



Financial Reporting Council

Position Paper

Restoring Trust in Audit and Corporate Governance

July 2022

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Introduction

1. The publication of the Government Response to the consultation on strengthening the UK's Corporate Governance, Corporate Reporting and Audit systems sets out the Government's policy positions responding to the three independent reviews on the audit product (Brydon¹), statutory audit services market (Competition and Markets Authority²), and the Regulation of that market (Kingman³). The Government Response sets out the reforms the Government proposes to legislate for and covers the respective responsibilities of directors and their responsibilities for governance, internal control, and corporate reporting; preparers of financial and non-financial information (usually professional accountants); auditors and providers of assurance services, and actuaries.
2. In its response, the Government has indicated that it intends to implement policy through a range of measures. Some will require primary legislation, and the Government has indicated in its briefing for the Queen's Speech that work will begin to draft a Bill for publication, which it will take forward subject to the availability of Parliamentary time. Other measures will be addressed through secondary legislation, changes to existing regulatory measures (including Codes, Standards and Guidance), and market driven measures.
3. This Position Paper sets out how the Financial Reporting Council (FRC) will support the Government's reforms as we transition into the Audit, Reporting and Governance Authority (ARGA). This focuses on five broad areas:
 - Revisions and additions to the existing suite of Codes, Standards and Guidance to implement reforms;
 - The development of new standards in shadow form to allow for voluntary adoption ahead of legislation e.g., Minimum Standards for Audit Committees;
 - Setting expectations for the markets we regulate to drive behavioural changes ahead of statutory powers, following the successful approach we have taken regarding the Operational Separation of the Audit Practice in the largest UK Audit Firms;
 - The development of guidance to address issues set out in the Government Response, subject to that guidance meeting the bar set by Sir John Kingman, that ARGA should be sparing in its issuance of guidance and focused on those areas where it has expertise; and
 - Setting high-level expectations around the future supervision and monitoring activities which will flow from the proposed revisions to existing Codes, Standards and Guidance and the creation of any new such documents.
4. As the Government moves forward with legislation, we expect there will be further actions that the FRC needs to undertake support the transition to ARGA, in particular to address revised statutory regulatory requirements for directors and preparers. As these become clear, we will communicate our proposals to stakeholders publicly.
5. For the sake of completeness, the reform package also covers two additional areas – regulation of the Actuarial Profession and the Institute and Faculty of Actuaries, and the development of ARGA as the Systems Leader for Local Authority Financial Reporting and Audit, in response to the recommendations made in Sir Tony Redmond's independent review⁴. Regulation of the accountancy profession is not covered in this paper, which deals primarily with actions the FRC intends to take ahead of legislation.
6. The purpose of this Position Paper is to provide clarity on how the FRC will address issues in the Government Response which currently fall within our remit. It allows our stakeholders to understand how that work will be delivered, by building on the "what" in the Government Response and explaining "how" and over what period. Our stakeholder engagement will also allow us to ensure that the reforms do not contain unforeseen consequences (for instance, changes to Corporate Governance may have knock-on implications for Audit), and ultimately that they

¹https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf

²https://assets.publishing.service.gov.uk/media/5d03667d40f0b609ad3158c3/audit_final_report_02.pdf

³https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

⁴https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/916217/Redmond_Review.pdf

can be delivered by those that we regulate in a way that meets legitimate public expectations but without disproportionate cost or burden.

7. Many stakeholders recognised the importance of the Government's original consultation White Paper addressing concerns across the whole corporate eco-system. This paper covers proposed reforms affecting Corporate Governance, Corporate Reporting and Audit. It also sets out how we will incorporate into the reforms, developments in international standard setting, so that we only have to open up each Code, Standard or piece of Guidance once to address the total reform. That requires some complex sequencing to ensure that revisions to Codes, Standards and Guidance can be addressed in a single pass.
8. The FRC already operates a rigorous due process covering the development of Codes, Standards and Guidance. All the proposals set out in this paper will follow that due process including public consultation and stakeholder outreach, and the publication of a feedback statement setting out how we have addressed stakeholder responses and how our proposed action supports the public interest.
9. The focus of this paper is mainly on the FRC's Regulatory Standards work. However, as set out in our 3-Year Plan we will also continue to develop our capacity in Supervision, Enforcement and Corporate Services to support our transition to ARGA, and in particular the implications for directors and preparers arising from the reforms.
10. The FRC is committed to acting as a proportionate and principles-based regulator and balances the need to minimise the impact of regulatory requirements on business, while working to support the delivery of high-quality corporate governance, reporting, audit, and assurance work to maintain investor and wider stakeholder confidence.

