Transparency International UK's response to the consultation on restoring trust in audit and corporate governance – Jul 2021

Executive Summary

Transparency International UK (TI-UK) has long campaigned for stronger anti-corruption controls within the UK. As such, TI-UK welcomes this consultation seeking to address important issues to strengthen the corporate governance framework and increase the quality of audits carried out. We hope the outcome strengthens the United Kingdom's controls on corruption and money-laundering.

TI-UK has developed comprehensive research and guidance demonstrating the business case, the need for, and steps to take to achieve more relevant and robust corporate anti-bribery and corruption oversight and reporting. We bring together our expertise to present our research and findings to inform the Government's approach to this ambitious reform.

Corruption, corporate disclosure and audit

Over the years there have been high-profile corporate failures involving bribery and corruption cases within companies whose accounts have been signed off by auditors. In many instances bribery, corruption and money laundering have been the predicate offences contributing to wider corporate failings. In these instances, **auditors have signed off company accounts despite major instances of corruption on their books**.

A recent example to demonstrate this is the case of Petrofac. In 2016 following allegations of bribery and corruption to win contracts, Petrofac's independent investigation was carried out by a law firm and KMPG.[1] Their investigation found no evidence that Petrofac was involved in a global scandal over bribery and corruption in the oil industry. The Serious Fraud Office announced its investigation into Petrofac the following year, in May 2017.[2] In January of this year a former senior Petrofac executive pled guilty to three accounts of corruption.[3]

Bribery, corruption and quality disclosures: a challenge to UK Businesses

Bribery and corruption remain a challenge and a risk to UK business. The 2020 Global Economic Crime Survey showed that 25 percent of respondents have experienced bribery in the past 24 months, and 38% of organisations have been asked to pay a bribe.[4] Corruption risks also extend beyond bribery – including areas such as a company's governance, top-level commitment, risk assessments, conflict of interests, charitable and political donations etc.[5]

Across different corruption risks, **one solution that reduces corruption risk for companies is transparency.** The reporting and public disclosures of a company's anti-corruption programme allows investors, civil society organisations and the public at large to monitor programme effectiveness and to encourage improvements. Transparency increases public trust in companies

[1] www.cityam.com/petrofac-auditors-find-no-evidence-support-bribery/
[2] www.sfo.gov.uk/cases/petrofac/
[3] www.sfo.gov.uk/2021/01/14/former-senior-petrofac-executive-pleads-guilty-to-three-further-bribery-offences/
[4] *Make it Count*, Transparency International UK (May, 20210), p. 10 www.transparency.org.uk/sites/default/files/pdf/publications/Make%20it%20Count%20-%20Transparency%20International%20UK%20%28web%29.pdf
[5] Transparency International UK report *Open Business* identified five main high-risk corruption areas which companies need to disclose against. These are: anti-corrupting programme, beneficial ownership, organisational structure, country-by-country reporting, and corporate political engagement. www.transparency.org.uk/publications/open-business-anticorruption-governance-disclosure-guidance

and provides increased security for investors on their investment choices. Companies also benefit from disclosure for multiple reasons: increased trust, reputation management, legal compliance and competitive advantage.[6] However, **relating to anti-bribery and corruption, meaningful disclosures around governance and anti-corruption are limited**.[7] Research by the Alliance for Corporate Transparency finds that a majority of the companies included in the research describe anti-corruption policies in their reports (88.1%) but only 19.7% disclose key issues and objectives.[8] Only 33.7% of companies describe main elements of their anti-corruption programmes, that is, processes through which they implement policies in practice less than 1 in 5 companies report on how they assess risks of potential areas of corruption (18.3%), which is striking compared to the great majority of companies addressing anti-corruption as a material issue.[9]

For those companies that do disclose anti-corruption approaches, it is hard to know to what extent this is robust and effectively reducing corruption risk. A recently released report, *The State of Play in Sustainability Assurance,* sought to better understand "the extent to which companies are reporting and obtaining assurance over their sustainability disclosures, which assurance standards are being used, and which companies are providing the assurance service" across different jurisdictions.[10] The report finds that "[t]he lack of consistent standards for reporting sustainability information is mirrored in the types and providers of assurance" and that as jurisdictions, chiefly the European Union and the United States, are moving forward with legislation relating to sustainability disclosures **"[a]ssurance practices need to mature alongside the reporting"**.[11] We wholeheartedly agree with this conclusion.

