

UK Audit Consultation Office

Submitted online

Brussels, 8 July 2021

Subject: Accountancy Europe's Response to *Restoring trust in audit and corporate governance - Consultation on the Government's proposals*

Dear Mr Kwasi Kwarteng,

Accountancy Europe is pleased to provide you with its comments on the Department for Business, Energy and Industrial Strategy (BEIS) Consultation on the UK Government's proposals (the Consultation Paper). As the umbrella organisation for 50 professional accountancy bodies (including 5 in the UK) from 35 countries, our response focuses on those questions in the Consultation Paper with global or European relevance for the audit profession and the corporate reporting ecosystem at large.

As the audit market is globally interconnected through networks of audit firms auditing companies and groups that operate worldwide, the discussion on the audit's future in the UK cannot be considered in isolation. We strongly encourage global coordination and cooperation on changes to reporting models, company's responsibilities, the auditor's role and supervision. This is needed to avoid different expectations in different countries and regulatory fragmentation posing additional barriers to entry to markets for both companies and audit firms.

We commend the UK Government for the quality of the process followed to arrive at the Consultation Paper, which included discussions with relevant stakeholders, including the audit profession. We also commend it for its clear 'root cause analysis' and adoption of a holistic approach to its proposed reform of the corporate reporting ecosystem. Indeed, to improve the robustness of the ecosystem, it is fundamental to look at all its parties: companies with their management, board of directors, audit committees and shareholders; auditors; regulators; and supervisory authorities. Measures adopted towards each of the parties should follow the principles of transparency and proportionality.

All key parties in the ecosystem have a responsibility to strengthen corporate reporting, auditing and assurance related to risk management, internal controls and companies' resilience and tackling fraud. These issues, including audit market concentration in the Public Interest Entity (PIE) end of the market and auditors' independence, need to be tackled at EU level too and thus we find this debate relevant. We would like to contribute to discussions and be part of finding solutions to strengthen the ecosystem, as well as enhancing the resilience and relevance of the audit profession and raising the bar on audit quality.

We are fully aware that these are all very complex and interlinked issues for which there do not seem to be ‘silver bullet’ solutions. There are different measures that can be adopted. We encourage legislators and regulators not to look at the potential measures in isolation as they are interlinked. They should be considered as a package to be applied within the ecosystem. Deciding on the most appropriate measures requires careful consideration and cooperation with all relevant parties in the corporate reporting ecosystem, including the audit profession. Accountancy Europe will continue discussions with its members to also come up with additional ideas for solutions that could be effective.

Our profession is open to changes, and looks forward to a fruitful dialogue with stakeholders to further develop its role. Changes to the current functioning of the ecosystem, including audit’s purpose and scope, should be based on inclusive debates on the practicability of the potential measures and the outcome of a cost-benefit analysis or impact assessment thereof.

Below we provide our comments on the key subjects with European and global relevance. Similar to the UK, the debate at EU level focuses on the ‘3 pillars of corporate reporting’: corporate governance, external audit and supervision. Our comments do not cover all potential measures and solutions that could be explored.

1. CORPORATE GOVERNANCE AND RELATED AUDITOR’S ROLE

STRONGER INTERNAL COMPANY CONTROLS (CHAPTER 2.1)

We believe that the internal control framework over financial reporting for companies should be strengthened. While there are various emerging risks relevant to most companies such as risks related to business operations, cybersecurity, supply chain, solvency, etc., the 2 most relevant issues for stakeholders seem to be fraud and going concern¹. Accordingly, the internal control and risk management systems in companies should adequately address these issues.

Proportionality and compatibility with existing requirements are important factors to consider when introducing new mandatory requirements for companies. In addition, stipulating robust corporate governance should be the starting point and the driver for enhancing the auditor’s role with regards to internal controls.

We support the UK Government’s preferred option where directors would be required to carry out an annual review of the effectiveness of the company’s internal controls over financial reporting. In addition, companies (or their directors) should issue a public statement about the effectiveness of the internal controls over financial reporting which cover material misstatements due to fraud and going concern. This disclosure could be made as part of a corporate governance statement included in a company’s management report, along with statements on the internal controls over financial reporting. Such a public statement would help ensure that directors are discharging their responsibilities with regards to the effectiveness of internal controls.

When a company makes a statement on the effectiveness of the internal controls over financial reporting that cover material misstatements due to fraud and going concern, naturally stakeholders will expect to receive a form of attestation on this statement and will turn to the auditor in the first instance. Therefore, we believe that most companies will include assurance engagements on the effectiveness of these controls in their Audit and Assurance

¹ See our recent publications on [going concern](#) and [fraud](#)

Policy. In practice, such an engagement might necessitate auditors to consider the internal controls over financial reporting as a whole.

RESILIENCE STATEMENT (CHAPTER 3.1)

Users of financial statements need a clear understanding of the risks that companies face and how those risks could translate into threats to the financial resilience of the business. They also need clarity on how mitigating actions that are within management control may be used to alleviate that impact. Therefore, the Resilience Statement's main objective should be to provide users with greater visibility over the business' resilience.

