Audit White Paper
8 July 2021

audit.consultation@beis.gov.uk

Response to the BEIS White Paper 'Restoring Trust in audit and corporate governance'

Background

The Local Authority Pension Fund Forum is a voluntary association of 83 local authority pension funds and seven LGPS pool companies, based in the UK with combined assets of approximately £300 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. Issues on accounting and audit have been a concern since the introduction of International Accounting Standards ('IAS'/'IFRS') and the banking crisis.

When audits fail, investments are worth less and substantial harm to the taxpayer can also occur.

Summary

- LAPFF is pleased that the While Paper helps to seal the transition from the Financial Reporting Council (FRC) to the Auditing Reporting and Governance Authority (ARGA). LAPFF was pleased the Kingman Review concluded the FRC was not fit for purpose.
- The White Paper seems to be more coherent at a technical level than the Brydon Review, which we note was part funded by the accounting profession, ironically. We assume that BEIS lawyers identified problems with some of the recommendations of that Review that would be inconsistent with the existing legislative framework.
- However, many of the questions are far too subjective and depend on the provision of more information to do justice for the subject. This is in part due to the Brydon Review covering far too much ground whilst missing many of the core salient points. A salient issue is setting up a competent regulator in the first place which is able to act intelligently.
- The question arises whether the auditors can live up to any changes given that they already have all the tools they need with the requirements of the Companies Act as interpreted by the Courts.

- In short, auditors merely need to do what they are supposed to do. That, therefore, requires **unpicking some of the problems – indeed disinformation -** that has been embedded in accounting and auditing standards and thinking **throughout the existence of the FRC.**
- Given that a key reason for the replacement of the FRC with ARGA was regulatory capture, it is essential that there is a thorough public interest review of the legal basis for accounting and audit, as opposed to merely following on from a position based on shallow audits and defensive, even misdirected, 'standards'.
- **At a most basic level proper accounts, business control and audits thereof can be boiled down to the information and business control to be a going concern. Whether profits are cash (not paper gains), the trend in such profits, whether net assets represent collateral, whether material fraud is absent and whether proper control is present are all essential ingredients to determining going concern status**
- Some claims in the area of accounting and auditing standards - which appear to be linked to defensive and defeatist auditing practices - can be corrected by observing the simplest of contradictions in some claims that have been made. It is disappointing to observe contradictions that officials overseeing the FRC had not noticed over many years.
- As a review of court decisions reveals, the law is not arbitrary, it is based on rational observation of business economics. It is clear that policy has been set without referencing the law, but rather based on a view that some of the large accounting firms and some of their advisers would prefer the law to be. Regulatory capture has led to regulatory failure and public harm.
- Over the last decade the Treasury Select Committee, the BEIS Select Committee and the House of Lords Select Committee have identified and criticised logical flaws in the arguments of the FRC and the Accounting firms, including on matters of going concern, fraud and the robustness of profits. It is therefore disappointing that not only had BEIS officials not applied similar critical thinking skills in undertaking their work in oversight. Indeed, the various Freedom of Information requests ('FOI') over recent years, showed officials taking the side of the FRC and some of the large accounting firms to try to defend the indefensible. That does not serve the interests of the public, nor does it serve Minsters well either. [These FOI's were requested by PIRC, among others].

- Positions that the FRC, accounting firms and some BEIS officials were lining up behind have not been merely subjective differences of opinion, but objectively wrong, whether by comparison to the law, or rational business economics.
- A simple example is the matter of the realisation (i.e. cash basis) of profits. The FOI requests show great effort was put in to trying to portray the law as something different to what Mr. Bompas had concluded it is[1]. **What that exercise failed to address was that reason the law requires the separation of unrealised (non-cash) profits is because it not possible to conclude whether a business is a going concern (i.e. capable of funding itself) without doing that.**
- Furthermore, some of the suggestions for governance reforms (essentially changes that relieve auditors of duties by placing additional duties onto directors) seem to have the objective of replacing the decision in Dovey v Corey 1901, whereby directors who have delegated to experts – as they do in the appointment of auditors – can (bar misfeasance on their own part) rely on those experts/auditors. The recommendations regarding "internal control" fit that mode. As referred to above**, if auditors are not already checking internal control properly then they can't be concluding on the matter of going concern.**
- We also note that BEIS is the department that oversaw the Post Office for two decades without addressing the significant problems of that organisation. We find it difficult to see how Ministers from each of the three main political parties which have been in Government over the many years that there was a problem would have gone along with it. It would seem that the officials either knew, but turned a blind eye, or did not spot the problem. Neither is acceptable. It is difficult to see how officials could not be aware given the coverage in both Computer Weekly and Private Eye over a number of years.
- In that context, it finally took MPs to see through things, and the cost of the scandal has been excess of £250 million. Both Commons and Lords Committees have asked questions and observed the contradictions and illogical answers, from members of the accounting profession, and in some cases Ministers, because of mis-briefing.

[1] BOMPAS

- In the case of Carillion, which we understand is a matter for legal action by the Official Receiver against KPMG, some clearly incorrect answers to Parliamentary Questions could be seen to hamper the recovery by the Official Receiver.
- We therefore recommend that BEIS officials responsible for accounting and audit policy undertake special independent training, to help rebalance the harm that is done **by taking and relying on advice from the parties they regulate**. It is unacceptable to have the civil service protecting its own mistakes contrary to the interests of Ministers and the public.
- The incorrect slant on the purpose of audit has also led to an unhelpful perspective on what is a 'public interest entity' ("PIE"). Many of the questions on what is a PIE would be unnecessary by merely looking at the legislative and judicial position on what an audit is for, which is to protect creditors and the public as well as shareholders.
- We have therefore copied the BEIS Committee, and Lord Sikka, Baroness Bowles, the Right Hon. Greg Clarke MP, Baroness Noakes as well as the Public Accounts Committee, on our response to this consultation. We also note, based on Baroness Bowles statement in Hansard, that the firm that advised the FRC - Herbert Smith - was the same firm that the Post Office[2] used to defend its indefensible position, and which has been criticised by the APPG[3] in connection with HBOS Reading problems.