Transparency International UK's position

The costs of bribery and corruption can have very material consequences for a company and their shareholders, notwithstanding the impact bribery and corruption can have on a broader range of stakeholders. **The UK needs to seize the opportunity held within this consultation to widen corporate reporting to sustainability reporting and ensure robust assurance of company disclosures, including anti-bribery and corruption and other sustainability disclosures.** Otherwise we will be left behind our counterparts.

Our response suggests more meaningful anti-corruption corporate reporting obligations, a reformed Audit industry that includes a mandate to audit for bribery and corruption risks within companies and an empowered ARGA that is independent and has teeth.

[6] See Chapter 1 of *Open Business* for the business case for corporate anti-corruption transparency.
[7] *Open Business*, Transparency International UK (March, 2020), p. 14 www.transparency.org.uk/publications/open-business-anticorruption-governance-disclosure-guidance
[8] Alliance for Corporate Transparency, 2019 Research Report: *An Analysis of the Sustainability Reports of 1000 Companies Pursuant to the EU Non-Financial Reporting Directive* (May 2020), p. 90-92 https://corporatejusticecoalition.org/wp-content/uploads/2020/02/2019_Research_Report-_Alliance_for_Corporate_Transparency-7d9802a0c18c9f13017d686481bd2d6c6886fea6d9e9c7a5c3cfafea8a48b1c7.pdf
[9] Alliance for Corporate Transparency, 2019 Research Report (May 2020), p. 90-92
[10] www.aicpa.org/content/dam/aicpa/interestareas/frc/assuranceadvisoryservices/downloadabledocuments/auditdatastandards/ifac-sustainability-assurance-reporting-final.pdf
[11] www.aicpa.org/content/dam/aicpa/interestareas/frc/assuranceadvisoryservices/downloadabledocuments/auditdatastandards/ifac-sustainability-assurance-reporting-final.pdf

Responses to the consultation questions

Q12. 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?

During Transparency International UK's research we have found that one of the reasons why companies are not disclosing meaningful anti-corruption information is because they are not gathering and measuring the necessary information on how they manage their corruption risks as part of their internal controls and risk management to subsequently disclose it.[12]

Requiring directors to provide information in a company's annual report on the effectiveness of the company's internal controls would be a welcome development that should result in increased transparency on company activities, the risks they encounter in the course of their activities, and the systems put in place to mitigate such risks. By disclosing such red flags, shareholders, stakeholders and the wider public would be provided with an effective early warning system enabling regulators to intervene at an early stage to resolve issues, potentially circumventing legal action from compliance failures or even corporate collapse. In the case of companies found to have had weak internal controls in place (i.e. Rolls Royce and Airbus) such reporting would reassure the public that where companies had failed to act appropriately in the past, directors were taking proactive steps to ensure such conduct would not be repeated.

Relating to the effectiveness of a company's internal controls and accountability, we reference our recently released research on measuring the effectiveness of the corporate approach to anti-corruption, *Make it Count.*[13] This report raises the bar for corporates to measure and demonstrate whether the activities they are undertaking are actually having the desired effect in reducing bribery and corruption risk.

Q13. 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 support **Option C**.

With regard to the government's initial preferred position in Table 2, and linked to our answer for question 12, we support the option for requiring directors to undertake an annual review of the effectiveness of all aspects of the company's internal controls, going beyond accounting records to include all aspects of a company's risk management controls and procedures, including in relation to anti-bribery and corruption. In this sense, we support the requirement for an explicit directors' statement about the effectiveness of the internal control and risk management system which goes beyond narrow financial reporting to best capture the range of factors that pose risks for the health of companies and wider stakeholders.

This would involve, as an example, disclosing evidence that the board or a board committee set the anti-corruption tone and that a senior executive has responsibility for the anti-corruption programme. Also, disclosing evidence that the board or a board committee provides oversight of the company's political activities.

