

18 November 2021

Shamima Hussain
Financial Reporting Council
8th Floor
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Dear Shamima

Proposed Revisions to the Audit Firm Governance Code

This letter describes our overall views on the consultation document on proposed revisions to the Audit Firm Governance Code (the Code), issued in August 2021, and is supplemented by our detailed responses to each question in the appendix.

We welcome the opportunity to provide input to this consultation. Deloitte has long recognised the benefits of strong governance and we voluntarily established our Audit Governance Board (AGB) in January 2021, ahead of the FRC's 2024 deadline. With operational separation underway and further audit and corporate governance reforms imminent, strong audit firm governance is more important than ever, and we are supportive of measures that strengthen governance, enhance audit quality and improve choice in the audit sector.

Deloitte currently has four Audit Non-Executives (ANEs), all of whom are members of our AGB¹ and three of whom are also Independent Non-Executives (INEs) and members of our UK Oversight Board (UKOB)² (collectively, the Non-Executives). The Non-Executives have provided input to this response.

We acknowledge the FRC's stated rationale for revising the Code at this time and support proposals that: promote good governance; ensure the relevant firms have appropriate levels of oversight and are taking account of the public interest; and enhance trust and confidence in audit. We recognise the audit and

¹ The Audit Governance Board is responsible for providing independent oversight of Deloitte's Audit & Assurance business in the UK. Details of our governance arrangements are available on our website [Governance | Deloitte UK](#)

² The UK Oversight Board is responsible for overseeing how Deloitte's non-audit businesses in the UK meet their regulatory and legal requirements, and for the oversight of certain firmwide matters such as financial reporting.

corporate governance landscape is changing and further changes to the Code may be required in the coming years as those reforms start to take effect.

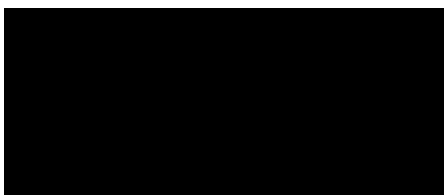
We highlight our following views on the proposals. More details, along with responses to all the questions in the consultation, are in the appendix:

- 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. However, 'the public interest' means different things to different people and under different circumstances so there is likely to be an inconsistency in approach across firms and across their Non-Executives when discharging their responsibilities in relation to the public interest. The use of a framework of matters to consider when justifying or challenging the justification of an action as being in the public interest may help to provide some guidance around the FRC's expectations when assessing firms in this regard.
- Notwithstanding the government's plans to change the definition of a Public Interest Entity (PIE), we note the proposed changes to the thresholds for applying the Code will likely mean some firms coming into scope for the first time. While we recognise it is important for any firm auditing public interest entities to have strong governance arrangements, we are concerned about any move that could counteract the measures being taken to increase choice in the PIE audit market. The Code would, though, operate on a comply or explain basis, thus providing the affected firms with the flexibility to apply the Code in a proportionate way that meets the principles, and we support that approach.
- We share the FRC's belief that strong global networks can have a positive impact on audit quality and resilience and have seen these benefits within our own network. We also recognise that membership of a global network can create risks, such as competing strategic priorities, and have controls in place to assess and mitigate risks to the UK firm. We acknowledge the FRC's interest in promoting transparency around decision-making at the network level, to the extent that such decision-making impacts a UK firm, and we strive for transparency in our public reporting and interactions with the FRC. At the same time, UK firms can, in general, only provide information that they own, manage and control.
- We agree Non-Executives should be positioned in a firm's governance structure in a way that enables them to observe and challenge decision-making in the firm. However, we have concerns about the proposal for Non-Executives to "influence decision-making" due to the potential for it to be interpreted in a way that goes beyond the act of challenge, resulting in chain of command issues and independence restrictions that may impact the ability of the firms to attract high calibre candidates.
- Having Non-Executives as members of our main governance bodies brings to governance considerations additional rigour, insight and an external perspective that we find invaluable. We support the Non-Executives having an open dialogue with the FRC and note the FRC already has regular private meetings with the Non-Executives at the firms that are in scope for its supervision.
- We agree that having at least some overlap between INEs and ANEs is beneficial in ensuring oversight is joined up and matters do not 'fall through the cracks'. One of Deloitte's ANEs is only a member of the Audit Governance Board and does not sit on any governance body of the firm or network. However, she does observe other governance discussions and finds it invaluable to her audit oversight

role to hear for herself the discussions around the firm's strategy and performance to assess their impact on audit quality and the resilience and reputation of the Audit & Assurance business.

