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Council of Institutional Investors®
The voice of corporate governance

November 4, 2019

Debbie Gillatt
Director Business Frameworks
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London SW1H 0ET
debbie.gillatt@beis.gov.uk

Dear Ms. Gillatt:

CFA Institute[1] is comprised of more than 160,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of U.S. asset owners, primarily pension funds, state and local entities charged with investing public assets and foundations and endowments, with combined assets of approximately $4 trillion of which more than 15% is allocated to international equities. Our associate members include non-U.S. asset owners with more than $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management. CII members share a commitment to healthy public capital markets and strong corporate governance.[2]

CFAI and CII are writing this letter to express to the Department for Business, Energy and Industrial Strategy (BEIS) our views on the benefits of key aspects of legislation – similar to that required in the United States under the Sarbanes-Oxley Act of 2002 (SOX) – aimed at improving the integrity of financial reporting and the related auditing process. We are sharing these views to help inform the BEIS as they consider Sir John Kingman's recommendation for a strengthened framework for internal control in the UK.[3,4]

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1 With offices in Charlottesville, New York, Washington D.C., Hong Kong, London, Brussels, Mumbai, Beijing and Abu Dhabi, CFA Institute is a global, not-for-profit professional association of more than 166,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 162 markets, of whom more than 160,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 154 member societies in 74 markets.

2 For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

3 See recommendation 51 of *Independent Review of the Financial Reporting Council*.

4 CFA Institute provided comments on the Brydon Review providing similar comments regarding audits of internal controls. CFA Institute also provide commentary on the Competition & Markets Authority Audit Market Study.

Internal Control Certification
Both CFA Institute and CII have long been supportive of the attestation over internal controls as required by Section 404 of SOX (SOX 404).[5] In particular, we have found the certification of internal controls by management (SOX Section 404(a)) – along with the attestation of disclosure controls and procedures required by SOX Section 302 – has been an effective behavioral change for management. These laws, which clearly place accountability (and legal liability) for internal controls over accounting and financial reporting with the principal officers of the company, have had the effect of increasing the resources necessary to enhance financial reporting. These certifications have had the effect of making upper management accountable for providing resources and attention to these important elements of financial management. We believe similar requirements should be implemented in the UK and, depending upon the respective laws, being attested to by management, directors or both as appropriate to UK law.

Internal Control Audits
We are also supportive of the audit of internal controls as we believe it provides a higher degree of assurance and accountability by the auditor and ensures management takes their certification responsibilities seriously. In complex businesses, testing of – and confidence in – internal controls is an essential element of the audit. As such, reporting on the auditors internal control work is something investors have found useful, and that assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets.

We believe auditors should provide an audit opinion on the audit of internal controls – not simply a communication reflecting their views on internal controls tested as a part of the financial statement audit. This is because, in a financial statement only audit, the auditor obtains an understanding of internal control that is sufficient to assess the factors that affect the risks of material misstatement and to design further audit procedures. However, in an audit of internal controls over financial reporting (ICFR), the auditor's objective is to express an opinion on the effectiveness of the company's ICFR. We believe that ICFR assessments by management only are not enough because management knows such assessments will not be challenged by the auditors if there is no audit of ICFR.

Strong Regulator
Investors have also been supportive of SOX because it created the US audit regulator – the PCAOB. A stronger, more independent, audit regulator who can evaluate audit quality and act as an incentive for auditors to exercise stronger professional skepticism, to mitigate the impacts of the current payor model, is something investors see as valuable.

To our mind, a stronger regulator is an essential and immediate first step in improving audit quality. More effective communication from regulators (globally, not just in the UK) regarding audit quality and the sources, root causes and severity of audit exceptions noted by regulators is an integral element of the improvement regulators must make.

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5 *See, e.g.,* Letter from Ann Yerger, Executive Director, Council of Institutional Investors to The Honorable Christopher Cox, U.S. Securities and Exchange Commission et al. (May 1, 2006), https://www.sec.gov/news/press/4-511/ayerger050106.pdf ("The Council considers Section 404 a core piece of the Sarbanes-Oxley Act and believes it is appropriate for all publicly traded companies, large and small").

CFA Institute and CII appreciate the opportunity to share provide these views and would be pleased to discuss our comments with you. If you or your staff have questions or seek further elaboration of our views, please contact Sandra J. Peters at sandra.peters@cfainstitute.org or Jeff Mahoney at jeff@cii.org.

Sincerely,

/s/ Sandra J. Peters

Sandra J. Peters, CPA, CFA
Senior Head, Global Financial Reporting Policy
CFA Institute

/s/ Jeffrey P. Mahoney

Jeffrey P. Mahoney, CPA, JD
General Counsel
Council of Institutional Investors

cc: Claire Hardgrave (claire.hardgrave@beis.gov.uk)