Department for Business, Energy & Industrial Strategy
1 Victoria Street
London
SW1H 0ET
By email: audit.consultation@beis.gov.uk

8 July 2021

Dear Sir, Madam,

Re: BVCA response BEIS consultation titled *Restoring trust in audit and corporate governance*

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 700 firms, we represent the vast majority of all UK based private equity and venture capital ("PE/VC") firms, as well as their professional advisers and investors. Between 2015 and 2019, BVCA members invested over £43bn into nearly 3,230 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. PE/VC-backed companies currently employ 972,000 people in the UK and the majority of the businesses our members invest in are small and medium-sized businesses.

Introductory comments

An important part of the PE/VC business model is to build robust and effective governance structures, fostering growth and innovation and creating long term value, as demonstrated by many academic studies. The PE/VC industry is committed to transparency and examples of this in practice include the BVCA's work on the Wates Principles for Large Private Companies and the Walker Guidelines, implemented and monitored by the Private Equity Reporting Group ("PERG"). Further feedback on how the PE/VC industry supports government priorities is included in the BVCA's 'New Horizons' report.

The BVCA has always been supportive of, and involved in, government initiatives on corporate governance reform, corporate reporting and the consideration of different stakeholders (including employees and pensioners), and work by the FRC on its ethical standard (i.e. the provision of non-audit services). Through our work on the Wates Principles for corporate governance and the Walker Guidelines on transparency, large UK private equity-backed companies currently provide significant levels of disclosure. Indeed, in many of these areas, private equity-backed companies are leaders, with a sharp focus on effective governance and responsible stewardship. Companies covered by the Walker Guidelines already comply with some of the requirements currently applicable to PIEs.

The BVCA stands ready to engage on the proposals set out in this consultation that are relevant to PE/VC fund managers and large private companies. We have previously met with representatives from BEIS and the FRC to discuss practice in the industry and are delighted to continue this dialogue, as well as assist in whatever way possible in the coming months and years as these recommendations are implemented.

Background to Private Equity and Venture Capital

Private equity and venture capital firms are long-term investors, typically investing in companies for around 3-7 years. This means a commitment to building lasting and sustainable value in the businesses they invest in. Typically, firms will sell their stake in a company by listing on the public markets or, more frequently, selling to a strategic buyer.

PE/VC firms raise capital to invest from sources such as pension funds, endowments, insurance companies, banks, family offices/high net worth individuals and sovereign wealth funds. PE/VC funds will invest in companies ("portfolio companies") in the earlier part of a fund's life until an agreed date (e.g. 5 to 6 years) and exit investments in the run up to the fund's tenth anniversary (which can be extended).

The fund's ownership percentage in the portfolio companies will vary depending on the PE/VC strategy (e.g. buyout, minority stake). Private equity acquisitions will often be partly financed by debt, often provided by a number of banks or other debt providers. Importantly, the portfolio companies will operate independently of each other and not as a single corporate group. The structural features of PE/VC funds have informed our feedback below.

Overview of BVCA feedback

Our response to this consultation is structured as follows:

- Appendix 1 – Corporate governance in PE/VC. This section explains how the PE/VC industry establishes and improves corporate governance in portfolio companies, including our involvement in developing the Wates Principles.

- Appendix 2 – The Walker Guidelines. This section sets out how the private equity industry provides further disclosure in the financial statements of large private companies in the UK and the review processes in place and oversight provided by the PERG.

- Appendix 3 – Provision of non-audit services to PIEs in a PE/VC fund. This section summarises the feedback provided to the FRC and the outcome when it expanded its ethical standard to cover large private companies.

- Appendix 4 – Answer to questions in the consultation. We have responded to the questions of most relevance to our membership.

Our summary feedback is set out below.

Proportionality and calibration

The UK has enjoyed high levels of investment due to the stability of our legal system and quality of our reporting regime. It is key that the reforms are both proportionate and balanced so that whilst helping to raise standards of corporate governance and audit, the reforms do not discourage investment in the UK and disproportionately impact the competitiveness of UK as a place to locate and to do business.

Private companies in the UK already adhere to higher standards of reporting and transparency. Disproportionate additional reporting or administrative burdens, with the associated additional costs, would hamper the UK's competitiveness as a destination for investment, especially if the information is not decision-useful for key stakeholders. Businesses across the country are focussed on recovering from the pandemic and this must be borne in mind as the proposals are implemented.

Furthermore, the new requirements should be better calibrated for private companies. This was the approach taken by the Government for reporting on corporate governance arrangements and was supported by the business community. A coalition of key stakeholders, including the BVCA, created the Wates Principles which are much better suited to private companies than the UK Corporate Governance Code.

Timeframe for implementation

The BVCA is very supportive of the phasing in approach presented in many of the proposals, whether it be over a number of years and/or after further consultation. We stand ready to provide feedback throughout this process to ensure that workable proposals can be implemented that achieve policy objectives and minimise the burden on UK business.

Provision of non-audit services

When the PIE definition is expanded, it is important to ensure that the regulation/legislation reflects the specificities of a typical PE/VC fund and does not treat it in the same way as a conglomerate/large corporate group. The provision of non-audit services (that are restricted under current regulation) should still be permissible to other companies (that are not PIEs) in the same PE/VC fund that contains one or more PIEs, and non-audit services to the PE/VC funds should still be permissible if they do not relate to the PIE(s). We agreed a sensible approach with the FRC on this matter when it expanded its ethical standard in 2019 to include large private companies. That approach sits within guidance and should be rolled into new regulation/legislation that applies to PIEs. If that approach was not maintained, given the amount of non-audit services provided to PE/VC portfolio companies by both 'Big 4' and challenger firms there is also concern that there would not be an appetite in the market to take on audits of PIEs held by PE/VC funds.

Section 1 – The Government's approach to reform, including the PIE definition

We understand the rationale for including some of the largest UK private companies within the definition of a PIE. If large private companies become PIEs, there needs to be some level of consistency in the thresholds that apply for different narrative reporting requirements in the UK. Option 2 therefore seems to be preferrable as it follows the approach being taken for the implementation of TCFD in the UK for large private companies.

The Wates Principles are relatively new, and more time is needed to judge their effectiveness before imposing new requirements. Alongside the phased approach for implementation, it would be appropriate to exempt private companies from some of the new requirements applying to listed companies, or provide for an alternative approach which is more tailored and less burdensome (e.g. on the internal controls attestation).

For the purposes of measuring turnover and number of employees in this context, it is important that separate companies are not considered part of the same corporate group merely by virtue of belonging to the same PE/VC fund's portfolio or different fund portfolios managed by the same manager.

Further clarity is required on the point at which a company becomes a PIE, e.g. if it is moving in and out of size-based thresholds. When looking at international groups with UK entities, a concept of where the weight of the activities of the company/group is based should be considered.

Further consideration may be required on what factors constitute 'public interest' as solely relying on turnover and/or number of employees is not necessarily appropriate, particularly when this has a disproportionate impact on certain sectors. We would like to be involved in further discussions with BEIS on this point if further factors are considered as part of the PIE definition.

Sections 2 & 5 - Directors' accountability for internal controls, dividends and capital maintenance and enforcement against company directors

When considering the new requirements for directors, it is important to take into account the extensive requirements already in place, set out in well-established and well understood legislation. There have been several new corporate governance and reporting requirements introduced recently, such as the Wates Principles and reporting on section 172 (of the Companies Act 2006), and these need the time to be established.

Many private companies have adopted the Wates Principles, which include reporting on internal control matters. In relation to the proposed annual review of the effectiveness of internal controls and disclosures by directors, it will be critical to give businesses the appropriate time to fulfil this requirement if introduced, with appropriate guidance and stakeholder engagement to ensure there is input from business. Our preference is to let the Wates Principles become more established, and recommend best practice disclosures rather than the introduction of a new regime, as these principles were designed specifically for private companies.

We would recommend that the requirements related to dividend and capital maintenance are limited to listed and AIM companies and we have provided feedback if the requirements were to capture private company PIEs. The current guidance on the definition of realised profits and losses is well-balanced and representative of generally accepted practice. ARGA's responsibilities should extend to reviewing this guidance, but not replace it altogether, as a principles-based regime must remain in place. Where a parent company discloses how much of its retained earnings are distributable, this would support an assessment of the legality of dividends. However, it would be costly and often impossible to get reliable quantified estimates on a group's dividend-paying capacity; qualitative disclosures on this would be preferable. We question the need to add a director's statement about the legality of proposed dividends into the annual report as there is already an implicit assumption that the payment of a dividend is legal, given the requirements of the Companies Act. It may not provide significant additional comfort to investors, and the company would incur costs to comply with this requirement. If these proposals are introduced for private company PIEs, significant guidance and consultation would be required.

The proposals relating to enforcement against company directors may deter individuals taking on non-executive roles and this would be to the detriment of companies in the UK (particularly those in regulated businesses). These proposals will place an additional onus on those directors with financial expertise, as well as making it harder to find generalist non-executive directors to join audit committees and boards. For example, there may not be a clear route for directors who join a company and "inherit" a control framework to demonstrate they have appropriately discharged their duties.