Detailed points

Unpicking the disinformation based on an 'expectations gap'

- The examples listed here are easily rebutted,

  Assertion: 'Fraud is not a matter for auditors to identify'.

  Simple rebuttal: Fraud clearly is a matter for auditors given that going concern (which is a required element of the audit opinion) is dependent on its absence. This is also clear from Court decisions.

2 https://www.fnlondon.com/articles/cross-party-mps-attack-herbert-smith-freehills-over-post-office-advice-20200730 "Cross-party MPs call for inquiry into Herbert Smith Freehills over Post Office advice"

3 https://www.appgbanking.org.uk/wp-content/uploads/2020/07/APPG-HSF-SRA-9-6-20-Final-1.pdf "The Lloyds Banking Group Reading Fraud – Undermining Confidence in the Legal Profession"

Assertion: ‘Determination of the realisation of profits is not required for a true and fair view’.

Simple rebuttal: The determination of whether profits are realised or not (i.e. that they are not merely non-cash valuation gains) is necessary when going concern is dependent on it. Unrealised gains can’t be used to service debt, pay down debt or make distributions.

A profit and loss account containing unrealised gains which are not disclosed would not only not satisfy the requirement for separation for dividend distribution purposes, but can’t be used **for even non-dividend paying companies** to service debt, pay down debt or invest in new assets or working capital, all pre-requisites for being going concerns.

A cash absorbing, unlike a cash generating, business requires external sources of funding.

Assertion: ’Directors are responsible for finding fraud not auditors’.

Simple rebuttal: This is betrayed by the Asset Co case, where the auditors were negligent for not identifying that directors were involved in the fraud.

- The matter of ‘Internal control’ is also relevant. An unstable system of control may be a threat to not only the numbers but also the going concern basis.
- LAPFF used Cherie Blair QC to negotiate with the FRC and in her opinion a regulatory system carrying the risk of illegality will be an illegal system. The FRC had, in LAPFF’s opinion, created a framework which avoids the law for defensive purposes. That is not surprising for a body captured by audit firm interests. ARGA must not fall into the same position. It is not surprising that an illegal system, due to ambiguity and bad practice, will have been a contributory factor to corporate failures.
- Once an audit firm is in a defensive position in a litigation context, then it is unlikely to admit the basis of law in setting standards, or even to Parliamentary Enquiries, as the BEIS Select Committee Enquiry showed.[4]

Regulatory environment

- We consider that the wrong thinking of the FRC also pervaded parts of BEIS. Various officials did, after all, attend meetings of various constituent parts of the FRC as observers over its lifespan. A Freedom of Information Request[5]

[4] The Future of Audit - Business, Energy and Industrial Strategy Committee - House of Commons (parliament.uk)
[5] ONS/FOI/2017/3410

('FOI') showed the DTI (then more latterly BIS) was not upholding the authoritative position – decided by the Office of National Statistics - which was that the FRC was and had been designated a public body since at least 2004.

As a result, the FRC did not conduct itself as a public body should from 2004-2019. We set out some extracts, as they demonstrate the extent to which officials within the DTI (and later BIS) and the FRC were prepared to use spurious arguments, circumvent basic facts and – as it appears - due process.

- An ONS document states:-

  "Otherwise, [REDACTED NAME] could well find herself lobbied by DTI, and we may find it being said that this lobbying tainted any subsequent decision that the ONS makes. So, ***best to involve Treasury, to preserve independence, and sanity****?*[6]

  Another ONS document states:

  "For national accounts purposes ONS classified FRC to the public sector in 2004. The board (and therefore the FRC Council) are public sector by appointment. The FRC were not happy and disputed the decision. Meetings followed between HMT, DTI, FRC and Cabinet Office. ***At one meeting, DTI insisted that ONS were represented and I went along****. During the first few minutes of the meeting I explained the ONS classification decision (very straightforward)* ***and then HMT insisted that I left the meeting. This was to ensure that ONS's integrity remained intact and we remained in a position to make an independent classification decision****.*

  "Since then there have been a few 'false starts' and a lot of wasted time on the classification of the FRC. We have now been approached three times to consider the classification of the FRC under new arrangements. On the first two occasions (August 05 then May 06) we have put the case document together and been almost ready to consult NACC when the request has been 'pulled' because the arrangements 'might be changing'. (Usually following requests for further information from us that might have lead them to believe that a public sector classification would result)".[7]

  "As you will be speaking to DTI on Thursday it might be an excellent opportunity to tell them about our protocol and the fact that we consider

[6] Email HMT 07 December 2004 19:43 Document 8
[7] ONS/FOI/2017/3410 email 6 February 2007 at 15:47. Document 17

classification cases when arrangements have been finalised. ***They have wasted enough of our time already****".*[8]

- Another ONS document states (where the issue was whether Secretary of State's nominees as Chair and Deputy Chair of the FRC exercised control of the FRC, as a body):-

  "Effectively they [the FRC and BEIS] are claiming that there are occasions when the board meets and neither the Chair or Deputy Chair are present. It would seem highly unlikely that any board meeting is arranged when they know that neither the Chair or Deputy Chair are able to attend. So this situation may presumably only arise when the Chair wakes up ill and the Deputy Chair is then stuck in traffic ***or some other equally unlikely hypothetical situation****. Were this to happen you may expect the meeting to be cancelled or for the Chair and Deputy to Chair to give their views and votes to be expressed at the meeting.*

  "If BIS / FRC can go through their records and provide examples of Board meetings being chaired and matters voted upon when neither the Chair and Deputy Chair were present ***then we can take this argument more seriously****?*[9]

- It was against such a background that FRC procurement – including legal opinions – occurred outside of the required procurement practice.

- Parliamentary Questions and Answers[10] showed that Herbert Smith – which had been the liability adviser to KPMG and PwC - received untendered legal work. Mr Richard Fleck of Herbert Smith had been on one or other FRC or predecessor body from 1986 until 2018.

- It was therefore difficult not to conclude that technical positions of the FRC were essentially the interpretation of the law according to PwC, KPMG and Herbert Smith people associated with the FRC. Whatever words may have been interpreted to come up with positions, avoiding the spirit of the law can't defy basic economics.