Corporate Governance and Stewardship

11. The UK Corporate Governance Code is a highly effective driver of good governance in the companies that adopt it, either as a requirement of the Listing Rules, or because they choose to do so voluntarily. The Code has been copied in many other jurisdictions and has been successful in our view because it is principles-based and flexible. It is important, therefore, in revising the Code, that it is not used as a convenient vehicle to add requirements that diverge from its underlying principles.
12. The focus of revisions to the Code will be as follows:
 - Providing additional support in the existing Code Provisions, where reporting is currently weaker, taking account of issues raised in our recent research and reports. These areas are outlined in our most recent annual report on the use of the Code⁵ and Culture report⁶;
 - Revising those parts of the Code which deal with the need for a framework of prudent and effective controls to provide a stronger basis for reporting on and evidencing the effectiveness of internal control around the year end reporting process;
 - Making necessary revisions to reflect the wider responsibilities of the Board and Audit Committee for expanded Sustainability and ESG reporting and, where commissioned by the company, appropriate assurance in accordance with a company's audit and assurance policy;
 - Including a Provision for boards to consider how audit tendering undertaken by the company takes account of the need to expand market diversity; and
 - Updating the Code to ensure that it covers proposed changes to legal and regulatory requirements as set out in the Government Response, including strengthening reporting on malus and clawback arrangements.
13. The revised Code will be supported by updated guidance – we will revise the *Guidance on Audit Committees* and *Guidance on Board Effectiveness* to align with the revised Code and to support the reforms in the Government Response. We will also revise the *Guidance on Risk Management, Internal Control and Related Financial and Business Reporting* specifically to take account of changes to Principles and Provisions on internal control and its effectiveness.
14. In response to the recommendation made by the Competition and Markets Authority (CMA), we will develop for use initially on a voluntary basis a set of Minimum Standards for Audit Committees, setting out expectations on how Audit Committees should work to address the issues raised by the CMA in its report. We propose to hold round tables with stakeholders in the second half of 2022 to develop these standards, so they are available to Committees for 2023 financial year ends. Where possible these standards will consolidate multiple pieces of existing guidance and provide a single source of information. These standards will also address how Audit Committees can support greater market resilience and diversity when tendering for audit services ahead of legislation. Supervision against the standards will commence in c. 2024, subject to legislation.
15. Our intention is that the revised Code will apply to periods commencing on or after 1 January 2024 to allow for sufficient implementation time. That will mean we consult on a revised Code and supporting material from Q1 of 2023.
16. When ARGAs are created, the Government's intention is that the scope of our Supervision Division's Corporate Reporting Review team will extend to include the whole annual report and accounts. Whilst the precise legislative detail regarding the content which will constitute the 'annual report' for these purposes has yet to be published, we expect that corporate governance disclosures will be in scope. We intend therefore to commence formal inclusion

⁵ https://www.frc.org.uk/getattachment/b0a0959e-d7fe-4bcd-b842-353f705462c3/FRC-Review-of-Corporate-Governance-Reporting_November-2021.pdf

⁶ https://www.frc.org.uk/getattachment/9fc6c466-dbd2-4326-b864-c2a1fc8dc8b6/FRC-Creating-Positive-Culture-Report_December-2021.pdf

of these disclosures from the first year of Code implementation. In the meantime, we will continue our inclusion of corporate governance reporting in a sample of routine reviews, initiate an initial pilot for remuneration reporting, and seek to engage with companies on a voluntary basis.

17. We are not proposing to consider any further revisions to the Stewardship Code in this period. The Government has confirmed that the FRC – working with the Financial Conduct Authority, the Department for Work and Pensions and the Pensions Regulator – will carry out a review of the regulatory framework for effective stewardship including the operation of the Code in the latter part of 2023, to allow two full years of reporting under the revised Code.

