraud or corporate failure;
   f. Increased efficiency/output;
   g. Lower cost of capital to firms;
   h. Decreased costs to defrauded investors;
   i. Lower precautionary costs to investors;
   j. Greater market stability;
   k. More investment;
   l. Lower costs from financial crises; and
   m. Economic growth.

ii. The cost and burdens of the reforms. This could include, amongst other things, an analysis of the:
   a. Total cost of each of the reforms on companies;
   b. Total cost of each of the reforms on audit firms;
   c. Changes in market capitalisation;
   d. Change in level of growth compared with previous years;
   e. Number of delistings;
   f. Impact on directors; and
   g. The impact on auditors.

iii. The effectiveness of the new regulator (ARGA).

It is crucial that an Impact Analysis is conducted before automatically and unconsciously extending the scope of the reforms to other entities.

3. **Extension Assessment**

After the Impact Analysis and the resulting modifications and adjustments have been made or certain requirements have been removed entirely, the third stage should consist of an assessment of which entities, such as large private or AIM-quoted companies, the reforms should be extended to, if any.

The Government and regulator should consult with all stakeholders and market participants on the appropriate entities, if any, that should come into scope of the requirements. As part of this, it should also be considered whether each requirement should apply to the additional entities in scope, or whether some of the more onerous requirements should be restricted to the entities it initially applied to, in the interests of proportionality and a regime that is fit for purpose.

4. **Transition Period**

Succeeding the Extension Assessment, the final stage is to allow for a significant transition period of at least three years before extending the scope of the requirements to additional entities.

It is vital that companies are given sufficient time to build the capacity and resources, as well as appoint the necessary personnel and expertise, to comply with more stringent requirements. Enforcing significant changes on companies too quickly could have considerable consequences and result in high levels of management stress.

The quality, supply and diversity of directors

During the consultation period in our discussions with the Government and the regulator, it became evident that there is little or no concern of the negative impact that these reforms could have on directors and the boards of quoted companies.

From the outset, one of our chief concerns has been the impact of the reforms on company directors, which is where the majority of the reforms are targeted. The reforms have the potential to significantly increase the burden and associated liability that directors face to the extent that their directorship will simply not be worth the risk.

In our survey with YouGov[26], an overwhelming 9 in 10 companies (90%) and 8 in 10 investors (81%) believed that the proposals would have a negative impact on prospective and existing directors in terms of their willingness to seek or retain a directorship. The significance of these results should not be underestimated. If the reforms are implemented as they are proposed in the consultation, there is serious concern over the impact it would have on directors or prospective directors who may retire from their roles or not consider taking on a directorship. This could have enormous and far-reaching implications for the supply of directors, the quality of directors and the diversity of directors. It has the potential to drive skilled individuals away from the public markets to private equity companies and/or consultancy arrangements, where they do not take on the responsibilities and associated liabilities of directors. This would cause the opposite effect of what was intended of the reforms.

In terms of board diversity more specifically, companies and investors believe that the reforms could have an impact on the following:

- **Experience**: 57% of companies and 33% of investors believe the reforms will have an impact on diversity of experience;
- **Skills**: 49% of companies and 23% of investors believe the reforms will have an impact on diversity of skills;
- **Education**: 35% of companies and 25% of investors believe the reforms will have an impact on diversity of education;
- **Ethnicity**: 28% of companies and 13% of investors believe that the reforms will have an impact on the diversity of boards in terms of ethnicity; and
- **Gender**: 27% of companies and 13% of investors believe that the reforms will have an impact on gender diversity[27].

Costs and benefits of the reforms

In reviewing the consultation document and accompanying Impact Assessment, there appears to be significant disparity between the costs and benefits of the reforms. As the consultation and Impact Assessment highlight, the costs are enormous; the proposals surrounding the PIE definition and internal controls, for instance, will cost up to £1.7 billion and £2.3 billion, respectively. This is a huge cost for

[26] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[27] Ibid.

companies and the UK economy. In practice, this will be felt worst by smaller companies who do not have the same levels of resources to dedicate to governance and compliance.

Despite these huge costs, there is a considerable lack of quantifiable benefits outlined in the consultation or Impact Assessment. The "logic model" contained in Figure 6 of the Impact Assessment is theoretical, based on assumptions, and is described on a best-case scenario basis, without any consideration of the interplay between the costs of the reforms and their potentially negative impacts, such as delistings and company directors resigning from their directorships.

It is unclear why the Government has made the assumptions that the reforms will achieve the benefit of economic growth. This does not appear to be grounded in reality.

As shown in the QCA/YouGov survey, we asked companies and investors to provide their feedback on what they believe the impact of the reforms would be on their/a company's growth. 0% of companies and 0% of investors indicated that the reforms would have a very positive impact on their/a company's growth. 59% of companies and 37% of investors indicated that there would be a negative impact on their/a company's growth, with 35% of companies and 27% of investors stating that there wouldn't be a change[28].

Furthermore, when asked whether the proposals would lead to any of the benefits detailed in Figure 6 of the "logic model", 0% of companies and only 21% of investors believed the reforms would lead to economic growth. It is not apparent, therefore, where the Government believes this growth would come from. The companies and investors, who are in the best position to judge the impact of the reforms, are clearly in disagreement with the Government and there is a strong suggestion that the nature of the reforms are anti-growth.

The new regulator's capacity

In a similar vein to the above, it is apparent that the Government has made some considerable assumptions about the capacity of the regulator and its ability to expand its workload so significantly. One of the key concerns raised both by our members and in discussions with other organisations is not only regarding the preparedness of the new regulator, but also its capability in all of the areas to be covered. It is not clear that the regulator has the requisite quantity and quality of personnel to carry out its proposed functions. The new regulator will be (and already is) hiring at a time when the audit firms will be doing the same to meet their PIE firm commitments.

Moreover, concerns have consistently been raised over the proposed extension of the regulator's powers beyond what is necessary, appropriate and sensible. The regulator should not become judge, jury and executioner.

Rather than expanding the scope of the regulator so considerably, the Government and regulator could consider providing training/accreditation for PIE directors based on the Continuing Professional Development (CPD) models widely used in the professions to ensure that directors remain fit for purpose and continually seek improvement.

[28] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

The need for transparency, accountability and scrutiny

On the basis of the above, it is essential that the impact of the proposed reforms and the performance of the new regulator are scrutinised and held to account in a transparent manner. The appropriate Minister from BEIS should be required to provide an annual statement on audit and corporate governance reform to the Chancellor for inclusion in their State of the City statement. This should include a clear statement on the effectiveness of ARGA.

QCA/YouGov survey

As a conclusion to this introductory section, we summarise some of the headline results of the survey conducted by YouGov. The survey asked investors and company directors for their views on the proposals in the consultation. The survey provided a description of each of the proposals and outlined the costs before we asked respondents for their opinions on the proposed reforms.

In total, we received 218 responses from companies (166) and investors (52).

To view the full results, please click here.

A breakdown of some of the key findings can be seen below.

- 95% of companies and 83% of investors believe that the phased introduction of the requirements should be paused in order to conduct a comprehensive review of the impact of the reforms before consideration is given to extending the scope.
- Nine-tenths of companies (90%) and four-fifths of investors (81%) believe that the proposals have the potential to deter prospective individuals from seeking directorships, or existing directors retaining their directorships.
- Nearly 9 in 10 companies (87%) and three quarters of investors (75%) agreed that the current proposals to expand the definition of a PIE would be too onerous and costly.
- Only 1 in 5 investors (21%) and 0 companies believe that the reforms would eventually produce the benefit of economic growth.
- Just 4% of companies and 15% of investors believe that there will be a significant increase in the level of confidence that the UK is an attractive listing venue.
- Just 2% of companies believe that the reforms will have a positive impact on their growth, with 59% believing the reforms would have a negative impact.
- Nearly two thirds of companies (58%) say that they would be likely to re-evaluate the worthwhileness of their listing/quotation. 63% of investors say that they believed companies would re-evaluate their listings/quotations as a result of the reforms.

- Of the 166 company respondents, 40% say that the appropriate market capitalisation threshold should be between £500m and over £1bn, with 1 in 4 (26%) indicating that AIM companies should not be included at all.

- Nearly two thirds (61%) of the companies surveyed say that the market capitalisation threshold should also apply to Main Market companies, with almost 1 in every 2 (48%) strongly in agreement.

Response to the Consultation Questions

Chapter 1: The Government's approach to reform

Chapter 1.3: Resetting the scope of regulation

Q1 Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.

Yes – we believe that large private companies should be included within the definition of a Public Interest Entity (PIE), where the public interest is greatest, as they are of societal importance. We agree with Sir Donald Brydon, in his review of the quality and effectiveness of audit, that other entities, such as large private companies, can be considered of significant importance to the UK economy.

In addition, extending the definition of a Public Interest Entity to large private companies puts these companies on a more equal footing with large public companies who are already deemed to be of public interest. Indeed, in many cases, private companies use public capital, including funding from taxpayer-owned financial institutions. Private equity backed businesses are often funded by institutional money, including pension funds.

In taking forward an expanded definition of a PIE, we believe that there should be consistency in the definition between large private and large publicly listed companies. This would help to create a more level playing field between public and private companies.

However, we believe that, in the first instance, the question around why a company should be identified as a PIE needs to be considered and addressed. This then needs to align with appropriate cut off measures. We believe that the basis for identifying a PIE should be broken down into three separate pillars. Namely, (P) public interest, (I) investor protection and (E) employee protection.

The first pillar, *public interest*, can be defined by the external impact of a company and its influence on broader political, social and economic objectives. External impacts would include how a company's conduct impacts customers, suppliers and third parties. The entity needs to be of sufficient size to have an impact on the desired policy outcomes and/or demonstrable impact on communities, with the best measure to define this size being turnover.

The second pillar, *investor protection*, can be defined as the impact of the entity's failure on market confidence. Market capitalisation is the most appropriate measure to use for this category.

The final pillar, *employee protection*, can be defined as the impact of failure on employment, developing workforce skills and intellectual property, the fair treatment of minorities and fair pay, amongst other factors. The number of employees is the most appropriate measure to use.

Accordingly, we believe that the definition of a Public Interest Entity should factor in turnover and number of employees along with a higher market capitalisation threshold (for public companies). With this in mind, the definition of a PIE should initially incorporate all FTSE 350 companies and then, if considered appropriate following our proposed approach to implementation, could be extended to other large companies (both public and private) with:

- over 500 employees; AND

- a turnover of more than £500 million; OR
- a market capitalisation exceeding £1 billion (on a market agnostic basis).

We agree with the Government's proposal in relation to the qualifying and ceasing to qualify as a PIE and suggest that a company should be required to meet the thresholds for three consecutive financial years before qualifying as a PIE.

Q2 What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.

Our preferred option for the large private companies to be included in the PIE definition is Option 2. This option reflects stakeholders better due to the "and" condition. In option 1, the financial criteria are very high thresholds when combined, but it can capture more unusual entities with a low turnover and small balance sheet who simply have a large number of employees. Option 2 does not give the same outliers but reflects better those entities that we would expect to capture due to wider public interest concerns.

As a result of this, we would consider that, when the Government redefines the existing definition of a Public Interest Entity, the Other Entities of Public Interest (OEPI) regime that currently exists would need to be removed as there is no longer a need for it. All entities that are deemed to be of public interest should be scoped into the new PIE regime. If they do not meet the thresholds of the new definition, then there should be no separate regime that scopes in other entities to the same restrictions as PIEs. As such, there should be only one regime.

Q3 Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.

No – we do not believe that AIM companies with a market capitalisation exceeding €200 million should be included in the expanded definition of a PIE. We believe that expanding the definition of a Public Interest Entity to companies on the AIM market with a market capitalisation exceeding €200 million (currently circa £170 million) is disproportionate and will have a significant negative impact on the growth of smaller companies on this market. This market is designed as a growth market with a principles-based set of rules. After nearly 30 years of operation, this approach is well understood, and investors recognise the difference between this market and the Main Market.

Proportionality should be at the heart of legislative and regulatory decision-making. The needs and size constraints of smaller companies should be at the forefront of the Government's and the regulator's thinking when re-setting the scope of regulation. This is a key component to ensuring the growth and development of small and mid-sized quoted companies, as well as overall growth in the UK economy, by making sure that businesses are not overburdened by compliance requirements.

AIM was established as a junior market to the London Stock Exchange's Main Market specifically for small and medium sized growth companies, to give companies from a range of geographies and sectors "access to a diverse set of investors and a supportive advisory community, who understand the needs of entrepreneurial businesses"[29]. Since its inception, "AIM has developed into the world's most successful and established market for dynamic high-growth companies"[30].

The proposal to expand the definition of a PIE to AIM companies runs counter to the foundations and fundamental principles of the AIM market, and the successes that have been achieved as a result of these principles. AIM is a unique market. It is unique in its approach and composition and, as a result, is the most successful growth market in the world. To ensure this success continues, it is imperative that small and mid-sized quoted companies continue to have a market appropriate for their growth and development. Its more flexible and lighter touch approach to regulation is a crucial element of AIM's success. It affords companies the ability to concentrate resources to stimulate growth and development, which has hugely positive implications, such as for job creation, increased tax take and improving returns for investors.

We recognise, however, that not all AIM companies are the same size, with some companies on the market reaching a certain stage in their maturity where greater regulation may be advisable to avoid negative outcomes. The €200 million market capitalisation threshold is, however, far too low and will destroy the positive development of growth companies who are not of systemic importance.

In its current format, the vast majority of companies (87%) and investors (75%) believe that the proposed expansion of the PIE definition will be too onerous and costly[31].