Directors are already subject to wide-ranging duties under statute and common law, which are well-established legally and generally well-understood by directors and their advisers. The courts and existing legal system provide consistency and sophisticated procedural checks and balances. Overlapping powers between authorities should be minimised to the extent possible. Where overlap is unavoidable, we consider that a clear and comprehensive memorandum of understanding between the ARGA and other authorities such as the FCA, Serious Fraud Office and Insolvency Service, will be vital in giving companies and directors clarity and certainty, and in avoiding the increased costs that would arise from parallel investigations and/or enforcement proceedings. We do not think that any additional duties, beyond those identified in the consultation, should be in scope of ARGA's enforcement powers.

If any new behavioural standards or enforcement powers are to be introduced, we believe that there should be significant consultation and engagement with business. Anything that might be introduced should be considered carefully in light of existing Companies Act and common law obligations to ensure there is no inconsistency of requirements. It will be very important for ARGA to provide clear and detailed guidance on how all director duties in scope of its enforcement powers are to be met by directors, and on how ARGA will seek to exercise its enforcement powers in practice.

Sections 3 & 4 – New corporate reporting and supervision of corporate reporting

Noting our comments above about the need to calibrate the reporting regime for private companies, we note that there are merits in the proposal for a Resilience Statement that consolidates the Going Concern and Viability Statements. Whilst some level of prescription on the nature of matters that should be captured could be helpful, in practice it would be better for companies to decide upon the most relevant and material matters (and this approach would address any commercial sensitivities). Careful consideration should be given to what might be included in each of the short-, medium- and long-term sections and detailed guidance should be prepared. For the medium-term section, a three-year period would be more appropriate than five years. The long-term section may include generic/boilerplate statements without further guidance.

On climate risk reporting, we recommend that TCFD reporting continues to be stand-alone as that would enable more focus on climate risk, as the nature and scale of potential impact to a company is typically over a much longer period than what is envisaged for the Resilience Statement.

The proposal for companies to have an Audit and Assurance Policy could help resolve confusion on how assurance is sought through various channels (including the report on internal controls, internal audit, external audit). Companies will need appropriate time to implement this policy, especially for private company PIEs given their starting point might require more work to implement the changes required.

We are in agreement with the decision not to introduce an annual public interest statement. We believe that a well thought out section 172 statement, which is already required in the financial statements would cover much of this disclosure. We are supportive of promoting best practice reporting in this area.

We broadly support the proposals related to the supervision of corporate reporting, particularly with regard to promoting brevity, comprehensibility and usefulness in corporate reports. Publishing Corporate Review Reports raises confidentiality concerns and how ARGA exercises its ability to change financial statements requires further consideration.

Sections 6 & 7 – Audit purpose and scope, audit committee oversight and engagement with shareholders

We believe that the design of sufficient and appropriate audit procedures to detect and identify material fraud is a current requirement within a statutory audit. Any additional requirements should be limited to actions taken to prevent and detect material fraud that impacts financial reporting. It would be a significant increase in scope and cost for directors to report on, and auditors to consider, controls to prevent and detect all fraud across an organisation. We agree that specific assurance on Alternative Performance Measures and Key Performance Indicators is beyond the scope of the statutory audit and the level of assurance required is a decision for the company and its shareholders.

We support, in principle, the proposals set out in section 7, such as giving ARGA the ability to set additional future requirements. However, we believe a full consultation process is key to the implementation of any new requirements. We note the proposals relating to engagement with shareholders will be applicable to premium listed companies in the first instance but could be applied to a broader group later, including private company PIEs. Our comments are therefore provided in this context and there needs to be more consideration/consultation before broadening the requirements out given the close relationship private companies have with their shareholders.

Section 8 – Competition, choice and resilience in the audit market

We do not have a strong opinion on this area and would like to point to our feedback above on the provision of non-audit services.

Sections 9 & 10 – Supervision of audit quality and a strengthened regulator

We would support the exemptions included in section 9 relating to the publication of commercially sensitive information to the audited entity, and the disclosure of any personal information that could impact on individuals.

Legal professional privilege is a fundamental right, the premise of which is that parties should be free to communicate with their lawyers, or to prepare for litigation, in absolute confidence, unless they specifically choose to share their privileged communications with third parties. We would recommend retaining the current position where it is at the audited entity/client's discretion as to whether it is prepared to waive privilege in its documents as against ARGA and, if so, on what terms.

We are broadly supportive of the proposals for the new strengthened regulator, along with its regulatory principles as described in section 10. It is also important that ARGA takes a collaborative approach working with businesses, the audit profession and government agencies. Businesses and audit firms may not always know what the regulator expects of them, particularly where subjectivity in reaching conclusions is considerable. ARGA could articulate its position with positive consultation, enabling businesses and the audit profession to reach conclusions that achieve worthwhile outcomes in the quest to restore trust in business and in audit.

We would be very keen to discuss the contents of this response with you and look forward to further engagement with BEIS and the FRC on the topics included herein. please contact Gurpreet Manku (gmanku@bvca.co.uk).

Yours faithfully,

Amy Mahon
Chair, BVCA Legal & Accounting Committee

Appendix 1 – Corporate governance in PE/VC

PE/VC firms seek to introduce and strengthen the corporate governance arrangements that are in place in the portfolio companies in which they invest. This allows them to monitor their investments, to ensure that there is a clear and well-structured strategy that is effectively implemented, and help the company to develop improved risk management processes. Effective governance provides PE/VC firms and portfolio companies with a strong platform to work with management to implement value-building initiatives during their ownership period. Given that it is most likely that the company will eventually be sold to a well-informed strategic buyer (or another sophisticated financial investor) who will have the opportunity to undertake extensive due diligence, building long-term sustainable businesses is an essential part of the business model. A private equity investor is unlikely to make the returns it seeks if it engages in short term behaviours and does not pay close attention to long term societal trends or policy changes. For that reason, sound governance that drives well-informed long-term decision-making is critical.

For the PE/VC firm itself, the benefits of good governance at a portfolio company level are intrinsically linked to its own success. Not only does it protect and enhance the value of investments, but is also important from a reputational perspective, especially as the PE/VC firm will need to fundraise in the future to secure its own longevity. There may also be reporting requirements from the PE/VC fund's own investors and other regulatory factors to consider (e.g. anti-bribery and corruption).

PE/VC firms are legally required to invest in a manner that is consistent with fund governing documents, which are heavily discussed with investors as part of the fundraising process. Detailed due diligence will be undertaken to understand the investment process of the PE/VC firm.

Corporate governance will be reviewed by the PE/VC firm in the due diligence stage of its investment and it will implement changes, in co-operation with the management team, soon after the acquisition of the company. The arrangements introduced will be bespoke and will depend on a number of factors. This includes the stage the company is at in its development (e.g. professionalising arrangements at a founder-owned business, preparing a company for an eventual listing on a public market, etc), whether the company operates in a regulated industry, the markets in which the company operates, the risk profile of the underlying business and products, etc. The intention is to implement a governance structure that is self-regulating with an emphasis on creating the right culture that ensures the effectiveness of the arrangements put in place. Some examples are set out below.

- **Board composition:** The PE/VC firm will typically appoint one or more of its own employees to be a non-executive director on a portfolio company's board to monitor its investment and participate in board-level decisions. The consent of such director(s)may be required on certain strategic matters, and these directors will of course be subject to the same fiduciary duties, including the duty to promote success under Section 172 of the Companies Act, as executive directors. The PE/VC firms will also seek to ensure that board members have the requisite skills and experience to serve on the board and to help implement its strategic priorities. When appropriate and helpful to ensure better informed decision-making, outside non-executive directors (i.e. not employed by the PE/VC firm) may be appointed to the board. The management team and the PE/VC firm will together determine the optimum size of the board, again based on factors specific to the company.

- **Audit and risk committees:** The type and composition of board committees will be bespoke to the company to ensure there are robust internal financial controls, quality assurance, risk and conflict management and transparent reporting.

- **Remuneration:** The incentive arrangements for management will be structured to ensure alignment of interests that support the long-term growth of the business, and typically a key element of this is ownership of an equity stake in the company. Management and employees will have formal employment contracts. A remuneration committee may also be in place.

- **Policies and procedures:** These will be implemented to cover areas such as fraud, bribery, corruption, health and safety, Environmental, Social and Governance ("ESG"), diversity and inclusion ("D&I"), conflicts of interest and other legal requirements applicable to the company. Many of these areas directly or indirectly impact the reputation and/or investment value of the portfolio company and therefore also impact the PE/VC firm.

    - PE/VC firms have embraced the sustainability and responsible investment agenda, recognising that it creates significant value creation and risk mitigation opportunities, as well as being increasingly important for an industry that raises almost all of its capital from institutional investors. There is, therefore, continued focus by our industry on measuring, managing and mitigating ESG-related risks, as well as seizing the opportunities that good ESG practices provide. The BVCA and Invest Europe have published a number of guides and case studies on this area, alongside e-learning and training[1]. A number of PE/VC firms are also signatories to the UN Principles of Responsible Investment ("PRI") and the initiative Climate International ("iCI") (private equity action on climate change)[2]. Investors often require a manager to comply with/have reference to PRI even where the PE/VC firm itself is not a direct signatory. Reporting on ESG matters, as well as adherence to an ESG policy, is also typically requested by investors as part of their reporting requirements.

