



**ICGN**

International Corporate Governance Network

The Rt Hon Kwasi Kwarteng MP  
Secretary of State for Business, Energy & Industrial Strategy  
Department for Business, Energy and Industrial Strategy  
London  
United Kingdom

Via email: [audit.consultation@beis.gov.uk](mailto:audit.consultation@beis.gov.uk)

8 July 2021

**Subject:** Restoring trust in audit and corporate governance

Dear Minister,

The International Corporate Governance Network (ICGN) is pleased to respond to the Department for Business, Energy and Industrial Strategy (BEIS) consultation on restoring trust in audit and corporate governance.

Led by investors responsible for assets under management in excess of US\$59 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 40 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. ICGN offers an important investor perspective on corporate governance to help inform public policy development and to encourage good practices by capital market participants.

Quality audit practices and transparent corporate reporting are fundamental to good governance and investor protection, and they represent an ICGN policy priority. Reflecting this importance, the recently revised ICGN *Global Governance Principles* define internal and external audit as a standalone principle, stating that "the board should establish rigorous, independent and effective internal and external audit procedures, to ensure the quality and integrity of corporate reporting." (See Annex for complete reference.)

The BEIS consultation is timely, and ICGN has been following the earlier studies leading to this consultation, including the Kingman review of the Financial Reporting Council, the Capital Market Authority review of the statutory audit market study and the more recent Brydon review on the quality and effectiveness of audit. We congratulate BEIS on the scope and thoughtfulness of this capstone consultation, which clearly addresses a wide range of issues and looks holistically at the wider audit and governance 'ecosystem'-- encompassing auditors, accountants, company executive management, company boards, investors, stakeholders and regulators

As an investor representative body ICGN will not address those consultation questions that are less focused on the role of investors. However we do address key themes that are of particular



interest to investors (including both shareholders and creditors) who are primary users of corporate reporting. Investors have considerable interest in promoting high quality audits in financial reporting, as well as assurance on sustainability reporting-- addressing not only financial factors, but also factors relating to a company's human capital and natural capital, including environmental, social and governance (ESG) matters. We believe that many of the proposals will help to enhance transparency, and provide greater awareness and accountability for directors, while providing investors with more "hooks" to guide engagement with companies and investment decisions.

After these initial summary points we will then respond in greater detail to some of the specific consultation questions.

## **Summary of key points**

### **The government's approach to reform**

The form of ownership structure of a company should not limit the government's approach to reform. We support the idea of widening the scope of public interest entities (PIES) to include large private companies. Even if not publicly listed on a stock exchange private companies can still be significant creditors and can have important impacts on a broad stakeholder base, including employees, customers, communities and society at large. Moreover, if higher standards are applied just to listed entities, this would create an unlevel playing field and potentially disincentivise companies from going public. The broad scope of this reform package suggests potential complexities or challenges in terms of implementation.

### **Director accountability and internal controls**

Prudent and robust oversight of internal controls should be something that boards already do, not least as part of their obligations to ensure financial statements provide a true and fair view of an entity's financial position. But to the extent there are boards where this is not the case, a directors' statement on internal controls has the potential to positively enhance the quality of board oversight.

### **Dividends and capital maintenance**

We support the renewed focus on distributable reserves and capital maintenance. Investors expect boards to know what their distributable reserves are to ensure they do not pay dividends out of capital, as doing so could undermine the going concern status and longer-term viability of the entity.

A key reason that capital maintenance rules matter to investors is that they are central to prudent and responsible stewardship, ensuring that directors only pay out dividends from realised profits and take account of likely losses and liabilities. Looking forward, for instance, we would highlight climate risks as a key consideration by directors and auditors under the capital maintenance requirements. And as the evidence base grows with regard to the financial impact



of other environmental and sustainability factors there is also the potential to assess capital maintenance with regard to a broader range of issues relating to natural and social capital.

