

BEIS Consultation

‘Restoring trust in audit and corporate governance’

Summary of the BEIS Response Statement

May 2022

On 31 May, the Government (BEIS) published its [Response Statement](#) (the Statement) following its consultation on reforms aimed at ‘Restoring trust in audit and corporate governance’. This was a significant consultation with 98 questions covering almost all 155 recommendations from the Kingman, CMA and Brydon reviews. BEIS received over 600 responses to the consultation from all parts of the financial sector and beyond.

The Statement summarises the themes from the responses received, and outlines the proposals BEIS intends to take forward through primary legislation, as stated in the Queen’s Speech on 10 May, secondary legislation (potentially using existing powers that the Secretary of State has under the Companies Act), or by other means, such as new or enhanced regulation. It also describes the proposals that will no longer be pursued.

“The corporate reporting system is highly interdependent, with many different actors having to play in it. The Government therefore believes that a holistic approach is needed, which involves all participants in tackling the problems that have been identified.” para 1.2.2

Who is impacted by the reforms?

BEIS has set out a broad programme of system-wide reforms for auditors, companies, directors, audit committees, investors, other stakeholders, and the regulator.

In a change to the original consultation that focused many of the reforms on premium listed entities, followed by Public Interest Entities (PIEs) at a later date, the Statement applies the changes directly to PIEs on a tiered basis according to the threshold described below. A smaller number of reforms (albeit quite significant) are just for FTSE350 companies.

Timeline for change

Although BEIS is clearly committed to these reforms, for most of the proposals there is no set timeline and a desire that they not be rushed and be allowed to develop over time. There is also an acknowledgement that market developments might drive change voluntarily, ahead of any formal implementation, for example in the demand for assurance through the Audit and Assurance Policy.

Proposals that will be taken forward through primary legislation as part of the Audit Reform Bill, may enter a ‘pre-legislative scrutiny’ stage by a joint committee of MPs and Lords, which will take evidence on the merits of the draft Bill and report to the Government, and/or

be subject to further consultation. It is expected that the Bill will then be formally introduced into Parliament following the 2023 Queen’s Speech, and be subject to the usual legislative stages, including consideration of individual clauses at Committee stage. The likely earliest effective date of any legislation would be 2024, although any changes introduced through other means might be earlier.

If you have any questions, please speak to your usual PwC contact or:

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Here are the headlines:

Overall approach:

- This is a **broad-ranging package** of holistic reform that stretches across the whole UK corporate reporting, governance and auditing system.
- The **timescale for reform is not yet established**, but is expected to stretch over several years. BEIS has emphasised that it will give careful consideration to the minimum lead times needed to deliver a measured and manageable pace of change.
- Implementation will be through a **variety of possible mechanisms**, including primary and secondary legislation and existing measures such as the UK Corporate Governance Code (the Code).

The key proposals:

- The **PIE definition** is to be expanded to include private companies, AIM listed companies, LLPs and third sector organisations, which have 750+ employees and £750M+ turnover. The PIE regime will move to a segmented basis with different requirements applicable for different tiers of PIEs.
- The Code is to be updated to require boards to provide an explicit statement on the effectiveness of **internal control systems** (financial, operational and compliance), and a basis for the directors' assessment.
- Legislation is to be introduced for an **Audit and Assurance Policy, Resilience Statement** and directors' disclosures over the prevention and detection of **fraud**.
- ARGA is to be established and will have greater enforcement **powers over directors** of PIE companies.
- **Managed shared audits** are to be introduced in the FTSE350 through legislation and implemented on a phased basis with ARGA able to determine exemptions.
- New disclosures are to be required around **capital maintenance** and legality of dividends.
- Minimum standards for **audit committees** around audit tendering and monitoring of audit quality are to be introduced.
- **Operational separation** of the largest audit firms is to be formalised.

How will the changes be implemented?

Below are the key proposals and the mechanisms by which BEIS indicates they will be implemented; this represents our current interpretation and we expect it will become clearer over time. More detail on each proposal is provided in the following section.