- **Regular and detailed management information:** Financial and non-financial key performance indicators (including on ESG and D&I) will be developed to enable the PE/VC investor to monitor company performance and progress against strategic objectives and the business plan. Depending on the size and nature of the business, a company may also integrate its management of ESG and D&I factors into a full corporate responsibility or sustainability programme and publish reports publicly as part its external stakeholder engagement strategy. Furthermore, PE/VC firms regulated under the Alternative Investment Fund Managers Directive are required to comply with transparency provisions in the Directive in respect of the annual reports of certain non-listed portfolio companies and the disclosure expected on acquisition of control of such companies.

Active monitoring is an important aspect of the PE/VC model. PE firms will typically take a controlling or significant minority interest in portfolio companies, thus will naturally closely monitor issues, including corporate governance issues, that may impact the value of their investment and swiftly address these. This is similar for VC firms, who will typically not take a controlling stake, but will have significant influence through additional rights attached to their shares such as board seats and certain veto rights. VCs will also actively monitor for issues and work closely with entrepreneurs to address concerns.

Over the years, examples of good practice in corporate governance have been shared with the UK and European industry in Invest Europe's professional standards handbook[3]. Importantly this is not a

[1] Further information is available on the BVCA website (here) and Invest Europe website (here)

[2] The number of UK private equity signatories to PRI increased by 127% between 2015 and 2020 to 75 firms. Nearly 90 private equity firms representing over US $700 billion in AUM have signed up to the iCI. Further details are available here

[3] Invest Europe Professional Standards Handbook, 2018 – available here

prescriptive set of guidelines as the arrangements put in place will depend on a wide variety of factors specific to the company.

The BVCA was a member of a coalition (including the FRC, CBI, IoD and TUC) that developed a suitable framework for large private companies to report on their corporate governance arrangements. The Wates Principles (named after the chair of the coalition, James Wates CBE) were published in December 2018 and we continue to promote and monitor their implementation.

We believe that due to the way the PE/VC firms/funds invest and monitor their portfolio companies, including the industry's involvement in the Walker Guidelines (see next section) and Wates Principles, the PE/VC industry has demonstrated its commitment to effective corporate governance. Given the focus on value creation and growth, PE/VC firms take into consideration the perspectives of important stakeholders. Therefore, as outlined in our response to the consultation questions, the implementation and shape of the final proposals needs to take account of the good practices already in place. It is vital that any new requirements are well thought through and balanced, in order to ensure that the UK remains an attractive place to do business and to not overburden companies with additional reporting requirements.

Appendix 2 – The Walker Guidelines

In 2007, the BVCA commissioned Sir David Walker to establish Guidelines that provide a framework for the private equity industry to enhance stakeholders' understanding of our activities and address concerns about a lack of transparency in the industry. These stakeholders include government, regulators, media, employees, customers and the public more widely. This was in response to the increased scrutiny and negative publicity the private equity industry faced in 2007 from the media, trade unions and politicians, culminating in Treasury Select Committee hearings

Since 2007, the industry has embraced and adopted these Guidelines with over sixty portfolio companies within scope currently providing additional disclosure in their annual reports voluntarily. Enhanced reporting by portfolio companies, and disclosures by private equity firms on their investment approach, helps to demonstrate that they are responsible owners and builders of businesses. The positive reputational impact benefits the portfolio company itself, as well as its owner, and the Guidelines support those portfolio companies with reporting ahead of a listing on a public market.

Scope of the Walker Guidelines

The Guidelines apply to the largest portfolio companies with a significant UK presence. The detailed definition given on the PERG website[4] and covers companies of significant value (measured on acquisition by the PE investor) and by reference to activities in the UK (more than 50% of revenues generated in the UK or UK employees in excess of 1,000 FTEs).

The acquisition value is a key threshold for determining whether a company is within the scope. The Guidelines do not cover companies that have grown organically to exceed the thresholds. The scope of companies covered is therefore narrower than if the definition had been solely based on employee numbers. This is deliberate, as the Guidelines are intended to cover large, high-profile companies in the UK and the transaction value at the point of acquisition is seen as a good indicator of this. Furthermore, a defined population with clear entry and exit points is needed as data on performance is collected for the EY report commissioned by the BVCA and PERG.

Narrative reporting requirements for portfolio companies covered by the Guidelines

Portfolio companies are required to publish their annual report and accounts on their websites within six months of year-end and include a number of enhanced disclosures that are normally required only of quoted companies. These enhanced disclosures follow those set out in the Companies Act 2006 (and included in the strategic report in the annual report) and cover:

a. Analysis of development and performance during the year and year-end, principal risks and uncertainties facing the company, and financial and non-financial key performance indicators.
b. Business model and strategy, trends and factors affecting future development, performance or position, environmental matters, employee matters, social and human rights issues, and gender diversity information.
c. Additionally, companies are required to make certain disclosures specific to the Walker Guidelines and the private equity industry:
    i. identity of the private equity fund(s) that own the company;
    ii. details of the composition of the board; and
    iii. a financial review of its position and financial risks.

[4] Private Equity Reporting Group - website

Therefore, companies covered by the Walker Guidelines will already be complying with some of the requirements that are currently applicable to PIEs now.

Monitoring compliance with the Guidelines and enforcement of the voluntary regime

The PERG is an independent body established to monitor conformity with the Guidelines and make periodic recommendations to the BVCA for changes to the Guidelines. The membership of PERG is set out below:

Nick Land	Chairman & independent member (Former Chairman of EY LLP, former Financial Reporting Council board member, NED)
Baroness Drake	Independent member (Labour peer, former TUC president, pension fund trustee)
Glyn Parry	Independent member (Experienced Finance Director)
Tony Lissaman	Industry representative (3i)
Ralf Gruss	Industry representative (Apax)

Each year a sample of portfolio company annual reports are reviewed for compliance with the Guidelines. The outcome of this review is published in an annual report. The level of expectation is not to simply meet a basic level of compliance. The PERG encourages and reports on the standard of disclosure, benchmarking against the best-in class FTSE 350 companies. The standard of listed company reporting continues to improve every year, so portfolio companies are also expected to improve their standard of reporting.

The PERG also monitors developments in narrative reporting and has recommended changes to the Guidelines such as the adoption of the requirements of the Strategic Report Regulations (that updated the Companies Act in 2013), and this led to further disclosure on human rights issues and gender diversity. **The PERG is also monitoring this consultation process and together with the BVCA, will publish a roadmap in 2021 on how the Guidelines could be amended in the future.**

The Guidelines operate on a 'comply or explain' basis. Very few companies opt to explain non-compliance with the Guidelines and so incorporate the disclosures required in the annual report. In its annual report, PERG will publicly name portfolio companies, and their owners, who do not comply with the Guidelines or provide a satisfactory explanation for non-compliance. It is the BVCA's experience that this is generally an effective approach to ensure compliance with the requirements, as firms do not want the negative publicity associated with being named in the PERG's report.

PERG has appointed PwC as an independent advisory firm to assist it in carrying out its review of the disclosures of a sample of portfolio companies each year. A Good Practice Guide[5] is published by PwC and PERG each year to aid portfolio companies in achieving a good level of disclosure.

The majority of private equity firms and their portfolio companies are compliant with the Guidelines. The independent nature of PERG, which monitors compliance with the Guidelines, ensures high expectations and standards. This is reflected in the results of the 2020 report[6], where PERG publicly notes that private equity firms need to spend further time with their portfolio companies to ensure knowledge of the Guidelines' requirements is embedded in the annual reporting cycle, and that companies seek to continuously improve the quality of the disclosures they provide (note compliance levels still remain

[5] Good practice reporting by portfolio companies, January 2021 – available here
[6] PERG Thirteenth Report, January 2021 – available here

high)[7]. Additionally, where companies are non-compliant with the Guidelines, they have been named as such in the public report.

[7] Compliance by portfolio companies in the sample reviewed remained high at 93% (2019: 100%). 60% prepared disclosures to at least a good standard which is a slight improvement on prior year (2019: 53%) and two companies produced excellent disclosures (2019: One).

Appendix 3 – Provision of non-audit services to PIEs in a PE/VC fund

In 2019 and early 2020, the BVCA engaged with the FRC on its revised Ethical Standard[8] which limits the provision of non-audit services by audit firms to their audit clients that are classified as Public Interest Entities ("PIEs") or Other Entities of Public Interest ("OEPIs"). The standard became effective for PIEs for accounting periods commencing on or after 15 March 2020, and for OEPIs for periods commencing on or after 15 December 2020. This appendix comments on *how* the restrictions will apply rather than the restrictions themselves[9].

BVCA position

The BVCA has always supported measures to improve quality and independence in the audit market. The reason we sought an adaptation to the FRC's initial proposals was to accommodate the fund structures used in our industry so as to not to limit choice for PE/VC firms.

The structure of private equity funds, and the way in which firms invest in and manage businesses, is very different to a typical corporate group. However, the Ethical Standard still applies because private equity funds will typically have controlling stakes in the portfolio companies in which they invest. Portfolio companies are acquired and sold by the fund more frequently than in a corporate group which adds to the complexity of managing independence conflicts as many audit firms will be used. In turn this means that there can be unintended consequences such as delays to a transaction timetable to address independence requirements, even where the threats to auditor independence are limited or non-existent. Private equity firms can therefore be at a disadvantage to corporate groups in a M&A process as it is more difficult for them to impose a change of audit firm or prevent a portfolio company from using an audit firm.

When BEIS implements changes to the definition of a PIE, we need to ensure the outcome agreed below (to address our concerns on choice of auditors) is carried forward into new regulation/legislation.

