

## Audit and Corporate Governance Reform – Summary of outcomes



The Government's response to the Department for Business, Energy and Industrial Strategy (BEIS) consultation, "*Restoring trust in audit and corporate governance*", was published on Tuesday 31 May 2022. You can view the Government response to the Audit and Corporate Governance Reform White Paper [here](#).

The BEIS Minister for Corporate Responsibility, Lord Callanan, published the long-awaited Government response following the closure of the consultation on 8 July 2021. The response reiterates the Government's plans for reform to revamp the UK's corporate governance and audit landscape.

This paper provides a summary of the Government's planned reforms, as well as the background to the White Paper and the QCA's response.

### Background

On 18 March 2021, the Business Secretary, Kwasi Kwarteng MP, published the consultation on audit and corporate governance reform, which ran for 16 weeks until 8 July 2021. The consultation was published following the three audit-related reviews (Sir John Kingman's review of the FRC, Sir Donald Brydon's review of the quality and effectiveness of audit, and the CMA's market study on statutory audit) and combined the 155 recommendations put forward within these reviews.

The White Paper proposed a major overhaul of the UK's audit and corporate governance regimes in the wake of some significant corporate failures in recent years. Many of the proposals within the consultation were of significant importance to the QCA and the small and mid-sized quoted company ecosystem. In particular, we highlighted the following proposals as specific areas of interest/concern:

1. The expansion of the definition of Public Interest Entities (PIEs) to include all Premium Listed companies and AIM-quoted companies with a market capitalisation above €200 million;
2. Increasing the accountability of directors through new requirements in relation to internal controls and dividends and capital maintenance;
3. New reporting requirements through a Resilience Statement and Audit and Assurance Policy;
4. The creation of a new regulator – the Audit, Reporting and Governance Authority, which would be given substantial new powers, including:
  - a. Giving the new regulator more power to direct changes to company reports and accounts;

- b. Giving the new regulator greater enforcement powers against directors of PIEs and strengthening malus and clawback provisions;
5. Increased director responsibilities regarding the detection and prevention of fraud;
6. Increasing audit committee oversight and engagement with shareholders;
7. Changes to audit purpose and scope; and
8. A proposal for managed shared audit, the operational separation of the largest audit firms, and increased regulator monitoring powers.

### **The QCA's Response to the Consultation**

On 8 July 2021, the QCA submitted a detailed and comprehensive response to the consultation (available [here](#)). Whilst we responded, in detail, to each question within the consultation, our response centred on two key concerns, which were reflected in the small and mid-cap community. Our two key concerns were in relation to the proposals to (a) expand the definition of a Public Interest Entity (PIE) to all Premium Listed companies and AIM-quoted companies with a market capitalisation above €200 million and (b) automatically extend the scope of reforms.

Instead, we proposed that:

1. 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 (public or 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. The automatic extension of the scope of the reforms should be removed and there should be a more thoughtful approach to implementation, which includes greater segmentation, a thorough impact analysis, a proper assessment of which other companies are in the public interest and the adoption of a transition period.

The consultation response also included the results of a survey we ran with YouGov (available [here](#)) which received nearly 220 responses; 166 from companies and 52 from investors. The headline results showed that:

1. 59% of companies believe the reforms will have a negative impact on their growth, just 2% believe the reforms will have a positive impact
2. 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.
3. 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.
4. Nearly two thirds of companies (58%) indicated that they would be likely to re-evaluate the worthwhileness of their listing.

## Short summary of the Government Response

This section provides a short overview of the key reforms.

