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The BEIS Committee's inquiry on the future of audit

This is a joint response from UKSA and ShareSoc on behalf of individual investors.

UKSA and ShareSoc represent the interests of private shareholders. In addition to our own members, there are 5 million people who own shares and have investment accounts with platforms in the UK. The Office for National Statistics estimates that individual investors own 12% of the UK stock market by value. In addition to this there are many more who have money invested in shares via funds, pensions and savings products such as employee share ownership schemes.

Our view is that:

1. The Siren voices of vested interests arguing for limited change should be dismissed.

2. The Quality of audits is the issue which concerns us most. The current approaches are not working. Radical alternatives should be considered.

3. Peer Review of FTSE 350 audits by challenger firms would be a particularly good idea, which should improve the quality of audit. The emphasis should be on reviewing of the key assumptions, not on duplicating low level admin tasks. 10% of FTSE 350 companies should be nominated for peer review in year 1 and 25% in year 2 of this new policy, starting with effect from year ends 31 March 2019 onwards.

We also draw attention to fundamental causes of the ineffectiveness of the shareholder vote on auditor appointment - namely, the lack of rights to disenfranchised beneficial owners and the failure of those intermediaries who hold those rights (institutional investors and fund managers) to exercise them in effective stewardship. The term "ownerless corporation" was coined at least 20 years ago, and the situation has got steadily worse[1]. The problem has attracted limited attention from policymakers. It suits the financial services sector, a powerful lobbying resource in its own right, to leave things as they are.

Our answers to your specific questions are shown below. We have also appended copies of our submissions to Sir John Kingman and to the Competition and Markets Authority.

[1] We would recommend the committee to watch Lord Myners' 2018 Autumn Address to the Institute and Faculty of Actuaries entitled "in investment how do we define long term?", available at https://www.youtube.com/watch?v=9nYJExU9Tn4

1. *What is the relationship between competition and quality in the audit market? How should reforms in one area complement the other?*

There is no necessary link between increased competition and improved audit quality. This fact notwithstanding, it is appropriate that there should be competition in the audit market and that users of audit services should have a reasonable choice of providers.

The Big Four are effectively an oligopoly; they undertook 97% of FTSE 350 audits in 2017. Recent audit failures provide strong evidence that audit quality is sometimes demonstrably poor. The FRC's AQR process has also identified far too high a percentage of audits that they rate as not good enough. In the case of KPMG this is in excess of 30%. However, the issue is not only one of audit quality and competition – or lack of it. There is plenty of evidence that current requirements surrounding statutory audit are not fit for purpose.

Lack of competition and the absence of meaningful third-party oversight of audit standards and / or a lack of serious sanctions for audit failures can all contribute to an erosion of quality standards. There is always a risk that competition will encourage providers to skimp and cut quality in order to keep prices down at the expense of quality. This is one reason why we are particularly keen on the peer review proposal discussed in 2.5 below. Disturbingly, however, research by the consultancy firm Proxima suggests that audit firms may be 'low-balling' their audit bids with the intention of increasing fees once they have won the contract[2]. Companies that switched their audit provider in the five years from 2013 found their fees rose by 45% on average. Fees for those who remained with the same auditor rose by an average of 38% over the same period.

A further vital distinction needs to be made between 'quality' and 'fitness for purpose'. Quality is relative; some audits will always be of poorer quality than others. Fitness for purpose, however, is absolute. If the procedures and processes that govern the statutory audit are not fit for purpose then all statutory audits will be fundamentally flawed. The quality of output may be excellent but, because if fails to meet the needs of the key stakeholders, it is a largely pointless exercise – and a waste of money.

Audit quality cannot be judged in isolation. The subject of the audit, the financial statements and the Annual Report itself, are further crucial factors requiring consideration. The Annual Report, a key document upon which shareholders make judgements about the performance and future viability of the company, is not fit for purpose. Annual reports are often too long, full of 'boilerplate' provided only for compliance purposes, contain more marketing 'puff' than factual analysis of performance and prospects and are often repetitious while also managing to omit key information which would be useful to shareholders. They are also, in some cases, presented in a way that makes them difficult to read (particularly in electronic format). Furthermore, the front (narrative) part of the annual report is not audited – even in areas which ought to be auditable, such as the appropriateness and consistency of performance metrics.