> *"Accounts that are prepared on a going-concern basis require an audited assessment of whether a company is capable of being a going concern or not. If accounts contain unrealised gains, as allowed by IFRS, those gains*

[8] ibid
[9] ONS/FOI/2017/3410 19/10/2011 at 09:38:29am – Document 50
[10] Written questions and answers - Written questions, answers and statements - UK Parliament PQ HL7046 18 April 2018 and HL7589

are not cash and cannot be used to service debt, pay down debt, invest in other assets or make distributions to shareholders.

How, then, can auditors sign off the accounts of a company as a going concern if the facts required to assess that position are totally masked by the standards?"

Baroness Bowles, 27 April 2021, Grand Committee, Hansard

The problems of the FRC seem to have shifted to the UK Endorsement Board

- LAPFF now has concerns with the UK Endorsement Board set up to endorse international accounting standards post Brexit. This was concisely set out by Baroness Bowles in the debate delegating powers to that board[11]. The UK EB is therefore chaired by the former head of public affairs of PwC (also a member of the Accounting Standards Board which approved defective accounting standards), the former head of Risk and Ethics of KPMG, and the accounting associate from Herbert Smith, which had commissioned both legal opinions from Martin Moore QC.

"*There is no mention that board member Kathryn Cearns worked for the ASB and then for the law firm Herbert Smith Freehills which, as well as providing defence advice to PwC and KPMG, also instructed the ICAEW's counsel to give the dubious true and fair legal opinions for the FRC, from which the Government eventually distanced themselves, as I discovered in FoIs."*

Baroness Bowles, 27 April 2021, Grand Committee, Hansard

- We do not draw succour, either, from representation purported to be on behalf of investors. We would expect any investor to understand that – absent guarantees to supply new capital, or commitment to extent borrowing - only a flow of realised profits can sustain being a going concern, as Baroness Bowles has clearly set out.

"Liz Murrall, an employee of the Investment Association, and Paul Lee, a consultant to the Investor Forum, are also on the Endorsement Board, and both those organisations are dominated by insurance companies, the accounts of which will benefit from using IFRS 17."

Baroness Bowles, 27 April 2021, Grand Committee, Hansard.

[11] https://hansard.parliament.uk/Lords/2021-04-27/debates/845EDA79-F036-4163-A796-55A1D5BD7482/details#contribution-A2250DF4-ECA6-4363-A279-87AA039252C6

Every member of an accounting standards board or endorsement board since 2005 purporting to represent investments was a member of the PwC CRUF

- This is quite an astonishing observation but can be seen with the UK representative on the **European Financial Reporting Council** (EFRAG), as well as the **UK Accounting Standards Board** (then called the Accounting Council) and also the **International Accounting Standards Board** as well as its satellite **'Capital Markets Advisory Group'**.
- It is therefore disappointing that the same applies to the **UK Accounting Standards Endorsement Board**. Both of the people shown as representative of investors have signed letters of the PwC run Corporate Reporting Users Forum ("CRUF").
- The CRUF is a PwC managed organisation. Perhaps unsurprisingly, CRUF letters on the subject of auditor duties repeat the same assertions on 'expectations gap' that Parliament months earlier had negated[12].
- The CRUF website refers to "thought leadership". That can be taken to mean the suspension of independent critical thinking and instead may lead to putting out material that suits the agenda of PwC. Essentially an "astroturf" lobbyist.
- We note that the new UK Endorsement Board[13] also refers to "thought leadership" as one of its functions. That cannot be correct. The purpose of the UK Endorsement Board is to assess whether accounting standards meet the exacting requirements of the law, not to be a conduit for Orwellian-like lobbying to persuade the public into accepting something that is inherently defective.

High rates of failure – and systemic causes

- The UK has very high levels of corporate failure compared to US or EU. The following are examples: Carillion, NMC Health, Thomas Cook, Finablr, Patisserie Holdings, the banks and Greensill (which was on the brink of listing). There also appear to be problems with Liberty Steel.
- LAPFF observes for the UK, there is poor audit quality of audits and defective accounting standards, as well as poor threshold standards for listing (e.g. Deliveroo, and Greensill Capital was apparently on the brink of listing). The US has better accounting standards and better audit regulation. The UK is relatively rare in not dealing with the controversial parts of international accounting standards in not having a second set of books (i.e. a parallel set of

[12] Global-CRUF-response-to-IAASB-Fraud-and-Going-Concern.pdf
[13] https://www.icaew.com/insights/viewpoints-on-the-news/2021/april-2021/uk-endorsement-board-marks-major-milestone

accounts which correct for the going concern relevant deficiencies of the IFRS system).

Spotlight on key points

- We see risk in the 'internal control' propositions to throw the burden onto directors. Much of the requirement is already embedded in the law in terms of the output required in adequate accounting records and true and fair view on a going concern basis. The issue of internal control is clear in the Barings case[14].
- The case law on reliance on auditors, Dovey versus Cory, is clear

> *"I cannot think it can be expected of a director that he should be watching either the inferior officers ... or verifying the calculations of the auditor himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details...."*
>
> **Lord Halsbury. Dovey v Cory 1901**

- Another landmark case Re Thomas Gerrard & Sons Ltd (1968) makes clear that once the auditor has approved the accounts, both the members and directors may rely on them.

> *"As events showed, the directors were willing to recommend and the members to confirm the payment of a dividend where they believed profits to be available. On the other hand, the directors could not lawfully pay, or the members approve, a dividend unless profits were available. In the real circumstances there was no such profit. The payment of a dividend in these circumstances was the natural and probable result of the false picture which Kevans [the auditors] allowed the accounts to present. The volition of the directors and members was addressed to this false picture. They never addressed and could not lawfully have addressed any volition to the real picture."*
>
> *"I think that auditors of a limited company are bound to know or make themselves acquainted with their duties under the articles of the company whose accounts they are appointed to audit, and under the Companies Acts for the time being in force; and that when it is shown that audited balance-sheets do not show the true financial condition of the company and that*

[14] Barings vs Coopers and Lybrand and others [2003] EWHC 1319 (Ch)

damage has resulted, the onus is on the auditors to show that this is not the result of any breach of duty on their part."

