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11h June 2019

Audit Reform and Regulation Team
Department for Business, Energy & Industrial Strategy
1st Floor, Victoria 1,
1 Victoria Street,
London, SW1H 0ET

DELIVERED BY EMAIL TO: frcconsultation@beis.gov.uk

Dear Sir or Madam,

RE: Independent Review of the Financial Reporting Council – Initial consultation on the recommendations

Periculum Associates Limited (hereafter "we" or "Periculum") welcomes the opportunity to respond to the public consultation on the proposed reforms to the Financial Reporting Council. We have provided recommendations to reflect our views pertaining to how UK publicly listed companies should strengthen corporate governance in response to recent high-profile failures that have eroded public and investor trust in the UK's corporate governance.

The UK's Corporate Governance Code and independent financial auditing standards should be reviewed to establish greater clarity of expectations for Board of Directors (the "Board"), Board sub-committees (e.g. Risk & Audit Sub-Committees) and independent financial auditors who play an integral role in the functioning of the corporate governance system. This system exists to promote trust in the strategic, financial and operating resilience of companies that forms the basis of financial decisions across a wide spectrum of stakeholders (*i.e.,* investors, analysts, customers, suppliers and clients*).* Corporate failures, such as the sudden collapse of Carillion, erode trust in the UK corporate governance system that the Audit, Reporting and Governance Authority must address through the use of tools that place greater consequence on persons who hold influential positions.

It is our view that the proposed consultation inadequately addresses the failures of independent financial audit firms, namely Deloitte, EY, PwC and KPMG (collectively known as the "Big 4"), and their contributions to the erosion of trust and confidence in the audit industry, leading to questions of misconduct in the UK's corporate reporting standards.

We believe the Audit, Reporting and Governance Authority should address the causes that have eroded public and investor trust in the UK's financial audit industry, and establish greater consequences for audit firms and individual professionals (*i.e.* managing partners), who knowingly act in bad faith (*i.e.* putting future revenues before audit independence and transparent reporting) or fail to adhere to strict standards of audit quality and professionalism.

In addition to the recommendations set out within the consultation, thematically, we believe the Audit, Reporting and Governance Authority should:

- Review current financial auditing standards and applied practices across the Big 4 to identify leading causes resulting in fragmentation in the application of such standards;
- Proactively take steps to identify and reduce variance in the interpretation and application of stated auditing standards, namely (i) the underlying procedures used by Big 4 firms to conduct financial audits; (ii) the internal assessment of audit independence, quality and reliability; and (iii) procedures to detect, respond to, and resolve conflicts of interest;
- Establish relative consequences for audit professionals and audit firms who fail to act in the best interests of the public; and
- Devise a penalty system, similar to the General Data Protection Regulation, applicable to UK publicly listed companies and auditing firms who fail to adhere to the principles and commonly accepted standards of the UK's Corporate Governance Code.

We hope you find the suggestions provided in this letter supportive of your objectives to create an Audit, Reporting & Governance Authority that retains the UK's position as a trusted leader in applied standards of corporate governance, audit, and reporting, and a reliable centre for global investors.

If you have any questions or would like to discuss any part of our response, please contact me at cthackray@periculumassociates.co.uk.

Yours sincerely,

Christopher Thackray

Christopher Thackray
Managing Director
For and on behalf of Periculum Associates Limited

Chapter 1

Question 2 (Recommendations 1, 2, 3, 4, 5, 6)

The proposed duties of the regulator should include the following:

- Sanction professional advisors who fail to comply with regulatory standards, who knowingly enter into conflict of interests, or who fail to demonstrate the principles of duty of care to the audit profession and the manner in which the outcomes are used by the public.
- Utilize technology to monitor trends and developments that could contribute to deterioration in the quality and completeness of independent financial audit services.
- Monitor trends pertaining to the evolving demands on the Board and develop standards that align the roles, responsibilities, activities and outcomes of the Board to industry trends, particularly addressing how they influence the structure and the standards of corporate governance.
- Inspect the quality and accuracy of information used by the C-suite executives and the Board to inform the strategic direction and accuracy of reporting pertaining to the current and future performance expectations of the company.
- Test and monitor the ability of Board executives to challenge C-suite executives on the transparency and reliability of information provided, particularly in the context of financial reporting and guidance to investors.
- Promote diversity in the number of firms involved in providing independent audit and advisory services to Board's and C-suite executives.

Question 4 (Recommendations 7, 8, 9, 10)

- The Audit, Reporting and Governance Authority should advocate for Board involvement with advisory firms beyond the "Big 4" and encourage Boards to seek greater involvement of non-executive directors to provide expertise beyond the Board's current level of experience (e.g. expertise in risk management, compliance, technology disruption, intergenerational changes, etc.).