We suggest this matter should be included by all companies in the Directors Statement, over a 'comply or explain' approach. Looking to the Modern Slavery Act as an example, we see the 'comply or explain' approach as a significant weakness of this Act, as it makes it too easy for a company to

[12] *Make it Count*, Transparency International UK, (May, 2021) p. 5 www.transparency.org.uk/sites/default/files/pdf/publications/Make%20it%20Count%20-%20Transparency%20International%20UK%20%28web%29.pdf

[13] *Make it Count,* Transparency International UK (May, 2021) www.transparency.org.uk/make-it-count-anti-bribery-corruption-measuring-effectiveness-guidance-companies

have said it has mitigated the risk of modern slavery without having taken the necessary steps to be able to demonstrate that a company has actually addressed this risk. Contrary to the point made in paragraph 2.1.12, to take a 'comply or explain' approach would not strengthen stakeholder trust in a company's statements, but leave too much room for a lax approach to addressing bribery and corruption risk.

In relation to the role of the auditor, we support Option C that would require an auditor to undertake additional audit and assurance to verify that the contents of the directors' statements on the functioning of a company's internal controls are accurate. This provision would replicate Section 404 of Sarbanes-Oxley Act requiring the auditor to assess and provide a written attestation on the controls. Implementing this requirement for audit firms would provide an incentive to challenge directors' statements, help identify fraud and provide further assurances for investors, stakeholders and the general public. In the case of corporate failure, ARGA should be given the powers to investigate the adequacy of an auditor's work and where non-compliance is identified ARGA should be able to take robust enforcement actions against audit firms and audit partners.

As the Kingman review noted, there is significant support for introducing a UK tailored version of the Sarbanes-Oxley Act amongst senior audit committee chairs with experience of working for US listed companies. There are understandable concerns relating to the cost of implementing similar provisions to those of the Sarbanes-Oxley Act voiced by professional bodies including the ICAEW. However, a UK version of the Act would encourage firms to develop automated and centralised systems which would result in long-term economic savings and would be more conducive to audit. According to the US Securities and Exchange, auditor's compliance with Section 404 provisions has become much less costly over time due to improved communications between auditors and management, focus on higher risk areas and overall streamlining of procedures.

We believe that audit firms should expand their expertise to these non-financial areas, that auditors with specific expertise could be contracted and that there is a role for strong internal audit in order to strengthen accuracy and robustness of the Director's statement. These steps would counteract that risk that the current audit firms would be auditing information for which they do not have expertise.

If implemented, such a measure would assist companies in setting the 'tone from the top' through displaying directors' commitment to rigour in the creation and management of company's internal control environments and therefore promoting company-wide ethical values. Failure to comply with the requirement should result in enforcement action of the same type currently used against directors for failing to keep adequate accounting records as required by the Companies Act. We note the importance here of an effective regulator that is resourced to be able to enforce the regulation.

Relating to the effectiveness of a company's internal controls and accountability we reference our recently released research on measuring the effectiveness of the corporate approach to anti-corruption, *Make it Count.*[14] This report raises the bar for corporates to measure and demonstrate whether the activities they are undertaking are actually having the desired effect in reducing bribery and corruption risk.

As ARGA develops standards and guidance for companies and auditors, we hope to see consultation with civil society in order to ensure guidance meets the most robust and quality standards possible.

In relation to paragraph 2.1.5, we recognise that additional corporate reporting and corporate governance requirements will fall on companies and entities emerging from the COVID-19 pandemic. However, these costs are outweighed by the potential increases to the protection of investors and wider public interests. We also note that with the growing demand for reliable, high

[14] www.transparency.org.uk/make-it-count-anti-bribery-corruption-measuring-effectiveness-guidance-companies

quality reporting from investors and other stakeholders this cost would be increasingly incurred anyway. If anything, a centralised reporting requirement will increase the ease with which companies can report instead of the current system of multiple, inconsistent reporting standards.

Q14. If the framework were to be strengthened, which types of company should be within scope of the new requirements?

All PIEs.

Q19. Do you agree that the above matters should be included by all companies in the Resilience Statement? If so, should they be addressed in the short or medium term sections of the Statement, or both? Should any other matters be addressed by all companies in the short and medium term sections of the Resilience Statement?