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[2] Financial Times 19.12.18 – UK blue-chips face higher fees by switching auditors.

The question of audit quality, therefore, is a complex one which is influenced by many factors. The level of competition is, in many respects, one of the less important ones.

Lest there should be any doubt about our view of audit quality, we believe that it fails to meet investor requirements by a significant margin. It is a matter of sheer luck that there have not been more audit failures recently. These failures result from a mixture of poor audit quality and a lack of fitness for purpose in relation to the depth and scope of the audit.

2. *Do you agree with the CMA proposals (when published)? Will the remedies proposed be likely to increase quality and trust in audits? Are there any potential unintended consequences?*

The CMA's Update Paper suggests four main remedies for improving audit quality. The recommendations put forward by the CMA are appropriately radical and most welcome. The picture that emerges of the audit market and the way in which large public companies procure audit services is less than flattering. It confirms that investors are right to be concerned.

Some of the recommendations made by the CMA depend for their implementation on the implementation of many of Sir John Kingman's proposals for the Regulator (the FRC). For example, the oversight of audit procurement and the management of audit contracts by the Regulator can only work effectively if the Regulator is properly empowered, resourced and funded as suggested by Sir John.

Our comments on each of the main four proposals in the Update Paper are summarised below.

2.1. **Regulatory scrutiny of audit committees**

The CMA's investigation into auditor appointment suggests that it leaves much to be desired. It indicates that while audit procurement has a veneer of rigour it falls well short of being professional. For example, although sound criteria are used for assessing tenders from auditors, the weighting of key criteria, such as price, are unclear. It also seems that there is often significant intervention or involvement in the process on the part of the executive directors (including the CFO). This represents a very clear conflict of interests. Coupled with this, there is an almost total lack of input on the part of investors and other key stakeholders.

We are supportive, therefore, of the CMA's view that there should be greater regulatory scrutiny of auditor appointment and management. The requirement that audit committees should report directly to the regulator before, during and after a tender selection process and that the committee should report regularly to the regulator throughout the audit engagement may sound draconian. However, the time is past for fiddling around the periphery while basically maintaining the status quo. We believe that the CMA's proposals merit serious consideration. <u>The Siren voices of vested interests arguing for limited change should be dismissed.</u> We comment further on this in relation to Sir John Kingman's recommendations in 5.3 below.

2.2 Breaking down barriers to challenger firms

2.2.1 Mandatory joint audit. The CMA review reveals that the Big Four audit firms undertook 97% of FTSE 350 audits in 2017. Intuitively this feels unhealthy from an investor point of view. Audit is hardly a capital intensive industry with high intrinsic barriers to entry – although the larger firms and their clients have made a good attempt at making it so by stressing the importance of global reach. This stranglehold could be further tightened as the use of sophisticated analytical systems based on 'big data' sweep into the audit market. A way has to be found of ensuring that mid-sized and smaller audit firms are not further excluded from the audit market for FTSE 350 companies.

We support the concept of joint audits for most FTSE 350 firms. Not only should it help to improve competition in the audit market, it also has the potential to improve audit rigour. For firms outside the FTSE 350, joint audits should be optional. Even if this increases the cost of audit by, say, 35%, it is likely to be a price worth paying if it improves audit robustness and reliability. When large investors are happy to sanction multi-million £ bonuses for directors in return for very average performance, there can be few reasons for quibbling over an increase in audit fees to achieve greater reassurance.

It is however, worth noting that average remuneration per partner is considerably higher at Big Four firms than at the challenger firms. Greater use of the challenger firms may mean that the overall cost of audit can be contained or reduced or that the audit could embrace more work for the same level of fee.