Thomas Gerrard & Sons Ltd (1968)

- We have seen no evidence that any auditor within any standards setting framework is likely to own up to either of those cases. Though we note that Ms. Jac Berry, of the French led audit firm Mazars, gave clear and fulsome evidence to the BEIS Select Committee enquiry. That indicates that the malaise is within the traditional UK-US led firms.
- Transparency on audit firm insurance would be welcome as the White Paper suggests. On the basis some firms clearly have not been following the law – if they had why would they misdirect standards and run with the 'expectations gap'. We question how third-party insurers could be prepared to provide professional indemnity cover for such a state of affairs. Grant Thornton, for example, told Parliament it was not set up to look for frauds in the same week the High Court repeated the existing law that was the auditors' function. By deduction that firm wasn't set up to do audits. The matter of captive (self-managed offshore) insurers is part of that. We therefore question whether the firms are carrying the risk themselves or if the reinsurance is sufficient.
- On an audit profession and an institute for auditors, we had assumed that being qualified to audit was a requirement of the training of the regulatory bodies from which auditors can practice[15]. If new institutes are needed, then that is an indictment of the professional standards of the existing bodies.

[15] The ICAEW, ICAS, ACCA and ICAI.

Question

1. Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons.

Yes. Given that the purpose of an audit includes creditor protection, thus every audit is a public interest audit from that perspective, irrespective of its listing status. The definition of a 'PIE' seems to have originated with the accounting firms.

2. What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons.

As per the response to Q1, every company is a public interest company. The harm done by Carillion, for example, was a result of the size of its contracting and creditor base. Any definition of a 'PIE' should take account of the size of the creditor base, which may need to have a regional perspective as well. Liberty/Gupta steel is a good example.

3. Should AIM companies with market capitalisation exceeding €200m be included in the definition of a PIE? Please give your reasons.

Yes. For the reasons given in the responses to Q1 and Q2, all AIM companies should be regarded as PIEs.

4. Should Government give newly listed companies a temporary exemption from some of the new reporting and attestation requirements being considered for Public Interest Entities?

No. Absolutely not. Greensill Capital for example, collapsed prior to a purported listing. Finablr collapsed very shortly after listing.

5. Should the Government seek to include Lloyd's Syndicates in the definition of a PIE? Please give your reasons.

Yes, see the answers to Q1 and Q2 above. Insurance syndicates have creditors, and in some cases circular liabilities (reinsurance). We are surprised that Lloyds Syndicates are not already regarded as PIEs.

6. Should the Government seek to include large third sector entities as PIEs beyond those that would already be included in the definitions proposed for large companies? If so, what types of third sector entities do you believe should be included and why?

Yes. See Answers to 1-6 above. These questions indicate a system wide problem with the definition of a PIE.

7. What threshold for 'incoming resources' would you propose for the definition of 'large' for third sector entities? Is exceeding £100m too high, too low or just right?

Any charity is a public interest entity from the perspective of people who donate. This issue requires public and Parliamentary debate.

8. Should any other types of entity be classed as PIEs? Why should those entities be included?

Yes. See responses to Q1-Q8, any entity with a creditor or asset base is a public interest entity. The US audit environment has confused matters as the criteria there is led by listing status as that is the only locus of Federal law. We are surprised for example that the position of the Pension Protection Fund hasn't been considered. Its interest is any company with a relevant fund.

9. How would an increase in the number of PIEs impact on the number of auditors operating in the PIE audit market?

Handled properly, the return to a market in properly conducted audits should lead to more opportunities from outside of the largest firms.

10. Do you agree that the Government should provide time for companies to prepare for the introduction of a new definition of PIE?

No.

11. Do you agree that the Government should seek to offer a phased introduction for a new definition of PIE?

No. If a matter is of public interest then it needs to be dealt with.

Directors' accountability for internal controls, dividends and capital maintenance

2.1 Stronger internal company controls

12. Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?

No. It would seem that a proper analysis of the existing internal control presumptions in s386 Companies Act 2006 would cover what most people would regard as 'internal control'. The requirement to know the financial position accurately 'at any time … at that time' cannot be achieved without proper internal control. It is remarkable that the FRC has never had any guidance on s386 Companies Act 2006. We note Lord Mackenzie's comments in 2005 when the ICAEW was lobbying to have s386 taken out[16].

13. If the control framework were to be strengthened, would you support the Government's initial preferred option (Table 2)? Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?

No. The first priority should be delivering the current framework.

14. If the framework were to be strengthened, which types of company should be within scope of the new requirements?

See response to Q13. The priority issue is getting a proper delivery (by companies) and audit thereof of s386 Companies Act 2006.

2.2 Dividends and capital maintenance

15. Should the regulator have stronger responsibilities for defining what should be treated as realised profits and losses for the purposes of section 853 of the Companies Act 2006? Would you support either of the two options identified? Are there other options which should be considered? What should ARGA

[16] https://publications.parliament.uk/pa/ld200506/ldhansrd/vo060301/text/60301-35.htm

consider when determining what should be treated as realised profits and losses?

Yes. LAPFF considers that whether profits or losses are realised is essentially for s393 (true and fair view) and s386 (adequate accounting records) and should be embedded in accounting standards. Without the separation of realised and unrealised profits it may be impossible to tell whether a business is a going concern or not. The s393 condition does not hold until the going concern position is established. For that to be audited, the auditor can only rely on the audited accounts delaying with realised and unrealised profits properly by their separate identification. Unrealised gains cannot be used to service debt or pay down debt and cannot be used to make investments or make distributions. It is not merely relevant to whether profits can be distributed. The Brydon Review did not seem to understand this. Nor did the defective legal opinions of the FRC that were challenged by George Bompas QC.

16. Would the proposed new distributable profit reporting requirements provide useful information for investors and other users of accounts? Would the cost of preparing these disclosures be proportionate to the benefits? Should these requirements be limited to listed and AIM companies or extended to all PIEs?