Structure of a PE/VC fund and its portfolio companies

PE/VC firms typically use a limited partnership to structure funds and an example of a structure is set out below.

- The general partner of the limited partnership fund will delegate its power and authority to the private equity manager (often limited liability partnerships with the partners being the PE/VC executives).
- PE/VC firms will manage one or more funds. The funds are closed-ended meaning that they have a limited life span, the industry standard being 10 years. The life span of a fund can be extended (if permitted in the fund's constitutional agreement) and this is typically up to two additional years.
- PE/VC firms raise capital to invest from sources such as pension funds, endowments, insurance companies, banks, family offices/high net worth individuals and sovereign wealth funds. These overwhelmingly institutional and well-informed investors will be limited partners in the fund and their liability is limited to the capital provided to the fund.

---

[8] FRC Revised Ethical Standard December 2019 – [available here]

[9] In broad terms, the restrictions limit advisory, including tax, services that can be provided by auditors of companies that are classified as PIEs and OEPIs to reduce conflicts of interest and other threats that could impair auditor independence.

- The funds will invest in companies ("portfolio companies") in the earlier part of a fund's life until an agreed date (e.g. 5 to 6 years) and exit investments in the run up to the fund's tenth anniversary. Typically, firms will sell their stake in a company by listing on the public markets or, more frequently, selling to a strategic buyer.
- The fund's ownership percentage in the portfolio companies will vary depending on the PE/VC strategy (e.g. buyout, minority stake).
- Private equity acquisitions will often be partly financed by debt, often provided by a number of banks.
- The portfolio companies will operate independently of each other.

In contrast to a corporate group which, more often than not, will use one firm for the audit of all its group companies, PE/VC structures (i.e. the manager, fund(s) and its portfolio companies) do not operate in the same way. This is described above. In particular, many PE/VC firms do not see it as their role to intervene in portfolio company management's decision as to which firm is engaged as auditors. Hence, it will often be the case that many different firms audit different portfolio companies.

The expansion of the PIE definition will bring into scope portfolio companies, who may have several different audit firms providing services. The portfolio companies and the PE/VC firm would then potentially be restricted in using any of these audit firms for services that it itself is looking to procure (even for the provision of services in relation to an unrelated portfolio company which itself is not a PIE). This restriction on choice is a significant issue as it conflicts with another fundamental point for a PE/VC firm, being their obligation (both contractually under the fund documentation and as a fiduciary acting in the best interests of its investors) to seek support and advice from the most relevant and appropriately experienced advisors. This advice includes due diligence services.

Practical impact of the Ethical Standard

In our engagement on this topic, we did not seek a general exemption for PE-backed portfolio companies (from the non-audit services restrictions) where they themselves are PIEs or OEPIs. However, we did want to ensure that these restrictions did not taint the other entities in a fund structure, including other (non-related) portfolio companies, and the fund manager.

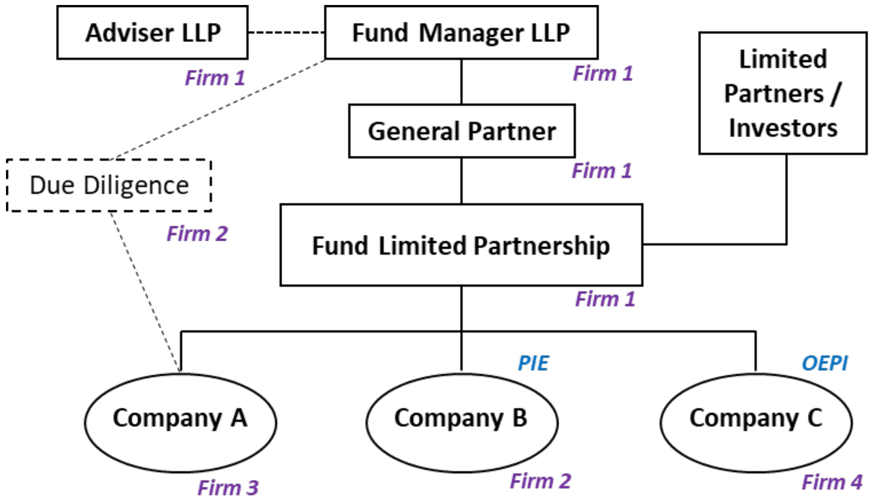
In February 2020, the FRC published implementation guidance[10] which clarifies what the "fund management entities" are in a typical fund structure and this ensures the restrictions on non-audit services are ringfenced to the OEPI in question (amendments for PIEs could not made as that was in legislation).

Some PE/VC firms already have some experience of the current and previous Ethical Standard where there are PIEs in their structures. The OEPI category[11] is a new UK definition and expands the types of companies covered by the Ethical Standard. The definition of an OEPI includes large UK private companies that meet the criteria to report on the corporate governance requirements (UK companies that are not already required to report on their corporate governance arrangements with either: 2,000 or more global employees; or turnover over £200m globally and a balance sheet over £2bn globally). Importantly, this definition excludes "fund management entities which are included within a private equity or venture capital limited partnership fund structure".

[10] FRC implementation guidance, February 2020 – available here
[11] FRC Glossary of Terms (Auditing and Ethics), December 2019, see page 22 – available here

Appendix 3 – Provision of non-audit services to PIEs in a PE/VC fund

The requirements for OEPIs partly follow the non-audit services restrictions applicable for PIEs. The permitted list of non-audit services applies to OEPIs, but the 70% non-audit services fee cap does not. The FRC approach to exclude fund management entities means that the advisor, the fund manager, the general partner and the fund itself based on the diagram below cannot be an OEPI. The effect of the FRC implementation guidance is that whilst technically the fund is the parent of the OEPI, the fund and the other fund management entities *themselves* are exempted from becoming OEPIs.



The BVCA has sought to help members understand the impact of the standard. This does not represent BVCA guidance for the private equity and venture capital industry as the application of the Ethical Standard to a particular fund structure will be fact-specific and early engagement with the relevant auditors is required. The above adaptation of the rules could also apply to other strategies/sectors that operate in a private equity-like manner.

The above adaptation of the rules cannot currently be applied to PIEs as that definition is in legislation. i.e. if the fund management entities already meet the definition of a PIE, they cannot be excluded. Therefore it is crucial that as part of the implementation of changes to the definition of a PIE, the approach taken for OEPIs is carried forward to cover all PIEs.

Appendix 4 - BVCA responses to consultation questions

We have limited our responses to those questions we believe are particularly relevant to our members.

Section 1 – The Government's approach to reform

Section 1.3 – Resetting the scope of regulator

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

We understand the rationale for including some of the largest private companies within the definition of a PIE. In particular, we note that – unlike in a public company – additional mandatory reporting is not required by shareholders in a private company, who are in a position to seek and obtain the information that they need in a format and with the frequency that is decision-useful for them. The needs of wider stakeholders are therefore paramount in this context, and that will affect the criteria that should be used.

In many cases extensive reporting and corporate governance arrangements for larger private companies are already in place, and it would be more beneficial and applicable for private businesses to be governed by these requirements instead, such as the Wates Principles. The Wates Principles are relatively new, and more time is needed to judge their effectiveness before imposing new requirements. As the proposed requirements are designed to better apply to listed companies (who have more resources and experience of extensive reporting), a more flexible and tailored set of requirements for private businesses would be more suitable, similar to the approach taken under the Wates Principles.

Alongside the phased approach for implementation, including the temporary exclusions (from some of the new requirements) for newly listed companies, it would be appropriate to exempt private companies more generally from some of the requirements applying to listed companies, or provide for an alternative approach which is more tailored and less burdensome (e.g. on the internal controls attestation). A much longer phased approach would be needed for high growth companies that are growing very rapidly, as this would give them more time to adjust.

Further consideration may be required on what constitutes 'public interest'. There is a risk that solely relying on turnover and/or number of employees to justify the considerable additional requirements (put forward in this consultation) could lead to disproportionate outcomes, undoubtedly capturing less mature companies that are constrained in the resources they can invest in compliance (e.g. high growth companies). It would also capture private companies in certain industries/sectors more than others, penalising those that employed workers rather than sub-contractors, for example. We would like to input into any further discussions on this point.

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

As set out in our response to Question 1, we believe there is a risk that basing the definition solely on turnover and/or number of employees could lead to disproportionate outcomes, and the Government should consider the significant regulatory costs that will be incurred by private businesses who become PIEs.

Consideration should also be given to the existing reporting thresholds, as well as the threshold proposed in the Government's recent consultation on mandatory climate-related financial disclosures under the

Taskforce for Climate-related Financial Disclosures (“TCFD”). It would be beneficial to ensure a level of consistency in reporting thresholds wherever possible, so that businesses can plan accordingly. Therefore, option 2 is preferable as it follows the approach for the implementation of TCFD reporting for large private companies.

Other factors to consider are set out below:

- *The point at which a company becomes a PIE:* A company may fall in and out of the thresholds over a period of time and further clarity is required on when the company definitely becomes a PIE. Would a company be considered a PIE under option 2 if it were to meet the thresholds at a certain point in time or will this be measured over a period of time? For example, if a large private company met the thresholds of for a period of at least 2 years.