Although it is a point of operational detail, the use of 'lotting' for audit procurement might be appropriate. This is widely used for framework agreements in public sector procurement. In the case of audit, the overall audit contract could be split into at least two lots. The regulator could provide guidance on appropriate lotting structures. Bidders would be able to bid for one or more lots. At contract award at least two firms would have to be awarded work covering different lots. At least one firm would need to be a 'challenger' – as the CMA recommends.

This approach would give companies more flexibility in deciding how to structure their audit contracts to meet their own specific needs. It would also encourage them to think innovatively. Coupled with the audit committee oversight requirements from the regulator outlined in 2.1 above, there should be limited scope for the process to be subverted to compromise the wider purpose and objectives of the CMA's recommendation.

2.2.2 Market Share Cap. We agree with the CMA that, whilst this is a viable option for encouraging greater market participation by the mid-sized and smaller audit firms, the joint audit solution is better. The joint audit is less interventionist in terms of the working of the market for audit services and it has the likely advantage of ensuring better audit quality.

2.2.3 Additional Measures to support challenger Firms. These are all interesting proposals. Given the mixed reception that they have received, we concur with the CMA's conclusion that they should held in reserve for further consideration if necessary. We do agree, however, that limiting the duration of non-compete clauses for partners when changing employers would be appropriate.

2.3 Market resilience. We agree with CMA that this issue requires further consideration. We do not have any specific proposals to add at this stage.

2.4 Full structural or operational split between audit and non-audit services. We fully support this proposal for reasons outlined in 4.2 below. We accept the CMA's conclusion that it would be difficult to achieve, particularly in relation to firms' international networks. However, just because it is difficult is not a valid reason why it should not be done. Difficulty of implementation should not become an excuse for inaction. We believe that splitting audit from 'consultancy' is such an important issue that it must be implemented. There is also the possibility that if the UK takes a lead in this matter it will prompt change in other countries around the world.

If concerns about culture are one of the key justifications for suggesting a split, then it is very difficult to argue that any such split should only apply to the Big Four firms. Quite apart for the fact that is seems manifestly unfair that this ruling should only apply to the Big Four, it also raises questions over what happens as some of the challengers start to grow and expand as they gain greater access to the audit market for FTSE 350 clients.

2.5 Peer Review

We agree with and support your provisional view is that peer review would be a useful remedy as part of the regulator's toolkit. [3]

Peer Review of FTSE 350 audits by challenger firms would be a very good idea. The emphasis should be on reviewing the key assumptions, not on duplicating low level admin tasks. We suggest that 10% of FTSE 350 companies should be nominated for peer review in year 1 and 25% in year 2, starting from year ending 31 March 2019.

3. *Do you agree with the Kingman proposals regarding the FRC (when published)?*

We agree in principle with all Sir John Kingman's proposals with on exception. We do not believe that abolition of the Stewardship Code is an option. The Code must be radically overhauled and made to work. Sir John's recommendations for strengthening the FRC while, at the same time redefining its role and remit, provide a sound basis for this. We discuss this further in section 5.3 below.

There is also a comment by Sir John in his letter to Greg Clark MP which we find surprising, to say the least. Sir John in his 'Case against' (change) states:

> '*Many believe very strongly that it is an inherent right of the board to appoint an auditor. (Typical comment, from one of the Big 4: "Any proposals which would result in the Board not being directly accountable for the appointment of auditors would run the serious risk of 'moral hazard' and undermine the concept of the joint stock company governed by a unitary board").*'

The reality is that currently the Board alone does not appoint the auditors. The shareholders have to approve the appointment; so it's a joint effort. It makes no sense for the Big Four to complain about moral hazard. Any moral hazard arises because the Board are indeed unfettered because the

[3] CMA Update Paper; page 124 - para 4.139

shareholders (that is to say the fund managers and institutions) pay no attention to their responsibilities. They do not act like real shareholders. They are merely agents managing other people's money. With few exceptions, their attitude to many 'shareholder responsibilities' is one of indifference and complacency. Indeed, there is plenty of evidence to show that, contrary to the perfectly appropriate requirements of Section 172 of the Companies' Act, companies are in many cases run in the interests of those managing them. The principle of stewardship has been forgotten.