Primary (a bill in Parliament) or secondary legislation (statutory instruments)

- Establishing ARGAs and setting its powers, objectives and duties (draft Audit Reform Bill)
- Increased regulatory scrutiny and enforcement powers over directors (draft Audit Reform Bill)
- Expansion of the PIE definition (draft Audit Reform Bill)
- Managed shared audits (draft Audit Reform Bill)
- Resilience Statement
- Reporting on distributable profits
- Audit and Assurance Policy
- Enhanced fraud requirements
- Operational separation
- Insolvency reforms (draft Audit Reform Bill)

Other mechanisms

- Strengthened internal controls over financial reporting (in the Code)
- A definition of realised profits (from ARGAs)
- Minimum standards for audit committees (from ARGAs)

The rest of this summary sets out in more detail the key proposals in the Statement and how they could impact directors, audit committees and auditors. Where helpful, we have also provided our perspective on how the proposals have, or have not, evolved since the original proposals in the consultation.

Expanding the PIE definition and a tiered approach to the requirements

As part of the draft Audit Reform Bill, BEIS intends to extend the definition of a PIE to large private companies with both:

- 750 or more employees, and
- an annual turnover of £750m or more.

Companies traded on Multilateral Trading Facilities, such as AIM, third sector entities and LLPs that meet the size thresholds listed above will also be considered PIEs. Lloyd's syndicates, local authorities and other public sector bodies are not intended to be included as PIEs.

BEIS does not intend to provide a temporary exemption from the PIE requirements for newly listed companies. However, BEIS will allow an adequate period between an entity exceeding the new PIE threshold and being subject to any new requirements. This will be a minimum of one full annual reporting cycle and further details will be set out in the draft Audit Bill. There will also be a smoothing mechanism whereby entities will have to continue to meet requirements for a set period after they qualify as a PIE, even if they drop below the PIE threshold. Details of this mechanism will also be included in the draft legislation.

The new threshold will apply to consolidated UK group accounts as well as to individual UK entities i.e. where a group files consolidated accounts in the UK, if the group exceeds the threshold, the parent will be a PIE. A UK-incorporated parent will also be a PIE if a UK subsidiary passes the PIE threshold.

All that said, BEIS does appear to be sympathetic to the issue of having multiple PIEs within a group and the risk of duplication, and has said it will consider a mechanism to help reduce this risk before introducing the legislation (for example, an option of either reporting at subsidiary level or reporting on a consolidated group basis).

Although it intends to expand the definition, BEIS is keen to ensure that the additional regulation is proportionate. As such, BEIS indicates that it will introduce a tiered approach to the requirements for a PIE (impacting both existing PIEs and new PIEs as a result of the expanded definition). The tiered approach will result in three levels of impact:

1. **Existing PIEs that do not meet the size threshold** - these entities will not have to meet any of the new requirements set out in the Statement, with the exception of premium listed companies which will have to meet new requirements that are implemented through changes to the Code.
2. **Existing PIEs that meet the size threshold** - these entities will have to meet the new requirements set out in the Statement, including in relation to the Resilience Statement, Audit and Assurance Policy, directors' statement on fraud measures, and new disclosures about capital maintenance.
3. **New PIEs as a result of meeting the size threshold** - these entities will have to meet the new requirements set out in the Statement (as outlined in 2 above) and requirements that already apply to existing PIEs, excluding the requirements to have an audit committee, to retender the audit every 10 years, and to rotate auditor every 20 years.

Note: Where aspects of the reform are introduced through changes to the Code, based on current requirements they would only apply to premium listed companies irrespective of whether the company meets the new size threshold.

The key changes for companies and directors

Increased regulatory scrutiny and enforcement powers over directors

- BEIS intends to give ARGAs the effective powers to enforce the financial reporting duties and to supervise the corporate reporting and audit related responsibilities of PIE directors (including PIEs that are not companies). Upholding the unitary board principle, this would include both executive and non-executive directors, and we are assuming from the way it is written, that, as originally proposed, all directors of a PIE will be included, including those that are not members of a chartered accountancy body.

