

15 November 2021

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Our Ref: NB/SJG/Crowe

Dear Madam

Proposed Revisions to the Audit Firm Governance Code

We are delighted to provide our response to the FRC's Consultation Document on the 'Proposed Revisions to the Audit Firm Governance Code'.

As a Tier 2 firm under the FRC's Audit Supervision Regime, Crowe¹ is one of the firms referred to within the Consultation Document that are anticipated to be brought into scope of the proposed 2022 Audit Firm Governance Code (AFGC) as a result of the planned changes. We recognise this and seek to embrace the requirements of the Code as part of our 'commitment to continual improvement in audit quality' agenda.

Whilst we have outlined our responses, where appropriate, to each of the 12 consultation questions within the Appendix to this letter, our key observations in respect of the proposed AFGC are as follows:

- **Comply or explain** – we have concerns regarding the requirements of comply or explain and whether in reality the AFGC 2022 will become a comply based code. Furthermore, we are concerned that circumstances giving rise to non-compliance (i.e. explain) may lead to undue regulatory criticism of such firms that choose to do this for certain requirements. We consider that for smaller firms (i.e. those outside Tier 1 supervision) a degree of proportionality and appropriateness of some aspects of the code may reasonably allow an explain approach to aspects of the code to be taken. We consider that the role of 'comply or explain' should be modified such that 'explain' will not to be suggestive of non-compliance but rather make explicit that firms are complying with the code to the extent it is applicable and appropriate to them. We refer to our further comments in response to Q1 below.
- **First time adoption of AFGC** – we recommend that those anticipated to fall within the AFGC 2022 for the first time are given the opportunity to start to plan from now for the adoption of the AFGC 2022 and are provided with an exemption from applying the AFGC 2016 should they fall within scope of that code between now and the adoption timetable for the new code, with early adoption encouraged on compliance with aspects of the code where possible.

- **Number of Independent Non-Executives (INEs)** – we consider clarity should be provided for smaller firms regarding how many INEs are needed and what transitional arrangements may be in place for unforeseen circumstances (where only two INEs may be appointed). There is an inference that it may be acceptable for smaller firms to only have two INEs but it is not clear if this is on a comply or explain basis.
- **Capacity of available INEs** – we do have concerns that there may be limited capacity in the market for INEs with the requisite skills, experience and appetite to undertake such a role, especially one which, under the AFGC 2022 is becoming more involved and onerous. Guidance and assistance may be required here to assist those firms undertaking first time implementation of the AFGC 2022.
- **Independence of INEs** – clarity is required to assist firms in respect of the assessment of independence from the firm for INEs. We note that in Appendix A of the consultation document that a proposal to appoint a former partner or employee would need to be subject to careful consideration, suggesting it could happen. This appears to present a 'grey area' where it is not clear in which circumstances such an appointment would be considered appropriate and reasonable.
- **Management responsibilities within the firm** – clarification may be needed regarding what is meant by the provisions of Section A 2 of the proposed AFGC 2022 regarding significant management roles.

For many smaller firms, a number of senior partners with the experience that may be most suited to a governance role, may also undertake some roles of leadership responsibility within the firm.

We believe a distinction needs to be made between those partners who have *significant management responsibilities* for the day to day executive powers, management and operation of the firm

and

those other partners who undertake other senior leadership roles (e.g. a market-facing lead, head of a business unit or responsible for elements of risk and compliance) within the firm that are outside the day to day executive powers, management and operation of the firm. We believe that latter category of partners should still be able to be part of the firm's governance structure.

- **Guidance** – as an improvement regulator, and a regulator that wants to encourage both audit quality and wider competition in the audit market, we believe that the FRC has a key role to play in supporting those firms who are adopting the AFGC for the first time in helping them understand what is expected, providing evidence of best practice within the market for them to consider and enabling them to first-time adopt the AFGC as effectively as possible. There should be a recognition from the regulator that such firm's may not be fully compliant on day one but will want to ensure that they embrace and adopt the code appropriately for their firms and get things right. We would like to see a formal programme put in place by the FRC for such support and a flexible and encouraging approach to such regulation would be welcome

Such guidance should also be extended to INEs as outlined in our response to Q10.

We trust that you will find our contribution of assistance in the review. We would welcome the opportunity to discuss our submission and/or provide any further clarification, if that would be helpful. If so, please contact:

- Nigel Bostock, Chief Executive – [REDACTED]
- Steve Gale, Head of Audit – [REDACTED]

Yours faithfully

Crowe U.K. LLP

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¹ Crowe in the UK is one of the top 10 audit firms by fee income. We are ranked eighth in the Advisor Rankings of stock market auditors both by number of clients and by market capitalisation of audit clients. Most of the clients within these numbers are listed on AIM with a number listed on the main market. We are the leading auditor to charities, having led the rankings with most audit clients for over 11 successive years, and an acknowledged specialist in auditing large pension schemes. The firm is the UK member of Crowe Global, the eighth largest international accounting network with revenues of approximately US\$4.17bn, around 40% of which is derived from audit. Our network members work with listed companies on markets around the world and collaborate on large, transnational audit assignments.