This is a further reason why the Investment Association's opposition to the radical change that Sir John has proposed with regard to the appointment and management of auditors should be dismissed.

4. *To what extent do conflicts of interest undermine trust in audit? How best can they be removed or mitigated?*

We have identified two particular areas in which conflicts of interest undermine trust in audit. These are discussed below.

4.1 **Appointment of auditors by boards of companies they audit**. The auditors are supposed to look after the interests of the shareholders. Unfortunately, at present the shareholders have no input to the appointment of the auditors. The auditors are appointed by the company's audit committee which allows plenty of scope for influence of the appointment from the executive directors. The CMA Update Paper confirms that this happens. These are the people who are having their homework marked by the auditor. They have every incentive to choose an auditor who will take a relaxed approach in exercising their 'professional' scepticism. It is also worth noting that the contractual relationship is between the company (the executive directors) and the audit firm. This reinforces the perception that 'He who pays the piper calls the tune'.

In many cases the way in which certain items in the accounts are presented will be influenced by the large bonus payment that directors stand to gain by achieving predefined outcomes. Challenging the way in which these items are presented and treated in the accounts is not something the directors are likely to welcome. There is clear evidence that, in the case of Carillion, it made good sense for the directors to want to retain goodwill valuations in the accounts that should have been written down sharply some years ago. In effect, assets were being maintained on the balance sheet at their original valuation long after they had become almost worthless. However, writing them down would have hit the P&L statement and might have called into question much sooner the Company's ability to go on paying large dividends. It has to be assumed that the auditors raised these (and other) issues. However, far from taking a firm line on them the auditors appear to have acquiesced to management's wishes.

It should be noted also that, not only do the shareholders have no input to the appointment of the auditors, they also have no input to the ongoing management of the audit contract. This is undertaken by the audit committee. Even if the idea of involving stakeholder or shareholder groups in the appointment of the auditors cannot be implemented, there should be regular contact between the shareholders and the auditor. In addition to the AGM there should be at least one meeting a year between shareholders on the one hand the auditors and members of the audit committee on the other. The executive directors should probably not be present. Issue covered should include:

- The programme of work of the external auditor;
- Particular aspects of the company's accounting and controls that the auditor has investigated, why and what they found;
- Issues that the audit committee has asked the auditor to look at, why and the conclusions reached;
- Adjustments to the accounts – what were they, how significant were they, what was finally agreed and why?
- The amount of time spent on the contract by the audit partner responsible;
- The programme of work agreed for the internal audit team and the outcomes, conclusions and, where appropriate, the actions resulting from their work.
- Whether the FRC have done an AQR or CRR and if so what were the key issues raised and actions that resulted. Also what was the last AQR rating of the company and why was this so.

Implementation of this suggestion, something which should be easy to do, would be a start in helping to address the clear conflict of interests that currently exists and to rebuild trust in audit.

We have noted the CMA's proposal that the Regulator should have more oversight of the ongoing management of the audit contract. We would like to see the Regulator act as a facilitator of these meetings.

4.2 **Cultural issues and conflicts of interest**. There is a clear difference between the culture required to build a successful consultancy business and the culture required for a trusted and well-regarded audit practice. Consultancy is project-based; having sold one project the consultancy team have to sell another (and another) to ensure a flow of new work to feed the business. This might be an extension to an existing project or a completely new project. It is also good if they can get a referral to a new client. To be effective at doing this the senior consultant needs to build close working relationships with the executive management team within the client company. It pays not to upset them. As a consultant it makes sense to go along with whatever the client wants. It is a case of just helping them to do it a bit better. If the client is uneasy with the consultant's recommendations, the consultant usually amends them. There is no point in trying to force the client to do something he or she feels is unworkable.

