

Via E-Mail: audit.consultation@beis.gov.uk

July 8, 2021

The Rt Hon Kwasi Kwarteng MP
Secretary of State
Business, Energy & Industrial Strategy
1, Victoria Street
London, United Kingdom SW1H 0ET

Dear Minister Kwarteng:

The CFA Institute appreciates the opportunity to comment and provide our perspectives on the UK Government's consultation, [Restoring Trust in Audit and Corporate Governance: Consultation on the Government's Proposals](#) (the Consultation). CFA Institute¹ is providing comments consistent with our objective of promoting fair and transparent global capital markets and advocating for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related audits – provided to investors and other end users are of high quality. Our advocacy position is informed by our global membership who invest both locally and globally.

We have a long history of promoting fair and transparent global capital markets and advocating for strong investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures – and the related independent audits – provided to investors and other end users are reliable and of high quality.

***BACKGROUND & APPROACH TO CONSULTATION RESPONSE:
CFA INSTITUTE EFFORTS IN SUPPORT OF IMPROVING AUDIT QUALITY***

CFA Institute has long advocated for audit reforms globally including, most recently, reforms to enhance the auditor's report and to increase transparency regarding audit participants (e.g., disclosure of engagement partner names, auditor tenure and use of affiliated firms). We have also advocated for audits of internal controls and auditor oversight reforms brought about by legislation such as the U.S. Sarbanes-Oxley Act of 2002 (SOX Act) and similar regulation globally. We have also contributed to the UK's efforts to reform audit and corporate governance. In 2019, CFA Institute provided comprehensive responses [Sir Donald Brydon's Independent Review of the Quality and Effectiveness of Audit](#) and the [Competition and Market Authority \(CMA\)'s Statutory Audit Services Market Study](#) proposals. Jointly with the Council of Institutional Investors (CII), we also provided our [views](#) to BEIS on the importance of internal controls over financial reporting².

¹ CFA Institute is a global, not-for-profit professional association of more than 181,000 members, as well as 160 member societies around the world. Members include investment analysts, advisers, portfolio managers, and other investment professionals. CFA Institute administers the Chartered Financial Analyst® (CFA®) Program.

² Recently, we also contributed our views to the [FRC](#) on the [Future of Corporate Reporting](#).

We made such contributions because we believe audit reforms in the UK have an impact on other audit markets given the global nature of the listed public companies subject to audit and the interconnected and global nature of the largest accounting firms. As the largest global organization of professional investors who has advocated for meaningful audit reforms in both the US and globally, we have devoted (and we will continue to devote) significant time to our consideration of UK audit reform given both its legacy and contemporary impact on the audit profession – a profession meant to serve the interests of investors and the public interest.

This Consultation represents the culmination of the UK Government’s efforts regarding improving the audit regulator ([Kingman Review](#)), competition in the audit market ([CMA Review](#)) and audit quality ([Brydon Review](#)) in 2018 and 2019. Given our earlier commentary, we believe it necessary to provide commentary on this document – which brings together the UK Governments consultations and recommendations – and to provide investor perspectives on the proposed reforms.

The Consultation – at 232 pages – is extensive and includes some 98 questions. While we have read the entirety of the document, we have only commented on specific matters of interest and provided some overarching observations in the section which follows. CFA UK, a member society of CFA Institute, has also [provided a response](#) to the Consultation.

OVERARCHING OBSERVATIONS

Consultation Falls Short of Expectations: Has the Expectations Gap Been Narrowed?

Audit Quality Requires an Investor-Centric Approach

We believe audit quality is the single most important area that needs significant improvement both relating to the audit process and product and the related regulation. While some of the proposals in the Consultation present bold new approaches, the Consultation, in our view, falls short in that it considers the needs of all stakeholders rather than determining that investors information needs are paramount to audit reform. We believe that any global approach is best commenced with the financial value creation objectives of investors. Conflation of the information needs of investors (participants in the capital markets) with the information needs of a wider group of users may actually reduce the quality and sufficiency of audit and corporate governance reforms.

Consequently, the UK Government’s approach, which appears to harmonize the needs of all stakeholders, ultimately falls short of narrowing the audit expectations gap or addressing the perspectives of investors on the role, responsibilities, and performance of auditors. Moreover, the proposals do little to advance the information communicated by auditors to investors. In fact, the UK Government’s rejection of investors’ expectations on important items such as management attestations and audits of internal controls over financial reporting and disclosure of audit fees reduces the credibility and utility of the reforms.