Appendix 1 – Responses to Consultation Questions

Consultation question	Crowe response
PURPOSE OF THE CODE AND APPLICATION	
<p>1. How appropriate do you feel that the revised purpose of the proposed 2022 Code is?</p>	<p>Crowe anticipates being one of the firms noted in the consultation document that would be brought within the scope of the proposed AFGC 2022. Accordingly, our responses are primarily focused on the proposed AFGC 2022 and we have not sought to compare and contrast the proposals to the existing AFGC 2016.</p> <p>With this in mind we note the following:</p> <ul style="list-style-type: none"> • We are supportive of the proposed AFGC 2022 but note the range of firms caught by the code varies significantly and it is important that proportionality and scalability is considered in this respect. • Whilst the Code operates on a ‘comply or explain’ basis, we are concerned that smaller firms, who might apply the Code in a different way to the one set out in the provisions if they felt the costs were disproportionate, risk incurring regulator dissatisfaction. We would encourage the FRC to have an active engagement with those firms that are adopting the AFGC for the first time to understand the spectrum from the key ‘red-line’ ‘comply’ requirements compared to acceptable day one ‘explain’ requirements. This will help in putting together implementation plans and prioritising key items. • Accordingly, firms adopting the code should do so in a manner which is proportionate and appropriate to the firm’s size, complexity and relative number of PIE audits in scope in applying the AFGC. Consequently, we believe the Code should recognise and encourage that an ‘explain’ rather than ‘comply’ approach to certain requirements of the code may be more appropriate. • We welcome the clarification provided in the proposed AFGC 2022 in respect of ‘Section E – Operational Separation’ to provide greater

	<p>harmony of what is expected of firms required to do so. However, as we indicated in our response to the BEIS consultation on reforms to corporate governance and audit, care is needed to ensure that the requirements and expectations of 'Operational separation' are not unduly and disproportionately extended to a wider group of firms that are substantially different practices.</p>
<p>2. What are your views on the proposed thresholds for application of the proposed 2022 Code?</p>	<p>Overall, we believe the thresholds appear sensible, albeit 20 appears an arbitrary figure and some explanation and rationale for this number would be helpful, especially given that many entities defined as PIEs have a relatively small market capitalisation.</p> <p>Under AFGC 2022, the proposed thresholds have changed from the audit of 'listed entities' to 'PIEs' and therefore it is important there is clarity, in advance of the adoption of the AFGC 2022, regarding what falls within the PIE definition. Such a definition should be consistent with the BEIS white paper definition once clarified and determined.</p> <p>In addition, clarification should also be given on the point in time in when an entity falls within scope of being a PIE (i.e. on engagement, signature of an audit report for that entity to be considered a PIE for the following financial year, when its market capitalisation has been over a specified level for a 6-month period etc).</p> <p>We support the 'floor' which has been set at a lower level than the entry point to ensure that firms do not fall in and out of scope without a substantial change in their circumstances. We consider the floor to have been set at a reasonable level.</p> <p>Whilst we understand the threshold regarding the audit of 20 PIEs, we are less sure of the threshold that has been set for falling within scope of AFGC 2022 by virtue of auditing only one FTSE350 entity and have commented further on this in our response to question 3 below. Furthermore, given the FTSE350 does change from time to time, there needs to be a more formal process for determining when an entity falls within the scope and for notice to be given to the audit firm to enable them to adopt the code thereafter within a specified time period (see below).</p> <p>Clarification should also be provided on how the thresholds may be determined in respect of firms who undertake Managed Shared Audits. It is our understanding that where firms are component but not primary auditors</p>

	<p>of a FTS350 entity, such audit engagements will not be caught within the AFGC 2022 thresholds for determining the number of PIE audits the firm has.</p> <p>Finally, consideration should be given for the regulator to provide firms with formal notice on when they fall within scope which is then followed by a specified transitional period (i.e.15 to 21 months) for subsequent adoption of the code from the point at which this notice is provided to enable the firm to adopt the code the first time.</p>
<p>3. Should the proposed 2022 Code apply to any firm that audits a FTSE 350 company? Please suggest alternatives?</p>	<p>We have reservations on the requirement for a firm to apply the AFGC if they audit only one FTSE350 company.</p> <p>We are concerned that this will present some anti-competitive and entry to market issues for a potential challenger firm already outside the scope of the AFGC and/or would lead to firms considering that they would have to make significant steps to voluntarily adopt the AFGC in advance of market entry. We consider further thought is needed in this area and some transitional provisions should be put in place to encourage appropriate market-entry of those firms that have the ability and appetite to undertake an audit or one or more FTSE 350 entities.</p> <p>Further, we are unclear at which point such a firm would be expected to apply the AFGC after accepting appointment as auditor to a FTSE 350 company. Would it be from date of appointment, the point the audit report is signed or from the firm's accounting period commencing after the date of appointment?.</p>
<p>4. What are your views on the proposed effective date of the proposed 2022 Code?</p>	<p>We support the proposed effective date for the AFGC 2022 code.</p> <p>The Consultation Document indicates that up to three or four firms may come into scope to apply the proposed AFGC 2022 and we envisage that Crowe is one of those firms.</p> <p>It is our key recommendation, albeit we recognise we have vested interest in this observation, that those firms anticipated to fall within the AFGC 2022 for the first time are given the opportunity from now to start to plan for the adoption of the AFGC 2022 and are provided with an exemption from applying the AFGC 2016 should they fall within scope of that code between now and the adoption of the new code.</p> <p>Whilst we recognise a concession from the existing AFGC 2016 is being</p>