We would be happy to discuss any aspect of our response with you. If you have any questions about our response, please contact me.

Yours sincerely



Stephen Griggs
Deloitte LLP

Appendix

Q.1: How appropriate do you feel that the revised purpose of the proposed 2022 Code is?

- 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. However, as the FRC acknowledges, 'the public interest' is an abstract concept for which there is no single definition; it means different things to different people and under different circumstances.
- Public interest considerations have long been a focus for Non-Executives, but care should be taken in linking Non-Executives' duties to such considerations and to recognise there will likely be inconsistencies in approach; for example the duty under Provision 38 for a Non-Executive to *"alert the regulator as soon as possible to their concerns...when they feel the firm is not adequately taking account of the public interest."*
- In 2014, the ICAEW undertook a project to set out a practical framework of matters to consider when justifying or challenging the justification of an action as being in the public interest. The use of such a framework may help to provide some guidance around the FRC's expectations when assessing firms in this regard.
- The intense scrutiny around audit and negative media events in respect of any individual firm have a significant impact on trust and confidence in the profession as a whole. Given the Code is intended to enhance trust and confidence in audit, the loss of an element of the purpose around helping the firm secure its reputation appears counterintuitive.
- While safeguarding reputation may be implicit within the third element of the Code's purpose around sustainability and resilience, in our view it should be made more explicit by, for example, editing that element of the purpose to become: "To safeguard the sustainability, resilience and reputation of audit practices and of firms as a whole."

Q.2: What are your views on the proposed thresholds for application of the proposed 2022 Code?

- Deloitte is not directly impacted by the proposed changes to the thresholds. However, we are concerned about any move that could counteract the measures being taken to increase choice in the PIE audit market.
- The Code would, though, operate on a comply or explain basis, thus providing firms coming into scope for the first time with the flexibility to apply the Code in a proportionate way that meets the principles, and we support that approach.

Q.3: Should the proposed 2022 Code apply to any firm that audits a FTSE 350 company? Please suggest alternatives.

- While FTSE 350 entities are systemically important and the firms that audit them should be strongly governed, entities regularly move in and out of the FTSE 350. Consequently, the proposal may lead to a volatility in application and we do not believe it is practical to apply the Code to any firm that audits a single FTSE 350 entity but does not otherwise meet the threshold for application.

- As an alternative for a firm that audits a FTSE 350 entity but less than 20 PIEs, the FRC could undertake other supervisory measures such as Audit Quality Review.

Q.4: What are your views on the proposed effective date of the proposed 2022 Code?

- The outcome of the BEIS consultation, 'Restoring trust in audit and corporate governance', will determine the definition of a PIE and, consequently, which firms are in scope for the Code. Depending on the parliamentary timetable, there may still be some uncertainty around the PIE definition at the time when the revised Code is proposed to take effect (accounting periods beginning on or after 1 January 2023).
- Firms newly in scope for the Code will need time to recruit high calibre Non-Executives. The Code would, though, operate on a comply or explain basis, thus providing those firms with the flexibility to apply the Code in a proportionate way during the recruitment process and we support that approach.

Q.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?

- We support the proposal that the Code is reserved for audit firm matters and that investor and audit committee arrangements are covered in separate guidance aimed specifically at each of those groups. The recommendations for these groups should make clear that investors and audit committees always have the ability to reach out to the Non-Executives where they have a cause for concern in relation to a particular statutory audit engagement.
- Further, we agree it is important for Non-Executives to be engaging, or attempting to engage, with investors and audit committees as key stakeholders for statutory audit. Non-Executives should explain in the firm's Transparency Report the steps they have taken to initiate engagement with investors and audit committees, but it should be acknowledged that sometimes these approaches will not be accepted. This is not the fault of the Non-Executives as long as a reasonable attempt was made.
- In our experience of previous engagement activity between Non-Executives and the investor community, the receptiveness of investor representatives has been inconsistent, so we support proposals to strengthen the Stewardship Code and promote more effective engagement and appetite from that side.
- We recommend that consideration should be given to expanding Principle Q: "Independent non-executives should have an open dialogue with the regulator" to cover dialogue with investors and audit committees in addition to the regulator, otherwise there is no overriding principle for this engagement activity.