This €200 million threshold is spurious. Not only is there a lack of clear justification for the threshold, but it is also unclear why a historic figure, derived from EU legislation, is being used as the threshold for resetting the future scope of UK regulation in a post-Brexit world. Including all AIM companies with a market capitalisation above €200m solely on the basis that these companies are currently captured by the regulator's monitoring and sanctioning powers in respect of the audits of these companies does not make sense. It is not plausible to automatically assume that these companies should be incorporated in the expanded PIE definition on this basis without any prior consideration for what the public interest actually is. Additionally, using market capitalisation as the only threshold is problematic because company values vary according to industry/sector sentiment and does not necessarily reflect the wider impact of a company.

The UK's withdrawal from the EU provides the Government with the opportunity to reconsider and rethink what the definition should be. The UK is no longer constrained by the EU Audit Regulation and Audit Directive and the Government should take the opportunity to pioneer a new definition that is appropriate to the unique nature of UK markets. The Government has the ability to put in place additional thresholds to which the proposed reforms in this consultation can be applied. A blanket approach to everything for all PIEs irrespective of their nature and size is excessive and disproportionate. Any figure should also be in Sterling and not Euros.

In our survey with YouGov, we asked respondents what they believed was the appropriate market capitalisation threshold. Regarding the responses from companies, 40% indicated that the market capitalisation threshold should be £500 million to over £1 billion, with a further 26% believing that AIM

[29] London Stock Exchange website, available at: https://www.londonstockexchange.com/raise-finance/equity/aim
[30] Ibid.
[31] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

companies should not be included in the PIE definition. In terms of investors, nearly two-thirds of respondents highlighted their preference for a more delineated approach[32].

Therefore, and as highlighted in our response to Q1, we believe the PIE definition should be changed to initially incorporate all FTSE 350 companies and then, if considered appropriate following our proposed approach to implementation, could be extended to other large companies regardless of which public market they are quoted on that have:

- over 500 employees; AND
- a turnover of more than £500 million; OR
- a market capitalisation exceeding £1 billion.

We believe that these thresholds are appropriate and proportionate and this is consistent with our preferred option for private companies. This would help to level the playing field between quoted companies on the Main Market and AIM and private companies and help with the level of understanding and consistency of application. Companies meeting these thresholds will also be of a size where they are likely to have a wider shareholder register, where direct investor influence is less easily achievable.

The market capitalisation threshold of £1 billion has a growing level of consensus from different groups. For instance, as highlighted in our introduction to this response, the European Commission's Technical Expert Stakeholder Group (TESG)[33] and High-Level Forum on the Capital Markets Union[34] have both recommended that the definition of SME be increased to €1 billion. This is on the basis that the €200 million market capitalisation threshold for SMEs no longer reflects market realities. As stressed in our introduction, the UK should not only seek to reflect market realities, but also ensure that the UK does not lose its competitive advantage over the EU. Moreover, the characteristics of the MSCI Europe Small-Cap Index[35] (which includes UK companies), shows a median market capitalisation of $1.2 billion.

In a similar vein, this is also reflected in the UK. The Investor Forum – the membership organisation which comprises leading asset managers and owners of the UK equity market[36] – recently published a white paper on Governing for Growth[37], which aims to identify a series of indicators for when a company is reaching a certain stage of maturity where it becomes important to build more resilience and potentially adopt greater governance structures. The Investor Forum includes a market capitalisation increasing beyond a threshold of £1 billion as an indicator of growing maturity. More specifically, they state that the "scale of value at risk,

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[32] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[33] European Commission, 2021, Technical Expert Stakeholder Group (TESG) report on SMEs: *Empowering EU Capital Markets – Making Listing Cool Again*, available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/210525-report-tesg-cmu-smes_en.pdf
[34] European Commission, 2020, Final Report of the High Level Forum on the Capital Markets Union, available at: https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf
[35] MSCI, Europe Small-Cap Index, May 2021, available at: https://www.msci.com/documents/10199/efd274e3-300f-43e7-8985-30ded93a7f00
[36] The Investor Forum website, available at: https://www.investorforum.org.uk/
[37] The Investor Forum, June 2021, Governing for Growth, available at: https://www.investorforum.org.uk/wp-content/uploads/securepdfs/2021/06/Governing-for-Growth.pdf

and the greater attention, both from investors and others, that it brings, may of itself mean that additional protections might be warranted"[38]. It is, therefore, apparent that UK investors view companies that have a market capitalisation over £1 billion as reaching a certain size whereby they should adopt improved practices and potentially be subject to further requirements. This would lead to suggest that setting the market capitalisation threshold for the new definition of a PIE at £1 billion would be deemed appropriate and acceptable by the investment community.

This is also reinforced by the results in the QCA/YouGov as 87% of companies and 75% of investors believe that the proposed expansion of the PIE definition in its current format will be too onerous and costly[39]. This demonstrates a belief amongst companies and investors that the proposed threshold is not set at the right level because the costs and burdens are too high.

That being said, and while we strongly believe it should not, if the market capitalisation threshold is taken forward as a threshold in isolation, we believe that, for consistency, this should be applied to companies on the Main Market of the London Stock Exchange too, with companies below this threshold not being considered a PIE. This received substantial support in the QCA/YouGov survey, with 61% of companies and 65% of investors believing that the PIE threshold should also apply to Main Market companies[40].

The expansion of the PIE definition would result in a significant proportion of small and mid-sized companies on the Main Market being captured. As highlighted above, there are nearly 400 companies on the Official List with a market capitalisation below £100 million and nearly 250 of these have a market capitalisation below £25 million. It cannot possibly be considered that these companies are truly within the public interest. Extending the definition to these companies could cause a mass exodus of Main Market companies, either delisting entirely to seek cheaper and easier means of raising finance, or seeking a quotation on AIM. This could have serious unintended consequences.

Q4 Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?

Yes – the QCA believes that newly listed companies should be given a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities. Our reasoning for this is twofold. Firstly, we believe that it is essential to ensuring that seeking a listing on a public exchange is an attractive and viable option for growing companies. Secondly, if our proposal to align the thresholds between private and public companies is not taken forward, a temporary exemption would allow companies to adjust to the heightened requirements of being a listed/quoted company, without overburdening them with the full regulatory panoply all at the same time as an IPO.

We recognise the viewpoint that there could be some merit in applying the measures to newly listed/quoted companies upon their listing/quotation as it means there is a greater level of understanding of the measures and requirements early in the process. Furthermore, there is the perception that an exemption could potentially undermine the purpose of the additional requirements, namely, to inspire confidence and public trust. However, we believe that the consequences of not applying an exemption are far greater than implementing the requirements immediately. It is very much a possibility that the UK will experience fewer small and mid-caps deciding to join UK markets as a result of these proposals, whether or not there are

[38] Ibid, page 6.
[39] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[40] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

temporary exemptions. However, aligning the definition of a PIE between large public and private companies as we propose would help to ameliorate such concerns.

Q5 Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.

No – we do not believe that the Government should seek to include Lloyd's Syndicates in the definition of a PIE. The QCA does not believe there is a public interest for Lloyd's Syndicates to be subject to the same requirements as PIEs. It is Lloyd's itself that is of greatest public interest and hence why it is already captured within the existing PIE definition.

Q6 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 – the Government should seek to include large third sector entities as they can still be considered to be of public interest. That is, if a private company, publicly listed company, or a third sector body is of a certain size, it is within scope of the interest of the public. For third sector entities, this should be similar, or equivalent, to our proposed thresholds for public and private companies. To treat third sector bodies differently acts in opposition to the overall objectives that the Government wishes to achieve in this consultation paper.

Q7 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 believe that there needs to be consistency between different entities in the expanded definition of a PIE. As a result of this, the threshold should be the same as, or equivalent to, that applied to Main Market, AIM and private companies. That is, over £500 million for "incoming resources" and over 500 employees. These organisations would have the potential to have a significant impact on stakeholders.

Q8 Should any other types of entity be classed as PIEs? Why should those entities be included?

Yes – large Limited Liability Partnerships (LLPs) and professional services firms where they meet the 500 employees and £500 million turnover thresholds on the basis of their potential to significantly impact stakeholders should be included.

Q9 How would an increase in the number of PIEs impact on the number of auditors operating in the PIE audit market?

An increase in the number of PIEs may potentially result in a decrease in the number of auditors operating in the PIE audit market. The pressure of increased regulation could, in fact, reduce the number of auditors willing to act for PIEs, meaning it is likely that there may be some imbalance between the number of new PIEs and the number of PIE auditors. There could also be a timing difference or lag caused by the increase in the number of PIEs and the number of auditors prepared to audit PIEs. If this is the case, a shortage in the number of PIE auditors could produce some significant unintended consequences.

It is not clear that an increase in PIEs will necessarily result in an increase in audit firms wishing to change their strategies to audit PIEs. In this light, audit firms could also resign from their current posts where previously non-PIE clients become classified as PIEs. This was the case when the extant PIE regime was introduced in 2016, with several firms, particularly in the mid-tier space, avoiding the regime due to the elevated risk and not wanting to take on the burden of increasing regulation. This would have required a significant amount of investment from audit firms to scale up and create the capacity to cope with the PIE requirements, which many did not wish to do. There is no clear reason why there would be a change in mindset now.

Furthermore, there is concern about the decreasing number of credible audit alternatives (and the corresponding knock-on effect for other accounting and professional services). An increase in regulation could also result in the Big 4 (or at least the Big 6) leaving smaller audit firms behind due to being able to cope with the additional complexity, resulting in a decrease in competition which is the opposite of what is intended with these reforms.

In addition, the practical implications need to be thoroughly analysed and understood before changes are made. We understand that commercial insurers are increasingly reticent about providing professional indemnity cover where firms increase their PIE audit work. If they do continue to provide cover, this comes at significantly increased cost, impacting the commerciality of such work and/or resulting in substantial fee increases for the work, which we have already seen in the last couple of years. Ultimately, this cost has to be borne by a company and its stakeholders. There is also the concern that the increased concentration that these proposals could engender could inadvertently result in PIE audits only being undertaken by the largest firms with some level of self/captive insurance arrangements.

Q10 Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?

Yes – it is imperative that the Government should provide time for companies and the audit profession to prepare for the introduction of a new definition of PIE and the more stringent regulation associated with the regime. Failure to provide adequate time for companies to prepare for additional obligations could have a negative impact on the market; in particular, as the sanctions for non-compliance that are proposed in the consultation appear to be significant, especially considering the powers proposed for the new regulator.

Moreover, following the UK's withdrawal from the EU after years of uncertainty and the COVID-19 pandemic that placed enormous stress on businesses of all sizes, it is essential that the UK can build its resilience in order to consolidate and build on its position as a global financial centre. The UK must take the opportunity to build back better, level up the nations and regions, and deliver growth and prosperity. As highlighted in the introductory segment to our response, small and mid-sized quoted companies have enormous potential when it comes to innovation, disrupting existing markets and creating new markets with the resultant jobs and wealth generation across the UK's nations and regions.

The reforms presented in this consultation could significantly hamper this. For this reason, we believe companies should be given, as a minimum, three years to prepare for the introduction of a new definition of PIE, particularly given the impact of the COVID-19 pandemic.

Q11 Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?

Yes – we agree that the Government should seek to offer a phased introduction for a new definition of PIE. It is essential that a phased introduction is offered so that companies of a smaller size who have more limited resources can build the capacity to manage the increased regulatory requirements and the additional burdens that come with it.

As set out in the introductory section to this response, it is essential that these reforms are phased in an appropriate and supportive manner. That is, they are introduced to entities within the FTSE 350 first. A thorough analysis of the impact of the reforms on these companies should then be undertaken and any modifications to the reforms should be made before a review is conducted to consider to which, if any, companies the reforms should be extended. Following this, a significant transition period of at least three years should be put in place for any additional PIEs that have been brought into scope by the reforms.

Our proposal for implementation through this proposed format received overwhelming support in our YouGov survey, with 95% of companies and 83% of investors agreeing that a comprehensive analysis of the reforms should be conducted before extending the scope of the reforms to other entities[41].

Chapter 2: Directors' accountability for internal controls, dividends and capital maintenance

Chapter 2.1: Stronger internal company controls

Q12 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?

On the whole, we do not believe there is a case for adding to the internal control framework for UK companies, and in particular, through the proposed attestation approach, as we believe there is no adequate justification to do so. The vast majority of companies in the UK exercise good internal controls and we have seen no evidence to suggest that there is a systemic issue that needs to be fixed.

The proposals presented in the consultation will not constitute a "strengthening" of the internal controls regime. Rather, they add to an extensive list of existing controls. If there are controls in the extant requirements that are not currently working, then these should be replaced by better controls, which would constitute a "strengthening" of the framework. Companies are already required to produce a directors' responsibility statement and to sign the statement of financial position to attest to their responsibility for the outcome of the accounts preparation process. Requiring a further attestation about part of the process for accounts preparation will not improve outcomes.

Where corporate failures occur, it is often as a result of executives who have overridden adequate control environments. We appreciate that there may be individuals that may operate in a deceitful and fraudulent manner, as well as those that lack competency, but this is a very small number in the overall population. As such, we strongly disagree with a near-total percentage of innocent and competent individuals being burdened with the highly costly and time-consuming requirements of a more prescribed internal controls regime in the UK. The proposed reforms are misguided and are not a proportionate response to tackling a very small minority who might operate weak internal controls.