	<p>requested, the consultation document does indicate additional work, costs and time for those firms adopting the code for the first time, and we consider this is not only a constructive, very fair and reasonable request given the planning and preparation needed for such firms adopting the code for the first time, but a critical recommendation if such firms to be able to be achieve adoption of the code in an effective manner. It would appear inappropriate for such firms to be distracted from the focus to adopt the AFGC 2022 from having to fall within the soon to be replaced AFGC 2016.</p> <p>Further to our point made against question 3, the Code should make it clear by which point firms should have adopted the AFGC once the threshold has been reached. We suggest that it is the firm's accounting period commencing after appointment to the twentieth PIE audit.</p>
<p>5. What are your views on the priorities for engagement with investors, audit committee members and other external stakeholders and how could we encourage interaction with INEs?</p>	<p>We recognise the importance of the requirement for audit firms to engage more widely with investors, audit committee members and other external stakeholders including greater interaction from INEs.</p> <p>For smaller firms within the scope of AFGC, greater clarity is needed to understand more specifically what proportionate expectations may be placed on such firms given the relatively fewer, potentially both in number and size, of PIE audits they have.</p> <p>In addition, equally there needs to be an expectation set from a company corporate governance perspective for the companies concerned to also proactively increase their engagement and liaison with INEs of the firms whom they are audited by.</p>
<p>LEADERSHIP</p>	
<p>6. To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?</p>	<p>There is a challenge in bringing greater partner oversight and accountability on the revised AFGC 2022 at the same time in which an increasing number of (smaller) firms are being brought into scope of the code.</p> <p>There is a risk that the code assumes a 'one-size fits all' approach in the area of leadership which is not proportionate to the relative size and complexity of firms caught by the code. Accordingly, it will be important that smaller firms are able to adopt a comply or explain approach which may be more appropriate and proportionate to their circumstances.</p>

<p>7. What are your views on the proposals to underpin connectivity with the global network and monitoring of its potential to impact the UK Firm? Do you have other suggestions for how this could be addressed?</p>	<p>It is important to recognise that not all networks are structured and governed in the same manner and so any requirements in respect of 'connectivity' must be flexible and proportionate to recognise these differences</p>
<p>PEOPLE, VALUES AND BEHAVIOUR</p>	
<p>8. How supportive are you of the approach taken to people and culture in section B of the proposed 2022 Code? Please include any suggestions for how we could improve it further.</p>	<p>We support the approach of Section B which brings together in one place the people and conduct related matters. We see the tone, culture, values, behaviour and conduct of the firm as critical components to the promotion, instilling and delivering of audit quality.</p>
<p>OPERATIONS AND FIRM RESILIENCE</p>	
<p>9. Are there any matters you believe we should include in section C that do not currently feature and/or can you suggest other improvements to how the proposed 2022 Code approaches operational matters and resilience?</p>	<p>The consultation document states that over the past few years, several Firms have established a partner-led audit quality committee to oversee initiatives to improve audit quality and that the FRC consider this to be a positive step in supporting audit quality as an alternative to an independent Audit Board.</p> <p>It is our view that the proposed 2022 Code should encourage Firms that do not have operationally-separate audit practices to adopt this approach and we have recently taken such steps.</p>
<p>INDEPENDENT NON-EXECUTIVES</p>	
<p>10. Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?</p>	<p>Whilst the code's principals and requirements are reasonably prescriptive, it would be helpful in due course for more specific guidance material to be prepared by the FRC for INEs as part of the implementation of the code. This will be specifically valuable for both new firms and new INE entrants into the AFGC 2022. Such guidance could include best practice illustrations, expectation statements and what is included and excluded from the scope of the role of an INE.</p> <p>The role of the INE can be challenging, especially in a new role, a changing governance structure and/or a firm adopting the AFGC 2022 for the first time. In an effort to be helpful and proactive for the benefit of the wider firm there is a risk that the role and scope of an INE could expand. It is critical that INEs do not overstep their role and remit by straying into matters which may be perceived to be decisions of Management, whether strategic or</p>

	operational management of the firm. Clarity, guidance and examples of best practice and expectations on key aspects of scope and terms of reference would be valuable.
11. What are your views on the proposals for strengthening the status and role of INEs? Please include any suggestions for other ways to increase their impact and effectiveness.	The point regarding the scope of the role of an INE is critical as it was noted from the consultation events that some concerns were expressed in respect of whether widening the roles for INEs too widely would impact the effectiveness of their primary focus.
OPERATIONAL SEPERATION	
12. What are your views on the proposed boundaries between the responsibilities of INEs and Audit Non-Executives? Please give examples of any potential difficulties you foresee with what is proposed.	We have no matters to note.