Furthermore, with a long to do list for the new regulator, as we describe below, combined with the fact that considerations set forth in the Consultation rely on potential or forthcoming revisions of: the Corporate Governance Code³, Stewardship Code⁴, a new paradigm of corporate reporting recently proposed by the Financial Reporting Council (FRC), and the relationship to corporate law (Companies Act), Listing Rules, and professional standards; results in a lack of clarity of these meaningful and core principles and presents a significant challenge in envisioning the full scope of the proposed reforms.

³ Chapter 5: “Subject to consultation responses, the Government proposes to invite the FRC to implement these stronger arrangements through changes to the UK Corporate Governance Code

⁴ See 7.3.10: “The Government also invites the regulator to consider revisions to its guidance on the recently revised Stewardship Code to promote greater engagement from investors on matters relating to audit quality.”

Overall, stepping back from the Consultation and all its contents, it is a challenge to collectively assess whether the proposed reforms in the aggregate actually address the much discussed “expectations gap” and what, and when, the audit market will be considered reformed.

Stakeholders to the Audit Process:

How Are the Responsibilities of Investors’ Intermediaries Changing? More Synthesis Necessary

While we have read and considered each of the Consultation’s 232 pages, as an investor organization we must not only read and analyze the changes but synthesize all these reforms and their resulting impact on audit quality and investment risk.

Investors must inherently rely on agents and intermediaries such as the audit committee, auditing firms, and regulators to protect their interests and ensure the performance of high-quality audits. Review of the Consultation, therefore, requires investors to ask themselves: how are the responsibilities of all the intermediaries upon which they rely (i.e., management, company directors, audit committees, auditors, and regulators) really changing? In the aggregate what is likely the consequence of such changes? There is nothing in the Consultation that provides such synthesis for investors.

Stepping away from the details of the Consultation, it would appear the UK Government’s most significant audit reform is relative to replacing the FRC with the new Audit Reporting and Governance Authority (ARGA) – as we address in the following paragraph. While certainly stronger enforcement by a regulator can be an effective deterrent, such enforcement must be swift, strong, visible and frequent. Further, a reputation of strong enforcement must be established by the new ARGA and the UK Government for investors to see evidence of credible deterrence. Further, while we are supportive of changes to strengthen ARGA, reliance on regulators is generally not the most immediate or preventative control as detection may be delayed or reactive rather than proactive.

We think it is necessary for BEIS to analyze the reforms by stakeholders and intermediaries to the audit process. In addition to considering the net effect of the reforms to the audit regulator as noted in the preceding paragraph, there needs to be an analysis of the impact of the reforms on all the intermediaries, for example:

- 1) ***Management*** – While management may be required to provide more disclosure of distributable reserves and prepare a more expanded Resilience Statement, they are not required to perform an assessment or certification of internal controls over financial reporting.
- 2) ***Auditors*** – While auditors must design an operational split to their firms, the details yet are to be determined; they will not be required to provide an analysis of the audit fees by audit area and staff level, and they will not be required to perform an audit of internal controls over financial reporting. There are also no changes to auditing or fraud standards as a result of the Consultation.
- 3) ***Audit Committee*** – The audit committee may have stronger oversight by ARGA, but it is not clear from the Consultation when and how ARGA will define such oversight.

What investors need is an itemized inventory and analysis (matrix) of the proposed reforms discussed in the Kingman, Brydon and CMA Review, along with an explanation of how the UK Government’s proposals in the Consultation will achieve the desired objective. In the present form, stakeholders are left to inventory and assess how reforms proposed by Kingman, Brydon, and CMA, have been addressed, or passed upon, and what the net result of all these reforms amount to – and when they will occur. An important matter for investors will be the resulting changes that have been made to the responsibilities and obligations of the intermediaries upon which they rely. An analysis of the resulting changes and a proposed timetable by intermediary would allow investors, and other stakeholders to the rulemaking, to assess the net result of the audit reform process. Without a clear picture of the nature, timing, and extent

of changes in roles and responsibilities of management, directors, auditors, and regulators, it will be difficult for investors and other stakeholders to take confidence in the breadth and scope of the reforms.

