

# FRC's Proposed Revisions to the Audit Firm Governance Code

ICAS Response

18 November 2021



## Introduction

ICAS welcomes the opportunity to provide our views on the FRC's proposed revisions to the Audit Firm Governance Code.

Our CA qualification is internationally recognised and respected. We are a professional body of over 22,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practices, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK's, and the world's, great companies.

Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Any enquiries should be addressed to James Barbour, Director, Policy Leadership:

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## General Comments

Achieving regulatory balance is important. Whilst we are generally supportive of the FRC's proposed revisions to the Audit Firm Governance Code, increasing regulation, oversight, governance and their related costs can present a barrier to entry for firms who might be looking to enter into, or increase their presence in the public interest entity (PIE) audit market. This is particularly so if audit is a small proportion of the firm's activity. We are starting to receive anecdotal feedback from members in business that audit costs are rising notably, and the pool of available competing firms is becoming smaller. The priority is to promote audit quality and diversity; maintaining, and potentially increasing choice in the audit market is fundamental if there is to be less concentration in the PIE audit market. Barriers to entry, where possible within a regulatory framework, should be low to encourage choice and diversity of audit suppliers. Therefore, we believe that there is a need to ensure that appropriate consideration is given to supporting those firms who are having to transition towards applying the Code for the first time. Additionally, further consideration should be given as to whether companies would automatically fall within scope were they to breach the recognition thresholds for only a short period of time.

Consideration also needs to be given as to whether any alignment of the proposed revisions to the Code will be required in light of the Government's forthcoming feedback paper on proposed reforms to audit and corporate governance.

## Responses to Specific Questions

### Question 1

How appropriate do you feel that the revised purpose of the proposed 2022 Code is?

### *Response*

Overall, we believe that the proposed revised purpose is reasonable. Serving the public interest is fundamental to the role of an audit firm and we support the introduction of an element to the Code's purpose around ensuring firms take account of the public interest in their decision-making.

Whilst additional guidance may add further clarity about how to fulfil that purpose, that desire has to be balanced against the extent to which further guidance would unduly lengthen the Code or require reference to separate guidance. On balance, we are supportive of the approach proposed by the FRC, but this is an area that should be monitored to assess whether guidance is required. It does, however, have to be accepted that ‘the public interest’ means different things to different people and under different circumstances, so there is the possibility of an inconsistency in approach across firms and across their INEs when discharging their responsibilities in relation to the public interest.

#### Question 2

What are your views on the proposed thresholds for application of the proposed 2022 Code?

##### *Response*

We are supportive of the proposed thresholds for application of the proposed 2022 Code. We also agree that stability in application is important. We note and are supportive of the move from using “listed entities” to “public interest entities” to better reflect the basis of the regulatory regime. However, there is a need to get clarity as soon as possible from the Government as to what changes, if any, are to be made to the PIE definition and the date from when any such changes would take effect. We do note that the FRC does not intend to publish its finalised revised Code to the spring by which time there should be greater certainty in this regard as firms that may be impacted need to know in early course to allow them to take the necessary actions.

We note the proposal to set a higher starting threshold and lower cessation threshold and accept the rationale for this approach. We would, however, ask that consideration be given as to whether a grace period would be helpful so that where a firm breaches the eligibility threshold for a short period only, this does not automatically result in it having to apply the Audit Firm Governance Code.

#### Question 3

Should the proposed 2022 Code apply to any firm that audits a FTSE 350 company? Please suggest alternatives.

##### *Response*

Yes, we believe that the proposed scope is sensible but would highlight our comments in response to question 2 above in relation to the potential need for a grace period where the eligibility threshold is breached for a short period only. Of course, generally, we appreciate that proportionality is served by the fact that the Code operates on a comply or explain basis, which does provide firms with flexibility in their application of the Code.

Depending on the Government’s forthcoming decision on whether to proceed with some form of mandatory managed shared audit, clarification may be needed as to whether an audit firm that was not the primary auditor of a PIE/FTSE 350 entity but was auditing components or a percentage thereof of the group, is deemed to be auditing such an entity for the purposes of applying the thresholds for the Audit Firm Governance Code.