A different, but related, topic is capital allocation, and we believe BEIS could have gone further here, given that this is a consultation about both audit and corporate governance. We would point to the interplay between today's capital maintenance and the allocation of capital to generate tomorrow's returns, as a critical aspect of corporate governance. Beyond the need to not pay dividends out of capital, there are implications for how boards devise and communicate their broader capital allocation policy, including issues such as share buybacks, incentive pay structures, internal investment and balancing the capital structure to realise the financial objectives of both creditors and shareholders as providers of capital.<sup>1</sup>

Linked to this it is important for both shareholders and board directors to understand a company's economic profitability and ultimately viability: namely the extent to which a company is generating a positive risk-adjusted return on capital. This focus might help investor and directors to focus on the underlying economics of the business, as opposed to short term share performance on outperforming a benchmark. Moreover companies may post nominal profits but are making an economic loss in turns of inadequate returns on capital, or the reported profit may be of lower quality if it is largely unrealised.

Therefore BEIS may wish to consider expanding the purview of its agenda to include a broader statement on capital allocation policy.

### **Resilience and assurance reporting**

We support the proposal to require a resilience statement, and believe this can be a useful discipline for boards to consider systemic risks (both social and environmental) in the context of their business models, strategies and operations. This can also serve as an engagement topic between companies and investors. As noted above, a strengthened capital maintenance regime would underpin a credible longer-term resilience statement.

### **Audit and assurance policy**

We support the requirement for an audit and assurance policy statement. Investors would expect that boards should have already developed policies of this nature, so it should not be a difficult or unreasonable incremental reporting challenge. When material issues are identified, the policy can also serve as an engagement topic between companies and investors.

A vote on audit and assurance policy might have merit in individual situations, but we believe that requiring a vote for all companies in all AGMs is excessive and could have unintended consequences of turning this initiative into a superficial boilerplate "tick box" exercise.

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<sup>1</sup> See ICGN Viewpoint on Capital Allocation, July 2019: <https://www.icgn.org/capital-allocation>



Investors have other voting options to address or send signals to companies on their view of accounting and audit quality, including the right to vote on the election of directors (and specifically audit committee members), to accept financial statements and statutory reports, to appoint auditors and to authorise the audit committee to set the remuneration of auditors. While investors have to date not often used these powers, it is not immediately clear that an additional vote on audit and assurance policy would change this. We believe that greater disclosures recommended in this consultation should generate closer investor engagement and scrutiny, and ultimately accountability through voting.

We recognise the argument that having a specific vote on the audit and assurance policy would require greater focus, research and attention on these important matters (not least from the proxy advisors who currently spend little time assessing accounting and audit quality), in a similar way to the vote on the remuneration policy. Consequently, this proposal could be kept under review in the event that other measures do not elicit the required shareholder engagement.

### **Strengthening the supervision of corporate reporting**

The Kingman Review of the Financial Reporting Council (FRC) identified a range of issues, including the FRC's limited regulatory powers. It is our hope that the replacement through the creation of the Audit, Reporting and Governance Authority (ARGA) will address this issue to enhance its effectiveness through strengthening its remit. Successful enforcement in practice will be the ultimate test of effectiveness. We comment below on the formation of ARGA.

### **Company directors**

We should be seeking to avoid creating unintended disincentives and that might discourage competent directors from serving on corporate boards. But at the same time board members have serious fiduciary duties and must be held accountable in cases of wrongdoing. In this context we believe the incremental powers to be granted to ARGA as outlined in the consultation are not excessive and are appropriate.

### **Audit purpose and scope**

Investors rely on audit quality to provide confidence in companies' capital strength and their reported financial performance. This provides an essential foundation to robust investment analysis and decision making, including voting decisions and corporate engagement priorities. However, confidence is only warranted if the audit process is conducted with appropriate expertise, rigour, independence, professional scepticism and constructive challenge.