No. See response to Q16, whether profits are realised or unrealised determines whether the accounts give a true and fair view on a going concern basis or not. It is not merely relevant to whether profits can be distributed. **The issue isn't merely a matter of choice for 'users' of accounts. The issue is parties affected by accounts.** We look forward to reviewing any responses from investors that do not understand this point.

17. Would an explicit directors' statement about the legality of dividends and their effect on the future solvency of a company be effective in both ensuring that directors comply with their duties and in building external confidence in compliance with the dividend rules? Should these requirements be limited to listed and AIM companies or extended to all PIEs?

No. The existing law is sufficient. The problem has been auditing firms, standard setters and the FRC not applying it, then trying to avoid it by defective legal interpretation which fails on basic logic as set out in the responses to Q15 and Q16.

18. Do you agree that the combination of recently introduced Companies Act section 172(1) reporting requirements along with encouragement from the investment community and ARGA will be enough to ensure that companies are sufficiently transparent about their distribution and capital allocation policies? Should a new reporting requirement be considered?

No. See responses to Q15-17. No new legal requirements are needed.

3 New corporate reporting

3.1 Resilience Statement

19. Do you agree that the above matters should be included by all companies in the Resilience Statement? If so, should they be addressed in the short or medium term sections of the Statement, or both? Should any other matters be addressed by all companies in the short and medium term sections of the Resilience Statement?

No. There is a risk that the Resilience Statement misses the fundamental driver of going concern, such as whether profits are realised or not.

20. Should the Resilience Statement be a vehicle for TCFD reporting in whole or part?

No. LAPFF agrees that Climate Change is a going concern and business model critical issue for many – particularly extractive – companies. However, the requirement needs to be implemented in such as way there is not superficial compliance or confusion, given the propensity of the accounting profession to give unchallenging perspectives. There is little evidence that the accounting firms carry authority on the subject matter and a risk that they would merely verify 'greenwash".

21. Do you agree with the proposed company coverage for the Resilience Statement, and the proposal to delay the introduction of the Statement in respect of non-premium listed PIEs for two years? Should recently-listed companies be out of scope?

No. Such a requirement would confuse the existing going concern presumption, which is one year from the date the accounts are signed, and existing requirements in common law when distributions are made from such accounts.

3.2 Audit and Assurance Policy

22. Do you agree with the proposed minimum content for the Audit and Assurance Policy? Should any other matters be addressed in the Policy by all companies in scope?

No. The audit and assurance policy should be inherent in the audit scope and opinion. Adding yet another statement would give scope for obfuscation. There is little evidence that additional statements required after the banking crisis have helped, as auditor and standard setters have not grasped basic fundamental issues. See also response to Q25.

23. Should the Audit and Assurance Policy be published annually and subject to an annual advisory shareholder vote, or should it be published and voted on at least once every three years?

No. See response to Q.22 above. The proposal - from the Brydon Review – is an idea from a report that missed fundamental points.

24. Do you agree with the proposed scope of coverage and method for implementing the Audit and Assurance Policy?

No. See responses to Q.s 21 and 22 above.

3.3 Reporting on Payment Practices

25. In order to improve reporting on supplier payments, should larger companies be required to summarise their record on supplier payments over the previous 12 months as part of their annual Strategic Report (applying at a group level in the case of parent companies)? If so, what should the reporting summary include at a minimum? Do you have alternative suggestions on how to improve supplier payments reporting?

Yes. Very comprehensive disclosure requirements were put into the Companies Act in the late 1990's. These were taken out by Statutory Instrument (2013/1970 The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013) which came into force on 1 October 2013. We note that the Accounting Standards Board approved that on the basis it did not provide 'useful information'. That

statement is an indictment of the concept of ‘useful to users’; the purpose of the requirement was to change behaviour.

As per the response to Q.22, something beneficial was removed from reporting requirements and something of little tangible benefit was put in its place.

26. To which companies should improvements in supplier payments reporting apply: companies which are PIEs and already report under the Payment Practices Reporting Duty, or PIEs with more than 500 employees?

The requirements should be related to the size of an organisation’s creditors and assets.

3.4 Public Interest Statement

27. Do you agree with the Government’s proposal not to introduce a new statutory requirement at this time for directors to publish an annual public interest statement?

Yes, as the issue of public interest as set out in earlier answers is confused.

4 Supervision of corporate reporting

28. Do you have any comments on the Government’s proposals for strengthening the regulator’s corporate reporting review function set out in this chapter?

The issue isn’t merely supervision of corporate reporting, what is needed is a critical review of standardised reporting requirements (accounting standards). The Dearing Review recognised that standards might be defective and set up the Urgent Issues Task Force – which was able to create new reporting practice within weeks of a problem being identified. The Interpretations Committee which sits alongside the International Accounting Standards Board is not only slow – it is institutionally not fit for purpose given it is controlled by large accounting firms, unlikely to challenge what they will have sanctioned in audits. The revision to the standard to deal with bad debts in banks took not weeks, but over 10 years. Given a vaccine for a novel virus can be developed within one year of that virus appearing there must be something institutionally wrong with accountants taking over a decade to fix a problem.

5 Company directors

5.1 Enforcement against company directors

29. Are there any other arrangements the Government should consider to ensure that overlapping powers are managed effectively?

The inclusion of matters relating to directors' responsibilities in a review intended to deal with deficient audits, confuses matters and distracts from the object of the exercise.

30. Are there any additional duties that you think should be in scope of the regulator's enforcement powers?

See response to Q.29. The confusion has arisen due to the FRC being an overseer of the members of accounting institutes, i.e. auditors and any directors who were members of those institutes.

31. Are there any existing or proposed directors' duties relating to corporate reporting and audit that you think should be specifically included or excluded from further elaboration for the purposes of the directors' enforcement regime?

See responses to Q.s 29 and 30.

32. Should directors of public interest entities be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audits? Should those standards be set by the regulator? What standards should directors have to meet in this context?

No. See responses to Q.s 29-31. Trying to refine directors' duties as a result of a review to deal with failure of audits is muddling and confusing too many issues. What is needed is a proper enforcement body to deal with company law breaches before the insolvency framework invokes responses – if any.