#### Question 4

What are your views on the proposed effective date of the proposed 2022 Code?

##### *Response*

We agree with the proposed effective date of accounting periods commencing on or after 1 January 2023. We would highlight that consideration also needs to be given as to whether any alignment of the proposed revisions to the Code will be required in light of the Government’s forthcoming feedback paper on proposed reforms to audit and corporate governance.

#### Question 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?

#### *Response*

We agree that a co-ordinated approach would be more effective as is proposed by the FRC. We are therefore supportive of the proposed revisions to the Code and the FRC's proposed actions including potential future changes to the Stewardship Code. Ultimately, however, there can only be enhanced engagement between these various groups if all of the actors really want this to happen and allocate sufficient resource to facilitate it.

Consideration also has to be given to those firms that will be new to having to apply the Audit Firm Governance Code as they may not have the same level of resource to engage in such activities.

We also agree that in general Transparency Reports would benefit from being shorter and more focussed on a firm's quality processes so they are more informative for the reader.

#### Question 6

To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?

#### *Response*

We are broadly supportive of the proposed changes in relation to partner oversight and accountability to owners. There is, however, a need to take account of the different stages that some of the firms may be at in their implementation of the Code. For those having to introduce this for the first time these proposed revisions may be challenging. Hence, there has to be a recognition that there is not a 'one-size fits all' approach and that where smaller firms choose to explain why they have potentially adopted an approach more suited to their specific circumstances this is given proper consideration by stakeholders.

#### Question 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?

#### *Response*

Whilst we understand the rationale for this proposed approach, we do have concerns as to how this would be operationalised. We recognise that there are risks for a firm with being part of a global network and that the UK firm must have controls in place to assess and mitigate the risks to the UK business. However, where decisions are made outside of the UK, as opposed to the relevant governance body sitting at a UK level, achieving this level of transparency is not practicable as the UK firm can only legally provide information relating to decisions that it owns, manages and controls.

#### Question 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.

#### *Response*

We are supportive of the approach taken. We have no suggestions for how it could be further improved.

#### Question 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?

#### *Response*

We are not aware of other matters that should be included in section C that do not currently feature.

We also have no other suggested improvements as to how the proposed 2022 Code approaches operational matters and resilience.

We believe that there is merit in encouraging firms that do not have operationally-separate audit practices to establish a partner-led audit quality committee to oversee initiatives to improve audit quality.

#### Question 10

Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?

#### *Response*

We believe that in general the proposed 2022 Code helps to clarify the role that INEs play in the firms. We note the escalation procedures for an INE to raise concerns with the regulator – this is an extreme situation and should be supported by a clear pathway of actions within the firms to facilitate resolution before it gets to this stage.

We do, however, harbour concerns that there is a risk that if INEs were to “influence decision-making” as opposed to providing oversight, this would cause significant independence concerns due to potential chain of command issues; and that independence restrictions may impact the ability of the firms to attract high calibre candidates. Therefore, there is a need to consider the possibility of such unintended consequences.

#### Question 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. We would also refer you to our response to question 10 above.

#### *Response*

We are supportive of these proposals. We have no suggestions for other ways to increase the impact and effectiveness of INEs. Please also refer to our response to question 10 above.

#### Question 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.

#### *Response*

We are supportive of the proposed boundaries. We appreciate that there is a difficult balance between ensuring independence and ensuring that both the INEs and ANEs are aware of relevant matters.

We have also clarified and strengthened the role of this Board and introduced a separation between the role of chair and that of the managing / senior partner. A separation of the roles of chair and chief executive is a core element of the UK Corporate Governance Code.



**Contact us**

CA House, 21 Haymarket Yards, Edinburgh, UK, EH12 5BH  
+44 (0) 131 347 0100  
[connect@icas.com](mailto:connect@icas.com) | [icas.com](http://icas.com)

@ICASaccounting

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