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The Governance Institute

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Dear Sirs

ICSA response to the Department for Business, Energy and Industrial Strategy (BEIS) Initial consultation on the recommendations of the Independent Review of the Financial Reporting Council (FRC)

We welcome the opportunity to comment on the BEIS initial consultation on the recommendations of the Independent Review of the FRC.

ICSA: The Governance Institute is the professional body for governance. We have members in all sectors and our Royal Charter purpose is to lead 'effective governance and efficient administration of commerce, industry and public affairs'. With more than 125 years' experience, we work with regulators and policy makers to champion high standards of governance and provide qualifications, training and guidance. ICSA is the professional body that qualifies Chartered Secretaries, which includes company secretaries. Company secretaries have a key role in companies' governance arrangements, including corporate reporting and audit, and most would consider the FRC their key regulator. Our members are therefore well placed to understand the recommendations of the independent review of the FRC, and the BEIS proposals to take these forward.

In preparing our response we have consulted, amongst others, with members of the ICSA Company Secretaries Forum, a group of company secretaries from more than 30 large UK listed companies from the FTSE 100 and FTSE 250. However, the views expressed in this response are not necessarily those of any individual members of any of this group, nor of the companies they represent.

We set out below some general comments, followed by our responses to specific questions set out in the initial consultation.

General comments

As The Governance Institute, our focus is on the FRC's role in corporate governance, rather than accounting, and our response therefore concentrates on this area of the FRC's role and the impact of certain proposals on boards and individual directors. We believe the corporate governance remit of the FRC's role currently works very well. We have always found the FRC to be open to engagement in a challenging but constructive way on all aspects of corporate governance and we very much hope that this positive approach will continue. We also believe that companies find FRC Guidance to be very useful, in particular the Guidance produced by the Financial Reporting Lab. We believe that doing away with Guidance will be a retrograde step and we hope that the new Audit, Reporting and Governance Authority (ARGA) will continue to produce assistance to companies through helpful Guidance and that the Financial Reporting Lab will be allowed to continue its excellent work.

We support the proposal in Recommendation 1 that the new regulator should be independent and have clear statutory powers and objectives, and agree with the need to set high standards for statutory audit, corporate reporting and corporate governance. However we would highlight that the FRC is a regulator of a profession and of company reporting, which is very different from regulators such as the Financial Conduct Authority (FCA), which are primarily focussed on the protection of the general public as consumers of financial services products, as reflected in the FCA's operational objectives. Those engaged in the audit profession and the users of corporate reports are a much smaller group of people, with a greater understanding of audit, reporting and governance than the general public, so it would be inappropriate for ARGA to try and replicate the approach taken by the FCA.

One of our main concerns about the proposals is that if ARGA takes an FCA-style approach to achieving its strategic objective it will be focussed entirely on protection, which may stifle business growth, and resulting value and employment creation for broader society. The BEIS initial consultation on the Kingman recommendations appears to focus primarily on risk prevention, to the extent that it could create an unnecessary regulatory burden that will restrict growth. It is important that the new regulatory environment is one in which business can thrive and provide economic benefit.

Responses to specific questions

Chapter 1: FRC structure and purpose

Q1. What comments do you have on the proposed objective set out in Recommendation 4?

We would query the wording in the strategic objective "… holding to account … professional advisers responsible …". As the new regulator will be the Audit, Reporting and Governance Authority, we would have expected its strategic objectives to refer explicitly to holding audit firms to account. We are not clear who professional advisers are in this context. If the intention is to extend its remit beyond audit firms, it would be better specify which professional advisers it intends to hold to account, for what it proposes to hold them to account, and how it intends to do that.

We would reiterate the concerns expressed in our general comments about the nature of ARGA as the new regulator of a profession and of company reporting, rather than primarily for consumer protection. There is a popular perception that statutory audit is intended to provide assurance to the wider public, rather than being primarily for the benefit of shareholders and major creditors (the expectation gap). In this context we have concerns that the wording "To protect … the wider public interest …" will reinforce this perception when this responsibility has not been established or accepted. We suggest this objective be amended to refer to protecting public confidence. This expectation gap is an important issue, on which we know that Sir Donald Brydon's review will focus, and we strongly recommend that the Government await Sir Donald's conclusions before taking action.