33. Should the Government's proposed enforcement powers be made available to the regulator in respect of breaches of directors' duties?

No. See response to Q.32. There needs to be a proper regulator of company law. The purpose of reform of the FRC to create ARGA is to deal with defective auditing.

5.2 Strengthening clawback and malus provisions in directors' remuneration arrangements

34. Are there other conditions that should be considered for the proposed minimum list of malus and clawback conditions? What legal and other considerations need to be taken into account to ensure that these conditions can be enforced in practice?

See Q33. We are surprised that such an important issue is given one question in a review intended to deal with defective auditing. This is a result of 'mission creep' from the Brydon Review which missed many of the points salient to auditing and reporting.

6 Audit purpose and scope

6.1 The purpose of audit

35. Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?

No. The purpose of the audit is very clearly set out in the Caparo decision.

"It is the auditors' function to ensure, so far as possible, that the financial information as to the company's affairs prepared by the directors accurately reflects the company's position in order, first, to protect the company itself from the consequences of undetected errors or, possibly, wrongdoing (by, for instance, declaring dividends out of capital) and, secondly, to provide shareholders with reliable intelligence for the purpose of enabling them to scrutinise the conduct of the company's affairs and to exercise their collective powers to reward or control or remove those to whom that conduct has been confided[17]."

It may be that the reason the Brydon Review did not refer to the Caparo case is because the clear objective is at odds with the 'somersaulting' that the Review undertook, to avoid the fact that realisation of profits is an accounts and audit matter (under the true and fair view requirement) but defective accounting standards are at odds with that.

[17] Caparo Industries PLC v Dickman [1990] UKHL 2

36. In addition to any new statutory requirement on auditors to consider wider information, should a new purpose of audit be adopted by the regulator, or otherwise? How would you expect this to work?

See response to Q.35. That wording extracted from the Caparo decision should precede the audit report.

6.2 Scope of audit

37. Do you agree with the Government's approach of defining the wider auditing services which are subject to some oversight by the regulator via the Audit and Assurance Policy?

No. All audit related assurance should be subject to oversight.

38. Should the regulator's quality inspection regime for PIE audits be extended to corporate auditing? If not, how else should compliance with rules for wider audit services be assessed?

No. This question is again too detailed in its implications to answer.

39. What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?

Yes, its role should extend beyond setting, supervising and enforcing standards.

6.3 Principles of corporate auditing

40. Would establishing new, enforceable principles of corporate auditing help to improve audit quality and achieve the Government's aims for audit? Do you agree that the principles suggested by the Brydon Review would be a good basis for the regulator to start from?

No. What is needed is not soft codes or principles, but adherence to the law.

41. Do you agree that new principles for all corporate auditors should be set by the regulator and that other applicable standards or requirements should be subject to those principles? What alternatives, mitigations or downsides should the Government consider?

No. See response to Q.40. What is needed is law and its enforcement, not soft codes and principles.

6.4 Tackling fraud

42. Do you agree with the Government's proposed response to the package of reforms relating to fraud recommended by the Brydon Review? Please explain why.

No. The Review was muddled about the purpose of the audit and missed what the BEIS Select Committee had identified which is that the presence of material fraud is contrary to being a going concern.

6.5 Auditor reporting

43. Will the proposed duty to consider wider information be sufficient to encourage the more detailed consideration of i) risks and ii) director conduct, as set out in the section 172 statement? Please explain your answer.

No. The auditor needs to be focussed on its legal objectives. There is clear case law which states that the first duty of an auditor is to understand their duty[18].

6.6 True and fair view requirement

44. Do you agree that auditors' judgements regarding the appropriateness of any departure from the financial reporting framework proposed by the directors should be informed by the proposed Principles of Corporate Auditing? What impact might this have on how both directors and auditors assess whether financial statements give a true and fair view?

No. The question misstates the law. The requirement is that the accounts give a true and fair view of the assets, liabilities, financial position and profit or loss. Once the words are stated wrongly then the true focus can be misdirected elsewhere. We are disappointed that the White Paper, in citing the law wrongly, opens up confusion.

[18] **Re** Republic of **Bolivia** Exploration Syndicate Ltd. (1913)

6.7 Audit of Alternative Performance Measures and Key Performance Indicators linked to executive remuneration

45. Do you agree that the need for specific assurance on APMs or KPIs, beyond the scope of the statutory audit, should be decided by companies and shareholders through the Audit and Assurance Policy process?

No. This makes a presumption about executive pay that is far too complex to cover in responses to two questions in this review. But as in the response to Q.35, the audit is intrinsically intended to deal with the holding to account of directors. The phrase 'the need for' makes this a loaded question. What must first be established is the appropriate framework for executive pay.

6.8 Auditor liability

46. Why have companies generally not agreed LLAs with their statutory auditor? Have directors been concerned about being judged to be in breach of their duties by recommending an LLA? Or have other factors been more significant considerations for directors?

As these are not transparent it is not possible to comment. The area of auditor liability, and auditor insurance needs to be opened up to transparency.

47. Are auditors' concerns about their exposure to litigation likely to constrain audit innovation, such as more informative auditor reporting, the level of competition in the audit market (including new entrants) or auditors' willingness to embrace other proposals discussed in this consultation? If so, in what way and how might such obstacles be overcome?

The area of auditor liability involves avoidance, obfuscation and excuses.

6.9 A new professional body for corporate auditors

48. Do you agree that a new, distinct professional body for corporate auditors would help drive better audit? Please explain the reasons for your view.

In asking the question it would seem that the existing professional bodies that auditors qualify with have failed.

49. What would be the best way of establishing a new professional body for corporate auditors that helps deliver the Government's objectives for audit? What transitional arrangements would be needed for the new professional body to be successful?

This is too complex to answer here. The basic issues of adhering to statutory audit purpose need to be addressed first. Again, this question is an indication of the 'mission creep' and lack of focus in the Brydon Review. If the motto of auditors ought to be 'complicate, distract and confuse' the Brydon Review seems to have gone along with that, rather than address the core problems.

50. Should corporate auditors be required to be members of, and to obtain qualifications from, professional bodies that are focused only on auditing?