We agree that specific disclosures should be required in the Resilience Statement. We suggest that the corporate approach to anti-corruption should be included in this statement. This includes both disclosures on *what* the company's anti-corruption approach is (based on the guidance included in Transparency International UK report *Open Business*[15]) and also information on *how* a company measures the effectiveness of their anti-corruption approach (as discussed in Transparency International UK report *Make it Count*[16]).

A 2020 Global Economic Crime Survey highlights that bribery and corruption remains a growing challenge for UK businesses. The survey showed that 25 percent of respondents have experienced bribery in the past 24 months, and 38% of organisations have been asked to pay a bribe. We suggest that **anti-corruption risk management is a resilience issue common to all businesses**, and that shareholders and other users of this Statement would benefit from all companies reporting on how they manage this risk. Indeed, it is essential that companies include anti-bribery and corruption reporting in their Resilience statement in order to demonstrate publicly that the company is identifying and managing corruption risks. This helps to:

- Provide information for investors to better understand the risks and opportunities linked to their investment. The quality of this information is key.
- Foster trust in relationships between a business and its clients along the supply chain.
- Drive internal improvement of policies and procedures: if a company knows that it needs to disclose policies and procedures publicly, it will focus its attention on making sure that these policies and procedures are fit for purpose.

Specifically relating to disclosures on anti-corruption programme risk management controls and procedures we include the following example of information to be included in our research, *Open Business*. Transparency International UK developed *Open Business* to offer guidance on corporate transparency, presenting a set of transparency principles across high-risk anti-corruption areas. The five key areas covered anti-corruption are: anti-corruption programme transparency, beneficial ownership transparency, organisational structure transparency, country-by-country reporting transparency and corporate political engagement transparency.

Examples of principles which companies should disclosure to demonstrate internal controls and risk management:

- **Anti-corruption programme transparency:**
  - Principle 1.2 – Anti-bribery and corruption policies: The company should publicly disclose a comprehensive anti-bribery and corruption policy, as well as other policies

[15] www.transparency.org.uk/publications/open-business-anticorruption-governance-disclosure-guidance
[16] www.transparency.org.uk/make-it-count-anti-bribery-corruption-measuring-effectiveness-guidance-companies

that contribute to its anti-corruption programme, and any supporting procedures to these policies. In addition, the company should publicly disclose how it implements these policies. These policies should be overseen by an accountable senior executive.
    - Principle 1.3 – Risk assessment: The company should explain its anti-corruption risk assessment and how this informs its anti-bribery and corruption programme. The company should also report its anti-bribery and corruption Key Performance Indicators (KPIs).
    - Principle 1.5 – Conflict of interest: The company should publish details of its policy and procedures that define, identify, declare and manage conflict of interest.
    - Principle 1.10 – Monitoring and review: The company should explain how it monitors and reviews its anti-bribery and corruption programme. This should include details of the extent to which this programme is subject to regular internal and external audit, and assurance that policies are updated according to recommendations.
    - Principle 1.12 – Dealing with incidents: The company should explain how it addresses material findings of bribery and corruption. It should also publicly disclose high-level results from incident investigations and disciplinary actions against employees and third parties.
    - Principle 1.13 and 1.14 involve sub-principles relating to managing third parties and private procurement transparency.
- **Beneficial ownership transparency:**
    - Principle 2.1: The company, whether public or private, should publicly disclosure its ultimate beneficial owners accurately and in a freely accessible format.
- **Organisational structure transparency:**
    - Principle 3.1: The company should publicly disclose all fully consolidated subsidiaries and non-fully consolidated holdings, and the percentages that it owns in each of these entities.
- **Country-by-country reporting:**
    - Principle 4.1: The company sold publicly disclose the nature of work, the countries of operations and the countries of incorporation of its fully consolidated subsidiaries and non-fully consolidated holdings.
- **Corporate political engagement transparency:**
    - Principles include reporting relating to the control environment, political contributions, lobbying and controls relating to the revolving door.
    - For example Principle 5.1.2: The company should publicly disclose evidence that the board or a board committee provides oversight of the company's political activities on at least an annual basis.

These principles are applicable across multiple corporate sectors and companies of varying sizes. As addressed in our *Make it Count* report, companies need to be able to detect and prevent corruption, and they can only do so by actively measuring to see if the approach they are taking is actually working.