Contrast this with the culture needed in an audit practice. Detachment, objectivity and professional scepticism are all things that one might consider to be important. Added to this is the need to understand that, while the client company may be paying for the audit, the auditor is actually supposed to be looking after the interests of the shareholders. With a ten-year audit contract there is no need and no justification for constantly trying to sell more to the client.

And yet, all too often there appears to be pressure on the auditor to pass leads and consultancy opportunities to colleagues in the consultancy side of the business. Consultancy can be highly lucrative – often much more so than audit work. The audit partners in most firms benefit from this as well in that they enjoy bonuses based on the overall performance of the firm – not just the audit part. A situation is thereby created in which both parties, the directors of the audit client and the auditors themselves, stand to benefit financially from a conflicted and easy-going relationship with regard to the conduct of the audit.

From an ethical point of view, consultancy and audit do not sit well alongside each other. The culture required for success in each case is fundamentally different. The measures of success should also to be different. Growing revenue by keeping the client happy is not an appropriate measure of success for an auditor. Unfortunately, the likelihood that the consultancy culture will assert itself within any firm providing both consultancy and audit is very real and is potentially damaging and dangerous.

We do not believe that simply banning auditors from doing non-audit work for audit clients provides the right answer. Such a move can only serve to reduce choice and competition in the audit market. No audit firm is going to dump its consultancy work with a non-audit client just so that it can bid for the audit contract. Despite the fact that auditors are already banned from doing certain types of non-audit work for audit clients there are still plenty of other areas of well-paid consultancy advice that they are allowed to provide, including many areas of IT upgrade and implementation, corporate strategy, new product development and M&A work.

We believe that the only viable solution is to implement a complete split between audit and advisory (consultancy) work and impose a ban audit firms providing consultancy services. In this context the following point should be considered: it is not always clear whether the large global firms are auditors with a consultancy sideline or whether they are really consultants with an audit sideline. Looking at the 2017 results for two of the largest firms is revealing. Ernst and Young, for example, had UK revenues in 2017 of £2.35 billion of which £689 million was accounted for by assurance (audit) services. PWC had UK revenues of £3.8 billion of which assurance accounted for £1.3 billion. For these two firms true audit work accounts for 25 -30% of total UK revenue. Given this level of dependence on consultancy work, it is not hard to see what sort of culture is likely to prevail.

5. *How important to the quality of audit is the relationship between auditor and audited company? How can we ensure that there is the right level of challenge? What role should shareholders have in ensuring high quality audits?*

The quality of audit is heavily influenced by the relationship between the (client) company and the auditor. In our response to Question 4 above we have described the conflicts of interest which we believe have a damaging impact on the relationship.

We believe that the auditor’s primary relationship should be with the shareholders. FTSE 350 companies should be required to organise at least one meeting each year between the auditor and the shareholders. Smaller companies should be encouraged to do the same. This should be facilitated by the audit committee and the Regulator, as we have outlined in 4.1 above.

There are four additional important issues which need to be addressed to create an effective framework within which the relationship between shareholders and auditors can work. These are discussed below.

5.1 Audit procurement. We have mentioned in 4.1 above that key stakeholders, particularly the investors, make almost no input to the procurement of the audit contract or its management. It is not even clear to most investors whether a satisfactory specification is issued to bidders for audit services. It is likely that very few investors have ever seen a specification for audit services and that even fewer have been asked to comment on it or to agree whether it meets their needs. This is a crucial issue. If the specification is wrong (or deficient in any way) the service purchased will not meet the needs and expectations of the key users. Money will be wasted buying a service that is not fit for purpose. In the worst cases it will positively unhelpful.

We believe that key stakeholders, such as the shareholders, should have much greater input to the procurement and management of the audit contract and the relationship with the auditor. Assuming that the audit is, in most cases, only tendered every ten years this should not be difficult to implement. We believe that the CMA's proposals, whereby the Regulator would play a much more significant role in overseeing auditor appointment are sensible and practical. We would like to see the Regulator acting as the facilitator for involving a small group of shareholders in the audit tendering and selection process.