- *PE/VC fund structures vs. conglomerates/corporate groups:* For the purposes of measuring turnover and number of employees in this context, it is important that separate companies are not considered part of the same corporate group merely by virtue of belonging to the same PE/VC fund’s portfolio or different fund portfolios managed by the same manager. It is critical that any change to the PIE definition reflects the specificities of a typical PE/VC fund and does not treat it in the same way as a conglomerate/large corporate group. We recommend that where consolidated accounts featuring separate portfolio companies are not required, as is the case for a PE/VC fund portfolio, those companies should not be treated as part of the same group for the purposes of assessing whether the proposed thresholds apply to them. Each portfolio company within a PE/VC fund is run independently of each other and not managed as a whole and, importantly, they are financially independent so that, for example, one company is not affected by the financial success or failure of another. Portfolio companies’ management will also typically appoint their own auditors, rather than being directed by the PE firm and as such there may be a number of different audit firms appointed across a PE/VC fund portfolio.

- *International structures:* Consideration should be given to the complexities of many businesses’ international structures. International groups with UK entities as parent companies or intermediate holding companies, or with foreign subsidiary operations included in the accounts of UK companies, could potentially be captured by the expanded PIE definition without having large numbers of employees and/or turnover based in the UK. A concept of where the weight of the activities of the company or group is based should be considered when defining any expansion of UK PIE definition. This is the approach taken in the Walker Guidelines as detailed in appendix 2.

The provision of non-audit services to portfolio companies in PE/VC funds that contain one or more PIEs

Considering portfolio companies as separate from the wider PE/VC fund is also critical to protecting their current access to non-audit services and also ensuring sufficient choice when appointing an auditor. The Government and ARGA need to continue the sensible approach taken by the FRC when it expanded its ethical standard in 2019 to include large private companies (set out in Appendix 3). Not doing so would mean that any auditor of a UK portfolio company, or a group of UK portfolio companies, that are reclassified as a PIE, would be prohibited from providing non-audit services outside of the FRC’s Ethical Standard list to any controlling UK parent undertakings of the PIE, and any of its worldwide subsidiaries.

The severe restrictions on choice of service providers would apply in a more complicated manner to PE/VC firms than corporate groups, and would have unintended and costly consequences including delays to transaction timetables. This is not only detrimental for PE/VC firms and the investment process, but also their investors (including pension funds, family offices and foundations) through additional compliance costs required, the financial impact of delayed transactions, potentially lower quality advice if the preferred advisor cannot be used and audit firms taking themselves out of the market. This would also negatively impact the fast-moving transactional nature of the industry, and does not seem in the public interest in a broader sense. This restriction on choice would also conflict with PE/VC firms' obligation (both contractually under the fund documentation and as a fiduciary acting in the best interests of its investors) to seek support and advice from the most relevant and appropriately experienced advisors. We discuss other potential consequences of this change in our response to Question 9.

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?

Yes. If the final package of reforms is proportionate, and do not constitute an onerous regulatory burden for PIEs, then this proposal could help to incentivise international businesses who might consider listing in the UK, giving them time to invest in building the required processes and structures. Lord Hill's recent review of UK listings rightly set out an important ambition for the UK to remain one of the most attractive places to grow and list successful innovative companies. The Government should ensure that the final package of reforms put forward in this consultation supports this ambition and does not deter companies from choosing the UK (even with the temporary exemption).

It is important to note that, given the proposed expansion of the PIE definition, the majority of large UK private businesses who would consider listing in the UK will likely have become PIEs, and therefore already subject to those requirements, diminishing for them the value of the temporary exemption.

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

We do not believe the Government should seek to expand the definition any further than is necessary or as currently proposed in the consultation. We are concerned about how the current proposals would lead to disproportionate outcomes for UK large private businesses, especially as they are focussed on recovering from the pandemic.

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

As we set out in our response to Question 2, it is critical to protect PE/VC firms' current access to non-audit services across their portfolio of companies, continuing the sensible approach taken by the FRC when it expanded its ethical standard in 2019 to include large private companies (set out in Appendix 3). Not doing so would inevitably lead to constrained choice within the audit market and a potential impact on audit quality as explained below.

It is common for PE/VC firms to have several portfolio companies that are audited by different audit firms and have adviser relationships that extend beyond the 'Big 4'. If a PE/VC firm became classified as a PIE, in line with the proposals set out in the consultation, then it would be restricted in using any of these audit firms for non-audit services outside of the FRC's Ethical Standard list (even for the provision of services in relation to an unrelated portfolio company). We therefore need a continuation of the FRC's approach for OEPIs and need to apply this to PIEs as well, otherwise PE/VC firms will either forgo non-audit service provision by one or more accounting firms if they provide audit services to the firm or any of its PIE portfolio companies, or will have to frequently change auditors of the various entities within its structure, with a significant limitation on which audit firms they could appoint.

PE/VC firms want to avoid the situation where there is one audit firm for the entire structure (in order to avoid conflicts) as this reduces the choice of audit firms available to portfolio companies that are operating independently of the PE/VC fund. This could potentially impact audit costs and quality if the relevant firm cannot be easily replaced.

Given the amount of non-audit services provided to PE/VC portfolio companies by both 'Big 4' and challenger firms there is a concern that there would not be an appetite in the market to take on PIE audits, as they would then be restricted in the other services they could provide across the rest of any PE/VC group.

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

We agree that there should be sufficient time provided to ensure that companies can prepare for the introduction of the new rules. This is especially critical for companies that are currently neither considered to be PIEs or OEPIs and therefore have historically not been required to adhere to the more detailed requirements on corporate governance and non-financial reporting.

We would draw special attention to the requirement of company auditors to be independent of their audited entities for periods of up to a three year prior to the first audit report. Given the increase in the number of companies that fall under the definition of a PIE, there is an increased risk that they will need to consider changing their auditor due to non-audit services (that previously were permissible) being performed. It is important that companies have sufficient time to make these changes and do not incur unnecessary additional costs as part of this process.

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

A phased introduction may benefit some companies if it includes a clear and sensible timeframe. The phased introduction may not benefit high growth companies that are growing very rapidly and a longer implementation timeframe for them may be required to give them time to adjust.

Section 2 - Directors' accountability for internal controls, dividends and capital maintenance

Section 2.1 – Stronger internal company controls

Question 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?

There have been several new corporate governance and reporting requirements introduced in the last few years, and we believe it will take time for these to become established. In particular, companies have only had one audit cycle of reporting on their corporate governance arrangements under the requirement introduced for financial years beginning on or after 1 January 2019. Many private companies have adopted the Wates Principles, which include reporting on internal control matters.

For example, under Principle 3 (Directors' responsibilities) the guidance states that "A board should establish formal and robust internal processes to ensure systems and controls are operating effectively, and that the quality and integrity of information provided to it is reliable, enabling directors to monitor and challenge the performance of the company, and make informed decisions. Principle 4 (opportunity and risk) provides that "A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, establishing oversight for the identification and mitigation of risks". The associated guidance refers to the need for the board to establish an internal control framework and agree an approach to reporting and escalation, including appropriate risk management systems.

We believe that the benefits of a framework for internal controls over financial reporting are clear for both directors and shareholders; they include reduced cost of capital due to increased confidence in the numbers and more efficient operations due to standardisation and automation of controls. Perceived issues relate to the cost of change and ongoing cost of compliance. Therefore, we would advise the Government to implement a clear and effective set of proposals, with enough flexibility to accommodate many different types of business and the judgement of the board as to what is most appropriate for their company. Further consultation and input from the business community is required, taking into account the various corporate governance and reporting requirements introduced in the last few years, such as the Wates Principles.

It will be critical to give businesses the appropriate time to fulfil this requirement if it is to be introduced, with appropriate guidance and stakeholder engagement to ensure there is input from business. For private companies, our preference is to let the Wates Principles become more established, and recommend best practice disclosures rather than the introduction of a new regime, as these principles were designed specifically for private companies.

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?

We appreciate the Government's intention to introduce effective mechanisms without imposing excessive burdens and costs on companies. We also support the Government's proposal to phase in extension of requirements to other PIEs.

The option outlined in Table 2 provides a good starting point, subject to the following:

- We believe that there is merit in learning from experience in other jurisdictions. The COSO framework, referenced in the consultation, provides required levels of rigour and is understood globally by regulators, companies and auditors alike. We therefore agree that there would be clear advantages in aligning any new mechanisms to a widely-adopted framework, particularly in the context of large groups, where subsidiaries are already familiar and complying with it.
- Any new mechanism should clearly indicate relevant materiality definitions including for 'material weakness' and 'significant deficiency' and the criteria for reporting such findings publicly.
- We are not clear as to how a requirement for external assurance only after the failure has occurred over several years, as suggested in point 6 of Table 2, would be of any comfort to investors. If an external audit requirement were to be introduced this would impose additional costs and a significant time burden on companies. Whereas listed companies may have well-established internal audit functions, many large private companies would need to create these functions from scratch. If an external audit requirement were to be introduced, private companies would need a lead time to ensure they can recruit new staff and implement the required internal controls.

There needs to be a balance between improving internal controls and not overburdening companies with mandatory processes. If new measures are to be introduced, the Government's preferred option would be the most proportionate approach and in line with other areas, such as section 172 reporting, where the obligation to report will focus the directors' minds on the need to have adequate procedures in place to report against. It is also helpful to companies if any new obligations closely mirror existing requirements – for example if the requirement for the board to report on internal controls could be aligned so far as possible with the section 172 reporting requirements in terms of format, location and other practicalities.