The Audit Reporting and Governance Authority: An Empowered Regulator, Protecting the Interests of Many Stakeholders, But with a Very Long To Do List (10)

An Empowered Regulator – We are very supportive of the proposal for an independent, self-funded, regulator with broad authority and a charge to improve audit quality. We also support, in general, the UK Government’s proposal to grant ARGA the necessary statutory authority to gather information, to conduct and report on meaningful audit firm inspections, to adopt appropriate rules and standards, and to rigorously enforce those rules and standards. ARGA must also have the authority to conduct investigations – including obtaining information from third-parties – and the ability of ARGA to enforce its rules, standards, and regulations with meaningful measures.

Protecting and Promoting the Interests of Many, Possibly Too Many, Stakeholders – The Consultation notes the proposed general objective of ARGA will be: “[t]o protect and promote the interests of investors, other users of corporate reporting and the wider public interest.” This, in our view, may be difficult to implement as it is vague and very broad. Financial reports and audit reports serve as the primary communication between companies seeking capital and investors providing capital. The accounting standards upon which those financial reports have been built are developed with the view that capital providers are the audience for the financial statements and financial reports are the anchor to most corporate annual reports. As such, providing ARGA with a remit that is broader than the audience for the financial statements may present an oversight and regulatory challenge for the new ARGA as not all stakeholders interests are aligned and the information being provided is not fit for all stakeholders purposes. As we have stated in the past, we believe that any global approach to improving corporate reporting is best commenced with the financial value creation objective of investors. In this way, jurisdictions don’t dismiss the proposals based upon the objectives or audience of the information, or its location. This is not to say that the information needs of other stakeholders are not important. Investors, in fact, are not a monolith and want to invest, for themselves or for their clients, based upon these civil society and policy objectives. Moreover, the aforementioned objective presumes that all users of corporate reporting share common perspectives and interests – which they do not. ***Accordingly, we worry that the Consultation sets at the feet of ARGA a responsibility to all corporate report users where the anchoring information – the financial statements – is not meant to serve the interests of this wider public interest.***

Significant Expectations, Long To Do List – ***The Consultation sets forth lofty expectations for ARGA, but few details in many cases. There are many activities that ARGA must undertake to bring the proposals in this Consultation to life.*** For example, the Brydon Review emphasized the importance of investor engagement, however, the Consultation simply defers to ARGA the duty to publicize channels for engagement. While we note the creation of the FRC’s new Stakeholder Engagement and Corporate Affairs team, we continue to believe that ARGA should be an investor-centric regulator. As stated above, we believe that incorporation of investor feedback is critical for the success of the new regulator. ***Accordingly, we believe ARGA should form an Investor Advisory Committee (IAC) to advise ARGA on investor perspectives and priorities. Consideration should also be given to establishing an office within ARGA that is dedicated to engagement with and outreach to investors.***

Moreover, as we note above, considerations set forth in the Consultation rely on potential or forthcoming revisions of the Corporate Governance Code, Stewardship Code, a new paradigm of corporate reporting recently proposed by FRC, and the relationship to corporate law (Companies Act), Listing Rules, and professional standards. How changes to these meaningful and core principles will manifest themselves presents a significant challenge in envisioning the full scope of the proposed reforms.

There are many other examples of actions necessary by ARGA, but no specific to do list with a timing of when and how ARGA will effectuate all these proposals. We believe BEIS and ARGA should publish a list of action steps and timeline to their completion such that progress can be measured by constituents.

SPECIFIC ITEMS OF COMMENT

As we note above, we are not responding to every question or every topic included in the Consultation. Below we include our thoughts on topics we considered top priorities for investors in our previous commentary and how they have manifested in this Consultation.

ARGA: Supervision of Corporate Reporting (4)

Power to Direct Changes to Company Accounts (4.2)

The Consultation outlines additional powers for ARGA as it relates to supervision of corporate reporting. ***We support the Consultation’s recommendation that ARGA should have all the powers necessary to fully supervise corporate reporting***, including ensuring that disclosures made outside the context of the corporate report are not inconsistent or misleading. ***The power to direct changes*** to the company accounts, while a potentially powerful tool, ***may only come too late to protect investors, and may create a form of moral hazard*** if directors believe that ARGA provides a backstop for completeness and accuracy of the financial reports.