The approach proposed would also seek to establish a separate framework outside of the FRC Guidance that is already in place which covers all areas of internal control and not just 'internal financial controls'; this is in use by UK companies, both quoted (*FRC Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* – September 2014) and un-quoted (*FRC Guidance on the Going Concern*

[41] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

Basis of Accounting and Reporting on Solvency and Liquidity Risks – April 2016). Given the date of these Guidance documents, and the lack of updating at the time of the revised Corporate Governance Code in 2018, it may be more appropriate to undertake a review of the approach to risk management and internal control to refresh and update the overall area, especially given the experience of risk and control activities during the Covid-19 pandemic.

Returning to the proposals presented, we have the following general points to raise about the benefits of the proposal to add an attestation requirement:

- Theoretically, this should lead to a decrease in those willing and able to disclose intentional inaccuracies and/or commit fraudulent activity, and thus ultimately leading to an unfounded increase in market confidence. However, we believe that those intending to be dishonest will continue to be dishonest and will not be deterred by the change in requirements.

We have the following points to raise about the disbenefits of the new regulation covering internal financial controls:

- Significant costs would be imposed on companies, and in particular, on smaller quoted companies by significantly increasing the amount of work and resources required of a company to refocus or implement systems and produce new disclosures. The majority of companies (84%) and investors (75%) agree that the proposals would be too onerous and costly[42]. Companies will face significant opportunity and compliance costs in order for directors and senior management to report and provide enhanced evidence specifically about the effectiveness of their company's internal financial controls. The regulator will also face costs from developing guidance which would be passed on to the companies. Audit fees would also increase substantially with the amount of work required for the auditors to be satisfied with the effectiveness of a company's internal financial controls. Even if not required by law, many audit committees will want auditors to do additional work to support an attestation.
- The increase in personal liability attached to the directors tasked with signing off on the disclosures, particularly the non-executive directors, would be pronounced and has not been considered appropriately in the consultation, especially as the board, and not individual directors, is required to sign-off and approve the company's annual report and accounts. How the liability regime for such directors will work has also not been set out in the consultation document. This could result in a reduction in the number of people willing and prepared to take on non-executive director roles, raising questions of how this fits with the Government's intentions to increase diversity on boards. When asked in our survey with YouGov, whether this proposal will disincentivise individuals from taking on the responsibility and associated liability, 84% of companies and 75% of investors agreed that it could have this affect[43].
- The benefits that will be derived from introducing new regulation around internal financial controls is unclear. Whilst it is not an uncommonly held belief that Sarbanes-Oxley improved the internal controls for companies in the US, there is little evidence to suggest a causal link. For instance, it did not stop high-profile collapses like Lehman and cases of fraud like Wells Fargo from happening. There is also the concern that the disclosures will not reduce or prevent intentional inaccuracies. What little evidence of improvement that there is relates to the whole package of Sarbanes-Oxley reforms,

[42] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[43] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

including audit committee constitution and practice that has been well established in the UK for many years. Audit committees are already able to obtain sufficient information about the accounts preparation process, provided they have the cooperation of the CFO and finance team, and have flexibility over the level of assurance they require beyond the minimum required by auditing standards. If the required cooperation does not exist, there needs to be changes of personnel, not the introduction of an attestation.

- The wider implications are significant and could have substantial consequences for the UK's public equity markets. It is likely to lead to existing executive and non-executive directors questioning their roles and deter prospective executives and non-executive directors from seeking employment with a publicly quoted company. This would have enormous implications for the quality of directors sitting on public company boards, as well as levels of diversity. It is important to not undo the important developments made in recent years, as shown in the Hampton-Alexander Review[44] and the Parker Review[45].
- Finally, and as is the case in the US, Sarbanes-Oxley has arguably failed to engender an increase in trust between companies and investors. As a result, investors have not invested more into public markets which has not prevented a fall in the number of listings and possibly led to smaller companies deciding not to float due to the expense and burden of the regime[46]. This is particularly evident when analysing mid-cap companies within the technology and communications sectors, with a percentage increase in the number of companies of 26% in the UK, 30% in EMEA and 64% in Asia, compared to a 31% decrease in the US[47]. The imposition of a new internal controls regime could, therefore, encourage more companies to leave (and fewer to join) public markets in the UK as the benefits do not outweigh the costs.

Q13 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?

No – we do not support the Government's initial preferred option, as set out in Table 2 of the consultation document. In addition to the comments made in our response to Q12, we believe that a deeper consideration of the purpose and likely effectiveness of the proposed focus of attention on the internal financial controls regime is needed. It is important to consider whether the proposals will indeed reduce and prevent intentional inaccuracies. In their current format, the proposals could be perceived as adding an additional layer of compliance for honest, competent and thorough executives, whilst having a limited impact on preventing dishonest management teams from intentionally reporting inaccuracies.

Given the extent and thoroughness of the process for the publication of accounts, accidental material inaccuracies are rare. The accounts are prepared under the supervision of the Finance Director (FD) (or in smaller companies, directly by the FD), reviewed by the audit committee, and then audited to check the accounts and to confirm judgements and estimates. The audit committee also obtain feedback directly from the auditors both with the FD and in private. Many companies also complete independent checks by

[44] Hampton-Alexander Review, February 2021, 5-year Summary Report, available at: https://ftsewomenleaders.com/wp-content/uploads/2021/02/HA-REPORT-2021_FINAL.pdf
[45] Parker Review, November 2020, An Update from the Parker Review, available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2020-report-final.pdf
[46] Herald Investment Trust, 2020, Annual report & financial statements
[47] Ibid.

insourced or outsourced auditors, for instance, to review key aspects of the systems and processes that lead to the items for inclusion in the financial statements. This can include, but is not limited to, internal audit checks of the revenue recording and procurement/purchasing/payroll/inventory systems.

Therefore, the multitude of checks and balances that are already in the system for preparing accounts seldom produce accidental material inaccuracies, which will not be further prevented by the Government's proposal. A dishonest management team who are willing to sign off on inaccurate accounts, will also be prepared to sign off on additional disclosures that their internal controls systems have operated effectively. The proposed option is likely to have little impact on the honesty and diligence of executives, especially asking them to operate outside of the current collective responsibility and duties of the board.

We asked companies and investors whether they believed the Government's proposal will be effective in addressing concerns and reducing the number of intentional inaccuracies/frauds. Whilst the majority of companies disagreed that they would have a positive impact, 69% of investors agreed that they would. Interestingly, however, only 15% of investors strongly agreed that the situation would improve as a result of the Government's proposal on internal controls[48]. This raises significant questions about whether the proposed reforms are worth the considerable burdens, costs and, as the Government's Impact Assessment states, potential delistings.

If the Government's proposal is taken forward, we see two likely outcomes:

1. For the majority of companies that operate good internal controls, the proposal would result in uninformative, boilerplate information used purely to comply with any such reporting requirements; and
2. For the minority of companies that do not exercise good internal controls, they will not admit to it anyway.

The proposals appear to have been established without the requisite understanding of the practical operation of running a business. The proposals are highly theoretical and lack credibility.

Rather than imposing an attestation around internal financial controls, the Government and regulator should instead focus on improving the enforcement of existing regulation.

The content of the Directors Responsibility Statement could be changed to provide additional reassurance about the oversight of the process for preparing financial reports. This does though risk creating additional boilerplate statements.

In addition to improving existing regulation, the Government and regulator could consider providing training/accreditation for PIE directors based on the Continuing Professional Development (CPD) models widely used in the professions. This is an area that has lacked any form of attention, especially in ensuring that Non-Executive Directors are up to date and remain 'fit for purpose'. Very few boards have a structured approach to the continuing education and development of directors, leaving individuals to do their own thing – this should also link into a key aspect of board performance activities.

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[48] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

Q14 If the framework were to be strengthened, which types of company should be within scope of the new requirements?

As highlighted above, the introduction of an attestation will not "strengthen" the UK's internal controls framework. There is a view amongst some of our members that the introduction of an attestation could serve to perpetuate dysfunctional boards.

There are already rules in place designed to ensure the quality of accounts. Whilst we do believe that these are working, if it is considered that this is not the case then the whole control framework needs to be reviewed and replaced with a framework that does work. Adding an attestation as a sticking plaster will not solve fundamental problems.

The QCA strongly believes that smaller listed/quoted entities should be excluded from the scope of any new requirements relating to internal financial controls. The requirements should only be applied to entities within the FTSE 350, who are of the greatest public interest and the most systemically significant. Typically, these companies have the resources and capability to comply with any further additive requirements.

It is important to ensure that the new rules are appropriately targeted at the entities that are fully able to comply. The costs of listing for small and mid-sized entities are already disproportionately high. This has led to public markets that are unwelcoming and open mainly to the larger entities that can bear these costs. This situation does not encourage growth and innovation in the UK.

As highlighted in our introductory segment there is a tension between these proposals and Lord Hill's Listing Review, namely, to encourage companies to list on public markets. These proposals are not targeted at a sensible level, and will inevitably reduce the number of companies seeking a listing.

The size and complexity of the entities to which these new rules are to apply must be considered in order to ensure that these entities have both the complexity of operations and the available resources to comply. Compliance burdens for smaller entities must be kept proportionate to ensure their continued use of the UK's public equity markets.

For this reason, it would be disproportionate to apply these proposals to any small and mid-sized entities that operate on the Main Market, AIM or Aquis Stock Exchange (AQSE). If the requirements do actually come into force, they should focus solely on the entities within the FTSE 350 who have the greatest impact on society.

The QCA also notes that, in his review of the FRC, Sir John Kingman emphasised that "giving special consideration to the importance of proportionality in relation to the size of the company"[49] was essential when considering any case for a strengthened framework around internal controls. This adds weight to our argument that these recommendations should only apply to all companies that form the FTSE 350.

Chapter 2.2: Dividends and capital maintenance

Q15 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

[49] Sir John Kingman, 2018, Independent Review of the Financial Reporting Council, page 13, available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

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 – in principle, the QCA agrees with the proposal to assign responsibility for defining realised profits and losses to ARGA, as well as enhancing the legal status and enforceability of the definition.

However, the QCA believes that, due to the complexity of the law surrounding dividends and maintenance of capital, there should be a separate review. We do not consider that this consultation is the appropriate place to change the requirements regarding dividends and capital maintenance. A separate, more substantive review should be undertaken in order to simplify some of the complexities that surround this, as well as provide new emphasis to the existing duty to consider a company's ability to pay its creditors.

Furthermore, there is a need for the requirements and guidance to be straightforward enough for all directors and companies to understand, as opposed to being so complex that specialist accounting/legal advice is required. The consultation paper suggests the rules are well understood, but this is often not the case in practice in respect of the effects of more complex accounting treatments. The QCA's members have indicated that there are instances, in both complex and straightforward situations, where a company does not get it correct due to the complexity of the rules.

Taking the proposals forward in their current format could also engender liability issues for directors.

It is also the view of some of the QCA's members that the affordability of a dividend is more to do with cash than retained earnings. Cash is easier to define and thus it might be easier to establish a regime whereby medium-term liquidity, rather than complex definitions of realised and unrealised profits, would make more sense to establish whether a dividend could be safely paid.

Q16 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?

Yes – the QCA agrees that the proposed new distributable profit reporting requirements will provide useful information for investors and other users of accounts. However, we believe that this should be required of the parent company only.

In order to take this forward, there is a need for enhanced and more straightforward guidance for companies on the determination of realised profits and distributable reserves. Smaller companies may struggle with the complexity of applying the requirements to arrive at an accurate amount to disclose.

Furthermore, we do not agree that these requirements should be limited to listed and AIM companies, and should be extended to all PIEs, if taken forward. There should be a level playing field between PIEs. It is unclear why it should just be listed and AIM companies, as the concepts of distributable profits apply to all. If a private company, for instance, pays out a dividend that it cannot afford to pay, it has an impact not only on the company, but its stakeholders too. A private company's stakeholders, namely, employees, suppliers and local communities, could be affected by the company paying an excessive dividend and then experiencing a period of potentially serious financial stress.

Q17 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 – the QCA does not agree with the proposal for an explicit directors' statement about the legality of dividends and their effect on the future solvency of the company in the current proposed format. As a result of this, we do not think the proposal would be an effective mechanism in ensuring directors comply with their duties and nor would it build external confidence in compliance with dividend rules.

As highlighted in our response to Q15 above, we believe that, in the first instance, a separate review around the law is needed to simplify the law in this area. In the absence of any such simplification, we are concerned with the two year look forward period for the solvency test and how it interacts with the common law solvency principle relating to dividends. We believe that a 12 month look forward period would be more appropriate. This would be in line with the existing obligations for Premium Listed companies regarding the going concern statement. If the proposal is taken forward, we do not agree that these requirements should be limited to listed and AIM companies and should be extended to all PIEs. If such disclosure is necessary, it should apply to all companies in a consistent manner.

Q18 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?

No – the QCA does not believe that a new reporting requirement should be considered.

Existing law and accounting standards are permissive when it comes to the disclosure of reserves, and the additional proposed disclosure can be accommodated without any requirement for changes in the law or accounting standards.

Chapter 3: New corporate reporting

Chapter 3.1: Resilience Statement

Q19 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?

The QCA recognises that how a company identifies and manages risks to its business is important to both the company itself as well as investors and other stakeholders. We agree with the proposed format to incorporate a company's existing going concern statement and viability statement in the short-term section and medium-term section, respectively, of the Resilience Statement. We also believe that, on the whole, the six matters outlined in the consultation to be included in the Resilience Statement are sensible indicators of a company's resilience.

However, requiring a company to report on the further specific disclosures in both the short and medium-term section of the Resilience Statement limits flexibility. That is, it takes away a company's ability to determine which specific matters of risk and viability should be considered and reported relevant to its own specific circumstances. A company is in the best position to use its discretion to report on resilience matters that are material and relevant to the company. In addition to this, the Resilience Statement also removes the ability of the company to define the short and medium-term. In some instances, it would make more sense for companies to be able to align it with their own medium-term planning horizons. For some, this will be shorter than five years, and for others it could be considerably longer.