Q28. 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 would especially be in favour of a new regulation which would standardise company reports into machine readable formats that would promote cross-comparison of financial reporting by regulators, investors and stakeholders alike, as well as promoting digital accessibility. Civil society organisations should be actively consulted in the development of any further guidance on standardisation.

By digitalising reporting there is the possibility over time of lower reporting costs for companies and radical improvement in how investors and other stakeholders can compare and use reported information.

Q32. Should directors of public interest entities be required to meet certain behavioural standards when carrying out their statutory duties relating to corporate reporting and audits? Should those standards be set by the regulator? What standards should directors have to meet in this context?

We note the suggestions in paragraph 5.1.24 relating to the behavioural standards applying to Directors of PIEs, and agree with it. Just as importantly, auditors must also be encouraged to exercise their professional judgement, to speak out when they spot problems and to complete their role with integrity and honesty. Therefore, we suggest the government also extend the requirement to meet certain behavioural standards to directors.

Q35. Do you agree that a new statutory requirement on auditors to consider wider information, amplified by detailed standards set out and enforced by the regulator, would help deliver the Government's aims to see audit become more trusted, more informative and hence more valuable to the UK?

The consultation speaks to the need to rebuild and maintain public trust in companies' practices. While the focus of the consultation in terms of broadening out risk assessment is on climate, anti-corruption measures cannot be left out. Bribery and corruption not only result in the loss of funds from the bribes paid, but also has a consequence of the costs associated with allegations and any fines to be paid. The **costs of bribery and corruption can have very material consequences for a company and their shareholders, notwithstanding the impact bribery and corruption can have on a broader range of stakeholders**.

We suggest the government, in order to meet the new purpose of audit *"[t]o help establish and maintain deserved confidence in a company",* goes beyond the Brydon recommendations and introduce the statutory requirement to include information which is relevant to a broader range of stakeholders including on anti-bribery and corruption. This should aim to broaden minimum reporting requirements in line with a better understanding of companies' embeddedness in communities and the potential consequences corporate failure can have on those stakeholders.

ARGA should produce details of additional requirements in a similar format to auditing standards in order that all audit firms are clear on the expected standard of work. ARGA should provide the reporting requirements necessary for companies, to avoid companies picking and choosing which elements they would like to report to stakeholders. For anti-bribery and corruption reporting, Transparency International UK has published *Open Business*, a comprehensive guidance on principles for companies to report against relating to the five high-risk anti-corruption areas identified.[17]

Open Business represents the findings of implementable and practical guidance on corporate anti-corruption disclosures following a thorough analysis of the current transparency climate. ARGA can use this resource to advance meaningful disclosures across the five high risk areas of corruption identified as part of the development of detailed standards.

A key part of the business case both for disclosure and for measuring the effectiveness of the corporate approach to anti-corruption is the need to build trust. Corporate transparency is a key way to secure and maintain trust with the consumer, with investors, between businesses and with employees.[18] With auditors reviewing this information the reporting becomes more reliable, thereby building more trust with users.

[17] www.transparency.org.uk/publications/open-business-anticorruption-governance-disclosure-guidance
[18] See Chapter 1 of *Open Business* www.transparency.org.uk/publications/open-business-anticorruption-governance-disclosure-guidance

By requiring robust corporate disclosures, the UK would still compete with the European Union - as they develop the Corporate Sustainability Reporting Directive - in terms of best practice standards set and being recognised as a place of responsible business.

Q39. What role should ARGA have in regulating these wider auditing services? Should its role extend beyond setting, supervising and enforcing standards?

We note the importance of ARGA's role in setting, supervising and enforcing standards. The regulator should not allow audit and consultancy firms to set the standard for international reporting. When designing the reporting for ESG disclosures, there needs to be a stakeholder based international governance structure.

We also note our concern that Auditors would not have the correct skill set to be auditing complex ESG reporting. While we do not have a solution to this beyond companies being encouraged to hire specialists to audit certain areas we believe it needs to be considered as this process continues.

Q64. 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?

In terms of addressing the conflicts of interest in commercial practices, that is the current practice of audit and consultative practices being offered by the same company / brand, we support the move for structural and legal separation of audit from consulting.