Corporate Reporting

18. The changes proposed in the Government Response will require either primary or secondary legislation. However, we will work in support of the reforms by developing a number of pieces of guidance referred to. These will provide implementation guidance for:
- The Resilience Statement;
 - Fraud Reporting by Directors;
 - The Audit and Assurance Policy and related disclosure requirements;
 - Capital Maintenance and Dividends, including distributable profits – to succeed the existing ICAEW/ICAS guidance.
19. We will also revise our guidance on the Strategic Report, in recognition of the significant changes and the expansion in proposed reporting to ensure that the Strategic Report is a source of decision-ready information. To minimise the need to revisit guidance, we will delay the completion of this work until the Government has set out its policy in respect of the use of International Sustainability Disclosure Standards in the UK, so that this can also take account of reporting changes that will be driven by their implementation. In finalising the timing for this work, we will be informed by our stakeholder engagement and market needs. If we find that there are issues that need more urgent attention, we will seek to address this.
20. On sustainability reporting – we strongly support the efforts of the International Sustainability Standards Board (ISSB) to develop a global baseline to support sustainability reporting. We will actively engage with the ISSB to raise the profile of its work and to make recommendations to further their proposals, working closely with other international regulators and standard setters.
21. More broadly, as the Government considers its legislative programme, we will work closely with colleagues at the Department for Business, Energy and Industrial Strategy to propose, for their consideration, ways to reduce the current non-financial reporting burden on companies. We have already been looking at potential opportunities to simplify and improve reporting requirements, whilst making sure the quality of information available to users of corporate reporting including both financial statements and the front half of the annual report is not affected.
22. Subject to the extension of Corporate Reporting Review powers, we intend to include new reporting disclosures in our review processes from the date at which any new reporting requirements commence. As mentioned above, we are piloting the inclusion of some non-financial reporting such as corporate governance disclosures and remuneration reporting ahead of legislation. We also intend to expand our “What Makes a Good...” series to include “What Makes a Good Annual Report and Accounts”. We will continue to publish CRR case outcomes on a quarterly basis, including reference to any findings related to non-financial disclosures where appropriate. These cases represent the outcomes of our work reviewing the published directors’ reports and accounts of public and large private companies for compliance with the law, including any substantive correspondence entered into and actions taken by companies as a result of that correspondence.
23. To further support implementation, the FRC Lab will carry out a series of projects to assist with the development of the new reporting requirements set out in the Government Response (including resilience statements, capital maintenance disclosures and audit and assurance policies). These projects will set out how companies might apply new reporting requirements to provide useful and meaningful information to users.

Audit

24. Audit has been the subject of significant regulatory activity and intense political and public scrutiny in recent years. The fundamentals of what an audit is will remain unchanged, as the Government has chosen not to expand the scope of an audit. However, we will consult on changes to address some of the policy points in the Government Response through revisions to standards, including revisions to our Ethical Standard to reflect stakeholder feedback, evidence gathered through our inspection programme and our enforcement work. There are also significant changes to ethical requirements driven by changes to the International Code of Ethics, not least a revised global public interest entity definition, which includes market traded entities. We have already taken forward a project to develop a Professional Judgement Framework, which we published on 23 June. This will help with the application of professional judgement in the context of an audit, which was recommended in the Brydon Report. Our Supervision division will continue to build on its engagement and outreach with Audit Committees, seeking improvement in audit quality outcomes and we will continue to work on non-legislative developments in our Audit Quality Review team, with a view to providing a more effective and efficient AQR process. Supervision will also implement the new PIE auditor registration process and undertake a project on improving auditor education.
25. Significant changes to the Ethical Standard will include:
- Revisions to take account of the new proposed framework that contains three levels of public interest entities: historical; new proposed UK public interest entities; and new public interest entities caught as a result to the changes to the international definition;
 - Changes to address those situations where the role of Those Charged with Governance is discharged by the Board, in the absence of an Audit Committee;
 - A consultation on whether it is desirable to exclude sustainability assurance work carried out in accordance with a performance standard adopted by the FRC from the UK aspect of the non-audit services fees cap;
 - Revisions driven by international changes to the fees and non-audit services sections of the Code of Ethics;
 - Consulting on whether to maintain the 'Other Entity of Public Interest' definition;
 - Revisions to simplify and clarify provisions incorporated as a result of European Law in 2016;
 - Necessary revisions to address issues identified as a result of our Supervision and Enforcement work; and
 - Any changes necessary to address the expansion of audit-related assurance work driven by sustainability and ESG, and the proposals around an audit and assurance policy.
26. Our intention is that the effective date for changes will align with the effective date for changes to the Code of Ethics⁷. This will mean consulting on a revised Standard in Q1 of 2023. Supervision against any new or revised standards, including the Ethical Standards will follow the respective commencement dates.
27. Significant thought has been given in the Government Response to the useability and informativeness of the audit process to stakeholders. Addressing these issues will require consultations on a number of existing ISAs (UK). However, in doing so, our approach will be to minimise divergence between the UK and international standards. The scope of those revisions will mainly focus on:
- Revisions to Auditor Reporting Standards – ISAs (UK) 700, 701 and 720;
 - Revisions to Auditor Communication Standards – ISAs (UK) 260 and 265;