Power to Publish Corporate Reporting Reviews (CRR) Correspondence and Summary Findings (4.2)

We strongly support the proposal to provide additional transparency for investors about the outcomes of reviews, including deficiencies or shortcomings identified by ARGA in corporate reporting. The U.S. SEC discloses its reviews of the filings of public companies.

Extension of Corporate Reporting Review Powers, including a Wider Range of Investor Information (4.2)

We agree with the Consultation’s proposal that ARGA’s review authority should be extended to the entirety of annual reports, including the proposed Resilience Statement, the proposed Audit and Assurance Policy, and the other corporate governance items in addition to other significant items published by corporations (such as earnings guidance and press releases).

ARGA: Enhanced Enforcement Powers

We support the Consultation proposals to grant the authority and power to ARGA to enforce duties related to corporate reporting and audit and holding all appropriate parties accountable. Vigorous enforcement is central to ARGA’s mandate.

ARGA: Supervision of Corporate Auditing & Audit Quality

Inspections of Statutory Auditors (9.2)

We strongly support the proposal to provide additional transparency for investors in the audit firm inspection reports. Transparent audit firm inspection reports will provide investors with new insights about firm performance and will also collectively encourage firms to compete on audit quality rather than on commoditized audit fees. ***We caution, however, that too much redaction could render them low utility.*** Summary reports have the potential to communicate certain information, but summary reports should not be considered a substitute for individual audit firm reports, which would be useful to investors and audit committees, who are charged with ensuring audit quality.

Setting Principles of Corporate Auditing (6.3)

We supported the Brydon Review proposal (6.4.2 of the Brydon Review) that modernization of the audit principles should be undertaken – which unfortunately were only highlighted but not met with any

particular action step in the Consultation. Setting forth the obligations of the auditor in a clear and concise manner helps all market participants as they consider the work of the statutory auditor. Further, the principles, and a new legal framework, would enhance ARGA’s ability to hold auditors accountable for deficiencies.

Auditor Tackling of Fraud (6.5)

Investors believe that auditors should undertake all reasonable steps to uncover and report material frauds. We concur with the need to modernize the auditing standard to account for the current environment and the expectations of investors. ***We also recognize that this is no small feat, including reaching a common, well understood, definition of fraud.*** We also believe, as noted below, that auditors should be obliged to report material matters to ARGA. We also believe that implementation of a whistleblower protection program could be a game changer for ferreting out fraud, which we have addressed in a separate section below.

Authority over Audit Committees (7.1)

In our [comment letter](#) to the [CMA Review](#) we set forth our views on regulatory oversight of the audit committee and expressed how important we thought such oversight was to improving audit quality. As we read the Consultation, we are not sure what the regulatory oversight will ultimately be and how it will be manifested. This appears to be a key item on ARGA’s to do list. We believe that ARGA should have all the power necessary and appropriate to enforce audit committee oversight.

We also believe that audit committee reporting should be enhanced to provide investors with more information about their oversight of the audit, including tenders, audit fees, and specific measures or metrics used to monitor audit quality.

Shareholders’ Ability to Raise Concerns (9.2)

We believe that audit committees, auditors, and ARGA should enhance their channels through which shareholders (and others) may raise concerns or complaints. We believe that two-way communication must be facilitated.

Internal Controls: Management Attestation & Auditor Assurance

(2.1: Stronger Internal Company Controls)

As the Consultation notes, “*Confidence in company reporting depends on the effectiveness of the internal controls and risk management processes...*” We have found that the combination of management and auditor representations as to the effectiveness of the internal controls over financial reporting (ICFR) have been an important driver of confidence in the integrity of financial reporting. This is the reason we provided a [letter](#) to BEIS on the topic under separate cover in late 2019 following the Brydon Review supporting such reforms.

CFA Institute has long been supportive of an evaluation by both management and the auditor as to the effectiveness of ICFR. ***We have found the report of the assessment of internal controls by management (SOX Section 404(a)) – along with the attestation of the disclosure controls and procedures (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 credible financial reporting. Consequently, these certifications have had the effect of making upper management accountable for providing resources and attention to these important elements of financial management.***

In complex businesses, testing of – and confidence in – internal controls is an essential element of the audit. As such, auditor reporting on internal control work is something investors have found useful. Further, assurance is an important driver of confidence in the integrity of financial statements and in the fairness of our capital markets.