Best practice guidance on both what reports should look like and suggested internal controls would be a helpful tool for companies and ensure they focus on improving controls in the most important areas. This is more likely to promote real and effective change than new obligations on their own, as well as providing clarity and certainty for boards.

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

We would support an approach that is aligned, as much as possible, with other relevant requirements such as the Audit and Assurance Policy and Resilience Statement i.e., a phasing in approach that includes all premium listed companies to begin with, and then two or more years later all PIEs (including whichever additional entities are categorised as PIEs). The idea of phasing-in is also mentioned in more detail in Table 2 of the consultation, which we support.

Section 2.2 – Dividends and capital maintenance

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

The regulator should have the responsibility to reappraise existing guidance on his matter, however we would urge caution against it making significant changes or replacing it altogether. Specifically, ICAEW/ICAS (Tech 02/17BL) is widely accepted as essential guidance for determining realised profits and losses for the purposes of Section 853 of the Companies Act 2006 ("CA06"). It was developed over a significant period of time by a working group with technical expertise and experience in this area, supported by legal counsel.

The current guidance is well-balanced and representative of generally accepted practice, and while lengthy it reflects the complexity of the accounting requirements it needs to address, and its discussion on qualifying consideration aims to define what is realised in cash or near cash in the modern world. ARGA's remit could be widened to include the "realisation test", in line with its overall enhanced role. This would reinforce the status of the guidance and help facilitate closer regulatory supervision of this aspect of accounting.

With regards to the two alternative options proposed, we support Option 1, namely the introduction in CA06 of a statutory reference that companies are to have regard to principles-based guidance on the defemination of realised profits. To be clear we disagree with the idea of moving away from the determination of realised profits by reference to generally accepted accounting principles. We would not support the introduction of binding rules: (Option 2). The latter would need to be highly detailed to address the various situations encountered in practice, and therefore they would be more difficult to update and remain relevant. In particular, defined rules are unlikely to work where there are circular/linked transactions, which can only be considered in the context of principles. Therefore, as long as there is a distributable profits/capital maintenance regime, especially for complex group structures, there are likely to be circular transactions so only a principles-based regime will work.

Question 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?

We would recommend that the requirements are limited to listed and AIM companies. While, in principle, such disclosures could be relevant to all companies, we would not support their extension to a broader group of companies. We have provided further feedback below if the requirements were to capture private company PIEs.

Where a parent company discloses how much of its retained earnings are distributable, this would support an assessment of the legality of dividends. However, as noted in the consultation, in some groups their subsidiaries' profits are distributed to the parent, to allow the payment of dividends. Consequently, the level of the parent company's distributable profits alone may not be representative of its future ability to pay dividends.

We support the flexibility in the proposals to disclose on a 'not-less-than' basis. Making a disclosure on all distributable reserves mandatory would prove challenging and, where records of these payments go back many years, onerous. The costs of making a disclosure of the exact level of distributable reserves could be prohibitive, even for holding companies without their own trading, due to the need to determine if intercompany transactions have taken place and whether elements of the profits are unrealised.

It is possible such a disclosure requirement may push companies to pursue capital reductions, in order to have more certainty over a minimum level of distributable reserves.

We further note that Section 850 of the CA06 allows older profits to be treated as realised, and losses to be treated as unrealised, where the status of the profits or losses cannot be determined after making all reasonable enquiries. The relevant dates to be used for the purposes in this Section go back over 40 years, so there may be merit in revising them.

The consultation also proposes disclosures of estimates of a group's dividend-paying capacity. In our experience, it would be costly and often impossible to get reliable quantified estimates. Distributable reserves are not based on consolidated financial statements, and accounting entries made in a group's consolidated financial statements may not even appear in any individual company's financial statements (even if prepared under a consistent GAAP). In addition, even if this was not the case, evaluation of the impact of impairments of subsidiaries paying dividends may need to be made up the chain of companies in a group.

We support qualitative disclosures on dividend capacity and constraints in paying dividends. As noted above, the level of distributable reserves in the parent is a snapshot that does not necessarily indicate the dividend capacity available in the group. There may be significant barriers to distributing profits realised by subsidiaries to the parent due to the need to maintain adequate capital at subsidiary level, to operate their businesses or as required by local regulations. The FRC's Financial Reporting Lab has published a number of helpful studies in this area in recent years.

With regards to the scope of any new requirements, the consultation explains that 'the rules on dividends apply to all companies alike and are of interest to creditors as well as shareholders.' This is consistent with the proposed scope of the new distributable profit reporting requirements, which we fully support.

Question 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?

We would recommend that the requirements are limited to listed and AIM companies. While, in principle, such disclosures could be relevant to all companies, we would not support their extension to a broader group of companies. We have provided further feedback below if the requirements were to capture private company PIEs.

It is important to note that there is already an implicit assumption that the payment of a dividend is legal, given the requirements of the Companies Act. As such, we question the need to add a director's statement about the legality of proposed dividends into the annual report as it may not provide significant additional comfort to investors, and the company would incur costs to comply with this requirement.

Directors are required to determine whether a dividend will be lawful, before proposing and paying the dividend. This includes ensuring that the relevant accounts show sufficient distributable profits (and other company law restrictions, such as the net assets test for public companies, are met), compliance with their statutory and fiduciary duties as well as common law requirements, including solvency and capital maintenance. Directors are already required to consider not only whether a dividend is lawful, but importantly that it would not create a cash flow problem or contribute to making a company insolvent. The proposed directors' confirmations could re-enforce this behaviour but need to be balanced with the associated costs of introducing new requirements. In practice, it is likely that some directors may seek additional assurance before making such a statement. In principle, there should be minimal additional cost associated with making such a statement, while increasing directors' accountability.

We agree with the requirement to state that the dividend is consistent with the Resilience Statement ("RS"). The consultation suggests that the RS might require a statement on sustainability of the company's dividend and wider distribution policy. More broadly, in making the RS, the directors will need to consider whether the company has retained sufficient capital, and has access to other sources of finance, to enable it to continue financing its business, deal with the uncertainties and the possible shocks to which it is likely to become exposed in future, as well as the sustainability of the business model and its investment needs. The proposed directors' confirmation will be most effective if high quality guidance supports the RS, including on assessing the resilience of a capital management framework in the context of the business model, risk appetite, regulatory and other external constraints and developments, including the impact of climate change. This could also provide non mandatory guidance to inform confirmations made by directors not required to prepare a RS.

The consultation did not clarify a number of elements, such as where the statement would be made. Dividends may be made at any time and the assessment of legality can only ultimately be made at the time of approving and making the dividend. Consequently, it seems unlikely that the disclosure would be included in the annual report. However, it is unclear whether this is a private statement to be minuted or to be filed with the Registrar.

The statement also refers to the 'directors' reasonable expectation that payment of the dividend will not threaten the solvency of the company over the next two years' and that 'where relevant, directors should also confirm that the dividend is consistent with the Resilience Statement'. We envisage that further guidance may be required to support directors in making such a statement. The wording differs in certain respects to existing solvency statements made, for example, in connection with capital reductions (section 643) and is more judgemental, with terms such as a 'reasonable expectation' and 'threaten the solvency'. The statement also covers a longer timescale (two years rather than a year from the date of the statement). The consultation does not explain the reason for the two years (which does not fit with the timescales set out in the RS, i.e. 1-2 years for the short-term, including the going concern statement, and 5 years for the medium-term).

It would also be important to clarify the legal implications of making such a statement, as well as its scope. This is important because distributions can come in much wider forms than dividends. For example, share buybacks, transfers of assets at an under value, intragroup debt waivers, etc. Clarity over scope will be particularly important if the legality of a dividend depends on making the statement.

It should be noted that if all directors are required to sign a statement, they will necessarily need to rely on financial information put to them by the internal accounting function and the CFO. As such, directors should not be strictly liable if in fact the company does become insolvent in the next 12 months as long as they acted reasonably in signing the statement. Otherwise this creates a disproportionate risk for non-executive directors in particular who are not involved in the day to day operations of the company.

A failure to sign a statement should not invalidate a dividend, but could be a standalone breach. This is because it creates a disproportionate burden where dividends are illegal and void on the basis of a failure in the process even though the company does in fact have sufficient reserves: this is evidenced by the current practice where public companies must file interim accounts at Companies House before paying a dividend. Failures to make this filing have on many occasions led to extensive steps (and costs) to unwind both the initial dividend and further steps that have been carried out in reliance on the dividend being valid. For example, if a dividend is paid by a subsidiary at the bottom of the chain, there might be a series of dividends to move the funds up through the chain. If the first dividend is void then so might all the others be.

Question 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?

The requirement to include section 172 reporting disclosures is relatively new and has led to improvements in this area. However, while some companies explain distribution and capital allocation policies well, this is not universal practice and more time is needed for the s172 reporting requirement to be embedded. In terms of scope, given this information is of most interest to investors, it may be sensible to limit such disclosure initially to AIM and listed companies.

Section 3 – New corporate reporting

Section 3.1 – Resilience Statement

Question 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?

Noting our comments above about the need to calibrate the reporting regime for private companies, we note that are merits in the proposal for a Resilience Statement that consolidates the Going Concern and Viability Statements. Some level of prescription on the nature of matters that should be captured could be helpful, where these do not cause commercial sensitivities. However, a better approach would be for companies to decide upon the most relevant and material matters.