Moreover, having prescribed requirements for the disclosures in the Resilience Statement could result in companies issuing boilerplate statements. That is, standardised disclosures, often taken from others and hence not reflective of the company's own position, and that change little year-on-year.

As a result, we believe that, if the proposal to require further specific disclosures is taken forward, they should be confined to the short-term section of the Resilience Statement and not included in the medium-term section too.

Q20 Should the Resilience Statement be a vehicle for TCFD reporting in whole or part?

Yes – we agree that, in the future, the Resilience Statement could become a sensible destination for TCFD reporting and disclosures about a company's climate-related threats and opportunities. The TCFD framework requires companies to report on how they are managing climate change threats and opportunities over the short, medium and long-term and aligns with the proposed structure of the Resilience Statement.

That said, it is important to ensure that integrating TCFD reporting within the Resilience Statement does not take away from the clarity of these disclosures. Consideration must be given to ensure that this does not occur.

In light of this, we believe that flexibility should be afforded as to the location of the disclosures, particularly given that these are extensive new reporting requirements which overlap with other climate-related reporting obligations. If a named destination is required, we believe that TCFD disclosures should be included in the non-financial information statement set out in the Strategic Report, noting that this is the proposed location in the Government's recent consultation on requiring mandatory climate-related financial disclosures by large companies.

Regardless of where the disclosures are located, it is important to emphasise that there should be consistency and alignment between the Resilience Statement disclosures and TCFD disclosures.

Q21 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?

The QCA believes that there should be a delayed introduction of the Resilience Statement for any entities outside the FTSE 350 for two years in order to give entities who are typically smaller the ability to prepare for the new requirements. Companies without a Premium Listing, such as those on AIM, have less experience of reporting on resilience through risk and viability disclosures. For this reason, the QCA acknowledges the proposal to introduce the Resilience Statement initially for Premium Listed PIEs only, noting the Impact Analysis and Extensions Assessment phases transition period we propose for companies outside the FTSE 350. As stated in the introductory segment to our response, we also consider that a post-implementation review and cost-benefit analysis should be conducted before the scope of this is extended further to other companies that might be considered PIEs.

Chapter 3.2: Audit and Assurance Policy

Q22 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?

No – the QCA does not agree with the proposed minimum content for the Audit and Assurance Policy. It is likely that the proposed content will lead to companies issuing boilerplate statements that are used repeatedly without making any major changes to the original statement year-on-year.

In the QCA/YouGov survey, around nine-tenths of companies (90%) and investors (88%) agreed that the Audit and Assurance Policy would lead to boilerplate statements[50]. Such a noticeably high number from investors would suggest that they believe the Audit and Assurance Policy would be largely uninformative and add little to no value, thus raising questions over the need for a policy.

Investors rarely speak to Audit Committee Chairs about the accounts preparation process or assurance. This is not an area of concern to investors and changes in this area will not result in the improvements to investor confidence that this consultation is seeking to achieve.

The production of an Audit and Assurance Policy is likely to produce substantial familiarisation costs for companies from having to assess and understand new requirements and making adjustments to their reporting systems. The proposed minimum contents adds to this cost further.

Furthermore, there is some duplication between the Audit and Assurance Policy and the audit committee report. We believe that a more sensible solution to the Audit and Assurance Policy is for the new regulator to issue guidance on how to make it clearly identifiable which parts of the accounts have been audited and which have sought assurance. In addition, if a majority of shareholders want further information to be audited or to have assurance sought, they already have the means to do so by voting through resolutions to that effect.

Q23 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 – as mentioned in our response to Q22 above, we do not believe that the policy should be taken forward. Instead, the company's directors could propose at an AGM what assurance, if any, they plan on obtaining on other information to be included in the annual report, with this then being voted on.

If, however, the Audit and Assurance Policy is taken forward, the QCA believes that it should be published and voted on every three years. Conducting an annual shareholder vote will add to the overall costs for companies, and we consider that publishing an annual Audit and Assurance Policy is disproportionate to achieving the aims of the policy regarding flexibility which allows companies to explain whether and if they are obtaining assurance.

Q24 Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?

No – the QCA does not agree that the Audit and Assurance Policy should be required of any company. As stated above in our answer to Q22, there is some overlap between the Audit and Assurance Policy and the

[50] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

audit committee report, with the audit committee being able to disclose the extent of assurance work that has been completed.

Furthermore, a concern that was raised by several of our members around this proposal was that investors rarely seek to speak to the Chairs of the Audit Committee. This suggests that there is limited reason or drive from investors for additional reporting in this area.

Chapter 3.3: Reporting on Payment Practices

Q25 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?

Yes – we welcome the proposals to improve reporting on supplier payments as existing disclosures are insufficient. Improved reporting on payment practices will help to mitigate against situations arising whereby large companies take advantage of smaller companies, for instance, to fund their working capital.

In terms of the reporting summary set out in the consultation document, it is not clear why the proposals refer to the company's standard payment terms. These may not be the same as what is contractually required, and it depends on which party's standard payment terms apply – the suppliers or the customers. It would be useful for companies to show the total payments made to suppliers over different time periods, such as 0 days, 1-30 days, 30-60 days, 60-90 days, and >90 days after the receipt of goods or services to which the payment relates. The company should then indicate the percentage of those payments that were after the contractual due date for payment.

The above would serve to indicate the extent to which a company struggles to pay their invoices on time, the length of payment periods that the entity is typically able to negotiate and/or able to exert undue pressure in negotiating lengthy payment terms.

We agree with the proposed location of the disclosure being in the Strategic Report.

Q26 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?

The QCA believes that all PIEs (based on our proposed definition) should report on their payment practices. It is important that a consistent threshold is applied to all entities.

Chapter 3.4: Public Interest Statement

Q27 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 Government's proposal not to introduce a new statutory requirement for directors to publish an annual public interest statement. We note that the regulator recently consulted on the *Future of Corporate Reporting,* with reference to the public interest statement. We believe that the outcome of this consultation should be released before consideration is given to introducing a public interest statement. It should contain a clear description of what criteria are used to determine the thresholds for companies to be designated as PIEs.

Chapter 4: Supervision of corporate reporting

Q28 Do you have any comments on the Government's proposals for strengthening the regulator's corporate reporting review function set out in this chapter?

On balance, we agree with the Government's proposal to strengthen the regulator's corporate reporting review (CRR) function inasmuch as the main focus of its CRR activity is on PIEs. In particular, we welcome the proposal to extend the regulator's CRR activities so that it can scrutinise the entire contents of a company's annual report and accounts. We believe that this is a logical extension, with limited reason as to why the regulator's review powers are constricted to the directors' report, strategic report and annual accounts.

Furthermore, in taking forward these proposals, we would emphasise that the regulatory principle to promote brevity, comprehensibility and usefulness is paramount. The regulator should also encourage active dialogue, which will result in better quality corporate reporting in the long-term.

In terms of the proposal to publish correspondence in full, we agree with this as summaries developed by the regulator could potentially limit clarity and add confusion around context. That being said, commercially sensitive information should be redacted.

The unilateral power to force through amendments to accounts is concerning. No one accountant has an undisputable view on how accounting standards should be interpreted or what an appropriate judgement/estimate is in applying the standards. Any change to the procedure for directors to be required to revise accounts needs to contain appropriate checks and balances. The current procedures ensure that directors and companies producing accounts are subject to a transparent and proportionate regime. If ARGA is given the power to unilaterally make changes to accounts without the need to seek a court order, this could seriously threaten this regime.

Finally, it is imperative that the regulator develops the skills and capacity, as well as enhances the quality of its staff before increased CRR activity can even be considered. This should then be underpinned by ARGA itself being subject to scrutiny by an independent body from the business community to hold it accountable for producing high quality work. It is essential that the regulatory body that is responsible for setting governance standards for companies should be seen to have applied to it robust and appropriate governance standards.

Chapter 5: Company directors

Chapter 5.1: Enforcement against company directors

Q29 Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?

The QCA recognises the need for an effective enforcement regime that holds directors of companies to account for their duties in relation to corporate reporting and audit. The FRC's enforcement in relation to company directors is widely recognised as being substandard and has resulted in an untimely and ineffective system.

However, it is essential to avoid overlap in the regulatory/legislative regime so that powers are managed effectively. It is the view of some of the QCA's membership that strengthening the enforcement regime in this light would result in a crossover between the powers of different regulators, which would inevitably add to the complexity of the regime. They believe that the existing powers held by the FCA and Insolvency Service are sufficient, but should be made more timely and effective in practice.

Moreover, it is the view of some of our members that the proposals to strengthen the new regulator's enforcement powers would undermine the role of the courts and that, if a director has breached their duties, it should be a matter for the courts and not for the new regulator to sanction them. There needs to be an appropriate cut off point for the regulator's power; it should not be extended so pervasively as is currently the case within these proposals. There is significant danger of regulatory overreach, which could impact the UK's hard-earned reputation as a country with transparent and fair rule of law.

Q30 Are there any additional duties that you think should be in scope of the regulator's enforcement powers?

It is not clear why the statutory duties set out in paragraph 5.1.21 does not include approval of the Strategic Report. Given the important content contained within the Strategic Report, particularly in relation to matters such as the business model and principal risks, it is not apparent why this has been omitted.

However, the QCA does not believe that there should be any additional duties in scope of the regulator's enforcement powers. The primary issue with the regulator's enforcement powers is that they have not been enforced properly, or have only been enforced after inordinate delays. In light of this, the focus should be on providing timely and proper enforcement of existing rules, as opposed to adding to the rule book.

Additionally, we believe strongly that the regulator's powers should not be extended beyond what is necessary, appropriate or within its capacity. In particular, where enforcement against company directors is concerned, this needs to be reasonable and not produce unintended outcomes as a result of undue powers that disincentivise directors. This concern is demonstrated in our YouGov survey where we asked companies and investors whether greater enforcement powers could deter prospective individuals from becoming directors, or existing directors from retaining their position. Over 4 in 5 companies (84%) and nearly 7 in 10 investors (69%) agreed that the reforms regarding enforcement could produce this consequence[51]. The Government must take this into account when extending the enforcement powers of the regulator; its powers must be considered and proportionate. Failure to account for this could have serious implications for the supply of directors.

It could also have wider implications for board diversity. In particular, companies and investors believe that the reforms could have an impact on the following:

- **Experience**: 57% of companies and 33% of investors believe the reforms will have an impact on diversity of experience;
- **Skills**: 49% companies and 23% of investors believe the reforms will have an impact on diversity of skills;
- **Education**: 35% of companies and 25% of investors believe the reforms will have an impact on diversity of education;

[51] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

- **Ethnicity**: 28% of companies and 13% of investors believe that the reforms will have an impact on the diversity of boards in terms of ethnicity; and
- **Gender**: 27% of companies and 13% of investors believe that the reforms will have an impact on gender diversity[52].

To this end, the Government must take into consideration the potential damage that these reforms could have on board diversity. In recent years, there has been important developments and improvements in board diversity, such as through the Hampton-Alexander Review[53] and the Parker Review[54]. It is important these reforms do not hinder, or, worse, reduce the positive developments that have been made.

Q31 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?

We do not believe that the statutory duties set out in paragraph 5.1.21 are designed for regulatory enforcement. As such, greater clarity will be required to give certainty to directors on what these duties actually entail and the circumstances in which action can be taken.

Q32 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 – the QCA does not believe that directors should be required to meet certain behavioural standards when carrying out their statutory duties regarding corporate reporting and audit. This represents a major addition to a directors' duties and responsibilities. Under the Companies Act 2006, a director is already required to meet certain general duties, such as to exercise reasonable care, skill and diligence[55]. Additionally, directors are already required to comply with Section 172 of the Companies Act 2006, which has wide-ranging obligations.

The imposition of a requirement to meet certain behavioural standards represents a disproportionate burden that could disincentivise companies from seeking a listing/quotation, as well as impacting on diversity by deterring candidates from seeking directorships in publicly quoted companies.

Q33 Should the Government's proposed enforcement powers be made available to the regulator in respect of breaches of directors' duties?

As highlighted in our response to Q29, the right place for enforcement is the courts. However, the QCA believes that, if the Government's proposed enforcement powers are made available to the regulator in respect of breaches of directors' duties, it is essential that the regulator uses these powers in a proportionate manner. This means taking into account the directors' backgrounds and considering the size and complexity of the company concerned and the consequences of any wrongdoing.

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[52] Ibid.
[53] Hampton-Alexander Review, February 2021, 5-year Summary Report, available at: https://ftsewomenleaders.com/wp-content/uploads/2021/02/HA-REPORT-2021_FINAL.pdf
[54] Parker Review, November 2020, An Update from the Parker Review, available at: https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/news/2020/02/ey-parker-review-2020-report-final.pdf
[55] Companies Act 2006, section 173 to 175

QUOTED COMPANIES ALLIANCE

In addition, and given the complexity of accounting standards, the regulator should also consider the extent to which the director sought the input of appropriate expertise in formulating the accounting applied, and the extent to which the auditor acted appropriately in light of what was presented to them by the directors as the proposed accounting approach.

Chapter 5.2: Strengthening clawback and malus provisions in directors' remuneration arrangements

Q34 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?