We believe that the Resilience Statement should focus in the short-term on going concern issues related to financial reporting. In the medium-term, it should cover other aspects related to the company's resilience, i.e. the ability to adapt to changes to survive and thrive in the long run. There could be flexibility in relation to the time horizon for the viability element depending on a company's business and the circumstances.

We also deem sustainability risk evaluation to be a vital part of the Resilience Statement. We are therefore supportive of including in the Resilience Statement matters like threats to liquidity, solvency and business continuity, supply chain resilience, investment needs and climate change risks, etc., as listed in the Consultation Paper. These are in line with the areas for which disclosure requirements are proposed in the European Commission's (EC) Corporate Sustainability Reporting Directive (CSRD).

In this respect, given the fact that companies and auditors operate in globally interconnected markets for which harmonisation is a big aid, the UK should consider relevant developments at EU and international level. This includes the aforementioned EC proposal for the CSRD as well as the International Financial Reporting Standards (IFRS) Foundation proposals to establish an International Sustainability Standards Board.

At EU level, we support the EC's proposal to extend the scope of sustainability reporting to all large and listed companies that significantly impact or can be impacted by the environment and society as well as the EC's proposal to require limited assurance as a first step.

AUDIT COMMITTEES – ROLE AND OVERSIGHT (CHAPTER 7.1)

Audit committees (or another body performing equivalent functions within a company), as one of the key parties involved in corporate reporting along with management, board of directors and auditors, should be equipped with appropriate skills and competences.

All PIEs should have a separate audit committee that has a sufficient number of members with competence in accounting and / or auditing and is, in the case of large PIEs, supported by an independent internal audit function and well-established whistleblowing structures.

Conceptually, having performance standards for audit committees that are monitored by an independent authority are desirable and would improve audit committees' functioning. Such standards are also vital to ensure a clear understanding of expectations from and accountability for audit committees.

2. EXTERNAL AUDIT

SCOPE AND PURPOSE OF AUDIT (CHAPTER 6.1 AND 6.2)

We strongly encourage global coordination and cooperation with regards to the audit's role and purpose to avoid different expectations in global markets.

We are supportive of both companies and auditors focusing on not only financial information but also on non-financial information reporting, called corporate sustainability reporting in the EU context.

Audit has a public interest function. Auditors should consider shareholders' needs and wider stakeholders' expectations. An Audit and Assurance Policy set by companies' boards could contribute to demonstrating the value, relevance and agility of audits and auditors.

The preparation and publication of the Audit and Assurance Policy is first and foremost a responsibility of the company's directors and the audit committee. An advisory shareholder vote on this Policy could be a way to increase the active involvement of shareholders in the company which is a fundamental element of the BEIS proposals.

We agree that such a Policy should focus not only on external auditors but also on internal auditors and potentially other assurance service providers. We would highlight that the assurance engagements specified in a company's Audit and Assurance Policy can be provided at a high-quality level, only if the following conditions are fulfilled:

- professional standards, including those which relate to ethics and independence, are applicable to all assurance service providers
- there is appropriate public oversight of all assurance service providers

TACKLING FRAUD (CHAPTER 6.4)

We agree with the proposed package of reforms relating to fraud included in the Consultation Paper. [In our recent publication](#), we set out recommendations to strengthen the financial reporting ecosystem in preventing fraud.

An appropriate, effective and adequate corporate governance system is key to detect and prevent fraud. Successfully tackling fraud depends upon a joint effort by all relevant parties who should pay specific attention to the risk of senior management fraud. Furthermore, all PIEs should be required to have, and publicly report on, their fraud risk management system.

In addition, the auditors could be required to publicly report their conclusion on the company's statement on fraud risk management systems (against an acceptable framework). In practice, such an engagement might necessitate auditors to consider the internal controls over financial reporting as a whole.

INDEPENDENT AUDITOR APPOINTMENT (CHAPTER 7.2)

The rare circumstances where the market does not work, and the regulator's intervention is needed for an auditor's appointment, should be defined based on firm and clear criteria. We

believe that such intervention should be used only as a last resort in exceptional cases, namely when a company cannot find an auditor.

For this to be practicable, there needs to be a safe harbour for the auditor / audit firm appointed by the regulator to address the risks that caused the company's failure to find an auditor in the first place. Regulatory risks associated with taking on an audit enforced by the regulator need to be clear and acceptable to the auditor / audit firm.

Another measure to consider is to give the regulator a right of veto in relation to the appointment of the auditor, in specific and justified circumstances, such as when quality issues have been identified around a company's audit. This is already the practice in some European countries.

MARKET OPENING MEASURES (CHAPTER 8.1)

We recognise that there is a limited number of audit firms auditing the largest PIEs. This is not the case only at a UK level, but also at an EU-wide level, although the number of players in the PIE audit market varies across EU Member States. As stated in the [latest EC's report](#) on overall EU-28 audit market, the number of audit firms auditing PIEs has decreased significantly in the period following the 2014 EU Audit Reform. We understand that, for example, in Austria, the number of audit firms complying with the demanding PIE audit firm requirements decreased from 18 to 11 over the last 3 years. In the Netherlands, since 2015, the number of audit firms licenced for PIE audits has decreased from 10 to only 6.