Some PE/VC firms have to prepare an ICAAP under UK financial services regulation (in future the ICARA) and the matters that need to be included are similar to those proposed for the Resilience Statement, except that the proposals include a requirement for two reverse stress test scenarios (whereas there is one required in an ICAAP). We do question the need for two reverse stress tests and would want to understand the differences that should be considered when undertaking them. We would further recommend some detailed guidance around the application of the reverse stress tests and scenario analysis. This will support companies to help ensure an appropriate and more consistent level of robustness as well as comparability between reporters.

We recommend that for the medium-term section, the mandatory assessment period is limited to three years as this is the planning period that companies typically adopt. Beyond three years it is difficult to predict the risks posed by the company or any changes to the business model. Also long-dated outlooks by definition are based on significant judgements where the greatest uncertainties lie and therefore the potential for divergence in real outcomes. It is important to ensure that directors are not judged (and subject to risk of enforcement) on such outcomes. Mandating a five-year assessment period is unlikely to result in any greater clarity of disclosures as three-year plans will be subject to extrapolation to arrive at a five-year plan. The long-term section may include generic/boilerplate statements without further guidance.

We also believe that Climate Risk assessment should not be included in the short- or medium-term sections of the Resilience Statement as this risk needs to be considered over a much longer-term outlook period.

On Climate Risk reporting, we recommend that TCFD reporting continues to be stand-alone as that would enable more focus on climate risk, as the nature and scale of potential impact to a company is typically over a much longer period than what is envisaged for the RS.

We are also supportive that the outcome of the Resilience Statement is published, however, would like to caution on the level of information that is included. We would recommend that the published information is similar to Pillar 3 disclosures required by financial services firms that provide an overview of the ICAAP process and does not include detailed information on assumptions used such as for stress and reverse-stress tests as these are judgmental and may confuse the reader or invite more questions from stakeholders that may not fully understand the business model or risks of a company.

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

We agree and are supportive that there should be clear correlation between these disclosures where appropriate (i.e. where climate change is a real threat to the resilience of the business). However, these disclosures should not be integrated, as it will either risk drowning out other significant resilience matters and/or reduce the clarity and focus of the TCFD disclosures. Further, TCFD will evolve through regulatory changes and so should remain separate to the Resilience Statement and included in the Strategic Report as was proposed in the recent BEIS consultation.

Question 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?

Yes, we agree with both proposals.

Section 3.2 – Audit and Assurance Policy

Question 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?

We welcome the proposal for companies to have an Audit and Assurance Policy ("AAP") as it can help resolve confusion on how assurance is sought through various channels (including the report on internal controls, internal audit, external audit).

We would suggest clarification on the types of assurance this policy would cover and whether it is intended to cover just financial reporting requirements or extend to the effectiveness of systems for handling risk and internal controls.

We are in agreement with the proposed minimum content of an AAP, however the requirements of the AAP should involve some flexibility to allow companies to tailor the report to their individual circumstances as well as outline any future aspirations when it comes to assurance. This will help avoid the policy becoming a 'boilerplate' document that does not add value.

Question 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?

We would recommend further clarification of the purpose of an "advisory" shareholder vote and how it would work in practice for private companies (indeed whether it is needed at all). For listed companies, shareholders would generally rely on views from shareholder proxy voters (e.g. in case of remuneration policies). This can create another level of confusion and uncertainty where such groups may not fully understand a business and therefore form a view on particular topic which may not be beneficial, such as the level of internal audit assurance sought or the level of resources dedicated to assurance which the company may be best placed to decide upon.

We believe that annual publication and voting would not allow sufficient time in the reporting cycle for consideration of shareholder (in the case of listed businesses) and other stakeholder (for all types of businesses) reactions to the AAP, for further policy development and proper engagement prior to an AGM. For listed businesses, we propose that the AAP is presented at the AGM and the board or management then address any shareholder queries. – i.e. not a "formal" vote – advisory or otherwise. This allows shareholders to raise questions with management on the AAP but not require the company to revise the AAP annually.

We recommend that the AAP is revised every 3 years unless there are material changes in the intervening period, to which the board could vote annually. The board would ultimately have discretion on the revision timeframe.

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

We support the principle that it is important that companies are providing transparency to key stakeholders on the level and nature of assurance obtained. As stated previously, companies will need appropriate time to implement these changes, especially for private company PIEs given their starting point might require more work to implement the changes.

Section 3.3 – Reporting on Payment Practices

Question 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?

We support the approach to improve supplier payment reporting and believe this will help smaller suppliers who themselves are less able to obtain working capital funding from financial institutions.

We consider that in addition to the existing requirement for subsidiaries to disclose information under the Payment Practices Reporting Duty that supplier payment information should be reported on a group basis within the Strategic Report. However further consideration is required on how this is phased in for groups with international businesses that currently do not report on this information. The performance over the last 12 months plus prior period comparative information should be included to ensure trends in supplier payments are evident to stakeholders.

Question 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?

We believe this should only apply to PIEs that are required to report under the Payment Practices Reporting Duty.

Section 3.4 – Public Interest Statement

Question 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?

We are in agreement with the decision not to introduce an annual public interest statement. The background in the consultation response sets out the sensible reasons why this statement is not needed at this time and we believe that a well thought out s172 statement within a set of financial statements would cover much of this disclosure. Therefore we feel it would be more beneficial to improve the quality of those disclosures rather than introducing new requirements. Further, new requirements, especially where they might be seen to be duplicative, will place significant burden on company directors considering the other requirements being raised as part of this consultation.

Section 4 – Supervision of corporate reporting

Question 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?

We support the broad principles of the proposals in this area and note in particular section 4.4.1 with regard to promoting brevity, comprehensibility and usefulness in corporate reporting. Whilst good quality information for investors is critical, we consider that too often this is lost in the voluminous output of annual reports which neither helps investors nor the companies that are required to produce this level of information. This is often not used by investors or other stakeholders and therefore generates considerable unnecessary costs and burden on companies.

Whilst extending the Corporate Reporting Review ("CRR") to the whole of the annual report may seem logical, there are a number of voluntary disclosures included in these "front half" sections and so we question the cost-benefit of the CRRs for these sections.

We would be concerned if ARGA was given the ability to change a company's report and accounts as there would be judgements used which can differ between the regulator, auditor and company. The regulator may not have all the information to provide a substantive view and further consultation may be required here. We also disagree with publishing CRRs as that can undermine the business model or result in proprietary information (such as specific structures) being available to competitors.

Section 5 – Company directors

Section 5.1 – Enforcement against company directors

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

Overall, the approach proposed in this section is problematic. It significantly risks people not being prepared to take on non-executive roles, thereby affecting the quality of available candidates. This is particularly critical in heavily regulated sectors such as financial services, given the already heavy regulatory expectations. We also think it will place an additional onus on those directors with financial expertise (especially CFO and audit committee chairs), as well as making it harder to find generalist non-executive directors to join audit committees.

It seems likely that the expansion of the definition of PIE will have a similar effect on the availability of high-quality directors for portfolio companies owned by private equity managers/asset management companies. It is also of concern that there may not be a clear route for directors who join a company and "inherit" a control framework to demonstrate they have appropriately discharged their duties if that framework is subsequently found to have deficiencies that pre-date their joining but affect ongoing operations. Given that the proposals now cover all directors rather than just chair, audit committee Chair, CEO and CFO, this could discourage non-accountants to take on non-executive roles.

With regard to this particular question, we consider that in general, overlapping powers should be minimised to the extent possible. Where overlap is unavoidable, we consider that a clear and comprehensive memorandum of understanding between the ARGA and FCA will be vital in giving companies and directors clarity and certainty, and in avoiding the increased costs that would arise from parallel investigations and/or enforcement proceedings.

We note the Government's intention (stated in paragraph 5.1.14 of the consultation) that ARGA's new civil enforcement regime for PIE directors will not replace existing arrangements for taking action against company directors (for example, for offences under the Companies Act 2006). We are concerned this may lead to difficulties in practice if, for example, an offence under the Companies Act 2006 could lead to parallel criminal and civil proceedings by separate agencies. Therefore, if any of ARGA's powers overlap with those of any other agencies (e.g. the Serious Fraud Office or Insolvency Service), it will be equally important to establish memoranda of understanding between ARGA and those other agencies.

We agree with the Government's decision not to introduce an authorisation scheme, as referred to in paragraph 5.1.12 of the consultation.

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

We do not think that any additional duties, beyond those identified in paragraph 5.1.21, should be in scope of ARGA's enforcement powers. If the government proposes to include any additional duties in scope of ARGA's enforcement powers, we think they should be subject to separate, detailed consultation at the relevant time. We consider that it will be very important for ARGA to apply the proportionality principle (mentioned in paragraph 5.1.19 of the consultation) when exercising its enforcement powers, and to provide clear guidance on how it would seek to apply the principle in practice. We are concerned that the new enforcement regime for directors could deter good candidates (especially those from non-financial backgrounds) from applying for board positions. Providing robust guidance on how the proportionality principle would be applied in practice, should help to mitigate this.

Question 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?

We agree with the statement in paragraph 5.1.23 of the consultation that the statutory duties relating to corporate reporting and audit are not designed for enforcement by a regulator. We think it will be very important for ARGA to provide clear and detailed guidance on how all director duties in scope of its enforcement powers are to be met by directors, and on how ARGA will seek to exercise its enforcement powers in practice (including by reference to the proportionality principle mentioned above). We believe that, until this guidance is provided, it would seem inequitable to commence enforcement.

