



In March 2021, the Department for Business, Energy and Industrial Strategy (BEIS) launched its consultation on “Restoring trust in audit and corporate governance”. KPMG LLP’s media statement issued when the consultation period closed on 8 July 2021 is on this [link](#) and our overall response is summarised below.

## Overall

**We support the broad direction of the reforms.** Reliable corporate reporting is vital to well-functioning financial markets, business investment and growth. Our financial regulatory system must be fit for purpose and internationally competitive so that we continue to be an attractive destination - for business and investment and as a magnet for talent.

**Audit has a role but, critically, others do too.** We are pleased that the BEIS consultation recognises both the importance of auditors’ work and that all parties within the corporate reporting ecosystem have a role to play for these reforms to be successful.

**Sequencing, prioritisation and careful implementation will be key.** Collectively, the consultation proposes a large number of individual reforms and this in itself presents a challenge. It’s important that sufficient time is given for effective implementation of these proposals, particularly given the complex legal framework considerations and other interdependencies which need to be taken into account.

**Recommendations which require investment, but will “move the dial”** in our view are:

- **the creation of ARGA**, a regulator with statutory powers, to regulate across the boardroom, rather than just those directors who belong to a professional accountancy body, which will address certain asymmetries.
- **a new framework for Internal Controls** reporting provided these are accompanied by a requirement for independent assurance. As seen in the United States, this can help drive reliable, higher quality, timely financial reporting, as well as significant economic benefits and act as an early warning indicator for fraud.
- **the new Resilience Statement** and revision to capital maintenance disclosures. This will give shareholders the information they want to understand the threats to a company’s business model over different timescales, the capital position of the business (including solvency) and the processes implemented by the Directors to withstand those risks and manage the capital position of the entity.

## Measures where we have concerns

- **Extension of operational separation** - We are supportive of the FRC’s model for operational separation in the UK, but any move to go further than this in future would likely threaten the overall success of the reforms.
- **Managed shared audits** - While we continue to support greater choice within the audit market, the route by which to get there remains problematic. The proposals create significant challenges, for example the duplication of work, increased costs for businesses and possible difficulties in identifying an appropriate UK subsidiary to share.

## The following factors must be considered for the reforms to succeed:

- Market capacity and capability
- Attractiveness of the profession (for both auditors and directors)
- Attractiveness of the UK in a global setting
- Proportionate costs and benefits aligned to clear aims
- Giving sufficient time for new measures to take effect



## Specific proposals

### *Chapter 1 - Public Interest Entities (PIEs)*

It is our view that changes to the auditing and corporate reporting requirements for PIEs (considered within the rest of the consultation) should first be finalised and implemented by existing PIEs before consideration is made as to the expansion of any definition of PIEs.

We believe it is important to clearly define what makes an organisation in the “public interest” and to determine the right criteria to measure which entities should be considered as PIEs.

### *Chapter 2 - Directors’ accountability for internal controls, dividends and capital maintenance*

#### *Stronger internal company controls*

We are in favour of a new internal controls framework with mandatory assurance based on benefits observed in the US following implementation of Sarbanes Oxley (SOx).

We support a regime closely aligned to SOx.

#### *Dividends and capital maintenance*

In our view, it should be possible to create a robust model for dividends and capital maintenance that meets the needs of shareholders and other stakeholders by implementing a strengthened solvency test. We are supportive of a solvency statement with alignment of time periods covered with the Resilience Statement – detailed guidance as to how this will operate in practice will be required. We support narrative disclosure of a group’s future dividend paying capacity.

### *Chapter 3 - New corporate reporting*

#### *Resilience Statement*

We are supportive of the introduction of resilience statements, with specific consideration of the following:

- Common list of risks must not become boilerplate
- Alignment of time periods (particularly with the Solvency Statement)

#### *Audit and Assurance Policy (AAP)*

We are supportive in principle but note that shareholder engagement is critical to the success of this recommendation. We believe publishing the AAP initially every three years might be more proportionate than doing so annually and would still enable companies to reap the benefits of performing such an exercise. We would recommend running a trial period for the advisory shareholder vote to assess the level of engagement. We have suggested an alternative whereby the regulator determines a mandatory scope of broader assurance based on engagement with investors (e.g., controls, KPIs impacting remuneration), which will improve comparability.

#### *Reporting on Payment Practices*

We agree that the disclosure of entity’s relationships with key suppliers may be relevant to shareholders and other stakeholders. Prompt payment of suppliers should be part of a company’s social responsibility, and therefore we are supportive of its inclusion within the Annual Report and Accounts.

#### *Public Interest Statement*

We believe in principle there is a need for companies to provide information about how they view their obligations in respect of the public interest. We are supportive of a separate report to address other stakeholders’ needs.

## Chapter 4 - Supervision of corporate reporting

We are generally supportive of proposals to strengthen the regulator's Corporate Reporting Review function. We support ARGA having powers to direct changes to the annual report and accounts, but an appeals process and appropriate checks and balances are required, as well as consideration of legal challenges. We believe that transparency of the Corporate Reporting Reviews can be achieved without requiring the publication of all correspondence during the process.