Chapter 2

Question 7 (Recommendations 17, 22, 23, 24, 26, 36)

- The review proposed in Recommendation 17 should consist of panel participants from across the professional audit and advisory industry and leading figures on Boards across major UK industries. The involvement of audit and advisory firms should include firms of all sizes.
- There should be multiple strategies for AQRs including deploying resources into live audits to assess the level of objectivity in the representation of observations and findings, and to assess the interactions between the independent audit firm and the Board in addressing material deficiencies identified.
- AQR resourcing should address the considerable influence and bias of the "Big 4", including professionals from a Big 4 alumni. Currently, it seems AQR resources will not identify biases that may lead to similar issues as stated in this letter.

- When reporting CRR findings, such findings should reference named individuals from the Board as well as named individuals from the applicable audit firm who are held accountable for the finding.
- To objectively assess the conduct and credibility/background of individuals, the Audit, Reporting & Governance Authority should acknowledge the changing reporting requirements of the public.

Further, they should review the changing demands on corporate governance and risk reporting to address the
increasingly complex nature of determining the credibility and resilience of a firm.

- Enforcement of standards should consider the group level earnings of audit firms and the culture and adaptiveness of audit firms in addressing the evolving demands and desire for increased reliability of audit.
- For an effective enforcement regime, the regulators should consider sanctioning audit companies and firms as well as individual professional advisors particularly those at partner level equivalent within their respective firms.
- The FCA senior manager and certification regime should be extended to positions held at the board level within PIEs.
- A failure in the duty of care or adherence to the standards of corporate reporting within PIEs should result in accountable individuals being unable to serve for a period of time on other boards.
- Revised audit standards should include quantitative measures on the outcomes of audit reporting.

Chapter 3

Question 8 (Recommendations 46, 45, 47, 49, 50, 51)

- The Audit, Reporting and Governance Authority should be forward looking, but regulators must also account for patterns of professional advisors and auditing firms that identify more systemic deficiencies in the practices they apply.
- Penalties should be imposed upon professional advisors and firms for failing to apply the standards of independent audit.
- The Audit, Reporting and Governance Authority should be more stringent on professional advisors and promote use of the regulatory framework to minimizes both financial risk and the relationship risk that comes from effectively challenging the Board's adequacy in addressing concerns.
- The regulator needs to act rapidly with respect to information they request from professional advisors.
- Professional advisors should have defined timelines and other stated procedural requirements when they are required to alert regulators about issues that could jeopardize the trust or effectiveness of the system of governance.
- The Audit, Reporting and Governance Authority should have authority to strike off partners or other professional advisors in significant positions that have violated, caused, or contributed to deficiencies in the effectiveness of independent audit.
- There should be a prescriptive approach to setting standards of independent audits. It is absolutely necessary to create a level playing field.

Chapter 4 (Recommendations 56, 58)

- The Audit, Reporting and Governance Authority should be monitored for their use of "Big 4" advisors as well as the hiring of Big 4 alumni in influential positions.
- The Audit, Reporting and Governance Authority should promote diversity in terms of the firms they invite into advisory and other subject matter positions.
- The Audit, Reporting and Governance Authority should avoid any conflict of interest to be effective, especially in their understanding that a part of their future jurisdiction will be overseeing the performance of "Big 4" firms. There is an innate level of bias in hiring "Big 4" that should be avoided.

- It is critical that the Audit, Reporting and Governance Authority take a multi-faceted approach to invite other firms with credible backgrounds to contribute to the setting of future standards and competencies of auditing firms and professional advisors.

Chapter 5 (Recommendation 67)

- The individuals hired into the listed positions should be adequately vetted to avoid conflicts of interest or bias that may influence their work, particularly as it pertains to governing the performance and effectiveness of "Big 4" alumni.

Chapter 6 (Recommendations 71, 72, 77)

- The Audit, Reporting and Governance Authority needs to not only promote competition, but also to enforce competition such that UK listed companies are requires to utilize independent professional advisors outside of the "Big 4" players.
- The Audit, Reporting and Governance Authority should establish goals top open-up the UK financial audit sector, promoting competition and encouraging new entrants through its own work, and through its relationships with investors and other influential stakeholders.
- If audit firms, such as the Big 4, repeatedly fail to meet stated and commonly accepted auditing standards, they should be banned from future auditing of UK listed companies.
- The consequences for auditing firms who fail to uphold the standards of the UK Corporate Governance Code and stated financial auditing standards, should be relative to the consequences to investors, employees, customers, suppliers and other stakeholders who relied upon the independent audit results to make financial decisions.