Q2. What comments do you have on the duties and functions set out in Recommendations 5 & 6?

We believe that the duties and functions of the new regulator set out in Recommendations 5 and 6 are broadly appropriate but have some specific comments.

We believe that, as regulator of company reporting, ARGA's duties and functions should include a duty to build relationships with companies in order that the regulator has a better understanding of the companies whose reporting it regulates.

We are not convinced that the duties and functions correspond with the strategic objective set out in Recommendation 4. There are no stated duties relating to professional advisers in general. We are not suggesting there should be, as we believe ARGA's activities should be restricted to regulating the audit profession, but believe that the strategic objective should be aligned with the new Regulator's duties. Likewise there are no duties to protect the wider public interest, save in the specific circumstances of investigating a company's affairs about any matter that falls within the Authority's statutory competence. We believe the wording of the strategic objective should make clear that protecting the interests of the public is limited to investigating a company's affairs where there are public interest concerns about a matter that falls within the Authority's statutory competence, rather than suggesting that statutory audits in general should provide assurance to the general public. (Please see our additional comments on Recommendations 47 and 48 in our response to Q 8 below.) As set out in our response to Q1 we suggest the wording of the strategic objective should be amended to refer to protecting public confidence.

We reiterate our concerns set out in our general comments relating to the application of these duties and functions, and nature of the new regulator. The duties focus entirely on prevention of audit failures and the protection of users of company reports, with no duties that promote business and an environment to support growth and economic value creation.

Q3. How do other regulators mitigate the potential for conflict between their standard setting roles and enforcement roles as set out in Recommendation 14?

We have not attempted to answer this question as it is outside our experience. We have left the question for other regulators to respond.

Q4. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

We would reiterate some of our general comments above in relation to the Corporate Governance remit of the FRC's role and the provision of Guidance, which companies find extremely useful – particularly that produced by the Financial Reporting Lab.

We believe the Corporate Governance function within the FRC currently works well. The Corporate Governance Code and Stewardship Code are based on principles and provisions, which operate on a 'comply or explain' basis. This is very different from the rules and standards that apply to audit and we believe it would be unfortunate if the Corporate Governance areas of the FRC's work were subject to the same regulatory regime as required for the audit function. We have always found the FRC to be open to engagement in a challenging but constructive way on all aspects of Corporate Governance and we very much hope that this positive way of working will continue as it is beneficial to all.

We also believe that a strength of the FRC Guidance, and the Guidance produced by the Financial Reporting Lab, is its practical nature. This is due to it being produced through extensive collaboration with companies, investors and others with experience of implementing the various codes, rules and legislation.

We would reiterate the importance of the structure and purpose of the new regulator achieving the right balance between setting high standards to protect the interests of users of audit services and company reports, and maintaining public confidence, whilst still creating a regulatory environment in which business can thrive.

Chapter 2: FRC Effectiveness of core functions
Q5. How will the change in focus of the Corporate Reporting Review (CRR) work to Public Interest Entities (PIEs) affect corporate reporting for non-PIE entities?

We agree that the focus of the CRR work should be directed towards PIEs, but the new regulator should also be given the necessary flexibility to select non-PIE entities for review should it believe it appropriate, proportionate and necessary to do so. For example, this might be where there are concerns relating to a specific sector or when an entity is of sufficient size that it could pose a risk and therefore it is in the public interest for its reporting to be subject to review.

Q6. What are your views on how the pre-clearance of accounts proposed in Recommendation 28 could work?

We have a number of concerns over Recommendation 28 on pre-clearance of accounts and believe the process would be fraught with difficulty.

First, we have some practical concerns. It is not clear who would initiate a pre-clearance process and, more importantly, whether the process would remain confidential. It is not clear whether pre-clearance would involve guidance, nor is it clear what the costs are likely to be. By way of one simple example, to what extent would it be necessary to publish correspondence between the company and the regulator regarding a request for pre-clearance; the prospect of the correspondence being published would significantly affect what either party included. The feasibility of pre-clearing company accounts would also be a concern as most large listed companies have 31 December year-ends, so the majority of pre-clearance activity would need to take place in a short time period during January and February each year. We also have concerns that an external person, without detailed knowledge of the company, would be unable to obtain sufficient understanding of the company in the time available to pre-clear a company's accounts.