The creation of a new auditing profession may help to enhance auditor professionalism, leading to higher audit quality and investor confidence in company reporting. However, this will only be the case if the underlying conflicts of interest are properly addressed through other measures



proposed in this consultation. Merely creating a new set of principles will not on its own tackle the root cause of the problem.

Effective implementation and cultural change through strengthened rules on independence from preparers will therefore be central to success. Establishing independence from accounting bodies may also help in this regard, but at the same time an effective auditor of financial accounts should also have strong accounting skills and experience in financial accounting. This will be required in areas relating to fraud detection, or in situations where a “true and fair” view might conflict with accounting judgements according to the applicable accounting framework.

A critical aspect of increasing independence of auditors is transparency by the profession to the public. Greater disclosure is needed to build confidence, for instance on remuneration structures, actual remuneration paid (aggregated appropriately to overcome privacy concerns), work done, and – importantly – policy outreach/lobbying/secondments provided to the government and other key market players. The latter has been a particular concern when it comes to the influence of the sector over policy making and regulation.

### **Audit committee engagement with shareholders**

We support further engagement between shareholders and audit committees. This requires not only a mutual willingness to engage, but also having better disclosures and content about the audit process to provide specific “hooks” for engagement.

The ICGN Global Governance Principles emphasise that the work of the audit committee should be explained in the annual report. The audit committee should engage with shareholders on any significant issues arising from the audit relating to the financial statements and how they were addressed. More generally, the audit committee should report to shareholders on the effectiveness of the audit process including audit tender, auditor tenure, independence, fees, and the provision of any non-audit services.

Investors should also be prepared to use their voting rights actively to send signals to the company and the audit committee about any audit quality concerns.

Where relevant, investor engagement should also extend to the auditor itself. We very much support a requirement for the company auditor to be present at the annual general meeting to respond to shareholder questions, as well as proposals for auditors to formally engage with shareholders on areas of concern.

### **Audit market competition**

We share BEIS’ concern about the concentration of the audit market and the need to develop greater competition to the Big Four auditing firms. It is less clear to us if the specific tactic of a shared audit is the best approach to dealing with this challenge. If this tactic is to be employed it will be necessary to monitor closely its effectiveness, and if the shared audit proves ineffective other tactics such as market share caps might also be considered.



We would underline that the ultimate objective must be to improve audit quality, so increasing competition will only work if combined with better mechanisms to monitor audit quality, thereby enabling shareholders to hold auditors to account for performance. This speaks to the importance of other proposals in this consultation, notably measures to increase disclosures linked to capital maintenance, resilience, fraud etc. Without that, the service over which auditors compete may remain opaque and with weak accountability.

## **ARGA**

A good case has been made to replace the FRC with ARGA, but the proof of its effectiveness lies in its successful implementation. It is positive to underscore ARGA's wider remit, powers and public interest mission, and we hope its accountability to the UK Parliament will enhance its credibility and impact. Inevitably, the simple creation of a new regulatory body does not mean that it will be effective. Its success as an organisation will require the right leadership, culture, skills and resources.

The proposed breadth of new powers and activities for ARGA are substantial and there is a danger of over-reach. By seeking to cover too much the regulator may find itself unable to do what is required to the standard needed. It will be vital that the regulator seeks to empower investors as far as possible to perform their function of oversight and holding directors and auditors to account, rather than seeking to supplant investors in this role.

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### **Questions 1-2: Should large private companies be included within the definition of a Public Interest Entity (PIE)? Please give your reasons. 2. What large private companies would you include in the PIE definition: Option 1, Option 2 or another? Please give your reasons**

Large private companies should be considered as PIE, because they can be as “systemic” as large listed companies, given their weight in the economy (employment, taxes, impact on communities). It is more sensible to rely on a turnover threshold than on number of employees. We would also note the dangers of only applying the higher standards to listed companies if this results in companies avoiding listing to avoid the rules. This would not only lower standards overall in the economy, harming all stakeholders, but could reduce incentives for listing and resulting in a less vibrant public market.