1. **Public Interest Entity (PIE) definition** – the definition of a PIE will be widened to include private companies and companies traded on MTFs (such as AIM and AQSE) if these entities have over 750 employees and an annual turnover of over £750 million
2. **Director accountability (internal controls)** – the UK Corporate Governance Code will be amended to require a directors' statement about the effectiveness of internal controls (applying to Premium Listed companies).
  - a) **Dividends and capital maintenance** – legislation will require 750:750 PIEs to disclose their distributable reserves and explain the board's long-term approach to dividends.
3. **New corporate reporting** – A statutory Resilience Statement and an Audit and Assurance Policy will be introduced and apply to 750:750 PIEs.
4. **Supervision of corporate reporting** – ARGA's powers will cover the entire annual report and accounts and the regulator will be given the power to commission an expert review.
5. **Company directors** – ARGA will have the powers to investigate and sanction breaches of corporate reporting and audit-related responsibilities by PIE directors. Amendments to the UK Code will also occur to increase transparency around bonus clawbacks.
6. **Audit purpose and scope** – improvements to auditing standards and guidance will be made by the regulator and legislation will require directors of 750:750 PIEs to report on actions they have taken to prevent and detect fraud.
7. **Audit committee oversight and engagement with shareholders** – ARGA will be given the power to set minimum requirements on audit committees in relation to the appointment and oversight of auditors.
8. **Competition, choice and resilience in the audit market** – the Government will bring forward the proposals around managed shared audit for FTSE 350 firms and will step up the pace of the operational separation of audit firms.
9. **Supervision of audit quality** – ARGA will look at non-legislative ways of improving the AQR process and continuing to seek consent from audit firms and audited entities where possible before publication.
10. **A strengthened regulator** – the Audit, Reporting and Governance Authority will replace the FRC. The new regulator will have significantly increased responsibilities and powers.
11. **Additional changes to the regulator's responsibilities** – the Government will take forward multiple proposals regarding the regulator's responsibilities.

## Overview of the Government Response

This section provides an overview of the Government response to the consultation, covering each of the 11 sections.

### 1. Re-setting the scope of regulation (the Public Interest Entity definition)

#### What was originally proposed in the White Paper?

BEIS proposed a significant expansion of the scope of the definition of a Public Interest Entity. This expansion would include large private companies and certain AIM-quoted companies with a market capitalisation of above €200 million.

### What feedback was received?

The Government has stated that the vast majority of responses supported including a smaller number of AIM companies than the proposed €200 million market capitalisation threshold would encapsulate. Respondents suggested that the market capitalisation figure should be much higher, or that it should be aligned with the large private company threshold.

### What is the Government response?

Having considered the feedback, the Government has concluded that a size-based threshold based on turnover and employees is the best option for the widening of the PIE definition. Therefore, the Government intends to extend the PIE definition to large companies with both:

- 750 or more employees; and
- An annual turnover of £750 million or more.

This definition is applicable to private companies and companies traded on multilateral trading facilities (MTFs), including AIM and AQSE. In order to qualify as a PIE, the Government has assured that a smoothing mechanism will be introduced, meaning that entities will have to continue meeting requirements for a set period after they initially qualify as a PIE. Details of this mechanism will be included in the legislation.

### What are the timelines?

The Government has said that, to ensure businesses and their auditors have sufficient time to prepare for and comply with PIE requirements, there will be adequate time provided between meeting the thresholds and being subject to new requirements. This will be set out in the legislation at a later date, but will be a full annual reporting period as a minimum.

### Could there be changes in the future?

Yes. The Government intends to legislate that Ministers can amend the size threshold by secondary legislation in the future, as well as including or excluding groups with specific characteristics such as sector or company type.

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

### **2.1 Internal controls**

#### What was originally proposed in the White Paper?

The White Paper discussed a range of options for strengthening the UK's internal controls framework, but also included the Government's preferred option. This option would include an explicit statement provided by the directors on the effectiveness of internal controls and also asked the questions as to whether external assurance should be sought. This proposal would make directors personally liable for internal controls over financial reporting.

#### What feedback was received?

Whilst a majority of respondents agreed that there was a case for strengthening the internal controls framework, there was significant disparity in how this could be achieved, and the degree of reform needed. Around 80% of respondents were opposed to making assurance on the directors' statement about internal control effectiveness mandatory. Respondents also highlighted that the

Impact Assessment accompanying the White Paper had significantly underestimate the likely cost of the Government's proposed approach.