See response to Q.48.

51. Do you agree that a new audit professional body should cover all corporate auditors, not just PIE auditors?

See response to Q.48.

7 Audit Committee Oversight and Engagement with Shareholders

7.1 Audit Committees – role and oversight

52. Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

Again, this focus on audit committee distracts from the core issue of defective audits when the case law is as follows:-

> *"I cannot think it can be expected of a director that he should be watching either the inferior officers ... or verifying the calculations of the auditor himself. The business of life could not go on if people could not trust those who are put into a position of trust for the express purpose of attending to details...."*
>
> **Lord Halsbury. Dovey v Cory 1901**

53. Would the proposed powers for ARGA go far enough to ensure effective compliance with these requirements? Is there anything further the Government would need to consider in taking forward this proposal?

N/a, see response to Q.52.

7.2 Independent auditor appointment

54. Do you agree with Sir John Kingman's proposal to give the regulator the power to appoint auditors in specific, limited circumstances (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?

Yes.

55. To work in practice, ARGA's power to appoint an auditor may need to be accompanied by a further power to require an auditor to take on an audit. What do you think the impact of this would be?

No. If a company is un-auditable it is probably un-investible.

56. What processes should be put in place to ensure that ARGA can continue to undertake its normal regulatory oversight of an audit firm, when ARGA has appointed the auditor?

It should make no difference.

57. What other regulatory tools might be useful when a company has failed to find an auditor or in the circumstances described by Sir John Kingman (i.e. when quality issues have been identified around the company's audit; when a company has parted with its auditor outside the normal rotation cycle; and when there has been a meaningful shareholder vote against an auditor appointment)?

This is a question that seems to result from a confused Brydon Review and has no answer.

7.3 Shareholder engagement with audit

58. Do you agree with the proposals and implementation method for giving shareholders a formal opportunity to engage with risk and audit planning? Are there further practical issues connected with the implementation of these proposals which should be considered?

No. This is fraught with difficulty and is a distraction from poor quality audits. Given that the statutory basis of all audits are identical, the proposal for some shareholders meddling in the process is entirely wrong. An example might be, for example, the largest shareholder in BHS or Sports Direct being involved. Why would such a proposal in any case be limited to shareholders. The biggest stakeholder in a bank is its creditors.

59. Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?

No. It's a distraction from poor quality audits.

60. Do you believe that the existing Companies Act provisions covering the departure of an auditor from a PIE ensure adequate information is provided to shareholders about an auditor's departure? If you believe those provisions are inadequate, do you think that the Brydon Review recommendations will address concerns in this area? What else could be done to keep shareholders informed?

No. The existing legal requirements essentially require auditors to whistleblow on departure. The Brydon Review was not evidence based and thus did not investigate existing use of this powerful tool.

8 Competition, choice and resilience in the audit market

8.1 Market opening measures

61. Should the 'meaningful proportion' envisaged to be carried out by a Challenger be based on legal subsidiaries? How should the proportion be measured and what minimum percentage should be chosen under managed

shared audit to encourage the most effective participation of Challenger firms and best increase choice?

There are too many moving parts here. The first issue is improving the quality of audits when the activity and standards of the FRC over the years has been a factor in the undermining of them. See for example '*Bringing Audit Back from the Brink. Morley Fund Management'* 2004[19]. which was prescient in predicting the crisis audit is now in. Audit was not pulled back from the brink.

62. How could managed shared audit be designed to incentivise Challenger firms to invest in building their capability and capacity? What, if any, other measures, would be needed?

The best model of this is in France. We note that whenever the challenger French firm Mazars raises it, it is quashed by the large firms lobbying against it. That may well be because the prospect of certain large firms opening their files to challenger firms may be embarrassing. We note that there are far fewer cases of audit failure in France.

63. Do you have comments on the possible introduction in future of a managed market share cap, including on the outlined approach and principles? Are there other mechanisms that you think should be considered for introduction at a future date?

LAPFF has supported a cap on market share since the inquiry of the Competition and Markets Authority.

8.2 Operational separation between audit and non-audit practices

64. Do you have any further comments on how the operational separation proposals should be designed, codified (in legislation and regulatory rules), and enforced in order to achieve the intended outcome of incentivising higher audit quality?

The voluntary 'code' led approach is unlikely to be as effective as a statutory separation. The view of the judiciary in the Caparo decision is incompatible with management consultancy affecting the culture of audit firms. That states:-

[19] http://visar.csustan.edu/aaba/IainRichards.pdf

"He receives his remuneration from the company. He naturally, and rightly, regards the company as his client. But he is employed by the company to exercise his professional skill and judgment for the purpose of giving the shareholders an independent report on the reliability of the company's accounts and thus on their investment. 'No doubt he is acting ***antagonistically t****o the directors."*

65. The Government proposes to require that all audit firms provide annual reports on their partner remuneration to the regulator. This will include pay, split of profits, and which audited entities they worked on. Do you have any comments on this approach?

This information should also be publicly available.

66. In the event that the Government wishes to go further than the existing operational split proposals in future and implement split profit pools in line with the CMA recommendation, do you have any comments on how these can be made to work effectively?

With respect to Q 66, this is too complex to cover in this response.

67. The Government believes these proposals will meet its objectives. In the event that they prove insufficient to improve audit quality, and full separation of professional services firms is required, do you have any comments on how to make this work most effectively?

With respect to Q67, this is too complex to cover in this response.

8.3 Resilience of audit firms and the audit market

68. Do you have comments on the proposed measures? Are there any other measures the Government should consider taking forward to address the lack of resilience in the audit market?

Bad firms should fail and be replaced by new ones. That's how normal free markets work. The FRC has clearly been captured by and propped up poor firms over the years.

8.4 Additional competition proposals from the CMA

9 Supervision of audit quality

9.1 Approval and registration of statutory auditors of PIEs

69. Do you agree with the Government's approach of allowing the FRC to reclaim the function of determining whether individuals and firms are eligible for appointment as statutory auditors of PIEs?

No. This is an odd question on the basis that the issue is creating ARGA to replace the FRC.