A second, more fundamental concern is the impact of Recommendation 28 on accountability for company reporting. The pre-clearance of accounts by the regulator would, to some extent, displace the role of the auditor. It would also take accountability away from the auditor and the company's directors and, potentially, transfer liability from the board and auditor to the regulator.

That said, in view of the proposed new regulatory powers to sanction individual directors (discussed under Q7 below) it would provide a level of comfort to directors, auditors and shareholders if pre-clearance was carried out in relation to any new or difficult interpretation in the accounts. However, it is difficult to see how the regulator would wish to accept liability in such circumstances, particularly in view of the limited time available for the regulator to gain a full understanding of the company and the specific issue in question. In our experience, most situations where an accounting treatment is called into question arise some time after the accounts have been published.

We suggest it would be advisable for the regulator to consider, probably through a detailed consultation, an appropriate process for a pre-clearance procedure and all the possible unintended consequences, including resource requirements, before implementing this Recommendation.

Q7. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

There are four recommendations we would highlight.

A) Audit expectations

We believe that Recommendation 17, the proposal that independent work be done to explore the issues arising from the audit expectation gap, should be carried out as soon as possible. It is difficult to see how the new regulator's Strategic Objective can be set and achieved without first understanding the issues arising from the audit expectation gap, setting out clearly the reasons why audit is carried out, who it is carried out for, and what should be the reasonable expectations of audit.

However, the expectation gap is not the only issue – there is also a delivery gap, and it is this on which ARGA should focus in the shorter term. As we said in our response to Sir Donald Brydon's call for views, *"Not only does the audit process not do what many in our society believe it should, it fails to do properly the bare minimum of what it is actually supposed to do. …. Both are significant and equally important issues and neither should be overlooked. To what extent do audit standards, regulation and legislation meet legitimate societal expectations and to what extent does auditor performance deliver high quality audits against existing requirements?"*

B) Wider role on corporate reporting

We are concerned by some of the assumptions which seem to underlie Recommendation 30: the proposal that a wider range of investor information should be regulated on the basis that, for example, investor presentations are *"not subject to the same quality control measures as information contained within annual financial statement"* so that there *"is therefore significantly more scope for companies to pick and choose measures, and interpretations of measures, which put a positive gloss on the facts."* We believe that all such information is already adequately regulated under the Market Abuse regime.

C) Individual liability for directors

We have concerns over Recommendations 35 to 38, which propose that certain directors be held to account individually for their duties in relation to the audit process and corporate reporting, and for their specific roles in the process.

We understand the current position that the FRC, as regulatory body for the audit and accounting profession, and for corporate reporting, is able to hold auditors to account and to sanction directors that are qualified accountants, but is unable to sanction directors that are not. Sanctioning directors under these circumstances is in their professional capacity as accountants, not as directors, and the proposal is that all directors be brought under a sanctions regime based on the position they hold as a director. Directors who hold the positions of CEO, FD, chair or chair of the audit committee would be subject to sanction by the new regulator for misconduct due to their specific role in relation to the company's audit and the company's reporting.

We understand that BEIS is also seeking feedback on whether the new regulator's ability to sanction should be extended to directors holding other positions, such as chair of other committees, or to all directors. Also whether it should apply to Public Interest Entities only, all listed companies only, or to all companies, and whether the regulator should be able to sanction the company in addition to individual directors.

We have a number of concerns about these Recommendations. We realise the intention is to try to create a ‘level playing field’ between directors that are accountants and those that are not. However, there is a fundamental difference between regulating members of a profession, who are always subject to the professional standards set by their professional body, against those standards as a member of the professional body, and the accounting regulator being able to sanction directors from all disciplines for their role as a director. This is a much more serious matter and the impact of sanctions on directors should not be underestimated.

Sanctioning a negligent audit is clearly a regulatory issue as audit is subject to compliance with standards. Likewise other regulatory regimes, such as that operated by the FCA, are based on the requirements of a ‘rule book’. Decisions taken by directors are frequently issues of business judgement, rather than the application of specific rules or standards, so there is a danger of the regulator substituting its own judgement for that of the director, with the benefit of hindsight. If ARGA is to go beyond the FRC’s current role of voluntary regulator of company reporting and regulator of the accounting profession to carrying out a different category of regulation including the ability to sanction individual directors for failures in their role as directors, it will need to have more formal, defined processes and be staffed differently. The activities of the regulatory body will also need to be regulated and controlled, and a proper tribunal process would need to be in place providing the ability to appeal decisions.