⁷ Periods commencing on or after 15 December 2024.

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- Revisions to Auditing Standards covering Law and Regulation and Reporting to Regulators, to include Brydon's recommendations on a 'duty to report' – ISAs (UK) 250 Sections A and B;
 - Conforming amendments to other ISAs (UK); and
 - Necessary updates to Bulletins and Practice Notes in support of revised standards, and to provide illustrative reports.
28. We will also consult on proposed guidance in the form of performance standards to support a consistent approach to assuring internal controls reporting and the new resilience statement. Our expectation is that although new standards will be developed over the next 18 months, the effective date would align with the revised Ethical Standard, with the development of guidance following the development of revised standards.
29. Linked to the Audit Committee proposals in paragraph 12 of this paper, and the references included in our proposals for the Corporate Governance Code, we will develop and consult on a policy paper setting out our approach in respect of the Government's proposed market resilience/ competition objective for ARGAs, and the work we will be doing to prepare ahead of legislation. This will include a framework for ARGAs' competition objective, and how we propose to set success measures for the effectiveness of market opening measures.
30. Having consulted on a new PIE auditor registration process in Spring 2022, we expect to transition to the new process from Autumn 2022 onwards. We will continue to develop our audit firm supervision model, including assessing the Big Four firms' progress in voluntarily implementing operational separation. Ahead of legislation, we will start to develop the policies and procedures necessary to deliver on the full set of audit supervision powers, including the use of expert reviews.
31. The FRC views a high-quality, well-respected audit profession which attracts and retains the brightest and best candidates as an essential ingredient for a functioning audit system and improved audit quality. The Government Response noted that "the Government expects the existing professional bodies to make substantial improvements to audit qualification, training and skills" over the next five years. This work is not dependent on legislation, and a project led by our Professional Oversight Team will engage with the professional bodies on their plans for these improvements. We expect this will involve consultation in late 2022/early 2023 and implementation across 2023 to 2024.
32. We also propose to use our newly developed Audit Sandbox to assist with the implementation of new or revised requirements in auditing and ethical standards, and how policy drives enhanced audit quality, innovation, and competition within the marketplace. The Sandbox will provide a safe regulatory space to allow for auditor-regulator dialogue on audit and competition policy related issues.