### **Question 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?**

We do not believe an exemption is called for. If there is one it should not be lengthy.



**Question 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, it would be useful to include large third sector entities that share a “public benefit purpose” using as criteria: sectors considered as “critical”: health, infrastructure and energy/utilities. University hospitals for instance or municipal utilities owned by the city are subject to their own regulation but they require further scrutiny and should be included as “large third sector entity”. Applying a “critical sector indicator” should outweigh the suggested “incoming sources” criteria of 100 M£.

**Question 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?**

Assurance of internal controls by external audit should be mandatory. The underlying assumption of an unqualified opinion by an external auditor is the reliability and the quality of internal controls of the company. It is certainly relevant to require external auditors formally express and publish their opinions on that matter; and directors should ensure that external auditors carry out such verifications.

Directors can be held accountable for negligence and lack of diligence over their oversight of internal control systems, but it seems difficult to hold them directly responsible “for establishing and maintaining an adequate internal control structure and procedures for financial reporting”.

**Q15: 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 consider when determining what should be treated as realised profits and losses?**

Yes, the regulator should be responsible for setting the guidance for what is treated as realised profits under Section 830, and also how the net asset test is met as required under Section 831. The current situation where the audit industry sets this guidance is not acceptable due to the obvious conflicts of interest. Auditors should not be put in charge of setting the rules that govern their own work. This self-regulatory model has resulted in a weakening of investor protections, and needs to be rectified.

Whether or not the UK government pursues Option 1 (guidance) or Option 2 (rules), it should be reviewed for consistency with requirements that the accounts provide a true and fair view (TFV) and provide a basis for determining legal dividends. This review should be conducted by an independent lawyer, which has no historical or current links to the audit profession.

We are concerned that the ICAEW and ICAS Guidance on calculating distributable profits (TECH02/17) runs contrary to ensuring a prudent approach to dividend distributions to protect



shareholder and creditor capital. A particular concern is that the ICAEW/ICAS Guidance treats accrued income as realised for the purposes of distribution, which opens up the possibility that dividends will be distributed out of profits not yet received.

Another area of concern relates to foreseeable losses and liabilities. The consultation suggests the accounting requirements are 'backward-looking'. This is not entirely true. To provide a reliable and prudent view, the statutory accounts are required to look forward to determining any likely liabilities or expected losses associated with a past activity. These likely losses/liabilities must be provisioned for when determining what is available to distribute. In other words, if directors expect a large environmental liability, for instance, they should not pay out a dividend that ignores this. Funds should be set aside, and dividends only paid if there are enough distributable reserves left over.

Our concerns are supported by two legal opinions provided by George Bompas QC in 2013 and 2015<sup>2</sup>. Bompas identifies flaws in the legal opinion provided by Moore QC, which the FRC has long relied upon, and which underpins the ICAEW / ICAS Guidance.

Given the importance of this matter, an independent review of these differing opinions would be timely.

**Q16: 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?**

Yes. Requirements for reporting of distributable profits are beneficial for investors and should be extended to all PIEs. The disclosure of such information is important to enhancing transparency on the dividend paying capacity of the entity, thereby backing up the directors' statement on the legality of dividends.

Rules on capital maintenance have a clear purpose and benefit to investors as well as the public: namely to provide confidence in the underlying capital strength and thus underpinning the going concern and viability statements. As highlighted in the consultation, companies have to make these calculations under Part 23 of the Companies Act 2006, and we believe they should disclose publicly what their distributable reserves are at both parent and group level, with any supplementary commentary on limitations to paying up dividends within the group structure<sup>3</sup>.

Since companies are required to calculate their distributable reserves already, requiring its disclosure should not involve excessive costs.

We would note, however, that it is concerning if companies do not know what their distributable reserves are, as suggested in the Consultation (*"Para 2.2.15 Where it is impossible to calculate the figure exactly, ... it is envisaged that companies will be permitted to report a 'not less than'*

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<sup>2</sup> See: <https://lapfforum.org/engagements/lapff-legal-opinions/>

<sup>3</sup> Certain large investors believe this disclosure is already a requirement under the Companies Act.