#### What is the Government response?

The Government considers that there is a big risk in putting a directors' statement on legislative footing and has instead opted for an approach to strengthen aspects of the corporate governance regime. As such, the Government intends to take a Code-based approach to strengthen the focus on internal control matters. The Government will invite the FRC to consult on strengthening the internal control provisions in the UK Corporate Governance Code to provide for an explicit statement from the board about their view of the effectiveness of the internal control systems (financial, operational and compliance systems) and the basis for that assessment.

#### What are the timelines and scope?

The Government has not commented on timeline and scope, possibly as this will be included in the future consultation by the FRC. However, the Government notes that there was general agreement that any new requirements should be phased in, starting with premium listed companies or – some suggested – the FTSE 350.

### **2.2 Dividends and capital maintenance**

In terms of dividends and capital maintenance, having considered the feedback, the Government intends to:

- Give ARGAs formal responsibility for issuing guidance on what should be treated as “realised” profits and losses for the purposes of section 853 of the Companies Act 2006;
- Require qualifying companies, or in the case of a UK group, the parent company only, to disclose their distributable reserves, or a “not less than” figure if determining an exact figure would be impracticable or involve disproportionate effort;
- Require companies to provide a narrative explaining the board's long-term approach to the amount and timing of returns to shareholders (including dividends, share buybacks and other capital distributions) and how this distribution policy has been applied in the reporting year; and
- Take forward a requirement for directors to make explicit statements confirming the legality of proposed dividends and any dividends paid in year.

In terms of the scope of the new disclosures, the Government considers that it would be appropriate to apply the new disclosures and the legality statement to companies that are Public Interest Entities (those that meet the 750:750 test for both listed and unlisted companies).

## **3. New corporate reporting**

### **3.1 Resilience Statement**

#### What was originally proposed in the White Paper?

The White Paper proposed that companies in scope of the new PIE definition should produce an annual Resilience Statement. This would set out a company's approach to managing risk and developing resilience over the short, medium, and long term, which would build on existing going concern and viability statements.

### What feedback was received?

The Government stated that there was broad support for the Resilience Statement in principle. However, there were certain concerns outlined, including in relation to the proposal that every Resilience Statement should address a minimum set of risks, as well as the proposal to mandate a minimum five-year forward look for the medium-term section of the Resilience Statement.

### What is the Government response?

The Government intends to continue with the proposal for the Resilience Statement subject to certain changes to address the concerns mentioned above. As such, the Government intends to:

- Legislate for companies to report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have arrived at this judgement of materiality;
- Replace the five-year mandatory assessment period previously proposed for the combined short- and medium-term sections of the Resilience Statement with an obligation on companies to choose and explain the length of the assessment period for the medium-term section; and
- To continue with its proposal that companies within scope of the Resilience Statement should perform reverse stress testing. However, in light of the consultation feedback, companies will be required to perform at least one reverse stress test rather than a minimum of two.

As a result of the above, the Government and the FRC intend that the existing viability statement provision in the UK Corporate Governance Code will no longer apply after the Resilience Statement enters into force.

### What are the timelines and scope?

The Government confirms that the Resilience Statement will apply to companies which are Public Interest Entities in line with the size thresholds set for the new definition (public and private companies that meet the 750:750 test).

## **3.2 Audit and Assurance Policy**

### What was originally proposed in the White Paper?

The White Paper proposed that Public Interest Entities should publish an Audit and Assurance Policy (AAP) which sets out a company's approach to assuring the quality of the information it reports to shareholders.

### What feedback was received?

The Government has stated that there was majority support for the Audit and Assurance Policy, as well as there being broad support for the minimum content. A majority of respondents favoured the policy being published every three years rather than annually. A majority of respondents were not in favour of the proposed advisory shareholder vote.