In principle, the QCA agrees with the ideas underpinning the strengthening of malus and clawback provisions within directors' remuneration arrangements. However, we have a number of comments to raise regarding the proposals outlined in this section:

1. Due to the difference in ease of enforceability between the malus and clawback regimes, it is important to be clear on which is being referred to as they are often used interchangeably throughout this section;
2. We do not agree with the statement in paragraph 5.2.3 that if the provisions are broadly drawn, they are difficult to enforce and believe that the exercise of discretion is needed; and
3. The proposed conditions in paragraph 5.2.5 are different to the triggers which the FCA currently applies.

Therefore, before this proposal is taken forward, consideration needs to be given to the above.

Chapter 6: Audit purpose and scope

Chapter 6.1: The purpose of audit

Q35 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?

The QCA broadly believes that a new statutory requirement on auditors to consider wider information could help the government realise its aims of creating more trusted and more informative audits in the UK. Auditors should already be considering wider information and should have the ability to exercise judgement to do so.

It is not immediately apparent, however, what is meant by "wider information". Auditors are already required to understand the business and undertake background searches on directors and controlling parties. Requiring auditors to consider everything would be unreasonable and most likely an impossibility.

Moreover, there are some potential pitfalls and costs. One obvious potential cost is that a new requirement would very likely result in higher overall costs of audit for businesses. Recent QCA research, The Small and Mid-Cap Sentiment Index[56], has shown that costs of audit have already increased markedly:

[56] Quoted Companies Alliance, Small & Mid-cap Sentiment Index, Wave 25, Q4 2020, The survey was conducted in October and November 2020 and had 141 respondents.

- 64% of companies report an increase in audit fees (with 7% reporting a decrease);
- The average annual audit fee for these companies was £138,000; and
- The average annual change was an increase of 26%.

The potential unintended consequences of this proposal are significant. Companies will face an opportunity cost because of the significantly higher costs of audit due to investments the auditors would have to make, thus restricting growth. It could also result in additional pressure points due to there currently being a limited market for PIE auditors.

Moreover, it is hard to conclude definitively whether this would make audit more trusted, informative and valuable. Without this, it is hard to justify the additional compliance cost when the benefit is not overly clear. There is a need for clear and well-understood standards and guidance to help to veer away from a box-ticking approach.

Q36 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?

It would be a coherent policy position for a statutory requirement on auditors to consider wider information to be accompanied by a new purpose of audit to be adopted by the regulator. However, it is not clear that the adoption of a new purpose of audit is necessary to accomplish the goals to ensure that the new requirement is followed by auditors. A change in the wording of the purpose of audit will not necessarily change individual auditor behaviour or culture.

Additionally, if an auditor's responsibilities were to extend beyond shareholders, consideration would need to be given as to how those parties benefitting can bear part of the audit cost.

Chapter 6.2: Scope of audit

Q37 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?

If there is to be a wider remit for audit, then the regulator should oversee it and there needs to be a clear framework and set of guidelines. This would also require the regulator having the expertise across a wider range of auditing services. At present, it is not apparent that the regulator would have the specialist skills to oversee this. As such, the proposals should not be taken forward until the regulator has enhanced its capacity and brought in the necessary personnel.

Q38 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?

It may be difficult for the regulator to review audit work in areas other than just the statutory audit. However, the principles should be the same if this is the case.

We do also recognise the need for a quality inspection regime for wider corporate auditing, and in particular, for new entrants who may not be from professional backgrounds or subject to an ethics code.

Q39 What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?

The new regulator should have greater powers than the FRC. However, it is important that ARGA has the right resources relative to its objectives and is not overstretched in its responsibilities, which could be the case at present. For that reason, it is essential that the supervision of core auditing services is deemed to be well covered before an expansion is embarked upon.

That said, it is important to avoid a situation arising whereby there are differences in standards and expectations if there are different standards and supervision of the wider auditing services.

There should be robust and appropriate governance applied to ARGA's role in this and all other areas.

Chapter 6.3: Principles of corporate auditing

Q40 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?

Establishing new, binding principles for audit could potentially bring the Government closer to its aims of improving audit quality. Generally, the principles suggested by the Brydon Review are a good starting point. It is necessary that an in-depth consultation is conducted with the audit profession and stakeholders to develop these principles further before they are taken forward.

Any update to the principles should maintain the objective of accounts presenting a "true and fair view" and not be restricted to "complying with accounting standards".

The principles already exist in the underlying professional bodies' codes of ethics and in the Auditing Standards themselves. Whilst we do not disagree with the principles suggested in the Brydon review, they need to be considered further and the way ARGA will enforce them also needs to be consulted on.

Historically, the FRC rarely applies proportionality or an understanding of the varying nature of PIEs and entities audited by firms outside of the Big 6. There is too much of an expectation of best practice driven by the audits performed by the Big 4 on the FTSE 100 without looking at the very different nature of smaller sized entities.

Consideration also needs to be given to how the principles will work in practice, as well as taking into account the brevity and usefulness of the information provided in the auditor reports which are already long.

Q41 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?

The QCA broadly agrees that ARGA should set the new principles. In terms of whether the principles should apply to all corporate auditors, it is important to first consider whether ARGA has the capacity to ensure that it is focussed and not overstretched. In addition, if the principles take primacy over other standards and requirements, they will need accompanying guidance in order to ensure they are not overly broad, and thus, meaningless in practice. Many of the new principles are currently reflected in the FRC's ethical standards so there will be an element of continuity.

It is important that the Government considers the full scope of relevant standards or requirements and is cognisant of creating contradictory or counterproductive principles. This is another reason why a comprehensive consultation is necessary. It will better inform the creation of principles, may identify areas where adjustment from other parties is needed to make the new principles most effective and as the principles will apply to a broader set of professionals involved in the audit process, it will offer an opportunity for contribution from a wider group.

This consultation should include the existing professional bodies, such as the ICAEW, ACCA and ICAS. These bodies have been monitoring and overseeing the accounting qualifications for a long period of time and can understand the nuances in the application of the existing principles and real-life scenarios. Without doing so, there is a risk that ARGA will not understand the principles nor apply proportionality in its enforcement and oversight.

Due consideration also needs to occur to ensure that the new principles are implementable. Auditors already have a set of international auditing standards and quality standards. The benefit of them being international is that they are comparable across the globe and that is of benefit to both auditors and companies. If the UK intends to have a set of principles, what happens when they contradict the global standards or how they change as the global standards evolve must be taken into account.

Finally, it will be important to provide guidance to clarify any potential differences between the principles and the standards. Failure to do so could leave auditors in an exposed position.

Chapter 6.4: Tackling fraud

Q42 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.

No – the QCA does not agree with the Government's proposed response to the package of reforms relating to fraud. In particular, we do not agree with the proposed requirement for directors to report on the steps they have taken to prevent and detect material fraud. It is important to consider the balance between the additional costs to the companies of a more robust audit regime, on the one hand, and the benefit to investors and other stakeholders, on the other hand. It is also likely that the proposal will be largely boilerplate and offer limited insightful information.

Companies will face costs from familiarising themselves with new fraud reporting requirements, as well as facing annual costs from reporting on the actions they have taken. Costs will also arise for auditors through familiarisation costs, as well as their ongoing assessment of directors' statements, which will be passed down to the company. For smaller companies with less resources and more limited capacities, this, therefore, represents a disproportionate burden.

Furthermore, it could be argued that the proposed reforms would inadvertently widen the expectation gap in creating an impression that goes above and beyond what can actually be expected of a company's auditors. Auditors cannot be expected to identify all situations where fraudulent activity is being perpetuated.

From the auditor's perspective, it is not possible to expect an auditor to understand and have the same knowledge of a company as the directors and management who are responsible for running the entity. Auditors are external to the company, perform the audit on a historical basis and are reliant on the information supplied to them by the company itself. There are clear limitations to an auditor's ability to access certain forms of information about a company, and, as a result, the extent and depth of analysis of a company conducted by an auditor is restricted and thus cannot report on a directors' statement with complete factual accuracy.

Additionally, we have some further observations as to why we do not agree with the proposals relating to fraud. Broadly, our reasoning for this is twofold.

Firstly, it is unlikely that the proposals will result in a marked improvement in the detection and prevention of fraud whilst increasing costs and burdens due to the requirement to report. The core concept of taking steps to prevent and detect fraud is a responsibility of directors and has always been their responsibility to do so. A change in the requirements to report on the steps being taken will not result in a significant change in the detection and prevention of fraud.

Secondly, that the proposed requirements will lead to the adoption of a tick-box approach by companies and boilerplate statements being issued that change little year-on-year. It will simply be about compliance without actually establishing how the directors safeguard the company from instances of fraud. Moreover, it would also result in boilerplate wording in the auditor's report based on the proposal set out in paragraph 6.4.5. The proposal, therefore, will add little to no value.

This sentiment is also expressed by companies. Only 26% of companies believe that the reforms will increase public confidence and result in an improvement in the detection and prevention of fraud. Whilst three quarters of investors believe that the reforms will have a positive impact, almost two-thirds of these investors believe that there will only be a slight improvement[57]. This raises questions about the worthwhileness of the proposed reforms, with it being apparent that the costs to companies will not be commensurate to the benefits.

Chapter 6.5: Auditor reporting

Q43 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.

The QCA believes that the proposed duty to consider wider information needs much more thought and consultation before implementation.

As stated in response to Q35, this proposal is also likely to increase the cost of auditing to companies. Audit firms will also need to implement mechanisms for risk management and quality control, which will inevitably increase costs further.

Additionally, the requirement to provide more detailed information in the auditor's report may have the counterproductive effect of making audits more inaccessible and less useful as too much detailed information is provided for stakeholders to decipher the information that is relevant to them. Whilst the PIE audit reports are much less boilerplate than non-PIE audit reports, they are becoming increasingly long and overly complex. Audit reports should be written in clear English and easy to understand and digest by all users of the accounts. It is important that the proposals do not hinder this.

It is essential the Brydon Review recommendation that "the evolution of graduated findings be left to the market place for audit services" remains central to the implementation of this proposed new duty placed on

[57] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:

auditors. This will ensure that the benefit to the company remains a central consideration and the increased costs are matched by an increased value from more detailed reporting. That said, it is important to ensure brevity and that the auditor's report remains useful. It could be argued that not many investors at the smaller end of the market use this information.

Chapter 6.6: True and fair view requirement

Q44 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?

The QCA believes that it contributes to the coherence of the reforms if auditors' judgements regarding the appropriateness of any departure from the financial reporting framework proposed by the directors is informed by the proposed Principles of Corporate Auditing.

The two principles that are most relevant to the proposal are:

- Auditors ask the directors to report any material information that may legitimately be disclosed to assist the understanding of users of an audit report, and, if necessary, disclose it themselves; and

- Auditors provide appropriate challenge to management, assessing critical information and explanations received for signs of over-optimism, judgmental bias or possible fraud.

These principles require that the information provided is broad and is well scrutinised, but this is open to a large degree of interpretation. The main risk is that companies and auditors will be overburdened by an incentive to provide and review too much information some of which will be irrelevant and consume resources unnecessarily. This risk can be mitigated by the auditors continuing to use the concept of materiality and by being required to mandatorily disclose in their audit report the level of materiality used (and how that was arrived at) in their audit work (which is already required for listed companies). This would help users of financial statements to understand that an audit is not a guarantee that the financial statements are entirely free from error, but that they can have a reasonable expectation that the auditors work has been rigorous enough to detect material fraud or error.

Furthermore, it appears strange that auditors alone are being given the general principles of the application of the true and fair override. Directors are also responsible, before approving the accounts, to ensure that they present a true and fair view. It is their decision as to whether or not there are circumstances to which compliance with accounting standards would conflict with that requirement, and thus, they must depart from those standards in order to show a true and fair view. In this light, there should be guidance for directors first that auditors can have regard to when making that challenge of management.

Chapter 6.7: Audit of Alternative Performance Measures and Key Performance Indicators linked to executive remuneration

Q45 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?

The QCA believes it is essential that the need for specific assurance on APMs or KPIs, beyond the scope of the statutory audit, should be decided by companies and shareholders. There is already a requirement to reconcile financial KPIs to the financial statements.

Moreover, without a clear standard which underpins a KPI, the auditor cannot give a meaningful opinion.

Chapter 6.8: Auditor liability

Q46 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?

The QCA believes that the size of any liability claims against its members' auditors would not be big enough to create such a catastrophic claim on an audit firm. Therefore, boards of member companies are inclined to resist requests from auditors to enter into such agreements.

Moreover, directors must satisfy themselves that they are adhering to their fiduciary duties when considering limitations of auditor liability. One potential danger of limiting liability is that it may lead to a reduction of audit quality and scope. Liability should only be limited if it is in the best interests of the company and therefore directors must satisfy themselves on this point.

For liability to be limited, investors would expect that the company received consideration in return for the concession, for example via a reduction of the audit fee.

In practice, however, it would be very difficult to arrive at an appropriate level for liability limitation as the nature and size of potential losses arising from negligent or poor auditing can be impossible to judge. Rather than the regulator and/or Government becoming involved in such bilateral issues between directors and auditors, other than the proposal to "make clear that directors will not be in breach of their fiduciary duties if they recommend in good faith that the company's members authorise an LLA", it is suggested that the matters be left to market forces.

Q47 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?

Yes – auditors' concerns about their exposure to litigation are likely to constrain innovation and this is unlikely to be removed to promote innovation or expansions in the audit market, especially as a consequence of the proposals set out in this consultation. The culture created by litigation, regulation and the regulator is one of extreme caution and a reluctance to do anything beyond what is required. Auditors conduct an audit to auditing standards, and to the interpretation of accounting standards set by their technical departments, in order to minimise any liability, meaning auditors no longer apply judgement. The ability of auditors and their firms to pro-actively help clients avoid difficulties and optimise their and their stakeholders' position has become increasingly constrained owing to well-meaning but ultimately flawed regulation. The role of the auditor or accountant as a "trusted adviser" of a company is no longer possible.