*figure for its distributable reserves. Any proposed dividend would not be allowed to exceed the known figure”). This suggests that companies are not routinely tracking their distributable profits, nor undertaking the required net asset test as prescribed under the Companies Act.*

Clearly, it is a step forward to prevent dividends if the board does not know that the company has sufficient reserves, but the government should go further and require that they work out what these reserves are and then publish them. This could be phased in over time, but it is not acceptable to allow companies to flout the legal requirement indefinitely.

**Q17: 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?**

Yes, an explicit statement about the legality of dividends should be extended to all PIEs because it is absolutely critical to promote transparency and disclosure on the capital strength of the entity, which in turn underpins confidence in solvency and future resilience.

It is not clear, however, why the outlook considered in the consultation would be limited to two years. We believe that any foreseeable loss/liability, as long as it is probable, should be considered, even if it happens to fall in, say, three years. Put another way, if directors decided to disregard a large liability just because it was due in over two years, this would be irresponsible.

As noted in the introductory remarks, we also see a strong capital maintenance regime – with associated disclosures – as an important foundation for a company’s capital allocation policy, a topic of considerable concern for investors.

**Q19: 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?**

We are supportive that the matters identified in the consultation (threats linked to a major disruptive event; supply chain resilience; digital security risks; dividend sustainability and climate change risks) should normally be considered in a company’s Resilience Statement, but we would tend to offer companies the flexibility also to identify those matters most relevant to them. This is part of their responsibility, so relying on a standardised list could undermine accountability or create risks of boilerplate disclosure.

We would note that the proposed Resilience Statement appears to largely duplicate what was intended with the Viability Statement. The fact that the Viability Statement has not delivered as expected raises questions of enforcement. To ensure that this proposed statement on long-term resilience does not suffer a similar fate, the government needs to ensure that ARGA is in a position to police implementation.



One issue that is worth emphasising is the links between the capital maintenance regime [Chapter 2] and the Resilience Statement. Future viability and resilience depend in part on capital strength today – taking into account foreseeable losses and liabilities (as required under the capital maintenance regime). This may be worth drawing out more strongly in the government's approach.

One area of growing concern for investors relates to climate risks, and associated future write-downs and liabilities that could increase risks to dividends and, in more extreme cases, insolvency. We would encourage the government to build on its recent guidance to companies to take account of climate risks in their financial statements, to ensuring these same risks are considered in the calculation of distributable reserves and also in credible scenario analyses to underpin longer-term resilience statements. These disclosures should be audited, and in cases where the company fails to produce this disclosure, the auditors should be asked to provide shareholders with a view of the material financial risks.

We would particularly like to see companies explicitly stress test their financial position and future resilience against a net zero pathway consistent with the Paris Agreement<sup>4</sup>. Moreover, given the government's plan to mandate reporting along the Task Force on Climate-related Disclosure Framework (TCFD) the government may also wish to consider the broader question as to whether the of sustainability reporting, including ESG factors, should also be addressed.<sup>5</sup>

**Q22: 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?**

We agree with the proposed minimum content, in particular with policies related to tendering of external audit services. However, we warn against boilerplate language in such policies: how would those policies be different from one company to the other?

**Q25: In order to improve reporting on supplier payments, should larger companies be required to summarize 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?**

It is positive to require transparency on supplier payments but to improve payment practices it would be necessary to have enforcement mechanisms in place.

**Q27: 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?**

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<sup>4</sup> See: <https://www.unpri.org/sustainability-issues/accounting-for-climate-change>

<sup>5</sup> See: International Federation of Accountants, *The State of Play of Sustainability Assurance*, June 2021: <https://www.ifac.org/system/files/publications/files/IFAC-Benchmarking-Global-Practice-Sustainability-Assurance.pdf>



Yes, we agree with the Government's proposal not to introduce a new statutory requirement on a public interest statement that would overlap with existing company reporting in this area.