### What is the Government response?

Having reviewed the feedback, the Government:

- Agrees that the AAP should be published every three years;

- Is not proceeding with the proposal that the AAP should be subject to a shareholder vote (companies instead will have to explain how they have considered shareholder views);
- Believes that the AAP should set out whether a company intends to seek external assurance over the Resilience Statement or over reporting on its internal control framework;
- Confirms that the AAP will require companies to describe their internal auditing and assurance process;
- Confirms that the AAP will require a description of the company's policy in relation to the tendering of external audit services; and
- Confirms that the AAP will be required to state whether independent assurance has been carried out and to what extent.

### **3.3 Reporting on payment practices**

In terms of reporting on payment practices, the Government continues to believe that there is a case for increasing transparency over how large public interest entities are performing on their payment practices to suppliers. The Government intends to consult on whether these regulations should be amended to enhance supplier payment reporting.

### **3.4 Public interest statement**

The Government confirms that it will not legislate at this time to create a new public interest statement reporting requirement. However, the Government and FRC will keep this under review.

## **4. Supervision of corporate reporting**

### *What was originally proposed in the White Paper?*

The White Paper set out proposals for widening and strengthening the regulator's powers in relation to its corporate reporting review (CRR) activities. In particular, it proposed giving ARGA stronger powers to direct companies to amend their reporting where necessary, replacing the FRC's existing ability to seek a court order. It also proposed giving ARGA a wider remit to scrutinise the entire contents of annual reports and accounts, including corporate governance reporting and voluntary elements, rather than just selected parts.

### *What feedback was received?*

Most respondents agreed with the proposals. However, it was highlighted that some disagreed, arguing that it would be wrong to replace a court process with an untested new regulator. Many also stressed the need for it to be balanced by an independent appeals or reconsideration process for companies that disagreed with the regulator.

### *What is the Government response?*

The Government intends to proceed with the proposals set out in the White Paper to strengthen and widen the regulator's powers to review corporate reporting other than in respect of pre-clearance. This includes extending the regulator's review powers to the entire annual report and to give the regulator power to commission an expert review.

## **5. Company directors**

## 5.1 Enforcement against company directors

The Government intends to give ARGAs the necessary powers to investigate and sanction breaches of corporate reporting and audit-related responsibilities by PIE directors. The details of this include:

- The Government believes that it is important for all directors (both executive and non-executive directors) to be within scope of the new civil enforcement regime;
- All PIEs will be in scope of the new regime;
- The new enforcement powers will relate to breaches of the directors' statutory duties relating to corporate reporting and audit;
- PIE directors may be held to account if they fail to comply with well-established values that are already embodied in directors' existing general duties in statute; and
- The Government does not expect to see a dramatic impact on the price or the availability of directors' and officers' (D&O) insurance.

## 5.2 Clawback and malus provisions in directors' remuneration arrangements

The Government continues to believe that companies that follow the UK Corporate Governance Code should explain more clearly to shareholders and other interested parties what malus and clawback conditions they have in place and be encouraged to consider a range of possible conditions. However, the Government will not take anything forward for now and will invite the FRC to consult on how the provisions in the Code can be developed to deliver greater transparency and to encourage a broader range of conditions in which executive remuneration could be withheld or recovered.

## 6. Audit purpose and scope

### 6.1 The purpose and scope of audit

#### What was originally proposed in the White Paper?

The White Paper put forward proposed changes around making audit fit for purpose, including:

- introducing a new purpose statement for auditors;
- introducing a new statutory duty for auditors to consider wider information and director conduct in reaching their judgements on financial statements; and
- enhancing auditor reporting.

The White Paper put forward proposed changes around the future scope of audit, including:

- regulatory oversight of a new corporate auditing framework;
- giving the regulator a new power to set enforceable principles for corporate auditing; and
- establishing a new distinct professional body focused solely on audit.

#### What is the Government response?

In terms of making audit fit for purpose, the Government believes that the regulator should seek to deliver change in this area through ongoing improvements to auditing standards and guidance, to help ensure auditors are fully and consistently considering wider information in reaching their audit judgements.



