



Minutes of the QCA Financial Reporting Expert Group

Held on: Tuesday 24 September 2019

Venue: BDO LLP, 55 Baker St, Marylebone, London, W1U 7EU

Present:

Matthew Howells (Chair)	Smith & Williamson LLP	MH
Rochelle Duffy (Deputy Chair)	PKF Littlejohn	RD
Edward Beale	Western Selection PLC	EB
Anna Hicks	Saffery Champness LLP	AH
Elisa Noble	BDO LLP	EN
Matthew Stallabrass	Crowe UK LLP	MS
Jon Wallis	Grant Thornton UK LLP	JW
Jack Marshall	Quoted Companies Alliance	JM

In attendance:

Claire Hardgrave	BEIS	CH
Michael Ashby	BEIS	MA
Liza Ennals	BEIS	LE

1. Welcome to

MH welcomed CH, MA and LE to the Financial Reporting Expert Group.

Introduction

CH explained that she was leading the team dealing with the reforms to the audit market and also supported Sir John Kingman's review into the FRC in 2018. CH stated that her team want to increase their stakeholder engagement in order to help find solutions and measures to help rectify and improve the current situation.

In her analysis of the CMA's recommendations, CH explained that she had noticed three overarching issues, including:

1. Choice constraints
 - Despite small and large companies being inherently different, they are constrained over the choice of auditor they have.
2. Supply and demand-side constraints
 - Whilst small to mid-tier audit firms are capable of performing high quality audit, there is a demand-side bias from FTSE 350 companies towards the Big Four.
3. The growth constraints of mid-tier audit firms
 - In order for small and mid-tier audit firms to grow and carry out more complex audits, these firms require considerable investment to enhance their capacity.

It has become apparent that the CMA think fundamental intervention within the audit market is necessary. There is a need for greater resilience within the market, which will also help ensure quality.

The AIM market does not have as many constraints, particularly in regards to the amount of tenders that companies on this market can choose between. One of the dangers with the CMA's recommendations is that it could trigger a trickle-down effect that could threaten the functioning of the AIM market.

Joint audit proposal

Despite the CMA's decision to remove the staged/shared audit proposals from their final recommendations, there was consensus from the group that this would be appropriate for a few years before joint audit took place properly. It was agreed that this would help mid-tier firms to enhance their capacity to be able to conduct more complex audits and the auditing of PIEs. At present, the cut-off point is between PIEs and non-PIEs.

Small and mid-tier firms need to grow in size and capacity to allow them to move between tiers. To this end, technology licensing was thought of positively by the group as a means to enhance the capacity of these firms. Technology licensing allows for a level playing field insofar that small and mid-tier firms will be aligned with larger firms in terms of their strategy and methodology, which would make joint audit an easier and more efficient process.

Other concerns

It was mentioned that having a lot of tenders was not an issue. Rather, the issues lie within the lack of differentiation. That is, there is often no difference between the audit products from one firm to another.

Accounting standards have become increasingly complicated, so much so that it is incredibly difficult for someone from a non-accounting background to understand what the accounts are communicating. As well as this, there is also difficulty in getting investors to engage on the subject.

Concerns with shared audit

There is a need for a framework to be produced that assists the functioning of shared audit so that small and mid-tier audit firms are included within the audit process and the audit is shared appropriately. However, one of the main concerns surrounding joint and shared audits is that it complicates the process, potentially paving the way for errors to be made or areas to be overlooked. There is value in a single partner conducting the audit as they can review the company as a whole. Although, on the other hand, two qualified auditors conducting the same audit is beneficial because it allows each partner to challenge and be challenged and offer different perspectives and viewpoints.

Liability

There are several issues in determining where liability should lie. For instance, the Big 4 should not be unfairly targeted, but equally, smaller firms should not be placed with a fine or sanction that could existentially threaten them.

In terms of finding a solution, CH explained that it was possible to design a proportionate system for fines that would be reflective of a firm's profits/revenue etc. It was mentioned that a lot of what is coming out of the FRC in relation to liability and fines is quite aggressive. The FRC should instead be working alongside firms in a constructive manner in order to arrive at a suitable outcome.

Operational split

A benefit of an operational split is that it will allow firms to focus more on the quality of audit. However, implementing an operational split will be more difficult for smaller firms.

MH thanked CH, MA and LE for their time. CH, MA and LE left the meeting.

2. APOLOGIES

Apologies for absence were received from Anthony Appleton, Matthew Brazier, Mark Hodgkins, Clive Lovett, Laura Mott and Claire Needham.

3. MINUTES OF LAST MEETING

The minutes of the last meeting held on 18 June 2019 were tabled and approved without amendment.

4. ISSUES FOR DISCUSSION

	ITEM	ACTION
a)	<p>Updates to the Financial Reporting Expert Group <i>Terms of Reference</i></p> <p>The group made the following comments regarding the updated Terms of Reference:</p> <ul style="list-style-type: none">• The purpose of financial reporting should be included in order to benchmark the work of the group• Paragraph 1 to be amended/rephrased to remove “especially”• Consideration needs to be given to the groups commitment/interaction with stakeholders as currently stated• The wording on the narrative reporting paragraph needs to be amended so that it accurately reflects the remit of the group.	<p>MH/RD/JM to update ToR in line with members’ comments.</p>
b)	<p>Updated QCA Audit Committee Guide</p> <p>This was not discussed.</p>	<p>None.</p>
c)	<p>Expert Group Stakeholder Map and future stakeholders to engage with the Financial Reporting Expert Group.</p> <p>The group expressed interest in engaging the following people/organisations:</p> <ul style="list-style-type: none">• FRC<ul style="list-style-type: none">○ Chair of the Endorsement Board○ Regulatory side○ PIE• CRAG• Non-Executive Directors Association• Investors	<p>JM to invite stakeholders to future meetings.</p>

	<ul style="list-style-type: none"> Shareholder Groups 	
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5. COMMUNICATIONS (information only)

	ITEM	ACTION
a)	<p>Henley Business School have been commissioned by the QCA and Downing LLP to undertake a research project to understand the role that NEDs play in smaller growth companies. The results were released at a launch event on Wednesday 4 September 2019.</p> <p>This was tabled for information only and not discussed.</p>	None.
b)	<p>Towards the end of July, the QCA published the results of two surveys of UK small and mid-caps in coordination with YouGov.</p> <p>i. The first survey analysed the extent to which small and mid-caps were managing the regulatory burden. The results indicated that 63% of these companies find regulatory compliance either excessive or demanding and 72% stated that they believe the reason why the number of companies on public equity markets in the UK has fallen is due to the increased regulatory burden.</p> <p>ii. The second survey analysed the impact of Brexit on small and mid-caps in the UK. The key findings include:</p> <ul style="list-style-type: none"> ○ The three years of Brexit preparations has negatively impacted companies ○ The information that the UK Government has provided to help prepare for Brexit has been inadequate ○ The majority of small and mid-caps are taking action to prepare for no deal ○ Small and mid-caps are most likely to favour remaining in the EU <p>This was tabled for information only and not discussed.</p>	None.
c)	<p>YouGov are surveying companies that adopted the QCA Corporate Governance Code to identify any ways in which we might be able to improve the Code and see if we can find evidence that following the QCA Code has helped companies. This is due to be released shortly.</p> <p>This was tabled for information only and not discussed.</p>	None.

6. ANY OTHER BUSINESS

None.

7. NEXT MEETING

Tuesday 3 December 2019, 4.30pm – 6.00pm (Venue: Grant Thornton, 30 Finsbury Square, London EC2A 1AG)