Stronger internal company controls

- BEIS has decided that the most proportionate way of increasing boardroom focus on internal control matters is to strengthen the requirements in the Code. So it will invite the FRC to consult on introducing a requirement in the Code for an explicit statement from the board about its view of the effectiveness of the internal control systems (financial, operational and compliance systems) and the basis for that assessment. This will be underpinned with guidance on how boards should approach the preparation of the statement, including the identification of acceptable standards, benchmarks or principles, and address definitional issues and the circumstances in which external assurance might be considered appropriate.
- As was originally proposed, BEIS will also require PIEs above the threshold described above, to state in their Audit and Assurance Policy (see below) whether or not they plan to seek external assurance of any reporting on their internal control arrangements.
- BEIS also plans to ask the FRC to explore with investors and other stakeholders whether, and how, the content of the auditor's report could be improved to provide more information about the work auditors have undertaken on the internal controls over financial reporting.
- While this is not a legislative change, BEIS will consider as part of its post-implementation review, if further measures are needed, and if there would be value in extending this to other PIEs (the Code only applies to premium listed companies). If necessary, new statutory reporting requirements relating to internal controls could be introduced using existing powers in the Companies Act 2006.

Enhanced fraud requirements

- BEIS intends to proceed with the proposal that directors should report on the steps they have taken to prevent and detect material fraud. This requirement will apply to PIEs above the size threshold set out above. BEIS considers that auditors' existing requirements to identify and report material inconsistencies in directors' reporting will be sufficient for reporting on directors' fraud statements, and will wait and see if this and recent revisions to the auditing standard on fraud have the anticipated effect in clarifying what is expected of auditors in explaining the work they have done to detect fraud.

Resilience Statement

- BEIS intends to introduce a statutory requirement for a Resilience Statement that will combine the existing going concern statement and viability statement. BEIS plans to replace the five year minimum assessment period previously proposed for the combined short and medium term sections of the Resilience Statement with an obligation on companies to choose and explain the length of the assessment period for the medium term section. Rather than mandate a prescribed set of resilience risks to be included, BEIS intends to legislate for companies to report on matters that they consider a material challenge to resilience over the short and medium term, together with an explanation of how they have arrived at this judgement of materiality.
- Rather than include two reverse stress testing scenarios, as was proposed, BEIS will require a minimum of one. Material uncertainties will also be disclosed in the short-term part of the statement, even if mitigated (effectively a gross disclosure). BEIS and the regulator will also consider how the Resilience Statement can effectively reference, make links to, and provide a coherent reporting framework with wider sustainability disclosures.
- This requirement will be for all PIEs over the threshold described above.

Capital maintenance disclosures and a definition of realised profits

- BEIS intends to give ARGAs formal responsibility for issuing guidance on what should be treated as realised profits and losses for the purposes of section 853 of the Companies Act 2006. The guidance would be subject to full consultation. BEIS also intends that companies (or in the case of a UK group, the parent company only) will be required to disclose their distributable reserves (which would be subject to audit), and provide a narrative explaining the board's long term approach to the amount and timing of returns to shareholders (including dividends, share buybacks and other capital distributions), as well as how this distribution policy has been applied in the reporting year. However, BEIS has decided against requiring that the group's dividend paying capacity be disclosed and instead will encourage it.
- BEIS intends to require that directors make explicit statements confirming the legality of proposed dividends and any dividends paid in the year, but has decided not to proceed with the proposal for assurance from directors that a dividend would not be expected to jeopardise the future solvency of the company over a period of two years. However, BEIS expects that the Resilience Statement will take into account a company's dividend policy.
- In a further change to the original proposals, rather than apply initially to listed companies and then PIEs, it appears BEIS intends to apply these requirements directly to all PIEs above the new threshold.

Managed shared audits

- BEIS intends to legislate a managed shared audit regime whereby UK-incorporated FTSE350 companies will either appoint a sole non-Big Four audit firm (i.e. a "challenger firm") or, if they appoint a Big Four audit firm, they must share a "meaningful proportion" of their subsidiary audits with a challenger firm. This requirement will be implemented over time and in a phased manner as audits fall to be tendered under the existing tender cycle.
- In relation to what is a meaningful proportion, BEIS plans to legislate to give ARGAs the power to set this percentage and amend over time as challengers grow in capacity and capability, and as the regulator learns more about the effectiveness of the overall managed shared audit regime. Also, BEIS has decided that companies can include international subsidiaries when allocating a meaningful proportion if they choose to do so. The framework will allow the regulator to grant exemptions under limited circumstances, and to impose conditions on those companies that are granted exemptions, where appropriate.
- BEIS retains the option to introduce a market share cap regime if it becomes clear that choice in the FTSE350 has not significantly improved.