In terms of widening the scope of audit, the Government will leave the market – companies, directors, investors – to shape the development of an enhanced wider assurance services market in the coming years, stimulated by the requirement to publish an Audit and Assurance Policy. The Government does not intend to legislate to give the regulator oversight of corporate audit. The Government expects the existing professional bodies to make substantial improvements to auditor qualification, training and skills.

## **6.2 Tackling fraud**

The Government intends to proceed with the proposal that directors should report on the steps they have taken to prevent and detect material fraud. This requirement will apply to PIEs above the 750:750 size threshold.

The Government believes that auditors' existing requirements to identify and report material inconsistencies in directors' reporting will be sufficient in reporting on directors' fraud statements.

## **7. Audit committee oversight and engagement with shareholders**

### **7.1 Audit committee oversight**

In terms of additional requirements for audit committees, the Government intends to proceed with giving ARGA the power to set minimum requirements on audit committees in relation to the appointment and oversight of auditors. The Government intends that this should apply initially to FTSE 350 companies only and that they do not believe it is appropriate or necessary to provide a power for ARGA to place an independent observer on the audit committee as was originally proposed in the White Paper.

### **7.2 Independent auditor appointment**

The White Paper considered giving ARGA the power to appoint a company's auditor in specific circumstances following the recommendation of Sir John Kingman. However, the Government has decided not to legislate to provide the flexibility for ARGA to be given such powers by the Government in the future.

### **7.3 Shareholder engagement with audit**

The White Paper considered the Brydon Review recommendations in relation to shareholder engagement on risk and audit planning, shareholder engagement on audits at general meetings, and shareholder engagement on auditors leaving office.

Having reviewed the consultation responses, the Government believes that a formal mechanism should be established to enable audit committees to gather shareholder views on the audit plan. The Government also continues to believe that shareholders should have better opportunities to ask questions about the audit at an AGM, although it does not believe a standing AGM item is necessary. The Government believes that the most appropriate way to encourage shareholder engagement with audits is to include appropriate provisions in the audit committee requirements that ARGA will have the power to put in place.

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

## **8.1 Market opening measures**

### What was originally proposed in the White Paper?

In the White Paper, the Government put forward two proposals to increase choice in the audit market. The first proposal would require FTSE 350 companies to either appoint a challenger firm as their sole group auditor or to be subject to a managed shared audit requirement to appoint a challenger firm to conduct a meaningful proportion of the audit. The second proposal was to make a secondary power so that the Secretary of State could introduce a market share cap if the review of the managed shared audit regime concluded that challenger firms were not becoming the sole auditors in the FTSE 350.

### What feedback was received?

Several issues came to light during the consultation period in relation to:

- The definition and composition of meaningful proportion within managed shared audit;
- Other aspects of the design of the managed shared audit regime; and
- The implementation of a market cap share.

### What is the Government response?

The Government is confident that the issues identified in the consultation responses can be addressed and has decided to proceed with the market opening measures, which will be implemented over time and in a phased manner. In relation to the percentages that should be used to define the boundaries of “meaningful proportion”, the Government plans to legislate to give ARGAs the power to set this percentage. The Government has also decided that legal subsidiaries should remain the primary basis of the managed shared audit regime.

Certain exemptions will be included in the market opening measures, recognising that circumstances may arise where challenger firms may not be able to act as a sole group auditor.

Finally, the Government intends to make powers available to introduce a market cap share in the future.

## **8.2 Operational separation between audit and non-audit practices**

The Government will legislate to give ARGAs powers to design and deliver an operational separation to take forward the operational separation that has begun on a voluntary basis so far.

The Government continues to support increased transparency in relation to the financial statements of the audit practice and remuneration policies that set audit partner pay. ARGAs will be given appropriate powers to increase transparency in both of these areas, including rules to require the publication of separate financial profit and loss financial statements for audit practices.

Finally, the Government will seek a power to make regulations to deliver full structural separation of audit and non-audit parts of the business if operational separation fails to yield an increase in audit scepticism, independence and quality.