These proposals expand the roles and expectations of auditors to the extent that, from some viewpoints, it will widen the expectations gap further – that is, investors and stakeholders will expect more from auditors because of these reforms but the core role of the auditor is not changing. Consequently, it will likely result in more 'disclaimer' wording in the audit report being used by auditors to limit their liability.

Audit innovation is also currently constrained by auditing standards. To resolve this, auditing standards should be less prescriptive about the audit process and more outcome-orientated. This would provide more space for innovation.

Furthermore, audit innovation is likely to already be focussed around improving audit quality and improving efficiency and effectiveness given the audit quality focus already in the market. This is a significant barrier to entry for more entrants into the PIE market. As this evolves there is a danger that without fees rising, the incentive for talent and firms to carry out audit activities will reduce.

There is real risk at present of many high-quality auditors, both as individuals and as firms, walking away from auditing, or firms facing a recruitment crisis because the profession becomes much less attractive due to these reforms. Being narrowly focused on just corporate auditing will not be appealing to many, and will ultimately lead to a deterioration in the quality of auditing as well as numbers of well-rounded auditors.

Chapter 6.9 A new professional body for corporate auditors

Q48 Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.

The QCA does not believe that there is a need for a new distinct professional body for auditors. There are also a number of potential issues with this. The knowledge required to audit financial statements is very different to the knowledge required to audit other information. The efficacy of creating a single professional body for auditors of financial statements and auditors of other information, which at the same time, divides the auditor of financial statements from the preparer of those financial statements, is unclear.

Consideration would also have to be given to ensuring that the corporate auditing profession was attractive for individuals to want to enter. In recent years, the culture around auditing has become increasingly negative, making it a less attractive career.

Furthermore, while a monopoly may level up quality in the short-term, it will not provide for continuing challenge and improvements which would be provided by competing professional bodies. Auditors will lose experience and learning from other disciplines by being part of a larger community, which is helpful with regards to understanding business models and financial reporting, for instance. It can be argued that the FRC's establishment as a monopoly over various parts of the corporate reporting environment has constrained innovation. Space needs to be provided for accountancy bodies, such as ICAEW and ACCA, to introduce improvements.

Q49 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?

Establishing a single monopoly professional body should not be the desired outcome. If, however, this is established, the training and development requirements would need to be proportionate and the cost of dual fees to the individual would need to be sensible.

If anything is taken forward, engagement with the existing professional accountancy bodies who have a wealth of experience in this aspect is essential. This must not be overlooked by BEIS or ARGA. The Government and regulator also need to be aware that the audit market is already currently resource constrained. Any new proposals, therefore, must not exacerbate this issue.

Given the complexities of this proposal, a separate consultation should be undertaken.

Q50 Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?

To an extent, a requirement for corporate auditors to be members of, and obtain qualifications from, professional bodies that are focussed only on auditing would help to ensure consistency and quality.

However, it will be difficult to encourage existing auditors who have been in the profession for a long time to take this on, with there being a potential that some would leave the profession altogether. In addition, and in order to attract the best quality individuals, a qualification needs to open up broader career opportunities than just auditing and should also cover financial reporting, for instance, given the complexity of accounting standards. Failure to do so could produce some serious unintended consequences. Firstly, it could lead to the profession becoming unattractive and lead to fewer high-quality people entering the profession. This would ultimately lead to a deterioration in quality and supply-side shortages.

Secondly, one of the benefits of the current system is that staff gain broad knowledge which actually helps them to become better auditors. A narrow range of training and a lack of experience in other disciplines creates more limited knowledge and reduces audit quality.

Q51 Do you agree that a new audit professional body should cover all corporate auditors, not just PIE auditors?

Yes – it would seem strange to have a different set of audit principles for PIE audits, for instance. This would likely fragment the profession. If the Government is adamant to take this forward, the QCA believes that a new audit professional body should cover all corporate auditors in order to help consistency and ensure supply. Not doing so will create a two-tiered system for auditing, which would impact on the audit market competition for PIEs even further.

However, as stated above, a single monopoly professional body should not be the desired outcome.

Chapter 7: Audit Committee Oversight and Engagement with Shareholders

Chapter 7.1: Audit Committees – role and oversight

Q52 Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

Broadly, the QCA agrees that ARGA should be given the power to set some additional limited requirements which apply in relation to FTSE 350 audit committees. However, we would like to stress that ARGA will become one of, if not, the most powerful regulators in the world and, as such, checks and balances on its powers need to be in place. In the first instance, ARGA should be able to demonstrate that it has improved its performance and built the capacity and quality required before automatically granting it such significant powers. We reiterate the point we made earlier about the need for suitable governance arrangements for ARGA; it must not be judge, jury and executioner.

We also believe that some of the requirements go too far, as well as it being imperative that the proposals cannot be extended to entities beyond those in the FTSE 350 without formal BEIS/parliamentary approval, if they are taken forward. Over two-thirds of companies agree that this should be the case[58]. We would, therefore, argue that only the Government should have the ability to extend the requirements to a wider scope of PIEs and this should not be delegated to ARGA.

In terms of our belief that the proposals go too far, we have the following observations:

- Firstly, the statement describing the audit committee "as an independent body responsible for safeguarding the interests of shareholders and other users of accounts" is concerning, as it represents a major change in directors' responsibilities within a unitary board structure. The Board appoints the audit committee and delegates certain powers to it. The Board can if it wishes ignore or over-rule an audit committee. The audit committee is not an "independent body" despite being composed primarily of directors categorised as "independent". Extending directors' responsibility to "safeguarding the interests of other users of accounts" is not something that should be done without due consideration.
- Whilst it is stated it will only be used if necessary, the power to place an observer on an audit committee is worrying. Placing an observer on an audit committee could significantly disrupt the effective functioning of audit committee discussions. When asked in the QCA/YouGov survey, companies and investors agreed with this. Over three-quarters of companies and half of investors agreed that it would affect the effective functioning of discussions[59]. It could also have the potential to result in ARGA ceasing to be independent of the entity in question.
- The proposal to give the regulator power to mandate requirements for the appointment and oversight of auditors, as well as monitoring and enforcing compliance, would impede the functioning of the audit committee. That is, it would impede the ability of an audit committee to seek an auditor appropriate for an entity's specific circumstances. This sentiment is supported by the evidence collected in the QCA/YouGov survey, with 72% of companies and 67% of investors agreeing that the proposal would have a negative impact on an entity if it were to lose the ability to appoint its own auditors[60].
- In general, mandating prescriptive requirements could lead to disempowering audit committee members and reduce the level of judgement needed. Over two-thirds of companies agree with this[61]. This could result in high-quality individuals being discouraged from seeking appointment to audit committees, as well as encouraging audit committee members to adopt a tick box approach. The overarching issue with some elements of this proposal is that it is introducing a rules-based approach to the UK's system which is not what the system is currently based upon. We must retain a principles-based approach to allow judgment.

Furthermore, it is the view of some of our members that this should not be required at all as it should be the investors who have the responsibility to appoint suitable directors. Investors should not be seeking to pass

[58] QCA/YouGov survey, BEIS consultation on audit and corporate governance reform, available at:
[59] Ibid.
[60] Ibid.
[61] Ibid.

over their responsibility to appoint suitably qualified and experienced directors to the regulator. If the regulator believes that a board is lacking in quality or experience, then the appropriate course of action is to bring this to the attention of investors and let them decide on any necessary changes.

Q53 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?

As highlighted in our response to Q52 above, the QCA believes that the proposed powers go too far.

In taking forward the proposals, we believe that the Government should first consider the nature of boards and responsibilities of directors, and the causes of recent failures which they are attempting to limit re-occurrence of, before considering the detail of any changes, taking into account our observations outlined in response to Q52.

Chapter 7.2: Independent auditor appointment

Q54 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)?

No – the QCA does not agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors. Firstly, this will impede the ability of an audit committee to seek an auditor appropriate for an entity's specific circumstances, which it is best placed to do so. Secondly, it removes the ability of an auditor to choose which companies it will and will not audit. This will have consequences for reputation, PI cover, amongst other issues. We do not believe that this should be the case and it should not automatically be assumed that ARGA is in a better position to carry out such a function better than an Audit Committee and/or non-executive directors.

The power to appoint auditors is a power to be exercised by shareholders, but almost invariably this power is delegated by shareholders to directors. If this system is not functioning properly, the obvious recourse is to suspend the delegation to directors, and for shareholders to fulfil their responsibility to appoint auditors in some other manner. Please see our responses to Q57 for more detail.

Additionally, and given the lack of choice in both the current market and, as referenced earlier in our response, in the market that will likely exist where the PIE definition is expanded but there are not more audit firms that become PIE auditors, it would be very difficult to find an auditor who was not conflicted.

Q55 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?

As stated in our answer to Q54 above, we do not agree with the proposal to grant ARGA the power to appoint an auditor and do not believe it should take away the power of an audit firm to decide on its own audit engagements.

There is also a legal problem with this proposal. It is not right that ARGA could force an auditor to take on an audit, and be subject to unlimited liability when its own risk procedures have declined the appointment. This could potentially open ARGA up to liability claims in the event that something went wrong.

Q56 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?

The QCA does not agree with the proposal for ARGA to appoint an auditor.

Q57 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)?

The QCA does not agree with the proposal for ARGA to appoint an auditor. If a situation arises whereby there are no auditors who want to work with a company, the company either needs to address whatever concerns are dissuading auditors from taking on the role, or, in more serious cases, a general meeting needs to be held at which shareholders can appoint a new board that auditors will be prepared to work with.

The power to appoint an auditor, would also impede ARGA's independence as it would also have the task of then inspecting the work of the firm it appointed.

Chapter 7.3: Shareholder engagement with audit

Q58 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?

The QCA welcomes efforts to improve communication and engagement between a company and its shareholders in relation to risk and audit planning. Our members are keen to obtain constructive feedback from their shareholders with regards to matters concerning risk and audit planning. The ability of shareholders to challenge directors on these issues is important and can increase the effectiveness of the processes.

However, there are practical, as well as theoretical, issues that will arise. For instance, just as companies vary in their structure, management and strategies, shareholders vary in their priorities and engagement approach. It is the view of some fund manager members within the QCA's community that investors do not have the appetite, expertise or resources to do this. It will also be important to draw boundaries clearly between what forms part of the statutory audit and what is the wider audit, so that auditors are only answering questions on their areas of expertise. It is important that these issues are considered before any proposals are taken forward.

In addition to the practical issues, it is also fundamentally important to take into account the increased workload that these proposals would create for companies. The proposals should, therefore, be proportionate and balanced. Typically, smaller companies, and in particular, those on AIM, have more limited resources than their larger counterparts residing on the Main Market. While such companies will commonly have a more concentrated share register than larger companies and feature a lower proportion of distant passive investors, they equally have very limited internal resource dedicated towards investor relations and thus may not necessarily be able to cope with the additional costs or administrative burdens that may arise if changes are made.

There are already a multitude of trigger points for shareholder engagement, with the creation of an additional trigger point doing little to improve matters whilst unnecessarily increasing the regulatory burden. Shareholders have the opportunity to use existing trigger points to have conversations with directors about risk and audit planning. Good audit committee chairs will welcome calls from shareholders on these topics. Bad audit committee chairs will identify themselves by refusing such calls, and shareholders will then have reason to replace them. Shareholders are not making use of existing opportunities to initiate conversations with non-executive directors and it is highly unlikely that the creation of an additional trigger point will encourage shareholders to initiate such conversations in future.

For these smaller companies, new implementing mechanisms to engage with their shareholders and communicating the summarised audit plan and updated risk statement to shareholders increases the costs and burdens for these companies. This must be taken into consideration when taking the proposals forward, as it will also result in companies having to offer higher levels of remuneration for the audit committees' increased workload.

Q59 Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?

In principle, the QCA agrees with greater audit committee chair and auditor participation at a company's AGM. However, there are concerns amongst auditors that speaking at such meetings would heighten the risk of creating a duty of care to individual shareholders.

Q60 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?

The QCA does not believe it is necessary to require additional information from auditors or companies on the departure of an auditor, as proposed by the Brydon recommendations. Shareholders already have the ability to require directors to hold a general meeting in response to an auditor being dismissed or resigning, despite this rarely being used in practice.

Chapter 8: Competition, choice and resilience in the audit market

Chapter 8.1: Market opening measures

Q61 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?

In principle, the QCA does not agree with the proposals surrounding managed shared audit. To the extent these proposals are taken forward, allocating on any other basis other than legal subsidiaries may be hard if there would only be one auditor providing an opinion on each legal entity in the group. However, we do not believe that the "meaningful proportion" should be based on a number of subsidiaries carried out by the Challenger vis-à-vis the other audit firm. A meaningful proportion of the total audit fee of the group might be an approach to consider as a means to ensure that the Challenger firm would be auditing a meaningful proportion of the group. It might in turn encourage more firms to participate in the market as it would result in them being remunerated commensurately with the other audit firm.

However, it is not clear whether this will address the issues raised. As the respondents quoted in the consultation demonstrate, in a market where auditors choose to tender, they will choose not to tender if the fundamentals are wrong. Trying to just impose a solution which doesn't appear to accord with the feedback is not going to achieve a sustainable outcome of greater competition. Even without joint and several liability, Challenger firms will have to invest heavily and will face considerable pressure. The risk versus reward must be right, with simply taking away the risk of litigation being too narrow. The Government, investors and others should be investing in challenger firms through grants, for instance, to help them overcome the barriers to entry set out above.