**Q32: 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?**

Yes, it would be useful to require behavioral standards set by the regulator. Fit and proper criteria used by the ECB to assess board members in banks could be a potential source of inspiration, and we also note that IOSCO and the Basle Committee have released papers on fit and proper assessments, addressing issues including experience, reputation, conflicts of interest and independence of mind, time commitment, and collective suitability.

**Q36: 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?**

Beyond shareholders, other stakeholders (including creditors) are also users of financial statements. However under the UK Companies Act, auditors are appointed by - and report to - shareholders. From this the primary purpose of audit is to provide shareholders with an independent opinion on whether a company's financial statements give a true and fair view of the state of the company's affairs; have been properly prepared in accordance with UK GAAP; and have been properly prepared within the requirements of the Companies Act 2006.

**Q37-39: 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? 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? What role should ARGAs have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?**

In order to avoid conflicts of interest, non-audit services should be performed by another external auditor not involved in statutory audit. ARGAs should prevent statutory auditors from undertaking wider services.

**Q40-41: 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?**

Yes, establishing enforceable principles would be a good start. It would testify to their commitment to act as a trusted third party if those principles were formally endorsed by auditors as part of their report, along the audit letter of representation.



**Q42: 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.**

Directors should publish their statement based on management, internal audit and external audit reports. It would make more sense if auditors have the obligation to report the lack of action by directors if they detect fraud, misconduct or any inappropriate activity.

**Q44: 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?**

We believe that any departure from IFRS should be done by reference to the legal true and fair view (TFV) 'override' requirement. Likewise, auditors should justify their opinions on compliance with the TFV standard by reference to the Companies Act, as they do today.

As outlined in the consultation, departures from IFRS are required to ensure the published accounts meet the statutory TFV standard. The consultation suggests that there is confusion over what this standard is and that there is a need to provide clearer guidance. They suggest this could come in the form of Principles of Corporate Auditing.

We would concur that there is a need for guidance, but this guidance must be firmly rooted in our common law standard not defined by what the audit industry is or what preparers would like it to be. We noted above under Q15 the existence of two legal opinions by Bompas QC (2013 and 2015), which have never been formally reviewed by the government, and yet they state that the current FRC guidance on TFV is flawed.

We would propose that the government seeks demonstrably independent legal input to review the existing TFV guidance and, based on this, publish the criteria for use of a TFV override.

**Q52-53: Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees? 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?**

It would be relevant to further consider if ARGA can impose pecuniary penalties on members of audit committees breaching their duties.

**Q54: 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)?**



The regulator would be conflicted if put in the position of appointing (even under exceptional circumstances) and supervising auditors. In specific cases, it should have the power to require the appointment of a new auditor by the company.

**Q59: Do you agree with the proposed approach for ensuring greater audit committee chair and auditor participation at the AGM? How could this be improved?**

Yes, their presence should be mandatory, and they should be given opportunity to answer questions from shareholders.

**Q60: 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?**

Yes, we agree that auditors should provide to shareholders a formal statement on the reasons of their departure. Among reasons listed by the Review (page 134), we should replace disagreement with the "audit committee" with "disagreement with the board", since the audit committee is only a consultative body, and we assume that any fundamental disagreement with the audit committee would also be supported by the board.

**Q65: 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?**

The regulator may wish to pay attention to solvency ratios to ensure that audit firms are able to meet liabilities imposed by any pecuniary penalties.

We hope that our comments are helpful, and we look forward to engaging with you in this or other matters where we could provide meaningful input. Should you wish to discuss our comments further, please contact me or George Dallas, ICGN's Policy Director, by email at [george.dallas@icgn.org](mailto:george.dallas@icgn.org).