Regulatory sanction for directors who have failed to comply with the directors’ duties requirements of the Companies Act is one thing, but if individual directors are to be held to account in circumstances that do not warrant prosecution and disqualification by the insolvency service and are not covered by the requirements of director’s duties under the Companies Act 2006 to exercise care, skill and diligence, taking into account any specific skills the director has, then the standards to which directors will be held to account will need to be clearly set out. It is not clear which body would set these standards, how they would be set, or whether they would be rules or principles. Clarity would also be needed around who would decide if the rules or principles had been breached and what legal safeguards and appeals process would be put in place for directors. The standards currently set by the FRC for accountants are clearly appropriate for the profession, but these would not be appropriate for directors from a variety of professional backgrounds, taking business decisions as directors.

Singling out individual directors for censure, other than where they are clearly personally culpable, strikes against the unitary board structure in the UK and the principle of collective responsibility. In our view this is so significant a part of the Companies Act, and one which was developed following considerable consultation and discussion of the appropriate balance of duties, that it should require primary legislation to make the change. Singling out individual directors in this way will also make it extremely difficult for boards to recruit independent non-executive directors, particularly as audit committee chairs, given the increased risks, reputational at least as much as regulatory that they will be incurring, at least without significant additional monetary compensation.

The audit committee is already subject to specific additional requirements to include a member that has recent and relevant financial experience and as a whole to have knowledge of the sector in which the company operates. In addition, shareholders already have the power to remove any, or all, of the directors if they are unhappy with a director’s performance.

D) Stewardship Code

We would also highlight recommendations 42 and 43, covering stewardship and investor relations, and the Government's response that the Stewardship Code must be demonstrably improved. We also note that the FRC is consulting on a revised Stewardship Code to address concerns identified in the review and have expressed our concerns in our response to that consultation.

We do not believe the revised Stewardship Code addresses the concerns expressed by the Independent Review of the FRC, including in respect of investment outcomes and effectiveness. Instead it appears to have focussed on broadening the definition to stewardship by seeking to capture all types of investment and introduce an emphasis on ESG factors. We agree that the Stewardship Code needs to be improved in terms of outcomes and effectiveness but believe the proposed changes will not achieve this aim.

The original Stewardship Code led to significant improvements in voting by institutional investors, leading to a clearly differentiated approach and increased engagement. It is our view that the definition of stewardship for the purposes of the Stewardship Code should revert to the previous definition focused on 'engaging issuers and holding them to account on material issues', and should be restricted to assets held in companies that are subject to the UK Corporate Governance Code. These assets are listed equity shares only, which represent ownership of the company and provide control rights. Ownership and control does not apply to other asset classes. This will afford clarity for investors and companies, with clear meaningful and substantive alignment between the Stewardship Code and the Corporate Governance Code, helping investors to hold companies and their management teams to account for compliance with the UK Corporate Governance Code.

Chapter 3: Corporate failure

Q8. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

The proposals in chapter 3 are closely linked to the 'expectation gap' discussed in our responses to questions on chapters 1 and 2. We believe it is important to address that issue first and establish what should be the legitimate expectation of audit, and for whose benefit, before putting in place regulatory powers to try to prevent corporate failure in the interests of those with legitimate expectations.

The points that we raise under our General Comments above are again relevant. This chapter appears to propose replicating the responsibilities of other regulators such as the FCA, but we do not believe a similar regulatory regime is appropriate for the regulator of audit, reporting and governance. The FRC (in the future ARGA) is a regulator of a profession and of company reporting, which is very different from regulators such as the FCA, which is primarily focussed on the protection of the general public as consumers of financial services products, as reflected in the FCA's operational objectives. Those engaged in the audit profession and the users of corporate reports are a much smaller group of people, with a greater understanding of audit, reporting and governance than the general public, so it would be inappropriate for ARGA to try and replicate the approach taken by the FCA.

It also envisages a forward-looking role for the regulator, again similar to that of the FCA, which does not sit easily with the role of the auditor and that of corporate reporting, which is to report on historical data. Attempts have been made to require companies to report forward-looking information such as the viability statement, with limited success, as highlighted in the Independent Review of the FRC by Sir John Kingman. This consultation acknowledges that a forward-looking role in overseeing company reports would be a 'world first' and we believe the Recommendations need to be thought through carefully before implementation.