## **8.3 Resilience of audit firms and the audit market**

The Government has decided to extend the FRC’s duties to monitor developments in the PIE audit market to the whole statutory audit market. This will include giving ARGAs the power to require information to monitor the health and viability of firms. ARGAs will also be given appropriate powers

to require audit firms to address any audit quality and resilience concerns identified, as well as the power to enforce against any non-compliance.

## **9. Supervision of audit quality**

### **9.1 Approval and registration of statutory auditors of PIEs**

In the White Paper, the Government set out its proposals for allowing the regulator to reclaim from the Recognised Supervisory Bodies (RSBs) the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs. The Government intends to take this forward.

### **9.2 Monitoring of audit quality**

#### *What was originally proposed in the White Paper?*

The White Paper set out proposals to legislate for the publication of Audit Quality Review (AQR) reports. The aim was to allow the regulator to publish its AQR reports on individual audits without the need for consent from both the audit firm and the audited entity.

#### *What was the feedback received?*

Many respondents indicated they did not agree with proposals to remove the consent mechanism for publication, and proposals to “publish in full” without anonymisation

#### *What is the Government response?*

The Government is asking the FRC to look at non-legislative ways of improving the AQR process and continuing to seek consent from audit firms and audited entities where possible before publication. In addition, the Government is asking the regulator to engage with investors and other users to improve the usefulness to them of the information published on AQR.

### **9.3 Regulating component audit work done outside the UK**

The Government intends to maintain the existing arrangements on access to overseas component working papers.

### **9.4 The application of legal professional privilege in the regulation of statutory audit**

The Government encourages legal and audit professionals to work with the regulator to resolve any issues that arise from instances where privileged documents shared with the auditor are not available to the regulator’s quality review system and enforcement system.

## **10. A strengthened regulator**

#### *What was originally proposed in the White Paper?*

The White Paper set out the Government’s decision to set up ARGA on a statutory basis. The White Paper set out four regulatory principles to which ARGAs should have regard when carrying out its policy-making functions:

- promoting innovation in statutory audit work, corporate reporting and corporate governance;

- promoting brevity, clarity and usefulness in corporate reporting;
- working closely with other regulators from the UK and internationally; and
- anticipating emerging corporate governance, reporting or audit risks by being forward-looking and acting proactively where possible.

#### What was the feedback received?

A significant number of respondents supported inclusion of an additional principle explicitly covering proportionality. Some respondents also suggested greater Parliamentary oversight of ARGA beyond that set out in the White Paper.

#### What is the Government response?

The Government intends to proceed with the formulation set out in the White Paper. In response to the suggestion of an additional regulatory principle setting out the need for proportionality, the Government does not believe this is necessary, citing that regulators already have to act in this manner due to the requirements both in general public law and in the Regulators' Code.

The Government intends to go forward with the proposals from the White Paper to introduce a duty on ARGA to respond to the remit letter, and to provide an annual report.

The Government intends to give ARGA statutory powers to raise a levy so that it has a sustainable and independent basis to carry out its regulatory activities.

### **11. Additional changes to the regulator's responsibilities**

The Government will take forward multiple proposals regarding the regulator's responsibilities in relation to:

- Supervision – accountants and their professional bodies
- Oversight and regulation of the actuarial profession
- Investor stewardship and relations
- Powers of the regulator in cases of serious concern
- Local public audit
- Independent supervision of the Auditors General
- Whistleblowing

### **QCA's position**

Overall, the QCA welcomes the Government's re-think on many of the audit and corporate governance reform proposals.

#### *Public Interest Entity definition*

In particular, we are pleased to see that the expansion of the scope of the definition of a Public Interest Entity to AIM-quoted companies with a market capitalisation above €200 million has been dropped and replaced with a threshold of over 750 employees and £750 million turnover. The original proposal would encapsulate a huge number of small and mid-sized quoted companies, potentially limiting levels of growth, innovation, and job creation to a considerable degree. The new

threshold is much more appropriate and proportionate, and will help to ensure that only those with genuine public impact are included within the definition.