We remain unconvinced that the proposed operational split (based on separate financial statements and the creation of a new board to oversee the non-audit side of the business) addresses the conflict of interest risks that have become embedded in the audit firms. The proposed split will not solve the tensions arising from: the potential conflict risks inherent in using shared systems, audit partners sharing in the profits earned from the consultancy side of the business, the risks emanating from 'one firm' culture, and conflict rules whereby firms may consider the potential loss of future non-audit work when deciding to bid for audits.

If the government decides to implement an 'operational separation' as endorsed by the CMA between audit and non-audit sides of the frim, it is vital that at minimum the new requirements comply with the CMA proposals as listed in the consultation document in section 4.5 and with the FRC's 2020 principles for operational separation. To be able to effectively supervise and monitor how audit firms are implementing the operational separation, an appropriate statutory framework should be developed giving ARGA appropriate inspection rights to both the audit and consultancy side of firms.

We have concerns that operational separation, in practice, does not create sufficient barriers or the necessary distance between the two parts of the firms, thereby preventing the development of two separate work cultures. If this approach is taken, the government should learn lessons from ring-fencing measures introduced into the retail banking system. A further key aspect of the new system will be a robust monitoring and assessment system that can analyse whether the operational separation is having any material impact on the sector and whether it is meeting the desired policy objectives. In addition, there would need to be in place a robust sanctions regime with a suitable deterrent for firms and audit partners for circumventing the operational separation. Considering the potentially burdensome nature of introducing these new requirements on both the regulator and audit firms, we would suggest the government revisit a structural split. If the operational separation is chosen, we would urge the government to accept the BEIS committee's request that the CMA and ARGA undertake a review into the effectiveness of the operational split within three years of the regime coming into place.

Further comments:

An empowered ARGA - adequate resourcing and strong powers

The proposals in the White Paper will stand or fall based on how the new audit regulator, Audit, Reporting and Governance Authority (ARGA), is established. A weak regulator that is beholden to the industry will not deliver the shake-up of audit that is clearly needed. We strongly welcome the creation of ARGA but to ensure it is strong and effective, the government must ensure it has robust governance arrangements - including open and transparent recruitment processes, a statutory code of conduct, and effective policies to deal with any potential conflicts of interest auditors face. ARGA must also be properly resourced to deal with complex investigations and finally, ARGA must have the power to issue effective sanctions.

Key here is the need for ARGA to be sufficiently resourced to deliver on its new mandate as an upgrade to the FRC. In order to promote genuine reform of the audit sector it is vital that ARGA has at its disposal the resources and 'appetite' to undertake and conclude complex investigations into audit failure within acceptable timeframes. It is equally important that ARGA can draw on the resources necessary to handle any legal challenges to its decisions that the larger audit firms may make.

10.2 Governance

Remit letter
We support the proposals for the regulator's remit letter to be renewed at least once per parliamentary term, and should be laid before parliament.

Annual report
The government should introduce legislation to require the regulator to present its annual report to the Secretary of State on an annual basis and then presented to parliament. The report should combine both a broad evaluation of the regulator's performance in meeting its objectives and regulatory principles, make recommendations for operational improvement and also contain specific statistical breakdowns of supervision and enforcement activities. The annual report of the Independent Fraud Panel should be included as an annex.

Other requirements
We welcome the government's plans to place the new regulator firmly within the scope of Freedom of Information Act as recommended by the Kingman review. In our view, the fact that the FRC was the sole exemption from some of the Act's provisions created a democratic deficit which should be corrected as soon as possible. Beyond this commitment, the proposals do not offer much detail on other aspects of transparency and therefore we would encourage the government commit to making ARGA as transparent as possible by promptly and pro-actively publishing its corporate governance documents, including minutes of meetings, registers of interests, rules, policies, accounts, annual reports, guidance, decision-making processes.