We set out our key concerns regarding the managed shared audit below:

- It increases the risk of financial statement manipulation if management decide to be deceitful, by having different firms looking at different aspects and no one firm having a full understanding. We note the Parmalat scandal that resulted in the company's collapse in 2003. In this situation, the audits of the company were split between firms, with no one firm being able to see the full picture. This ultimately resulted in the management being able to get away with fraud due to the managed share audit. There is no reason to believe that similar situations will not occur again.
- It reduces, or at best complicates, the issue of liability. If there are issues with an audit, it is very likely that firms will not accept their responsibility and instead point to the joint auditor. There is already a significant shift in the market in recent times as many listed company audit engagements previously carried out by the Big 4 are now carried out by BDO, Grant Thornton, RSM and Mazars, for example. This shows that auditor choice does exist and is effective in practice. By taking on such audits, those audit firms are acquiring greater expertise and, as their clients grow and become FTSE 350 companies, the audit firms are growing with them and are better able to pitch for further FTSE 350 audits.

Q62 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?

In order to incentivise Challenger firms to invest to build their capability and capacity, they would have to know that there are rewards at the end. It is imperative that they receive a meaningful proportion of the audit with a fee commensurate to the fee earned by the lead auditor.

However, it still may not be possible to incentivise Challenger firms sufficiently. It is very possible that a Challenger firm might not be able to reach the levels of capability, capacity and skill to, for instance, take on aspects of a FTSE 100 financial institution, as they simply do not have the expertise. Therefore, they will have built up a cost base without achieving the necessary additional revenue. There is also a risk here that they will just end up being responsible for the riskiest subsidiaries that the group auditors do not want to do, or the mundane ones. The group auditors/lead auditors, that consist of the Big Four, will likely drop the riskier and least cost-effective audits for the Challenger firms to pick up with no real reward.

Q63 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?

Despite our concerns around shared audit highlighted in our responses to Q61 and Q62, the focus should be on making the shared audit work. We do not believe that introducing a managed market share cap will work.

Chapter 8.2: Operational separation between audit and non-audit practices

Q64 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?

The proposals appear to be proportionate and should be codified, supervised and enforced by ARGA when made effective.

However, there is concern amongst our members that operational separation only works for the largest firms. Smaller firms cannot sustain the central costs of operational separation and the business models of these firms may not be able to support it. In addition, due care and consideration will have to be given to any potential unintended consequences, such as auditors questioning their roles under the new proposals.

Q65 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?

The QCA does not agree with this proposal as it is unnecessary and appears to be regulatory overreach. The regulator has the ability to obtain information during its reviews, meaning that there is little justification in providing an annual report on partner remuneration. The regulator should, instead, be involved in assisting audit boards in setting policies, but the analysis should rest with the firms. A more pragmatic solution to addressing concerns about audit partner remuneration would be to require that all audit firms have a remuneration committee, whose members should comprise independent non-executive directors.

Q66 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?

The QCA does not agree with the CMA's recommendation to split profit pools and believes that the Government should not implement this in the future. Splitting profit pools goes against the partnership model adopted by firms.

Q67 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?

No – full separation of professional services firms would have the consequence of not enabling smaller firms to take on bigger audits as they would not be able to take on the burden as well as the compliance costs of full separation.

In the event that these proposals prove insufficient, this should be consulted on at a later date.

Chapter 8.3: Resilience of audit firms and the audit market

Q68 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?

Some proposals have the potential to produce unintended consequences, such as reducing competition and making audit an unattractive career. These would have a negative impact on resilience.

Regarding the proposed measures, the information gathering conducted by the regulator needs to have a clear purpose and should not overly burden firms with excessive levels of compliance. The key to building resilience is proportionate regulation.

Chapter 9: Supervision of audit quality

Chapter 9.1: Approval and registration of statutory auditors of PIEs

Q69 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 – the QCA agrees with the proposal to allow the FRC to reclaim the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs. Albeit the regulator must take a reasoned and informed approach to determining whether individuals and firms are eligible for appointment. Without this approach, there is a risk ARGA could inadvertently shrink the audit market for PIEs by not allowing smaller firms to become a PIE auditor. There should be an appropriate appeals structure.

Chapter 9.2: Monitoring of audit quality

Q70 What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?

Any information that could divulge commercial terms, is subject to legal privilege, would cause unreasonable reputational damage or litigation, or contains any personal information should be excluded within AQR reports.

Whilst accepting a negative AQR report always impacts the reputation of audit firms, the nature of the content being reported should be borne in mind especially where it arises from a disagreement in judgement where the answer is not immediately obvious.

Q71 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?

The regulator, audited entity and the audit firm will likely have different views which may not necessarily be independent. If there is disagreement, the matter should be taken to an independent body to form a binding view.

Chapter 9.3: Regulating component audit work done outside the UK

Q72 Do you agree with the Government's approach to component audit work done outside the UK? How could it be improved?

No – we do not agree with the Government's approach to component audit work completed outside the UK. It is unfair to take enforcement action against a UK group auditor if they have followed the requirements of the auditing standards to obtain access to the component auditors but that is not possible due to local laws. The powers must take into account those restrictions before seeking to immediately penalise UK group audit firms.

One potentially expensive solution is to require an additional audit of the component for the purposes of preparation of the group accounts in a manner that allows the group auditor sufficient access to the staff and working papers of the component auditor performing this additional audit.

Chapter 9.4: The application of legal professional privilege in the regulation of statutory audit

Q73 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?

No – we do not agree that it is problematic. We also do not believe that this should be changed in order to preserve the relationship between a client and their lawyer. Additionally, there is not sufficient evidence to suggest this is widely needed.

This appears to be regulatory overreach. There has to be a stage where the regulator's powers are not expanded beyond those that it needs for the purposes of its role and those that apply to equivalent regulators internationally.

Chapter 10: A strengthened regulator

Chapter 10.1: Establishing the regulator

Q74 Do you agree with the proposed general objective for ARGA?

Yes – the QCA agrees with the proposed general objective for ARGA. ARGA needs to be outcome orientated when setting regulation and guidance, and look to replace regulations or guidance that do not improve outcomes, rather than keep them and add to them.

ARGA also needs to have its powers subject to sufficient checks and balances in order to ensure that it is effective and performing well in its functions. As part of this, it is important that ARGA's powers do not overreach and become excessive as is the case with some of the proposed reforms. It may be necessary that there is a separate review or appeals body created for ARGA composed primarily of investors (as it is their interests that ARGA is seeking to protect).

Q75 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 – the QCA agrees that ARGA should have regard to the regulatory principles as set out in the consultation document when carrying out its policy-making functions. In addition to these regulatory principles, we believe that ARGA should also hard-code the principle of proportionality into its regulatory principles. That is, ensuring that any new regulatory action is proportionate in its approach, having regard to the size, complexity and resource availability of all entities, as well as balancing the subsequent costs and benefits of regulatory developments. At all times, the focus needs to be on outcomes and retiring or replacing outmoded regulation so as to minimise the size of the rule book and associated guidance. There should be robust and appropriate oversight of ARGA to ensure that this is achieved.

We recognise that this will be legislated for under the Regulator's Code, but it should be elevated to a principle. It is imperative that the new regulator operates in a proportionate manner and applies proportionality when carrying out its policy making functions.

As part of this, ARGA should, in accordance with its regulatory principle of proportionality, be required to conduct an impact analysis of any proposed reforms when carrying out its policy-making functions. However, rather than using the whole market for the basis of the analysis, there should be a hard-coded requirement that analysis should be segmented. For instance, the impact of any proposals should be analysed for the FTSE 350, Main Market and AIM, as well as these markets collectively in order to accurately assess their relative impact and ensure that they are appropriately targeted, and the burdens and costs do not outweigh the benefits to each segment.

The appropriate Minister from BEIS should be required to provide an annual statement on audit reform and corporate governance to the Chancellor for inclusion in his/her State of the City statement. This should include a clear statement on the effectiveness of ARGA.

Chapter 11: Additional changes in the regulator's responsibilities

Chapter 11.1: Supervision: Accountants and their professional bodies

Q76 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?

No – this is unnecessary and collaboration between the regulator and the professional bodies should be sufficient.

Q77 What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?

As proposed in our response to Q71, the audited entity and the auditor should have the right to take decisions to an independent party for a binding decision on matters in rare circumstances. The regulator should not have the power to unilaterally compel compliance.

If, however, this is taken forward, a clear set of principles which the regulator will use in deciding whether or not to compel will be needed, as well as establishing an appeals process. The regulator should also publish a notice of its reasons and report to the Secretary of State about how it has used the compliance power in an appropriate manner.

Q78 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?

No – the regulator's enforcement powers should not be restricted to members of the professional accountancy bodies. All accountants should be treated equally. It would not be fair to not hold, for instance, accountants working in the UK from overseas and registered with overseas bodies, to account. They should be held to the same standards.

Q79 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 – the QCA agrees that a central code of ethics would seem reasonable. However, it is not clear what the need is to expand on the code of ethics and practice beyond what is already applied by the professional bodies. It should also be the professional body itself that has the power and right to remove an individual.

Chapter 11.2: Oversight and regulation of the actuarial profession

Q80 Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?

We do not believe that ARGA should be looking to take on additional responsibilities concerning the actuarial profession. Rather, we believe that ARGA should focus on carrying out its existing responsibilities to a high standard before seeking additional remits which could potentially make the regulator less effective.

Q81 Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?

We have no comments.

Q82 Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.

We have no comments.

Q83 Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?

We have no comments.

Q84 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?

Technical standards for determining long-term liabilities, such as for pensions, should require the use of assumptions taking into account the period over which those liabilities fall due, rather than, as at present, assuming the continuation of current circumstances.

Q85 Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?

We have no comments.

Q86 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?

We have no comments.

Q87 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?

We have no comments.

Q88 Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?

We have no comments.

Q89 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?

We have no comments.

Q90 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?

We have no comments.

Q91 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 comments.

Q92 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?

We have no comments.

Q93 Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?

We have no comments.

Chapter 11.4: Powers of the regulator in cases of serious concern

Q94 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?

No – it is not clear what ARGA would do with this information and seems unnecessary.

ARGA should be clear and establish its expectations on what is reportable by a PIE auditor. In this, they should set out clearly, and in one location, what the reporting requirements are.

Q95 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?

Yes – statutory protection is vital. This would give the best chance for the desired outcome to be achieved. It would also help give comfort to the auditors knowing that they could not be sued for making a disclosure.

Q96 How much time should be given to respond to a request for a rapid explanation?

The request for a rapid explanation should only be used in extreme circumstances in order to balance the need to act quickly to protect the public interest with placing burdens on entities that are already facing difficulties. It is also likely that each case will have unique characteristics, which makes it difficult to specify a time period. It would be more appropriate for the regulator to make an initial request with a reasonable timeframe depending on the circumstances and the counterparty has to explain whether it can or cannot meet the timeline.

Q97 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 – subject to the regulator obtaining an agreement with the expert reviewer, publishing a summary would help to ensure that the new regulator's course of action is seen to be fair. However, we believe that this should only be used in exceptional circumstances and the company in question should be able to put forward its views as to why publication is not appropriate.

Q98 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?

No – it is unclear why it matters who identifies the non-compliance as to what powers the regulator has. ARGA will have adequate powers to regulate corporate reporting and audit.

Appendix 1

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-sized quoted companies.

The value of our members to the UK economy is vast – as is their potential. There are around 1,250 small and mid-sized quoted companies in the UK, representing 93% of all quoted companies. They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes[62].

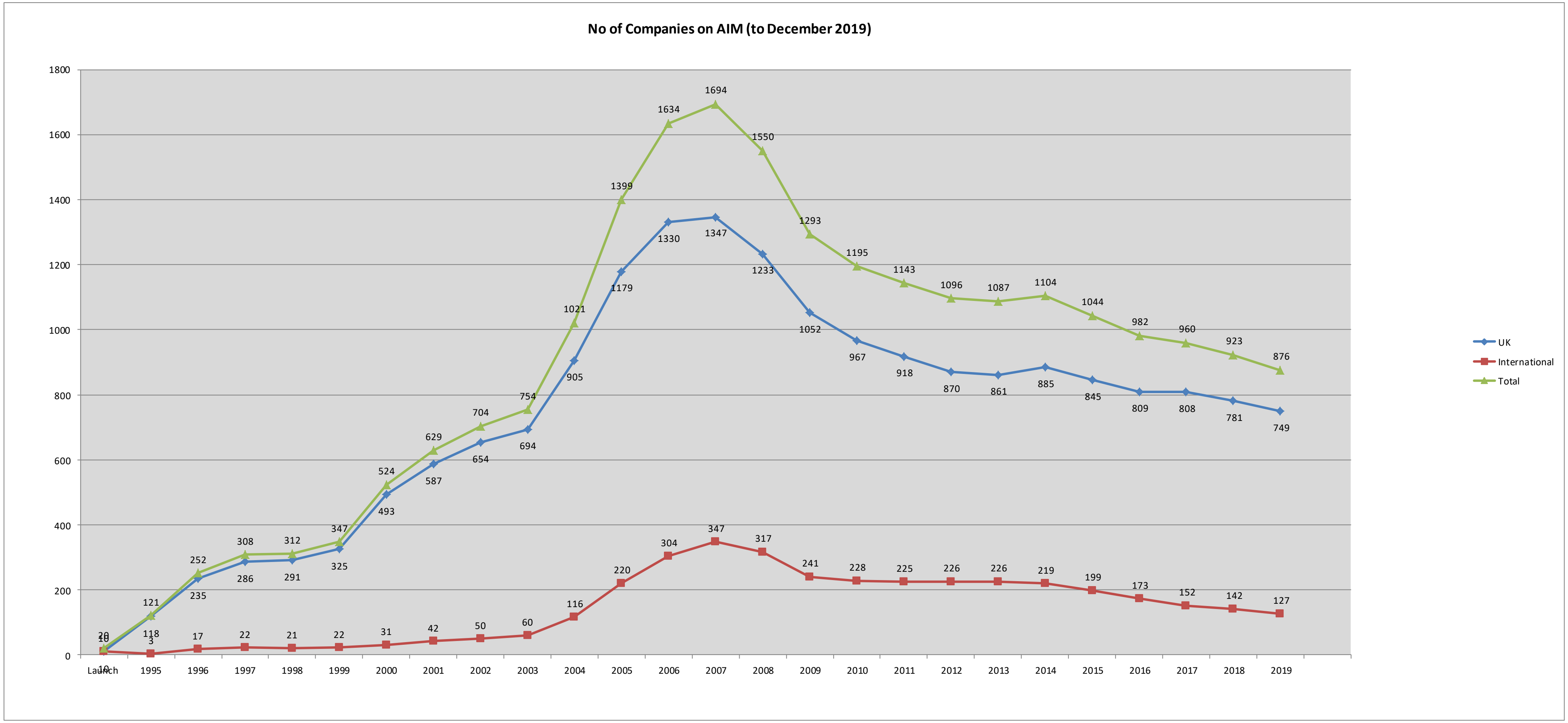
Our goal is to create an environment where that potential is fulfilled.