#### *Reporting requirements*

In a similar vein, it is encouraging to see that some of the requirements, such as in relation to the Resilience Statement, tackling fraud, and dividends and capital maintenance, will only apply to PIEs that meet the 750:750 test. Additionally, it is good to see that the Government has amended, and diluted, many of the proposed reforms having considered the issues raised by consultation respondents.

We also welcome the Government's decision not to put a directors' statement regarding internal controls on legislative footing, and instead, to invite the FRC to consult on strengthening the internal control provisions in the UK Corporate Governance Code to provide (on a comply or explain basis) for an explicit statement from the board.

#### *ARGA's power and the UK Code*

That being said, it is essential that ARGA adopts a proportionate regime when strengthening the provisions in the UK Code to ensure that the size constraints and burdens that will be placed on smaller quoted companies on the Main Market are understood and accounted for. As stated in the Government's response to the consultation, their initial predictions on costs were significantly underestimated; the FRC must ensure that a thorough impact assessment on costs and burdens is part of their consultation.

Similarly, as ARGA takes on its increased responsibilities and powers, it must do so in a proportionate way. We are disappointed that the Government is minded not to add an additional regulatory principle setting out the need for proportionality on the basis that this is already included in general public law and in the Regulators' Code. We do not believe that this goes far enough and adding proportionality as a regulatory principle would put it on a proper footing and ensure that the regulator can be held accountable to this and be scrutinised on their performance.

#### *What next?*

The Government will now seek to legislate to implement many of the reforms. While there is a considerable amount to digest, we will continue to work with BEIS and the FRC as the reforms are taken forward to ensure that proportionality is always at the front of their minds.

## Comparison Table

Key areas for reform	Current regime/original consultation proposal	Final proposal/planned reform	Reaction
<b>1. Public Interest Entity (PIE) definition</b>	<p><b>Current regime:</b> The UK definition of a PIE is inherited from the EU and includes certain companies listed on the stock exchange, banks, and insurance firms</p> <p><b>Consultation proposal:</b> To extend the definition of PIE to include large private companies and AIM-quoted companies with a market capitalisation above €200 million.</p>	<p>The Government intends to extend the scope of the definition of PIEs to include private companies and AIM-quoted companies with 750+ employees and £750+ million turnover.</p>	<p>Improvement – the 750:750 test will help to ensure that the majority of small and mid-caps are out of scope of the extended PIE definition</p>
<b>2. Internal controls</b>	<p><b>Consultation proposal:</b> To strengthen the internal controls regime in the UK by adding an attestation requirement to an annual review of effectiveness.</p>	<p>The Government will invite the FRC to consult on strengthening the internal control provisions in the UK Corporate Governance Code to provide (on a comply or explain basis) for an explicit statement from the board about their view of the effectiveness of the internal control systems.</p>	<p>Slight improvement – the decision not to place the requirement on a legislative footing is positive, but the FRC must act proportionately when making changes to the UK Code, considering the cost and burdens on small and mid-caps in particular</p>
<b>3. Corporate reporting requirements</b>	<p><b>Consultation proposal:</b> To introduce new corporate requirements, including a Resilience Statement and an Audit and Assurance Policy</p>	<p>The Government will take forward the proposals to introduce a requirement for a Resilience Statement and an Audit and Assurance Policy, but will make certain amendments in order to take on board the issues raised by respondents.</p>	<p>Improvement – largely welcome the changes that have been made to the initial proposals regarding the Resilience Statement and Audit and Assurance Policy. However, there is still concerns that the requirements will lead to boilerplate statements that add limited value</p>
<b>4. Supervision of corporate reporting</b>	<p><b>Consultation proposal:</b> To broaden the regulator’s review powers so that it can scrutinise the entire contents of a company’s annual report and accounts and direct changes to it</p>	<p>The Government intends to proceed with the proposals set out in the White Paper to strengthen and widen the regulator’s powers to review corporate reporting other than in respect of pre-clearance.</p>	<p>Neutral – broadly agreed with the Government’s initial proposals and agree with them to the same degree now</p>