5.2 Nominee accounts and shareholder rights. Statistics from the ONS show that in 2016 UK individuals owned 12.3% of UK quoted shares by value. This represents an increase from an historic low of 10% in 2010 and 2012. This figure included UK individuals who own shares in UK listed companies in their own name and individuals who own shares through a nominee. Increasingly, in recent years retail shareholder have been encouraged to hold their shares in nominee accounts. Shares held in an ISA have to be held in a nominee account as do shares held in a SIPP. Many brokers and advisors steer their retail clients strongly in the direction of using their appointed nominee. The system of holding shares in nominee accounts is certainly convenient form an administrative point of view. However, many people appear unaware that it is the nominee who is the legal shareholder. The investor is simply the beneficial owner of the shares.

The rights of beneficial owners in nominee accounts vary from country to country. In the UK the beneficial owners have very few rights. They do not, for example, have the right to receive a copy of the annual report nor do they have the right to attend the company's AGM and vote. This right can be granted by the nominee if the beneficial owner requests it and the nominee agrees. Some nominees do agree, some agree but charge the investor for the privilege of attending the AGM and voting while others refuse the request. This is an injustice on which UKSA and ShareSoc have been campaigning for some time.

This system needs to change. It has lead to the disenfranchisement of retail shareholders on a grand scale and in doing so has weakened corporate governance. Retail shareholders, people who are investing their own money, should be able to enjoy the normal rights of shareholders and should be encouraged to attend meetings run by the companies in which they have invested. Without change, shareholder engagement with auditors and audit committees will be frustrated just as it has been with voting and attendance at AGMs.

The recent cases of Beaufort and Unilever are clear evidence of the need for change in the way nominee accounts work. The Law Commission Review of Intermediated Securities has identified this as an area for them to work on. The BEIS Committee should stress that this Review needs to be given a much higher priority.

In this electronic day and age it should not be so very difficult for nominees to develop systems which allow retail shareholders to exercise their normal rights and to do so in a way which is quick and easy and does not involve additional charges.

5.3 Role of institutional investors and fund managers. The institutional investors and fund managers are the 'stewards of other people's money'. Many, although by no means all, have proved themselves to be utterly lazy and remiss in this respect. The Stewardship Code has been tightened in recent years to try and encourage fund managers to at least vote the shares they hold on behalf of their investors. However, the Stewardship Code itself is at best 'light touch' and at worst ineffective. There is, for example, no requirement for fund managers even to sign up to the Stewardship Code if they do not want to.

Sir John Kingman proposes that the Stewardship Code should be reformed or abolished. The notion that it should be abolished is not acceptable. Strenuous efforts should be taken to ensure that the Code is reformed so as to force fund managers and major institutional investors to take their stewardship responsibilities seriously. Given the charges that most levy on their customers it is scandalous that they have been able to get away with doing so little for so long. Abolition of the Stewardship Code would play straight into the hands of those fund managers that are happy to sit back and do as little as possible. Abolition is simply not an option.

We note also Sir John Kingman's comments in his response to Greg Clark MP that the large investors (fund managers) do not want to see any meaningful change in the relationship between companies and auditors. Sir John states:

'The fact is that at present, investors (or at least their representatives, the fund management community) are very clearly opposed to radical change of the kind I have described….. The investment community appears to be assuming that change would involve depriving shareholders of their current right to approve the choice of auditor. As I say above, I do not believe this needs to be, or should be, the case.'

He goes on to say:

I note in my separate report on the FRC that the investment community is not currently as engaged in, or concerned about, audit weaknesses as they might be. When for instance the Investment Association asserts in its response that "IA members consider that historically the audit sector has served investors well in that instances of audit failure have been relatively isolated", I do wonder whether there is not at least some potential danger of complacency or at least inattention.