The absence of any meaningful proposals to strengthen the accountability and the oversight of internal controls is very disappointing. The Consultation rejected many of the Brydon Review suggestions.⁵ Further, the Consultation provides for options which, in our view, represent minor incremental changes over the status quo and do little to significantly advance the current landscape. The UK Government's proposal is very disappointing and, in our view, may provide investors with a false sense of comfort about the strength of an entity's ICFR, when in fact no transactional testing may have been performed (e.g., assessing the "design" or the "entity" level controls).

Further, as we experience the dialogue amongst stakeholders on these options, we believe there is confusion and a misperception or misunderstanding regarding what the UK Government's proposal will actually accomplish relative to standards on management attestation and audits of internal controls over financial reporting in other jurisdictions.

We believe auditors should provide an audit opinion on their assessment 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 controls 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, the auditor's objective is to express an opinion on the effectiveness of the company's ICFR. We believe that the options presented in the Consultation are not sufficient because management knows such assessments will not be challenged by the auditor if there is no audit of ICFR. It is essentially a self-assessment, and one that does not require monitoring or measuring control risks associated with financial reporting.

We believe the UK Government should reconsider this element of the Consultation as the UK is lagging other jurisdictions on this important aspect of financial reporting and audit quality and makes the UK less competitive in the pursuit of investment capital – increasing the cost of capital. Recent literature indicates that firms exempt from the attestation requirements can make additional common equity more costly.⁶

The narrative that management and auditor assessment of internal controls over financial reporting is too expensive is one that used to exist in the US market. It is a common, but undemonstrated, narrative regarding virtually every accounting, disclosure and audit reform. Investors view the benefits of audits of ICFR as exceeding the costs. The US market has seen a reduction of restatements and blow-ups – like Carillion – over the last two decades. ***Investors are in near unanimous agreement that ICFR management attestations and audits have demonstrated they are cost effective.***

The behavioral change of this change in management and auditors' responsibilities should not be underestimated.

⁵ Independent review into the quality and effectiveness of audit, paragraphs 13.1.8, 13.1.11 and 13.1.12

⁶ David Webber, Yanjua Sunny Yang, The Debt-Equity Choice When Regulatory Thresholds are Based on Equity Values: Evidence from SOX 404, *The Accounting Review* (2020) 95 (2): 339–364.

Transparency of Company Dividends and Capital Maintenance (2.2)

We agree that certain high-profile examples of companies paying out significant dividends shortly before profit warnings and, in some cases, insolvency, have raised questions about the robustness of the dividend and capital maintenance rules - and the extent to which they are being respected and enforced. ***We support proposals for additional transparency and disclosure regarding the calculation of distributable reserves and estimates of the dividend paying capacity, including robust disclosure of any constraints. Our view is that for the computation of distributable reserves and estimates of dividend paying capacity to improve, there must be improved disclosure such that policymakers and regulators can discern the computational improvements needed.***

Further, ***our view is that management and the board of directors – first and foremost, rather than the auditor – should be responsible for these computations and disclosures.*** The proposed Resilience Statement may be an appropriate location for directors to set forth their policy, approach, and calculation. Any change, however, should have broad application without limit to only a certain subset of UK companies.

A Resilience Statement (3.1)

We support the UK Government’s proposal to increase the quality of disclosure to investors about a company’s viability and resilience. ***We agree that ARGA will need to provide meaningful guidance about the specific items that should be disclosed. We believe, however, that how a company addresses ubiquitous risks or threats, such as cyber-threats or risks to the supply chain, should be required for all companies. The proposed minimum standards for short-term, medium-term, and long-term horizons appear reasonable.***

We do not believe that the resilience statement would be an appropriate location for sustainability disclosure (such as that called for by TCFD) or how a company addresses climate-related risks.

We note that the UK Government’s proposal requiring at least two reverse stress testing scenarios, while a common methodology for financial institutions, is uncommon among operating companies or funds. However, the exercise should be valuable for management and for investors to understand the choice of the most likely scenarios made by the company. We caution that the disclosure should not be boilerplate but tailored to the specific risk factors of the company.

We also believe that the Resilience Statement should be subject to auditor review.

Audit and Assurance Policy (3.2)

Investors have little transparency into oversight of the performance of the audit. ***Accordingly, we are supportive of the proposal for providing investors with more information about the performance of the audit. We believe that the policy and the related disclosure should cover how the directors’ have satisfied themselves that the information not subject to audit or assurance is reliable,*** such as alternative performance measures (APMs) or Key Performance Indicators (KPIs).