The key changes for audit committees

Minimum standards for audit committees

- BEIS intends to proceed with giving ARGAs the power to set minimum standards for audit committees in relation to the appointment and oversight of auditors. As part of the standards, ARGAs will also include appropriate provisions to encourage shareholder engagement with an audit. The main focus is on FTSE350 companies but, once the requirements have been implemented, ARGAs will monitor their impact and the BEIS will consider whether they should be extended to a wider community of PIEs.
- BEIS continues to believe that a formal mechanism should be established to enable audit committees to gather shareholder views on the audit plan. Similarly, shareholders should have better opportunities to ask questions about the audit at an AGM, although BEIS does not believe a standing AGM item is necessary or sufficient to achieve greater shareholder engagement. These could both be implemented through the new audit committee requirements.

Audit and Assurance Policy

- BEIS intends to introduce a statutory requirement for audit committees/boards of PIEs that meet the threshold described above to develop and publish (for most in the same section as the Audit Committee Report in the Annual Report) an Audit and Assurance Policy that explains the company's approach to assuring the quality of the information it reports to shareholders beyond that contained in the financial statements. This will include whether any independent assurance is 'limited' or 'reasonable' or whether an alternative form of engagement or review has been performed. It will be published every three years with an annual update report from the audit committee on the assurance activity and how it is progressing. Companies will have to demonstrate how they have taken account of shareholder and employee views, although it won't be put to shareholder advisory vote.
- The Audit and Assurance Policy will have a minimum requirement that it will set out whether, and if so how, a company intends to seek independent (external) assurance over any part of the Resilience Statement and over reporting on its internal control framework and to describe their internal auditing and assurance process and approach to audit tendering.

The key changes for auditors

- Many of the reforms outlined above will also impact auditors, most notably the requirement for a managed shared audit. However, there are also a number of significant reforms in the Statement that have an impact primarily on auditors and the audit profession. One of the most significant is that the Government intends to introduce legislation to empower the regulator to require an 'operational separation' of the largest firms. Steps are already being taken by these firms to implement operational separation of their audit businesses from their non-audit businesses on a voluntary basis.
- Two areas BEIS decided not to take forward relating to auditors were the establishment of a corporate auditing profession (instead BEIS will expect the professional bodies to make substantial improvements to auditor qualification, training and skills), and the proposal that auditors should consider wider financial and other information when making judgements (BEIS will instead leave this to companies, directors, and investors to shape the development of an enhanced wider assurance services market, stimulated by the requirement to publish an Audit and Assurance Policy).

Establishing ARGAs and setting its powers, objectives and duties

Impacting all parties are the plans to establish the Audit, Reporting and Governance Authority (ARGA) to replace the FRC with the goal to “implement high quality and high standards and encourage improvement by regulated entities and individuals”.

ARGA will have a range of statutory responsibilities and powers that the FRC does not have. These include formalised responsibility for overseeing the accounting and actuarial professions, a stronger role in auditor registration, and new powers to tackle breaches of company directors’ duties relating to corporate reporting and audit.

Insolvency regulation reforms

Although not the focus of this summary or included in the Statement, the draft Audit Reform Bill will include provisions to reform the regulation of insolvency practitioners. BEIS has not yet published its response to the consultation “The future of insolvency regulation”, which closed on 25 March, and so at this stage it is not clear what provisions relating to insolvency will be included in the Bill.

Next steps

We will continue to engage with BEIS and the regulator as they work through the next stages of developing the legislation and regulatory changes. We also encourage interested parties to engage and be part of the reform process that will impact all of us in the future. If you have any questions on this summary of the broader reform agenda, please speak to your usual PwC contact or you can contact Sotiris Kroustis at sotiris.kroustis@pwc.com or Jayne Kerr at jayne.l.kerr@pwc.com

You can also find out more about what some of the key reforms might mean to you and what we hope is helpful, practical guidance for preparers seeking to proactively implement the proposals, such as the Audit and Assurance Policy, in our Restoring Trust Series found [here](#).

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