We identify the issues that matter to our members. We keep them informed. And we interact to build the understanding and connections that help our members stay ahead.

The influence we have, the influence we use, and the influence we grow, ensures that our members always benefit from the impact of our initiatives.

[62] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf

Appendix 2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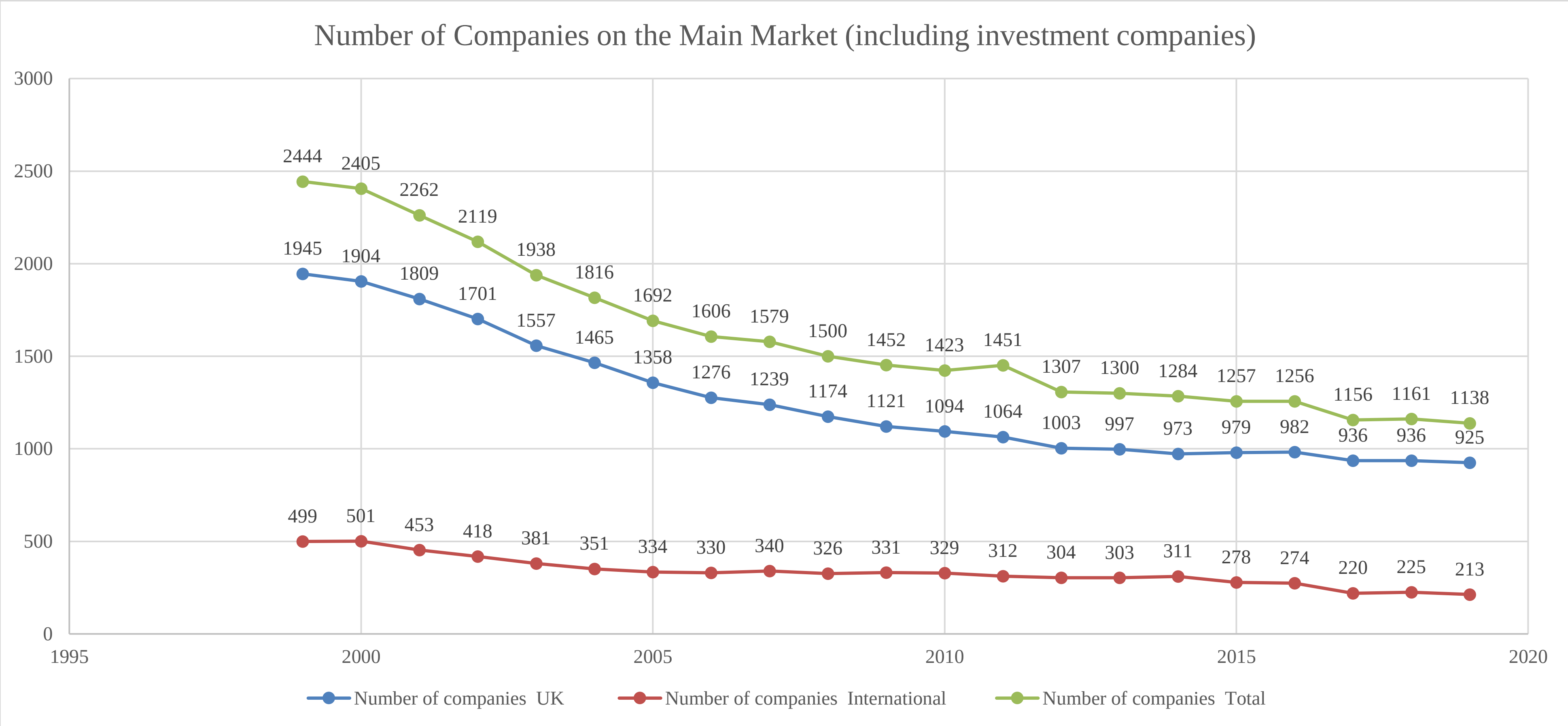
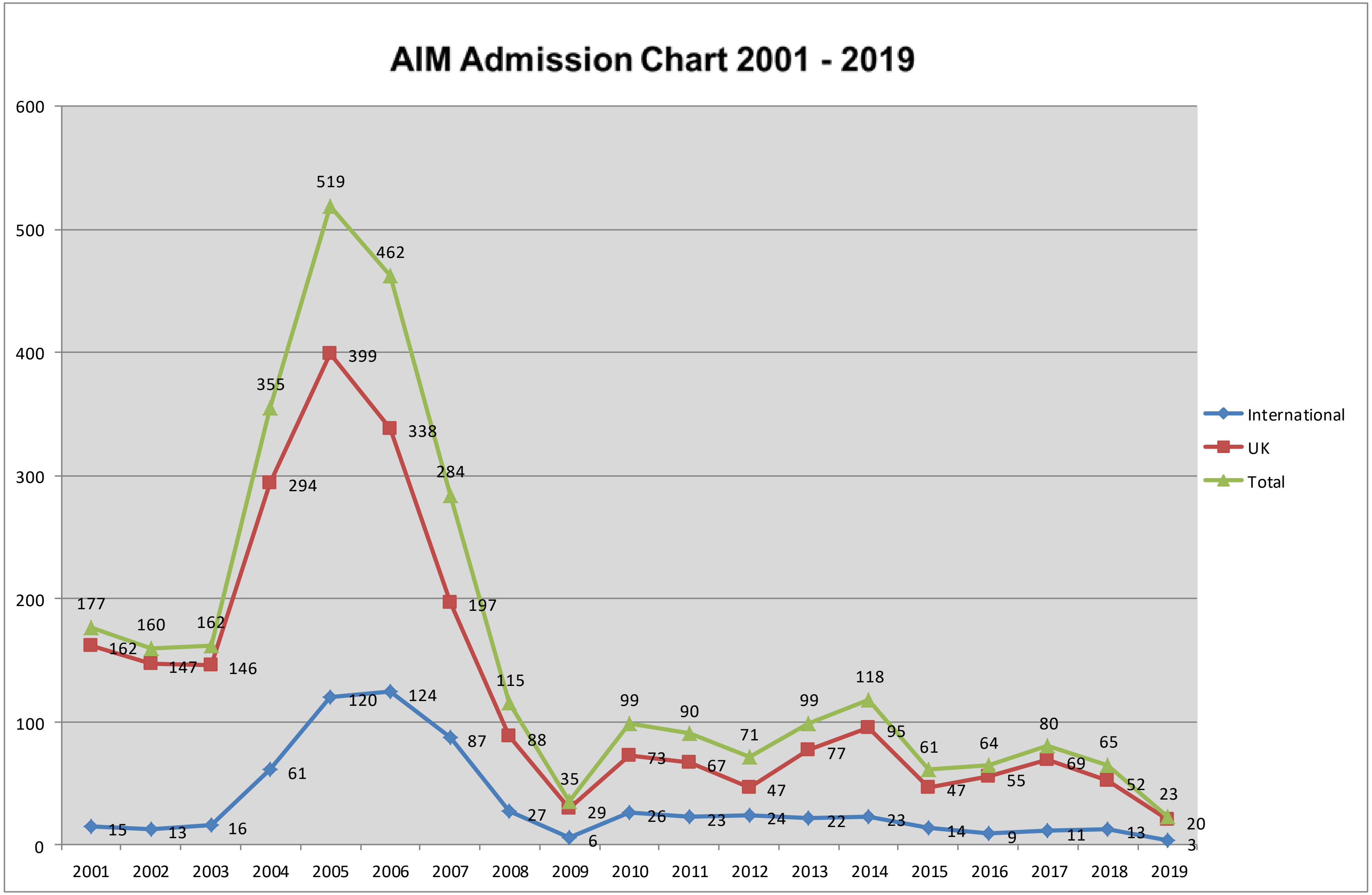
Appendix 3[63]



[63] Please note that these figures are gross and should be reduced by the number of investment companies that currently populate the market. Excluding these investment companies, the number of companies quoted on the Main Market has fallen by 60% since 1999. This compares with a 52% decline when financials are included. Furthermore, when looking below the largest 350 companies, the number of non-financial companies on the Main Market has fallen by 72% since 1999. By December 2019, the number had fallen to just 252. Further information can be found in a report by Hardman & Co. and the QCA here: https://www.theqca.com/article_assets/articledir_404/202121/Hardman-Insight-Are-public-market-closing-to-smaller-companies-May-2020.pdf

Appendix 4


AIM Admission Chart 2001 - 2019
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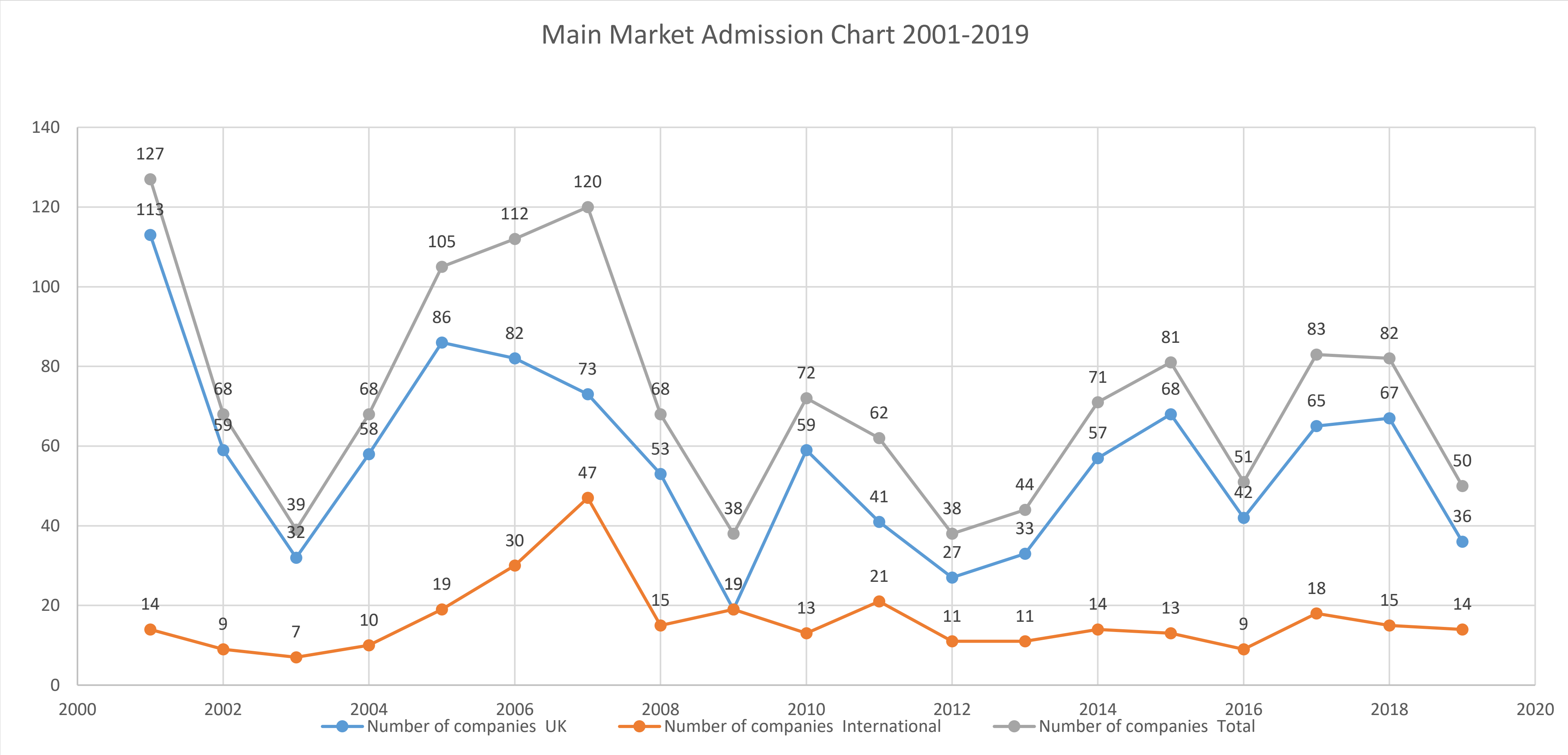
Appendix 5


Main Market Admission Chart 2001-2019
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