<p><b>5. Investigation and enforcement powers of the regulator</b></p>	<p><b>Consultation proposal:</b> To give the regulator investigation and enforcement powers to hold all company directors to account (including those that are not chartered accountants), as well as strengthening malus and clawback provisions</p>	<p>The Government intends to give ARGA the necessary powers to investigate and sanction breaches of corporate reporting and audit-related responsibilities by PIE directors. The Government will not take anything forward for now on clawback and malus provisions but will invite the FRC to consult.</p>	<p>Neutral – broadly agreed with the original proposals and welcome the decision not to move forward on the provisions relating to clawback and malus for now</p>
<p><b>6. Audit purpose and scope</b></p>	<p><b>Consultation proposal:</b> To amend the purpose and scope of audit, establish principles of corporate reporting, introduce requirements on directors to help tackle fraud</p>	<p>The Government believes that the regulator should seek to deliver change in this area through ongoing improvements to auditing standards and guidance. The Government does not intend to legislate to give the regulator oversight of corporate audit. The Government intends to proceed with the proposal that directors should report on the steps they have taken to prevent and detect material fraud.</p>	<p>Neutral – in terms of the proposals to amend the purpose of audit Negative – in terms of the proposals to require directors to report on the steps they have taken to detect material fraud</p>
<p><b>7. Audit committee oversight</b></p>	<p><b>Consultation proposal:</b> To give the regulator the power to set additional requirements regarding the audit committee’s role in the appointment and oversight of auditors</p>	<p>The Government intends to proceed with giving ARGA the power to set minimum requirements on audit committees in relation to the appointment and oversight of auditors. The Government intends that this should apply initially to FTSE 350 companies only and they will not provide a power for ARGAs to place an independent observer on the audit committee.</p>	<p>Neutral – agree that it should apply to the FTSE 350 only (any potential expansion should only occur after consultation) and broad agreement that ARGAs should not be able to place an observer on an audit committee</p>
<p><b>8. The audit market</b></p>	<p><b>Consultation proposal:</b> To establish a managed shared audit regime, require the operational separation of audit firms and giving the regulator powers to monitor the resilience of the audit market</p>	<p>The Government has decided to proceed with the market opening measures, which will be implemented over time and in a phased manner. The Government will also legislate to give ARGAs</p>	<p>Slightly negative – it may be very difficult for managed shared audit to work in practice and may not address the issues it was set out to address</p>

		powers to design and deliver an operational separation.	Positive – agree with the proposals surrounding operational separation
<b>9. Supervision of audit quality</b>	<b>Consultation proposal:</b> To allow Audit Quality Review reports to be published by the regulator without consent from the audit firm and the audited entity	The Government will ask the FRC to look at non-legislative ways of improving the AQR process and the FRC will be required to seek consent from audit firms and audited entities where possible before publication.	Slight improvement – the decision to consider non-legislative ways of improving the AQR process is largely positive
<b>10. A new regulator (ARGA)</b>	<b>Current regime:</b> The Financial Reporting Council (FRC) has a mixture of statutory, voluntary and contractual functions <b>Consultation proposal:</b> To establish the Audit, Reporting and Governance Authority in place of the FRC placing it on statutory footing, making it funded by a mandatory levy and giving it new powers	The Government intends to proceed with the formulation set out in the White Paper. In response to the suggestion of an additional regulatory principle setting out the need for proportionality, the Government does not believe this is necessary.	Negative – the decision to not include the addition of a regulatory principle setting out the need for proportionality is a considerable missed opportunity
<b>11. Changes to the regulator’s responsibilities</b>	<b>Consultation proposal:</b> To increase the regulator’s responsibilities	The Government will take forward multiple proposals regarding the regulator’s responsibilities.	Neutral