In the process of exploring market opening measures, it is necessary to understand why decisions of market participants have led to the current market structure. Therefore, we welcome alternative measures being considered and debated further, taking into account the points of view of different stakeholders.

In the context of increasing the number of audit firms in the upper end of the PIE audit market, legislative interventions will not be effective on their own. Regulatory burden and the liability regime for auditors also need careful consideration. The potential costs and risks, especially of auditing PIEs, should not be at the expense of audit quality, innovation and competition. The regulatory framework, including the liability regime, should also not be disincentivising audit firms, especially those outside of the Big Four, as that could lead to further concentration in the PIE audit market.

We welcome measures that aim to increase choice and capacity in the PIE audit market noting that substantive change in the market structure is likely to take place only in the medium to longer term. In this regard, managed shared audits or joint audits could be measures for consideration to open the audit market, subject to due consideration and understanding of the applicable framework, standards and liability regimes. Setting a market share cap can equally help opening the market to 'challenger firms'. However, as other measures mentioned above, it would limit the ability of shareholders to select and appoint their auditor they deem appropriate for their sector and business.

More detailed work will be required to better assess potential measures. For example, an additional option could be to have the engagement quality review done by a 'challenger audit firm'. Assessing different options will entail further discussions with stakeholders, analysis

and modelling to determine which approach will be most conducive to enhancing the level of choice in the PIE audit market whilst maintaining audit quality.

OPERATIONAL SEPARATION BETWEEN AUDIT AND NON-AUDIT PRACTICES (CHAPTER 8.2)

We recognise the Competitions and Markets Authority's (CMA) concerns referred in the Consultation Paper about whether:

- firms' providing both audit and non-audit work has an impact on the quality of audit
- there exist tensions between a firm's non-audit and audit functions
- above-mentioned tension dilutes the culture of objectivity and challenge required by auditors performing a public interest function

Proposals for improving audit firms' governance and decision-making must be grounded in the objective of promoting and enhancing audit quality. The following principles set in the UK Financial Reporting Council's (FRC) guidance could be an appropriate basis for considering to achieve this:

- independent oversight of the audit practice by the Audit Board
- specialists supporting the audit practice and conducting the transactions between the audit practice and the rest of the firm on an 'arms-length' basis
- a separate profit and loss account for the audit practice
- remuneration policies and practices for audit partners rewarding primarily high quality work
- more transparency by firms about the governance of the audit practice

We believe that audit firms should stay multidisciplinary² as the audit of financial statements should not be considered as an isolated practice. We observe an increasing demand from stakeholders for more corporate reporting by companies on matters other than financials. This is accompanied by expectations of the auditor's involvement in providing additional attestation and assurance services. Provision of a wider range of such services has become key to the auditor's role to serve the public interest. Hence it is crucial that the 'audit practice' should encompass other services besides the statutory audit function on financial statements.

Finally, the requirements on audit firms' governance should be designed in a way which does not lead to market distortions by disincentivising challenger firms from scaling up their operations.

3. SUPERVISION

Accountancy Europe is supportive of robust supervision over reporting and auditing, both at EU and national level, which often reinforce each other.

The coordination and cooperation between different supervisors (on reporting, auditing, securities markets, etc.) within a jurisdiction should be improved and better interlinked. At EU level, we support further harmonisation and enhancement of how national oversight authorities discharge their duties in all areas relevant to the corporate reporting ecosystem, including audit, with the ultimate aim of improving corporate reporting and audit quality.

² See our publication: [*How do multidisciplinary teams contribute to audit quality?*](#)

MONITORING OF AUDIT QUALITY (CHAPTER 9.2)

We are in favour of more transparency in regard to audit inspection reports in so far as it adds to the initiatives by regulators, professional bodies and audit firms to apply audit quality indicators that are useful to stakeholders. At EU level, the transparency of audit oversight bodies' work varies. Individual audit firm quality or other inspections' results are published and made publicly available only in 4 EU Member States whereas summarised results are made public in the rest.

We are open for considering proposals towards further transparency and harmonisation in this area by publishing individual audit firm results across all EU member states, subject to proportionate regulation. To be balanced and give a fair view, these reports with inspection results should also include remedial actions taken by audit firms as agreed with the regulator, like it is for instance the case for reports published by the US Public Company Accounting Oversight Board (PCAOB). For this, the inspections system must allow for a dialogue between the regulator and the auditor or audit firm. In the European context, such public reports should only concern the control of the firm as per the International Standard on Quality Management (ISQM) 1. Sharing engagement-specific and personal information within these reports would require careful consideration.

A STRENGTHENED REGULATOR (CHAPTER 10)

Whilst Accountancy Europe is supportive of robust supervision and the need for enhanced regulators at EU and national level, there have to be appropriate checks and balances in the system to help ensure that all stakeholders have confidence in the system.

We thank you for the opportunity to comment. For further information on this letter, please contact Hilde Blomme on +32 (0) 2 893 33 77 or via email at hilde@accountancyeurope.eu.

Sincerely,



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President



Olivier Boutellis-Taft
Chief Executive

ABOUT ACCOUNTANCY EUROPE

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