Q.6: To what extent do you support the changes proposed in the areas of partner oversight and accountability to owners?

- We acknowledge the importance of appropriate reward and progression arrangements for board members to support their ability to robustly challenge management. In our view “appropriate” arrangements could include, for example, protecting the elected members of the board from any executive 'interference' in their reward/promotion during their tenure on the board and for a certain period thereafter. Other elements of reward and progression not connected to their board membership, such as for high quality audit, could remain the same as for anyone else in a similar non-governance role.
- Given the new governance arrangements being introduced around operational separation, it would be helpful for the Code to be clear on which board(s) are intended to be captured by these provisions.
- In relation to Provision 8 and access to information, we have some concerns about information-overload. Providing Non-Executives, who have much less day to day involvement in the firm, with the same information as management could result in key information not being visible because it is buried in a huge amount of detail. For Non-Executives to discharge their duties effectively, they should receive appropriately focused information. We support the view that Non-Executives should have the ability to access the same information in unfiltered form (subject to independence and confidentiality restrictions), but only at their request and with that quantity of information not being provided routinely.
- We agree that the requirement to have a regular external board evaluation represents good governance practice, but it will be important to consider the practical application and whether there are any independence and/or objectivity implications. For example, would it be appropriate to use a provider who had also assessed the board of one of the firm’s audited entities and/or to use a direct competitor? For firms the size of those in scope for the Code, credible providers will be in relatively short supply.

Q.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?

- We share the FRC’s belief that strong global networks can have a positive impact on audit quality and resilience and have seen these benefits within our own network. We also recognise that membership of a global network can create risks, such as competing strategic priorities, and have controls in place to assess and mitigate risks to the UK firm. The implementation of ISQM 1 will further formalise and enhance those controls, thus ISQM 1 requirements should be reflected in any changes to the Code in this regard.
- We acknowledge the FRC’s interest in promoting transparency around decision-making at the network level to the extent that such decision-making impacts a UK firm, and we strive for transparency in our public reporting and interactions with the FRC. At the same time, UK firms can, in general, only provide information that they own, manage and control. The key for the purposes of the Code should therefore be the UK firm demonstrating the controls it has on and within its perimeter to manage the risks to the UK firm, with acknowledgement that UK firms will, in general, have no right of access to information about another network firm and vice versa.