9.2 Monitoring of audit quality

70. What types of sensitive information within AQR reports on individual audits should be exempt from disclosure?

This is far too open and complex a question. The issue is setting up a competent regulator in the first place which is able to act intelligently.

71. In addition to redacting sensitive information within AQR reports on individual audits, what other safeguards would be required to offer adequate protection to the entity being audited whilst maintaining co-operation with their auditors?

This is far too open and complex a question. The issue is setting up a competent regulator in the first place which is able to act intelligently.

9.3 Regulating component audit work done outside the UK

72. Do you agree with the Government's approach to component audit work done outside the UK? How could it be improved?

This is far too open and complex a question. The issue is setting up a competent regulator in the first place which is able to act intelligently.

.

9.4 The application of legal professional privilege in the regulation of statutory audit

73. Do you agree that it is problematic if documents that the auditor reviewed as part of the audit are unavailable to the regulator because of the audited

entity's legal professional privilege? If so, what could be done to solve or mitigate this issue while respecting the overall principle of legal professional privilege?

This question is not sufficiently clear on what documents are subject to such privilege. The issue is setting up a competent regulator in the first place which is able to act intelligently.

10 A strengthened regulator

10.1 Establishing the regulator

74. Do you agree with the proposed general objective for ARGA?

Emphatically. No. The proposed objective is *'To protect and promote the interests of investors, other users of corporate reporting, and the wider public interest.'*

This makes the flawed assumption that 'users' need to read the accounts to gain benefit from proper accounts. The intended protection of the law extends to stakeholders who should not need to read the accounts, e.g. employees or creditors of a bank. The protection to them comes from the fact that proper audits ensure that companies are correctly, for example, assessed as being going concerns or not and not overtrading.

As an analogy, the Plimsoll Line is painted on a ship not to be 'useful to users' - it is there to ensure that the ship does not overload. Transparent and 'usefulness' are not the same concept. The term 'useful' also has no objective meaning.

Also the term 'corporate reporting' has become too remote from the concept of accounts, i.e. something in which the numbers add up. A better objective might be '*To protect and promote the interests of shareholders, creditors and other stakeholders in accounts and other corporate reporting, as well as the wider public interest."*

75. Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?

Not unless, as per the response to Q.74, the objectives are correctly expressed.

10.3 Funding: a statutory levy

11 Additional changes in the regulator's responsibilities

11.1 Supervision: Accountants and their professional bodies

76. Should the scope of the regulator's oversight arrangements be initially confined to the chartered bodies and should they be required to comply with the arrangements

77. What safeguards, if any, might be needed to ensure the power to compel compliance is used appropriately by the regulator?

78. Should the regulator's enforcement powers initially be restricted to members of the professional accountancy bodies? Should the Government have the flexibility to extend the scope of these powers to other accountants, if evidence of an enforcement gap emerges in the future? What are your views on the suggested mechanisms for extending the scope of the enforcement powers to other accountants (if it is appropriate at a later stage?

79. Should the regulator be able to set and enforce a code of ethics which will apply to members of the chartered bodies in the course of professional activities? Should the regulator only be able to take action where a breach gives rise to issues affecting the public interest? What sanctions do you think should be available to the regulator?

These questions have not been answered as the pertinent issue is adherence to existing law, not piecemeal carve ins and carve outs..

11.2 Oversight and regulation of the actuarial profession

80. Is ARGA the most appropriate body to undertake oversight and regulation of the actuarial profession?

No. The concept of linking actuaries to accounting is flawed. Like proper accounts, competent actuarial work doesn't merely report outcomes, it affects them, e.g. setting the contribution rate.

81. Should the regime for overseeing and regulating the actuarial profession be placed on a strengthened and statutory basis?

Q81 – 93 are out of the scope of dealing with defective audits.

82. Do respondents support the proposed principles for the regulation of the actuarial profession? Respondents are invited to suggest additional principles.

83. Are the proposed statutory roles and responsibilities for the regulator appropriate? Are any additional roles or responsibilities appropriate for the regulator?

84. Should the regulator continue to be responsible for setting technical standards? Should these standards be legally binding? Should the regulator be responsible for setting technical standards only?

85. Should the regulator be responsible for monitoring compliance with technical standards? Should it also consider compliance with ethical standards if necessary?

86. Should the regulator have the power to request that individuals provide their work in response to a formal request - and to compel them to do so if necessary?

87. Should the regulator have the power to take appropriate action if work falls below the requirements of the technical standards? What powers should be available to the regulator in these instances?

88. Do respondents agree with the proposed scope for independent oversight of the IFoA? In which ways, if any, should the scope be amended?

89. Should the regulator's oversight of the IFoA be placed on a statutory basis? What, if any, powers does the regulator require to effectively fulfil this role?

90. Does the current investigation and discipline regime remain appropriate? Should it be placed on a statutory basis? What, if any, additional powers does the regulator require to fulfil this role?

91. Do respondents think that the regulator's remit should be extended to actuarial work undertaken by entities? What would be the appropriate features of such a regime, including the appropriate enforcement powers for the regulator?

92. Should the regulator's independent investigation and discipline regime for matters that affect the public interest also apply to entities that undertake actuarial work? Should the features of the regime differ for Public Interest Entities?

93. Does the regulator require any further powers in relation to its regulation and oversight of the actuarial profession?

11.3 Investor stewardship and relations

11.4 Powers of the regulator in cases of serious concern

94. Are there others matters which PIE auditors should have to report to the regulator? Could this duty otherwise be improved to ensure that viability and other serious concerns are disclosed to the regulator in a timely way?

This questions has not been answered as the definition of “PIE” is confused.

95. Should auditors receive statutory protection from breach of duty claims in relation to relevant disclosures to the regulator? Would this encourage auditors to report viability and other concerns to the regulator?

Q95-98. Again, these questions are far too detailed and should be matters for a competent new regulator.

96. How much time should be given to respond to a request for a rapid explanation?

97. Should the regulator be able to publish a summary of the expert reviewer’s report where it considers it to be in the public interest?

98. Are there any additional powers that you think the regulator should have available where an expert review identifies significant non-compliance by a company in relation to its corporate reporting and audits?

.