Yours faithfully,

**Kerrie Waring,  
Chief Executive Officer, ICGN**

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**Annex: ICGN Global Governance Principles: Excerpt re Audit****Principle 8: Internal and external audit**

***The board should establish rigorous, independent and effective internal and external audit procedures, to ensure the quality and integrity of corporate reporting.***

**Guidance****8.1 Internal audit**

The board should oversee the establishment and maintenance of an effective system of internal control to properly manage risk which should be measured against internationally accepted standards of internal audit and tested annually for its adequacy. Companies should have a dedicated internal audit function with clearly defined oversight and reporting structures. Where such a function has not been established, full reasons for this should be disclosed in the annual report, as well as an explanation of how adequate assurance of the effectiveness of the system of internal controls has been obtained.

**8.2 External audit**

The board should establish formal procedures to ensure an effective and independent external audit of the company's financial statements to provide assurance to shareholders and relevant stakeholders around a company's financial position, performance and prospects. The external auditor's direct reporting relationship and accountability should be to the independent audit committee.

**8.3 Audit Committee**

The board should establish an audit committee comprised entirely of independent non-executive directors. At least one member of the audit committee should have recent and relevant financial expertise and all audit committee members should be financially literate, including a basic understanding of accounting. Audit committees should also have a clear understanding of how sustainability factors can impact the company's financial statements. The terms of reference for the committee should be disclosed and include:

- a) monitoring the integrity of the accounts, financial statements and any formal announcements relating to the company's financial performance, and reviewing significant financial reporting judgements contained in them.
- b) maintaining oversight of key accounting policies and accounting judgements in accordance with generally accepted international accounting standards, and disclosing such policies in the notes to the company's accounts.



- c) reviewing the effectiveness of the company's risk management approach and system of internal controls, and the internal audit function.
- d) agreeing the minimum scope of the audit as prescribed by applicable law and any further assurance that the company needs.
- e) annually assessing the quality and effectiveness of the audit (including the use of audit quality indicators) and ensuring independence of the external auditor including in relation to the provision of non-audit services and related fees.
- f) recommending to the board the appointment, reappointment and, if necessary, the removal of the external auditor and audit fees. Non-audit fees should normally be less than the audit fee and, if not, there should be a clear explanation as to why it was necessary for the auditor to provide these services and how the independence and objectivity of the audit was assured.
- g) approving the terms of reference for the audit engagement and ensuring that contracts do not contain specific limits to external auditor liability to the company for consequential damages or require the company to use alternative dispute resolution.
- h) engaging with the external auditor without management present to discuss any risks or other concerns that were significant to the audit process, including any significant questions or disputes regarding accounting practices or internal controls.
- i) overseeing the interaction between management and the external auditor, including reviewing the management letter provided by the external auditors and overseeing management's response; and
- j) reporting on the committee work in the annual report and engaging with shareholders either directly or via the board.

#### **8.4 Audit Committee report**

The board should explain the work of the Audit Committee in the annual report and engage with shareholders either directly or via the board on any significant issues arising from the audit relating to the financial statements and how they were addressed; and more generally report to shareholders on the effectiveness of the audit process including audit tender, auditor tenure, independence, fees, and the provision of any non-audit services.

#### **8.5 External auditor report**

The board should publish a report from the external auditor in the annual report which should provide an independent and objective opinion whether the accounts give a true and fair view of the company's financial position and prospects.



## **8.6 Shareholder approval**

The board should recommend the appointment, reappointment and remuneration of the external auditor to shareholders for annual approval.

## **8.7 Auditor resignation**

If the auditor resigns then the reasons for the resignation should be publicly disclosed by the resigning auditor.

## **8.8 Audit rotation**

The engagement partner should be named in the audit report and audit rotation should be promoted at appropriate intervals both at the audit partner and firm level. The company should publish its policy on audit firm rotation and engage, when appropriate, new audit firms to broaden market competition. The audit committee should be directly involved with, and accountable for, the procurement process for new external auditors.