Actuarial Regulation

33. Actuarial work underpins many aspects of our society: members of pension schemes and insurance policy holders rely on the actions of individuals who make decisions based on actuarial information. Increasingly, actuarial work is used in emerging fields, a key example would be how actuaries have contributed to the analysis of and debate on pandemic modelling during the Covid 19 pandemic. It is therefore critical, in the public interest, that actuarial information is of an appropriate standard. The public has a right to expect such information to be reliable.
34. The Government Response provides a sound foundation to address the weaknesses in the current regulatory regime for actuarial work, originally raised in Sir John Kingman's review. Currently the FRC undertakes its actuarial regulatory roles in the UK on a contractual basis (likewise the regulation of accountants). The government intends to strengthen that regime by putting it on a statutory footing, similar to other regulated professions, including a risk-based monitoring scheme to assess the quality of actuarial work. In doing so we are keen to engage with existing regulated actuarial communities and any new stakeholders which will come into scope in the preparation for ARGA.
35. Pending legislation, we will commence to implement the new regime in time for ARGA's effective date. This work will include:
- Establishing what actuarial work should be considered as being of public interest, and therefore within ARGA's statutory regulatory scope;
 - Concluding our post implementation review of the FRC's Technical Actuarial Standards to ensure that they are consistent with ARGA's regulatory objectives and remit;
 - Developing and implementing a risk-based monitoring framework. We would look to conduct a pilot exercise ahead of full implementation, to road-test new processes and procedures and give informal feedback;
 - Reviewing the actuarial disciplinary scheme and preparing new guidance and operating procedures for ARGA's actuarial enforcement role which will be subject to public consultation;
 - Setting out the regulatory standards that ARGA, in its statutory oversight role, will expect actuarial professional bodies to adhere to; and
 - Preparation of new Memoranda of Understanding with other sectoral regulators (e.g., TPR, PRA, FCA).
 - Carrying out work to design and implement a proportionate monitoring and oversight regime

Local Audit Systems Leader

36. The Government has indicated that ARGA will be the systems leader for local authority financial reporting and audit. The financial reporting landscape is complex, and the timeliness of reporting is poor, and the audit market is far from resilient. We have recruited a director to lead this work, and our priorities are currently:
- Carrying out stakeholder outreach to determine priorities and early action areas for the systems leader;
 - Working with colleagues in the Department for Levelling Up, Housing and Communities (DLUHC) and the National Audit Office to facilitate the transfer of the Code of Audit Practice, when legislation allows;
 - Working with the DLUHC, HM Treasury and CIPFA LASAAC to determine whether the current complex financial reporting framework for local authorities can be simplified, whilst still meeting HM Treasury's reporting requirements in support of the Whole of Government Accounts; and
 - Building on the success of Practice Note 10 for the Central Government Sector, by consulting on proposals for a specific practice note for local public audit in England.
37. We have issued revised guidance to the Recognised Supervisory Bodies for recognising Key Audit Partners for local audit, which is applicable now. Taking on the systems leader role in shadow form, our new Director of Local Audit will join in September 2022 to develop an industry-led workforce strategy, with support from DLUHC.

Transfer of Independent Supervision of the Comptroller and Auditor General to Parliament

38. Sir John Kingman noted the inconsistency and potential conflict which exists whereby the FRC fulfils the role of Independent Supervisor of the Comptroller & Auditor General, when the Auditor General is an officer of the House of Commons. He recommended that new arrangements be made to place responsibility for Independent Supervision into the hands of Parliament, who can then determine who is best placed to carry out the oversight work on their behalf.
39. The Professional Oversight Team will support the transition of the Independent Supervisor role to an appropriate Parliamentary body, working with BEIS to achieve this, and subject to legislation. Shadow arrangements have been in place for the 2021 reporting cycle, and these will continue in 2022.

Funding

40. The Government intends to give ARGAs statutory funding so that it can operate on a sustainable and independent basis. ARGAs will be empowered to make rules requiring that market participants pay a levy to meet the costs of carrying out its regulatory functions. Implementing a new statutory funding model is a complex exercise, and we therefore intend to invite views this Summer on the high-level principles on which ARGAs' funding model should be based.

Government proposals requiring legislation

41. A significant proportion of the proposals contained in the Government Response require legislation to take effect. In particular, the proposed new definition of a public interest entity will not commence without the requisite primary legislation being passed. We have described in this paper the work we intend to do which is within our existing remit to commence. Some of these activities are dependent on the timing of secondary legislation which the Government has indicated it intends to bring forward when Parliamentary time allows, which is outside of the FRC's control. We are publishing this early view of our intentions, to support the planning and engagement activities of our stakeholders, many of whom are keen to have greater certainty on when and how various aspects of reform will happen. We will use our annual 3-Year Plan and other key publications to provide progress updates as needed, and ensure that wherever possible, our stakeholders have a reasonable period of time in which to prepare for future regulatory changes that may impact them.

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July 2022



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