We support additional investor engagement but question the practicality of obtaining a shareholder vote on the policy. Further, we question whether audit committee accountability and responsibility may be side-stepped by pointing to an investor vote. We believe, however, that the disclosure should include a discussion of how the audit committee obtained and incorporated investor views in the policy.

We also believe that ***the audit and assurance policy misses the mark by leaving out important information*** about: (1) how the ***audit committee assessed audit quality***, including the use, if any of indicators of audit quality, (2) how the audit committee ***determined the auditor’s appointment*** or

reappointment, (3) how the *audit committee assessed materiality* and *whether any key audit matters were discussed* and (4) *audit fees* (and how independence was maintained, if there were non-audit services provided). The absence of such transparency, which many investors believe is a staple of any meaningful reform, is disappointing.

Malus and Clawback (5.2)

We believe that a clawback requirement is appropriate in circumstances in which compensation targets were achieved due to certain behaviors such as misconduct, fraud, inaccurate financial information, the misrepresentation of financial performance, or other inappropriate conduct that leads to investor loss. As the Consultation notes, listing rules could ensure that companies adopt a remuneration recovery policy. In addition, the UK Government should consider granting the power to ARGA to order repayment, if necessary and appropriate in the public interest.

Audit Purpose and Scope (6.1, 6.2)

We agree that the scope of the *audit has not kept pace over the decades that have rapidly transformed business models due to increased globalization and technological change*. As the Consultation notes, companies routinely provide information outside the context of the statutory audit. We continue to believe audit quality is the single most important area that needs significant improvements both relating to the audit process and product and the related regulation.

Without question, the privileged access of the auditor to corporate insiders, directors, and a wide variety of operational data provides an opportunity for additional verification, validation, and assurance. ***We agree that auditor’s obligations should include consideration of wider financial (published and unpublished) and director conduct in their audit responsibilities***. For example, auditors should consider climate-related commitments and whether such commitments are consistent with the assumptions and estimates used in preparation of the financial statements. Further, ***we believe that auditors should “read and consider” material information, such as investor presentations and news announcements, since this information may relate to assumptions, or estimates contained within financial statements***.

We also support the proposition of modernization of the audit profession and audit scope. We also agree that auditors should consider the behavior or conduct of directors and other insiders in reaching their judgements. Many accounting standards require the assessment of the “intent” of management, such as the intended use or life of assets, the assumptions and estimates of fair value, accounting for derivatives, assessing impairment, and many others. Moreover, clarity and transparency of an auditor’s duties would benefit both investors and ARGAs.

Auditor Reporting (6.5)

We agree with the Consultation that auditors should provide investors and other users with more meaningful and useful information about the conduct of the audit and the outcome. ***Significant efforts and investor-paid costs go into an audit, yet investors are provided very little information. CFA Institute members have consistently supported efforts to enhance the quality, relevance, and value of auditor reporting. The audit report is the primary mechanism for auditors to inform investors about the performance of the audit***. We agree that auditors should report on the proposed new duty to consider wider information in the conduct of the audit. In addition to the specific elements detailed in the Consultation, we also believe that the ***auditors should provide details about quantitative and qualitative materiality and the factors used in assessing materiality levels***. Auditors should also provide primary disclosure of the reasons for any auditor departure.

The FRC and UK Government reviews have identified a “chink in the armor” in its early warning system to regulators. As the Consultation discusses, statutory protections apply to certain disclosures made by

auditors to the Financial Conduct Authority (FCA) and the Prudential Regulatory Authority (PRA), but those same protections do not extend to auditors of public interest entities (PIEs) which are not FCA or PRA authorized firms. ***We agree with the recommendations that equivalent statutory protections should be extended to auditors of PIEs.***

We also observe that a mere checklist of items for disclosure may not achieve the intended purpose or result of auditors providing an early warning. We encourage the application of a dynamic assessment of trends, transactions, events, and other information (e.g., all available information) that would reasonably be likely to result in information indicating that a material breach of a regulatory requirement has or likely has occurred. Further, the auditor should also consider whether the information, if known, would likely result in ARGA exercising early intervention. ***We encourage setting forth principles that require auditors to use all available information and their cumulative knowledge, regardless of whether obtained during the performance of an audit, a review, or the provision of non-audit or other professional services in their assessment.*** As the Institute of Chartered Accountants of England and Wales (ICAEW) noted, auditors depend on their cumulative knowledge (including the provision of non-audit services) when understanding the business and identification of key issues. Further, we believe the expectation for reporting should be as soon as practicable by the auditor, rather than defining a specified timeframe for the disclosure or at the time of the issuance of the audit report.