## Chapter 5 - Company Directors

### *Enforcement against company directors*

We are supportive of ARGA having powers to hold PIE directors to account in the same way as auditors and have recommended the following:

- Enforcement must be transparent and proportionate
- Measures must not deter people from becoming directors
- Must avoid duplication with other regulators / bodies
- Clear guidance from ARGA needed to ensure rules are applied proportionately, transparently and consistently

### *Strengthening clawback and malus provisions in directors' remuneration arrangements*

We believe it is helpful to include a framework designed to build confidence in corporate governance by ensuring that remuneration can be withheld or recovered in the event of serious director failings although we note that the UK Corporate Governance Code currently provides such provisions.

Government should provide companies with both guidance as to how to interpret the various triggers and sufficient leeway to apply them in practice.

## Chapter 6 - Audit purpose and scope

### *The purpose and scope of audit*

We support the broader redefinition of the purpose of audit. We believe that the inclusion of wider information within the statutory audit remit could increase the relevance of the opinion, aligning more closely with the risks associated with the business. However, there is a need to consider the legal impacts of such a change.

We believe that ARGA should put a detailed framework in place, covering wider auditing services alongside the expectations of and accreditation of those performing these services.

We believe that the regulator should oversee the audit or assurance work performed over wider information within the financial statements; this would be easier if ARGA has a role in determining what should be mandatorily assured (see AAP).

### *Principles of corporate auditing*

We are supportive of a set of overarching and binding principles to govern the operations of audit and assurance providers; however we do not consider this to be one of the key reform priorities.

### *Tackling fraud*

We are supportive of greater clarity of the responsibilities of directors and auditors in relation to the prevention and detection of fraud. We have recommended this is covered by the proposed new internal controls reporting.

### *True and fair view requirement*

We agree that the true and fair requirement and associated override is an important 'safety valve' and that there are no systemic issues with the current requirements and their application.



### ***Audit of Alternative Performance Measures (APMs) and Key Performance Indicators (KPIs) linked to executive remuneration***

We believe that APMs and KPIs used in determining executive remuneration should be mandatorily in scope for assurance.

#### ***Auditor liability***

A number of the reforms currently proposed will potentially increase the scope and extent of auditors' liability. In our view, serious consideration should be given to introducing mandatory liability capping provisions. Anything less is unlikely to gain the required traction as there is no incentive for companies and their shareholders to voluntarily agree to limit the liability of their auditors.

#### ***A new professional body for corporate auditors***

Instead of setting up a separate professional body focused on only auditing, we would encourage greater development of professional auditing skills within existing professional bodies to achieve the desired outcomes.

## **Chapter 7 - Audit Committee Oversight and Engagement with Shareholders**

### ***Audit Committees – role and oversight***

While in our experience Audit Committees of FTSE350 companies generally take their responsibilities seriously and discharge them diligently, we are supportive of minimum standards and have recommended these standards cover all aspects of the role, not just appointment and monitoring of auditors.

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

We support initiatives that will contribute to improved interactions with shareholders (as a body). However, we would not advocate formal approval by investors of planning matters for each audit including scope or materiality as these should not be set in stone, but flex through the audit depending on changes in the company's circumstances. This responsibility should remain with a company's Audit Committee which is responsible for overseeing the audit.

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

### ***Market opening measures***

We are supportive of greater choice within the market. However, proposals for managed shared audits create significant challenges to implementation and risk duplication of work, increased costs for businesses and possible difficulties in identifying an appropriate UK subsidiary to share. Furthermore, although these measures are intended to help address the issue of choice in the UK audit market, we have seen no evidence that they will have a positive impact on audit quality. However, we have previously offered to participate in a pilot and remain committed to help find solutions to these challenges.

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

While supportive of current voluntary measures in the UK as detailed in the Financial Reporting Council's (FRC's) Principles for Operational Separation (which we are already implementing), we do not support full legal separation or separate profit pools, as these could risk damaging audit quality and reduce the scope to invest in and maintain current audit operations.

## **Chapter 9 - Supervision of audit quality**

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

We are supportive of transparency and publication of anonymised Audit Quality Review reports. However, we believe there is a risk that un-anonymised reports could impact the capital markets and the attractiveness of the profession.



## Chapter 10 - A strengthened regulator

### *Establishing the regulator*

We are supportive of ARGA becoming a statutory regulator however:

- Reference to it becoming an improvement regulator should be included in its remit
- There needs to be an appeals process and appropriate checks and balances

We believe that competition powers should remain with the CMA alone, to avoid duplication.

## Chapter 11 - Additional changes in the regulator's responsibilities

### *Supervision: Accountants and their professional bodies*

We consider it important that there is a mechanism for professional bodies to be able to have an alternative view to ARGA.

With the proposals for ARGA to hold all directors to account, as well as providers of assurance / wider audit services, we agree that at this time, enforcement powers could be restricted to those who are members of professional accountancy bodies.

### *Oversight and regulation of the actuarial profession*

The replacement of the FRC with ARGA would present a good opportunity to establish a new focused actuarial regulatory body. Either a stand-alone Actuarial Regulator, or at least a segregated Actuarial Regulator within ARGA, with a sole remit around the actuarial profession.

Where actuaries work as part of audits, we note the proposed approach would lead to inconsistent treatment compared with other audit specialists such as tax specialists or property valuation specialists.

### *Powers of the regulator in cases of serious concern*

We do not believe that auditors are hesitant from disclosing information to regulators when there is a duty to report even though they don't have statutory protection.

We believe ARGA should look to other regulators on how they approach publishing summaries of expert reports. We envisage that there would be limited instances where companies or audit firms would not work with the regulator to agree an appropriate implementation plan to address recommendations made, meaning publication of reports would rarely be required.

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