- Every firm is structured differently and Deloitte’s structure operates as follows:
 - Deloitte’s UK firm is the UK affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited (DTTL or Deloitte Global), a UK company limited by guarantee. Neither Deloitte NSE LLP nor DTTL provide any client services, rather they serve coordinating roles for Deloitte NSE and the Deloitte network respectively, which comprise legally separate, independent firms, each of which provides services in a particular jurisdiction subject to applicable local laws and regulations.
 - The UK firm has a seat on Deloitte NSE and Global governance bodies, giving it the ability to influence and monitor strategic decisions taken at the NSE and network levels and then to tailor their implementation for the UK firm, as appropriate, and mitigate any risks to the UK firm.
 - For example, a Global Risk Executive (GRE) acts as a sounding board and a critical link to drive consistency and alignment in the execution of a global quality and risk management strategy across the Deloitte network. The GRE’s membership comprises risk leaders from across the network, including from the UK firm, giving them the ability to shape global strategy and policies. The UK firm’s risk leader is a member of the UK firm’s Executive and is responsible for implementing the global quality and risk management strategy in the UK firm, tailoring it as necessary, and for monitoring and overseeing the UK firm’s reputation and risk practices, processes and initiatives.
- Deloitte UK’s Non-Executives are not in a position to “monitor the activities of the global network”, beyond what the UK firm is afforded via its seat on Deloitte Global governance bodies, as again they have no right of access to information outside the UK’s territory. Deloitte UK’s Non-Executives have oversight of the Deloitte UK risk management framework, providing them with access to information about the controls and mitigations in place in the UK firm to manage network and other risks to the UK firm. They meet regularly with various UK partners, including those in Global roles and the Chair of our AGB, Baroness Ford, is a member of the Global Independent Non-Executives Advisory Group, providing high-level sight of network activities.
- We currently report in our Transparency Report on the principal risks to the UK firm, including details of the threats, mitigations and risk exposure trends, and will continue to do so. There is also close co-ordination between the Deloitte Global Risk Group and the risk teams in Deloitte UK and across the network to ensure there is a shared understanding of emerging risks and that the respective enterprise risk frameworks are appropriately aligned and reflective of the risks faced by the network as a whole.
- The UK firm strives for transparency concerning its relationship with DTTL, including the role that DTTL and DTTL governance bodies play in setting network strategy, but the terms of reference for those governance bodies are confidential, not public and are maintained outside of the UK firm’s control. Given the disclosures we already make in our Transparency Report, we do not believe publication of the specific terms of reference for these bodies would be of material benefit to our stakeholders.

Q.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.

- The most important asset of an audit firm is its people and we support proposals that seek to clarify and enhance people-related principles by bringing them, and the corresponding responsibilities of management and Non-Executives, into one section.

- Audit firms are diverse in their make-up, with people from many backgrounds and cultures. It is key that the culture of the firm is such that everybody, no matter their background, feels included and valued. Furthermore, diversity of thought is an important driver of innovation and improved quality that goes to the heart of a firm's purpose, not only to deliver high quality, but to make an impact through its work and through developing its people. Embedding a diverse and inclusive culture has benefits for the stakeholders of clients and entities being audited and for the audit firms themselves, particularly in attracting and retaining talent.
- Consequently, diversity and inclusion should be a core part of the firms' people management policies and procedures and, in our view, should feature more prominently in the Code, for example in:
 - Principle G – “A firm should foster and maintain an *inclusive* culture of openness which encourages people to consult, challenge, contribute ideas and share problems, knowledge and experience in order to achieve quality work in a way that takes the public interest into consideration.”
 - Provision 13 – “A firm should establish policies and procedures to promote *diversity and inclusion* and encourage people to speak up and challenge without fear of reprisal, particularly on matters relating to this Code and the firm's values and culture.”
 - Provision 17 – “Independent non-executives should be involved in reviewing people management policies and procedures, including remuneration and incentive structures, recruitment and promotion processes, training and development activities, ~~and diversity and inclusion~~, to ensure that the public interest is protected and that diversity and inclusion are central to these. They should monitor the firm's success at attracting and managing talent, particularly in the audit practice.
- We note the FRC has reworded the existing provision around key performance indicators (KPIs) for governance to specify that they should be “meaningful”. The FRC's report dated May 2020 following its Audit Firm Governance Code implementation review, highlighted marked differences in how firms approached governance KPIs. Therefore, similar to the FRC's approach to Audit Quality Indicators, in our view it would benefit readers of transparency reports if the FRC established a core set of governance KPIs on which the firms should report.

Q.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?

- The Executive Summary of the consultation states that the proposed revisions align the Code with the language and intent of ISQM 1.
- There is, however, no explicit reference to ISQM 1 in Section C or to how the ISQM 1 assessment of risk and the effectiveness of internal controls should align with and complement the wider review of the effectiveness of the whole firm's system of internal control required in Provision 24. Clarity as to expectations in this regard would be beneficial in achieving the maximum benefit from both assessment processes.

Q.10: Do you think that the proposed 2022 Code is clear enough about the role INEs play in the Firms?

- We first appointed Non-Executives as members of our main UK Board in 2011 and established our Audit Governance Board, chaired by, and comprising a majority of, ANEs in January 2021.