True and Fair View Requirement (6.6)

We believe that there must be no “true-and-fair-view override.” If the “true-and-fair-override” is to be invoked, it is our view that there must be presentation of the amounts required under the applicable accounting standards with a discussion of the override items in the notes to the financial statements.

Professional Auditors (6.9)

We support the view in the Consultation that assurance services can be provided by auditors and others. We support a regulatory paradigm that addresses all who provide such services to ensure a level playing field and consistency in quality.

Audit Committee Engagement (7.3)

The current state of technology and the virtual networks that been developed during the pandemic should provide new opportunities for audit committees to engage with shareholders. ***We also believe that auditors should establish a mechanism to increase the nature and extent of engagement with investors.***

Audit Market: Competition and Resilience (8.1, 8.3)

While we support the principle of increased competition, choice, and resilience in the audit market, it is unclear how some of proposals in the Consultation will achieve the stated objectives. For example, the proposal for a mandatory shared audit regime seems cumbersome and difficult to implement. ***While better than joint audit – a concept we strongly disagreed with – it is not clear from the Consultation how this would contribute to improved audit quality, how investors would observe or understand the differences in the scope and responsibilities of the shared audit regime, nor most importantly to the objective of implementing the shared audit regime, how this enhances competition, choice, or resilience in the audit market.***

We also have difficulty understanding how the market share cap would be implemented and how it would directly correlate with an improvement in audit quality.

We also support the monitoring of the audit market by ARGA. Market studies and other examinations should be publicized.

Operational Separation Between Audit and Non-audit Practices (8.2)

We note that FRC is continuing to implement operational separation of the largest audit firm practices in the UK. ***We are interested in transparency of those plans, their assessed effectiveness, and publication of financial statements. How these plans are actually effectuated and operationalized is a major issue of interest for investors. Investors want to know that audit is a profitable, independent business. Failure to disclose audit fees – as noted above – is a missing element of this analysis.***

We support providing ARGAs with all necessary powers to best serve the public interest through promulgation of standards of quality assurance for audit firms and their related enforcement.

Whistleblowing (11.7)

We support the Brydon recommendation – but not included as part of the Consultation – that there should be legal protections for whistleblowing disclosures made to audit firms and audit partners, as well as directly to the regulator.

Tips remain the most common way that fraud is detected, and the vast majority of the suspicions are reported to supervisors, investigators, and other interested persons.⁷

The Consultation notes a concern that by protecting workers with statutory whistleblower protections, commercially confidential information could be transmitted to the PIE’s audit firm. In practice, auditors often encounter commercially confidential information in the due course of conducting audit, interim procedures, or in the performance of non-audit services. Various ethics codes require the auditor to comply with the principle of confidentiality when encountering commercially confidential information. In fact, one questions the ability of the auditor to discharge professional responsibilities without any access to commercially confidential information.

Further, the Consultation notes that “[i]t remains important that auditors are made aware of issues with their client” but then appears to preclude the auditor from obtaining potentially critical information from whistleblowers because it would be burdensome and related to “issues not within the scope of the audit.”

It would be helpful to have more information of the nature and extent of the “risks around disclosure of commercially confidential information to the audit firm” and how potential whistleblower tips would fall outside the scope of the audit.

Moreover, it appears that the Consultation does not address the risks of failing to adopt whistleblower protections, such as latent discovery of fraud, the lack of reporting of fraud to regulators and other stakeholders, and the risk that without an appropriate and protected avenue to raise their concerns, potential whistleblowers may report outside of the regulatory structure, such as to the press. Adopting meaningful protections for whistleblowers serves the entire financial ecosystem, not just those harmed by fraud.

⁷ [Report to the Nations](#), ACFE, 2020.



Thank you for your consideration of our views and perspectives. If you have any questions or seek further elaboration of our views, please contact Sandra J. Peters at sandra.peters@cfainstitute.org or Robert Peak at robert.peak@cfainstitute.org

Sincerely,

/s/ Sandra J. Peters

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