



ICGN

International Corporate Governance Network
Inspiring good governance & stewardship

The Financial Reporting Council

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Via email: afgcreview@frc.org.uk

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Financial Reporting Council Consultation:

Proposed revisions to the Audit Firm Governance Code

ICGN submission

The International Corporate Governance Network (ICGN) is pleased to respond to the Financial Reporting Council's (FRC) consultation regarding its proposed revisions to the UK Audit Firm Governance (Code).

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.

Our policy positions are guided by the ICGN Global Governance Principles (GGP) and the ICGN Global Stewardship Principles, both of which have been developed in consultation with ICGN Members and as part of a wider peer review. We believe our GGP have relevance for the governance of all forms of organisation, including audit firms— particularly with regard to questions of leadership, culture, values, and independence. As a specific area of focus, audit quality is a clear priority for ICGN and its investor Members, and external audit is focused upon in Principle 8 of ICGN's GGP.¹

¹ ICGN's Global Governance Principles (2021):
www.icgn.org/sites/default/files/ICGNGlobalGovernancePrinciples2021

The UK is an important market for ICGN, as many of our Members are based in the UK, and an even larger group of ICGN Members invest in UK companies. ICGN engages regularly with UK regulatory bodies, including the FRC, and we recently provided detailed comments to the Department for Business, Energy, and Industrial Strategy (BEIS) consultation on restoring trust in audit and corporate governance.²

Proposed Revisions to the UK Audit Firm Governance Code

We recognise the global leadership the UK has shown in many areas of regulation in the areas of governance and audit quality, including development of the world's first audit firm governance code in 2010. The Code has helped to shape thinking and practice about audit firm governance, not only in the UK, but globally. To keep the Code fresh and effective in promoting audit quality, it is appropriate to periodically consider revisions to the Code, so we welcome the FRC's consultation regarding the Code.

ICGN is supportive of the Code and its role in strengthening audit firm governance, specifically with respect to the three-part purpose behind proposed revisions — 1) to promote audit quality, 2) to ensure firms take account of the public interest, and 3) to safeguard the sustainability and resilience of audit practices and firms. We believe the Code sets a positive standard for audit firm governance not only in the UK, but globally. From our perspective as an investor body, the main changes proposed by the revised Code appear to be sensible, and we do not have detailed commentary on the individual questions.

ICGN is generally supportive of the new Code's focus on audit board independence and the distinct roles of the Independent Non-Executives (INEs) and Audit Non-Executives (ANEs). We support the tighter independence requirements, as well as the practice of operational separation. We believe these have relevance for both large and small audit firms, so we also support the Code's broader scope in application.

At the same time, however, we are alert to potential unintended or disproportionate consequences that these stricter standards might bring to smaller audit firms. This could potentially relate to incremental costs that might arise in bringing on independent directors or loss of staffing flexibility that might arise in operational separation. As the Code is applied more broadly in the UK, the FRC will need to monitor the impact on smaller audit firms and whether the Code is working effectively or if there is scope for more proportionate guidance.

ICGN applauds the revised Code's recognition of the importance of long-term sustainability, culture, and employee engagement. Diversity of workforce and diversity of skill set within audit firms both contribute to better decision-making and, ultimately, higher-quality audits and other client services. While we support the continuation of firm separation, we note the importance of diverse and specialist skill sets within audit firms to meet the fast-paced, changing needs of clients — so that investors can derive appropriate trust and confidence from audits. Operational separation steps are already being successfully implemented in some UK audit firms. While this

² ICGN Comment Letter to Business, Energy and Industrial Strategy (BEIS) consultation on restoring trust in audit and corporate governance (July 2021): www.icgn.org/sites/default/files/ICGNLetterBEISaudit

process continues, it should not cross the line of creating “audit-only” firms, which would reduce the ability to hire and retain the best and brightest skilled people with appropriate subject matter expertise and would have a long-term negative impact on overall audit quality.

Finally, we would like to underscore the need for audit firm boards to understand the needs of investors as a critical stakeholder. Many investors have concerns about the political influence of audit firms in influencing the “rules of the game” in terms of the audit profession in ways that might challenge audit quality for the users of auditor reports. In this context we recommend the FRC consider also requiring audit firms to disclose their public policy outreach and government lobbying, both directly and behind the scenes through other membership bodies. It is both important for both ANEs and INEs of audit firms to understand these investor concerns, and we believe that audit firm board members should engage regularly with the investor community as part of the governance process. As one possible tactic to reinforce independence and investor accountability, the FRC might wish to consider having one audit firm board slot appointed by investors.

In conclusion, ICGN applauds the efforts of the FRC, and we hope that our feedback and comments are helpful in your deliberations. 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.

Yours faithfully,



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