Question 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?

Given the potential complexities in this area, we think it is difficult to provide a meaningful response without further specific detail on what the proposed behavioural standards might be.

However, by way of general comment, we would note that directors are already subject to wide-ranging duties under statute and common law, which are well-established legally and generally well-understood by directors and their advisers. We have some concern that introducing new behavioural standards designed to overlay certain of these duties risks creating areas of overlap and/or conflict, and thereby uncertainty (which, among other things, may have the effect of deterring good candidates from applying for board positions). Depending on the extent of any new behavioural standards, there is also the (highly undesirable) potential for directors to face situations where a proposed action needed to meet a behavioural standard might constitute a breach of statutory or common law duty (or vice versa).

We therefore consider that, if the government proposes to introduce any new behavioural standards, they should be subject to further, detailed consultation at the relevant time and that ARGA should provide clear and detailed guidance on how any new standards should be applied in practice and how ARGA would seek to enforce them (in particular, with a view to avoiding conflicts or potential conflicts with existing director duties). Anything that might be introduced should be considered carefully in light of existing Companies Act and common law obligations to ensure there is not inconsistency of requirements.

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

While we are generally supportive of the government's aim to give ARGA meaningful enforcement powers, we have some concern that granting ARGA enforcement powers in relation to director duties, risks creating significant conflict and uncertainty.

As noted above, directors are already subject to wide-ranging duties under statute and common law, which are well-established legally and generally well-understood by directors and their advisers. The courts and existing legal system provide consistency and sophisticated procedural checks and balances. Granting enforcement powers to ARGA in this area would be a fundamental change to the existing legal system and would give rise to the risk that ARGA and the courts make conflicting decisions/judgments in relation to the same alleged breach by a director. The uncertainty created would undermine confidence in the existing system and (amongst other things) may have the effect of deterring good candidates from applying for board positions. If ARGA is to be granted such powers, it will need to adopt sophisticated and transparent procedures (including efficient appeal procedures) for dealing with cases. It should also provide detailed guidelines on how it will exercise its powers and (importantly) minimise the potential for reaching decisions that may conflict with the outcome of any parallel court proceedings.

We would welcome the opportunity to comment further on these proposals when additional details are available.

For the avoidance of doubt, we assume the government only proposes to give ARGA enforcement powers in respect of the director duties specified in paragraph 5.1.21 of the consultation. We do not consider that it would be appropriate for ARGA's enforcement powers to extend to director duties more widely.

Section 5.2 – Strengthening clawback and malus provisions in directors' remuneration arrangements

Question 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?

We do not propose to comment on this matter specifically, but as a general matter we do not consider that any other conditions should be considered for the proposed minimum list of malus and clawback conditions. It is important that the proposed list of minimum triggers are given careful consideration and that they make clear they only relate to serious matters. There is a risk that misconduct for example could cover trivial and irrelevant matters. Companies could perhaps be given the freedom to adapt the triggers to their own circumstances, based on guidance produced by the regulator.

Section 6 – Audit purpose and scope

Section 6.4 – Tackling fraud

Question 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.

The design of sufficient and appropriate audit procedures to detect and identify material fraud is a current requirement within a statutory audit and therefore we consider the proposals to be aligned with this. However we would note that there should be careful consideration placed on facts known after the event with regard to the level of "culpability" assigned to auditors in cases where fraud is perpetuated.

Any additional requirements should be limited to actions taken to prevent and detect material fraud that impacts financial reporting. It would be a significant increase in scope and cost for directors to report on, and auditors to consider, controls to prevent and detect all fraud across an organisation.

Financial reporting controls are predominantly used to stop error or fraud. Requiring auditors to report on the accuracy of the director's statement on of financial reporting controls will effectively require them to report on almost all financial reporting controls. It will be important that this is not confused with the internal controls proposals (in chapter two) that recommended that audit committees and shareholders decide on whether internal control effectiveness statements are subject to assurance.

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

Question 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?

We agree that specific assurance on APMs and KPIs, beyond the scope of the statutory audit, should be decided upon by companies and shareholders through the AAP. Such metrics are key to the effective reporting of the performance of a company and are intrinsically linked to the statutory financial reporting of those companies. Whether the statutory audit also covers the assurance of such metrics, is a matter for the company and its shareholders to decide upon e.g. the level of assurance required on such metrics.

Section 6.8 – Auditor liability

Question 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?

Typically statutory audits have continued to apply unlimited liability as a result of historic practice and the additional requirements of changing the approach. Whilst liability should be proportionally applied in all cases, after the event, we consider that there could be an adverse impact on the confidence placed in statutory audits where investors and other stakeholders perceive that the impact on an auditor is limited to an amount that is not seen as being "fair".

Section 7 – Audit Committee Oversight and Engagement with Shareholders

Section 7.1 – Audit Committees – role and oversight

Question 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?

We do not agree with this proposal and if it is taken forward, a consultation process on any new powers and new requirements would be needed as there is little detail in consultation. The principles-based approach in the current regime ensures audit committees consider matters relevant to the specific business in question.

Question 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?

Further information on how ARGA will implement the proposed powers is needed to answer this question effectively.

Section 7.3 – Shareholder engagement with audit

We note the proposals in this section will be applicable to premium listed companies in the first instance but could be applied to a broader group later, including private company PIEs. Our comments are provided in this context.

Question 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?

In the context of PIEs that are large private companies, the majority of our members' investments into businesses will result in board representation and/or communication and reporting as a majority shareholder, which results in sufficient board and shareholder alignment. We believe any requirements being implemented need be proportionate and relevant for private companies. In a listed context, new requirements need to be mindful of a small minority of shareholders detracting from key/significant issues.

Question 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?

In a private company context, there is a closer relationship between the PE/VC investor/shareholder and audit committee chair and auditor. In a listed company context, greater participation by the audit committee chair and audit partner at the AGM could increase the focus of responsibility of these roles. However, in practice the detail of any requirement needs to be well thought through to make participation worthwhile for listed companies as the legal liability consequences might result in pre-prepared concise responses which avoid depth of understanding for the shareholders. In principle, we agree with the proposals but would question how in practice they would be implemented and how they might work.

Question 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?

We believe the existing provisions covering the resignation, for whatever reason, of an audit firm from a PIE audit are adequate to inform shareholders. We also note that shareholders already have powers available to them to require the directors to hold a general meeting in response to an auditor resignation or dismissal should they wish to discuss such matters with the company's board.

Section 8 – Competition, choice and resilience in the audit market

Section 8.2 – Operational separation between audit and non-audit practices

Question 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?

We do not have a strong opinion on this area and would like to point to our feedback on the provision of non-audit services in appendix 3.

Section 9 – Supervision of audit quality

Section 9.2 – Monitoring of audit quality

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

We would support the exemption of commercially sensitive information to the audited entity (which could impact on their competitive position) being excluded from the AQR reports. We would also support the exemption from disclosure of any personal information that could impact on individuals within the audited entity and the auditor.

Question 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?

Please see our response to question 70.

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

Question 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?

Legal professional privilege is a fundamental right, the premise of which is that parties should be free to communicate with their lawyers, or to prepare for litigation, in absolute confidence, unless they specifically choose to share their privileged communications with third parties. We would caution against the Government removing this right, even if it is restricted to the provision of documents to ARGA that have been provided by the audited entity to the auditor as part of the audit.

We are concerned that regardless of the safeguards or restrictions that are put in place, once privileged documents have left the hands of the person to whom the privilege belongs, and have been shared with a third party such as ARGA, there is no guarantee that the documents will not be disseminated further (e.g. under ARGA's enforcement processes) and find their way into the public domain as a result (and that the privilege in them will therefore be lost as against the rest of the world, too).

The best solution would be to retain the current position where it is at the audited entity/client's discretion as to whether it is prepared to waive privilege in its documents as against ARGA and, if so, on what terms. Otherwise audited entities may, as the consultation paper recognises, feel constrained in their ability to seek legal advice or, more likely, become very wary of sharing that advice with their auditors, on the basis that it may subsequently make its way to ARGA.

Section 10 – A strengthened regulator

Section 10.1 – Establishing the regulator

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

We are broadly supportive of the objective. However ARGA's powers, and in particular how far reaching or restrictive its powers are, how much discretion it has, and its overall operation as the 'improvement regulator' that the Kingman Review obliges, will need very careful consideration as well as consultation.

Question 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?

We broadly agree with the regulatory principles set out for ARGA in the consultation paper. Additionally, there is a need to build in proportionality and for ARGA to be an improvement regulator. In that regard, the regulator needs to consider the way in which it discharges its regulatory responsibilities. The FRC has historically focused on deficiencies and enforcement. In contrast, ARGA has the potential to become a globally respected improvement regulator.

To be a globally respected improvement regulator and raise the overall standard of corporate governance, reporting and audit quality, careers at ARGA need to be attractive enabling it to recruit some of the best talent and experience in the market.

It is also important that ARGA takes a collaborative approach working with businesses, the audit profession and government agencies. Businesses and audit firms may not always know what the regulator expects of them, particularly where subjectivity in reaching conclusions is considerable. ARGA could articulate its position with positive consultation, enabling businesses and the audit profession to reach conclusions that achieve worthwhile outcomes in the quest to restore trust in business and in audit.