Sir John's masterly understatement notwithstanding, this is a damning reflection on the Investment Association and its members. Their comments and the complacency they display should be dismissed with the contempt they deserve. They smack of a 'dog in the manger' attitude on the part if the IA's members. They have failed miserably in their responsibilities as shareholders acting on behalf of savers to ensure that the relationship with the auditor, the company and shareholders works properly. However, they seem determined to ensure that nobody else shall intervene to bring about change. Again, the status quo is simply not acceptable. The 'radical change' that Sir John outlines should be fully implemented.

5.4 **Early termination of audit contracts**. A further area of opacity involves the early termination of an audit contract by either side. Currently there is no requirement to for the company or the auditor to say why the contract has been terminated. If an auditor resigns the audit or is dismissed by the company the shareholders must be told why.

It has to be assumed that an auditor will only resign the audit contract or be dismissed by the company if serious disagreements have emerged and the working relationship has broken down. In this situation it is vital that shareholders are told exactly what has gone wrong. There are strong arguments for suggestion that the company should be forced to call an EGM so that both parties can be questioned by shareholders.

6. *Are the proposed reforms of audit consistent with other recent reforms of corporate governance? Are there any other consequential reforms required?*

There are two areas on which we have further comment.

6.1 Independent Review of the quality and effectiveness of the UK audit market by Sir Donald Brydon. While we believe that the work of Sir John Kingman and the CMA has been excellent and we applaud the radical proposals they have put forward, they do not address the tasks and material that the auditors are processing. If the standards and practises that the industry is working to are inadequate, improving competition in the audit market and strengthening the role and remit of the regulator will make no difference to the usefulness and reliability of the statutory audit. As Jonathan Ford writing in the Financial Times[4] has commented:

> *'Spurious precision and an over-reliance on sometimes unverifiable "fair" values has made auditors suspend the critical judgement they once employed to ensure accounts were not overstated. They shelter too much behind "tick-the-box" rules. These are not problems that will be addressed by changes to the structure of the marketplace or the mechanisms by which auditors are appointed.'*

Mr Ford goes on to say, it is important that these shortcomings are addressed and Sir Donald's Review provides an opportunity for this which must not be lost.

We are in full agreement with this. A review of the accounting rules and accounting standards is a critical requirement if the statutory audit is to change to meet investor needs.

6.2 Perverse outcomes and the Law of Unintended Consequences. Following the reviews by Sir John Kingman, Sir Donald Bryden and the CMA, it is hoped that radical change will take place in all areas surrounding the provision of statutory audit services and in regulation of accounting and auditing in the UK. However, it is vital that the new regulatory body, Sir John Kingman's proposed The Audit, Governance and Reporting Authority, should maintain a close watch on outcomes of changes following implementation and that it should be ready to take robust and decisive action if results start to emerge which are damaging or dysfunctional.

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[4] Financial Times 31st: Unclear accounting rules compound the UK's audit problems – Jonathan Ford – 31st December 2018 .

The outcomes of successive corporate governance reviews by Cadbury, Greenbury, Lord Myners and others on executive pay are instructive. Proposals were originally made with the best of intentions to encourage remuneration systems that would reward directors for outstanding performance. Instead, the system has been 'gamed' to a point where it has become a running sore in the eyes of many people. Absurd amounts of money are now paid to chief executives, often for poor or mediocre performance or for performance that owes more to market factors rather than individual skill, expertise and effort. Sadly a stage appears to have been reached where nobody has any idea how to stop the process and reset it.

The original idea was that shareholders would provide the necessary oversight to ensure that directors' pay was effectively controlled. Unfortunately, retail shareholders (who would have argued strongly for restraint) have been almost completely disenfranchised and stripped of any opportunity to make their views clear at AGMs. The large shareholders, mostly City institutions and fund managers, have, for the most part shown indifference amounting to incompetence in controlling pay.

To add to the problems, reporting on pay has become a 'car crash'. Remuneration reports often run to twenty pages or more summarising schemes which not even the recipients understand. Pay projections which conform to statutory requirements are often patently misleading while key information which would aid understanding does not have to be presented.

Similar outcomes must not be allowed to happen with audit reforms.

Peter Parry – Policy Director, UK Shareholders' Association

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