Recommendations 47 and 48
We have a number of concerns about Recommendations 47 and 48 that state the new regulator should be able to commission a skilled person review, paid for by the company, in circumstances where there is any significant interest arising from its strategic objective, and that the new regulator could publish the report.

We do not believe this activity is, nor should be, within the new regulator's strategic objectives or its duties and functions. This proposal would appear to replicate the FCA's right to commission a skilled persons report in relation to regulated financial services firms, which is for an entirely different purpose and is inappropriate for ARGA as regulator of audit, reporting and governance. We believe any concerns the regulator may have should be addressed to the audit firm, not the company, and its response should be to hold the audit firm to account by requiring detailed explanations from the auditor. We also believe there is no justification for requiring such action by the regulator to be paid for by the company. We believe ARGA, as regulator, should be properly staffed to undertake its stated duty "to investigate a company's affairs where there are public interest concerns about any matter that falls within the Authority's statutory competence"

We also do not believe it would be appropriate for the new regulator to publish reports in the majority of circumstances. The auditor and the regulator should resolve issues by private correspondence whenever possible. If, in exceptional circumstances, ARGA feels that the issues raised should be brought to the attention of shareholders, then it should have the right to publish the auditor's response, together with a response from the company.

We also have concerns over how these Recommendations would work in practice. The there is no clarity over the meaning of the words "where there is any significant interest arising from its strategic objective". It is not clear when a 'skilled person' would be appointed and what their role would be. It is also likely that any investigation would provide access to the most sensitive of company information and involve an external person, without full knowledge of the company, making a judgment on the company's operations – with no accountability. It is not made clear if the 'skilled person' would help identify whether a significant issue actually exists, or identify what action should be taken once a significant issue is identified. Either way, this appears very unsatisfactory, particularly as the recommendation is that it should be paid for by the company. There could also be unintended consequences. Should the company in question be an FCA regulated firm, the situation could arise whereby both ARGA and the FCA commission skilled person reviews from entirely different skilled persons, in relation to entirely different strategic objectives, and therefore resulting in very different outcomes. The courts have, historically, been very reluctant to 'second-guess' the legitimate business judgements of boards of directors and we believe that ARGA should exhibit a similar reticence.

Recommendations 49 and 50
We agree that the regulator must have the necessary powers but it is not clear how the powers proposed in Recommendation 49 would work. There would need to be clarity over areas such as whether it would be shareholders or the Regulator that receive the additional assurance on the viability statement or the output of any additional board evaluation.

However, we agree with Recommendation 50 that, in the most serious cases, the Regulator may issue a report to shareholders. In such circumstances we believe it would be appropriate for the Regulator, not the company, to issue the report.

Internal controls

We have some comments on Recommendation 51 that the framework for internal controls be strengthened, learning lessons from the US Sarbanes-Oxley regime (SOx). This might be by adapting the SOx regime for the UK environment and including some aspects of current financial services regulation, including increasing liability for companies' Finance Directors, and also requiring assurance at the time companies make an initial public offering.

First, we would highlight the very different regime for UK companies under 'apply and explain' for Principles and 'comply or explain' for Provisions, compared with the rules based system for US companies. We believe the requirement to 'apply' Principles is a more robust approach than rules as it requires broader application of both the letter and the spirit of Code requirements, not just complying with the wording of a rule in a 'tick box' fashion. We believe the current internal controls regime in the UK is robust and would suggest that BEIS may find it useful to receive input from internal auditors as to their experience of the quality of the validation provided by internal controls systems.

We would add that many global companies already comply with requirements of SOx, not to mention the requirements of many other countries. A number of non-US companies delisted from US exchanges, or decided not to list in the US, following the implementation of SOx, and a number of US companies decided to delist and become private due in some cases, we are told, to the significantly increased burden and liability under SOx.

We think that the quality and effectiveness of what is currently undertaken by companies should be established before additional layers of assurance are added. We believe there is a danger that adding too many levels of checking as the situation can result in various levels relying on others to have carried out the required checks, which weakens the system rather than strengthening it.

We will be interested to see the Government's proposals for the implementation of Recommendation 52 regarding the viability statement. It is important that any reform is proportionate to the benefit achieved.