- However, we recognise that governance structures vary from firm to firm and the same approach may not be appropriate for all firms. Therefore, we support the FRC's approach of providing a degree of flexibility in Principle M around where firms appoint Non-Executives within their governance structures.
- We agree Non-Executives should be positioned in a firm's governance structure in a way that enables them to observe and challenge decision-making in the firm. However, we have concerns about the proposal for Non-Executives to "influence decision-making" due to the potential for it to be interpreted in a way that goes beyond the act of challenge. While we note the UK Ethical Standard excludes Non-Executives from the definition of a covered person, many firms are also subject to international rules, particularly SEC and IESBA, and an explicit requirement to "influence decision-making" under Principle M, coupled with access to the same information available to management under Provision 8, may give rise to chain of command issues. This could result in onerous independence restrictions for the Non-Executives that may impact the ability of the firms to attract high calibre candidates and we suggest the FRC investigates this further.
- We agree Non-Executives should provide constructive challenge and specialist advice to management, with a focus on the public interest. However, we refer to our response to Q.1. regarding a potential lack of consistency when forming their own views on where the public interest lies and the impact this may have on any positive duties linked to public interest considerations.

Q.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 support proposals to strengthen the status and role of Non-Executives, while maintaining the attractiveness of the role to high calibre candidates.
- Having Non-Executives as members of our main governance bodies brings additional rigour, insight and an external perspective, to governance considerations that we find invaluable. By way of examples of how Deloitte ensures the impact and effectiveness of its Non-Executives and of practical ways of ensuring effective 'mutual reliance', Deloitte Non-Executives:
 - Are the sole members of a Non-Executive Committee which provides a forum for them to invite members of management to present on areas of particular public interest and for them to meet privately to discuss matters of relevance to their remit without management present
 - Have an engagement plan setting out certain individual oversight responsibilities across the firm that they discharge through regular one-to-one meetings with key members of management to discuss any particular concerns, issues or matters of public interest. In their monthly Non-Executive Committee meetings, the Non-Executives share information and keep each other updated on discussions to which they have been party
 - Have a direct reporting line with the Ethics Partner and, in addition to regular meetings, discuss particular ethics/whistleblowing matters with him on an ad hoc basis as necessary
 - Attend meetings of various other Deloitte forums where audit quality or other public interest matters are discussed, to observe how these are conducted
 - Are supported, individually and collectively, by a dedicated chief of staff to help them navigate the firm

- We support the Non-Executives having an open dialogue with the FRC and note they already have regular private meetings with the FRC as part of the programme of audit firm supervision, in which they have the opportunity to raise any concerns. We understand the FRC anticipates most concerns referenced in Provision 38 would be resolved between the Non-Executives and management without needing to be reported to the FRC.

Q.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 agree that having at least some overlap between INEs and ANEs is beneficial in ensuring oversight is joined up and matters do not ‘fall through the cracks’. Since establishing our AGB in January 2021, our experience is that the overlap helps:
 - Ensure the AGB has the earliest opportunity to understand the impact of wider firm strategy and decisions on the Audit & Assurance business, including issues affecting its brand and reputation
 - Enable the interests of the Audit & Assurance business to be better represented at the wider firm, including on audit bid decisions and other issues that affect both the audit practice and the rest of the firm
 - Allow the AGB to provide input on decisions that affect specialists who contribute to the work of the Audit & Assurance business, but who do not sit within it
 - Allow the AGB to observe the differences between the Audit & Assurance business and the non-audit businesses, such as the additional rigour around the audit partner admissions process
- There are practical considerations around achieving a greater degree of separation between ANEs and INEs in terms of recruiting larger numbers of high calibre Non-Executives and ensuring an effective communication flow between the firm and the two non-executive groups.
- One of Deloitte’s ANEs is doubly independent, meaning she is only a member of the AGB and does not sit on any governance body of the firm or network. However, she does attend part of the UK Oversight Board meetings as an observer and finds it invaluable to her audit oversight role to hear for herself the discussions around the firm’s strategy and performance to assess their impact on audit quality and the resilience and reputation of the Audit & Assurance business.
- We refer to our response to Q.11. around how we ensure effective ‘mutual reliance’.