Chapter 4: The new regulator: oversight and accountability
Q9. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

All the recommendations in Chapter 4 setting out the oversight and accountability of the new regulator appear to be improvements. However, the concerns we expressed in our response to Question 7 about the accountability of the regulator are also relevant here if it will have the power to sanction individual directors, as proposed under Recommendations 35 to 38.

Chapter 5: Staffing and resources
Q10. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

Our response to Question 7 where we commented on the need for the new Regulator to be staffed differently if the Regulator has the power to sanction individual directors, as proposed under Recommendations 35 to 38 is also relevant here, as are the points made in our response to Q8 on Recommendations 47 and 48 that the Regulator should be properly staffed to undertake investigations if it identifies any significant issues, rather than engaging a third party 'skilled person' to carry out a review.

We also believe it will undermine confidence in the Regulator if the Regulator feels it needs to hire a 'skilled person' to fulfil its strategic objective.

Chapter 6: Other matters

Q11. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

We have no comments on the matters set out in chapter 6.

Chapter 7: Interim steps

Q12. Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

We would highlight a number of issues to be borne in mind before the interim steps are taken further.

Category 1

- We believe Recommendation 17 covering the matter of audit expectation should be carried out as a matter of priority as the outcome of this work will impact a number of decisions on other recommendations.
- We would urge the FRC and BEIS to postpone the implementation of the recommendation to reduce the Guidance produced (Recommendation 31) without consultation. Companies find the FRC's Guidance, particularly that produced by the Financial Reporting Lab, to be very useful.
- We believe that reforms to the Viability Statement (Recommendation 52) should be subject to consultation prior to implementation by FRC and BEIS.

Category 2

- The new Regulator's Strategic Objective (Recommendation 4) should be reviewed and amended to align it with the duties and functions (Recommendations 5 and 6).
- We believe the revised Stewardship Code should be reviewed again, with a focus to achieving the outcome set out in Recommendations 42.

Category 3

- With regard to Recommendations 28 (pre-clearance of accounts); 35 to 38 (individual liability of directors) and 51 (internal controls) we believe it is important that these recommendations are thought through and any unintended consequences considered before primary legislation is sought for these proposals.
- Likewise, recommendations on the powers of the new regulator (Recommendations 49 and 50) should be considered again in the light of the outcome of further consideration of Recommendations 28, 35-38 and 51.

Conclusions

Q13. What evidence or information do you have on the costs and benefits of these reforms?

The costs of these reforms will be dependent on the details surrounding implementation and so we have nothing to add at this stage. The most significant costs will, we believe, be incurred should the Government implement a controls regime similar to that of Sarbanes Oxley in the US.

Auditor appointment

We have some concerns about the further proposals by Sir John Kingman that the regulator be given the right to change the arrangements for the appointment of auditors in certain circumstances and approve audit fees for PIEs where it sees a case for doing so in the interests of quality.

We agree that in certain circumstances where there are serious concerns over an auditor, the regulator should be able to step in and investigate, as the regulator of audit. However, the focus should be on investigating the auditor. Only in circumstances where the findings of such an investigation warrant intervention by the regulator should the regulator step in and oversee the arrangements for auditor appointment. This action should not be an automatic response to one of the three occurrences set out in the consultation as these circumstances will not always demonstrate a need for the regulator to intervene. A company may part company with its auditor outside the usual rotation cycle for a number of reasons and not all will demonstrate a problem with the auditor. Likewise, a meaningful shareholder vote against the appointment of the auditor could occur for a number of reasons, and will not always be related to the auditor's role as auditor of the company.

Although the proposal says the changes would not change the fundamental role of shareholders, we believe they do. It is the role of shareholders to appoint the auditor and to authorise the board to set the fee. It is not the role of the regulator. A higher fee is no guarantee of higher quality. Every company's audit requirements will be different, and the audit plan and coverage will be different in every case. A quality audit depends on a number of factors, not least the engagement of skilled professionals and a positive working relationship between the audit partner and the audit committee, creating an environment in which all concerns can be discussed openly.

Q14. What further comments do you wish to make?

We have no further comments.

We hope you find our comments helpful and would be happy to expand on any of these points should you wish to discuss them further.

Yours faithfully

Peter Swabey
Policy & Research Director