Leadership and Board: role and membership
If ARGA is to function as envisaged by the government it is essential that its integrity and independence is enshrined in law from the outset. Under the plans in their current form, ARGA will be legally and operationally independent of the government but will fall "under the government's strategic direction." The exact relationship remains undefined but the white paper suggests giving the Secretary of State powers to appoint non-executive members which would be agreed upon by the Chair of the BEIS Select Committee. This approach is welcome but could be further strengthened by giving the BEIS Select Committee the ability to nominate candidates for scrutiny hearings with

appointment proposals being submitted to the Secretary of State to take the final decision. Any appointment mechanism for ARGA should meet the independence criteria defined by the CSPL in its report on upholding standards in regulators and any ministerial guidance received by ARGA should be published. There is also a more symbolic issue that if the government is committed to audit reform, then ARGA's board requires 'new blood' and a fresh impetus to regulate the audit market. Steps should be taken to prevent the FRC's current board from being reappointed en masse to head ARGA.

Establishing greater independence between the regulator and industry must be a primary consideration but the plans in their present form do not offer much detail on how the government proposes to achieve this and are therefore a significant gap in the proposals. We suggest that the regulator follows the best practice identified by the CSPL and ensures that staff at all levels are clearly aware of conflicts of interest and are explicitly advised about the risks of bias in decision making. In addition, the government should guarantee the independence of the body's chair by putting in place measures to safeguard against potential conflicts of interest between the person's role as chair and their professional duties.

We would also like to see the government put in place strong revolving door prohibitions preventing ARGA board members from re-entering the audit industry immediately after finishing their mandates and an outright ban on serving board members holding industry positions. It is vital that once appointed, board members are required to declare actual or potential conflicts of interest at every board meeting, with recusals clearly recorded, and that these declarations and minutes of meeting are regularly published in the public domain. The FRC's current 'decision makers register of interest' publication should be carried over into ARGA and should be expanded to include references to specific incidences where measures were taken to mitigate perceived or real conflicts of interest in relation to decisions taken at board level. Obligations on conflicts of interest should be based on the recommendations of the Boardman review and include a staff code of conduct, a centralised database of declarations and training and guidance offered to all ARGA staff members.

Lastly, ARGA's board should contain representatives from civil society organisations to ensure that the views of the public and other societal stakeholders are represented during board meetings and when voting on implementing new rules or policies.

Enforcement

We share the concern expressed in the Kingman review into the length of time it takes for the FRC to conclude investigations. It should be noted that despite benefitting from additional powers to speed up its case handling the FRC continues to miss its target to conclude investigations within 2 years. To solve these issues the new regulator should be given sufficient resources as well as powers to compel audit firms to provide relevant information required during the course of an investigation so that investigations can be concluded within a maximum two year period.

In addition, despite the FRC seeming to have an appropriate set of sanctions available to it (reprimands, fines, requiring the waiver or repayment of client fees and exclusion from professional bodies), we note that fines issued by the FRC to audit firms when compared to annual revenues are negligent and are seen as a cost of doing business. We suggest the government should reassess this area urgently to ensure the new regulator can levy fines of an appropriate size that will act as a deterrent for the firms to improve compliance. The government should take into consideration the recommendations of the Clarke review into the FRC's enforcement procedures to develop a formula for fines that balances the need to act as a deterrent while considering the egregiousness of the conduct and also the size of the audit firm.

11.7 Whistleblowing

As the 2020 Rihan vs Ernst Young case has demonstrated, it is of vital importance that auditors come

forward with information when audit firms conspire with their clients to hide evidence of criminality and other wrongdoing. Whistleblowing in the audit sector is rare, and it is generally accepted that becoming a whistleblower involves a major risk of financial loss through the risk of subsequent unemployability. While it is further recognised that auditors face serious challenges to maintain their anonymity after coming forward. The Rihan case has demonstrated that audit firms are prepared to pursue whistleblowers through the courts, even when evidence of their wrongdoing is divulged to the public in the process thereby creating another disincentive for auditors to come forward. Despite dozens of FRC investigations over the years into audit firms for serious failings and misconduct, the FRC has only investigated 25 cases based on whistleblower concerns, none of which resulted in any firm action which suggests that there is significant distrust of the existing protections for whistleblowers. These low numbers are not consistent with whistleblowing trends in other areas of the economy where 40% of occupational fraud is detected through tips from employees, customers, vendors, and other anonymous sources. In this context it is clear that the current system for handling whistleblowers is in need of an overhaul.

In general, we support the logic of Brydon's recommendation to bring audit firms within the scope of the Public Interest Disclosures Act to harmonise the profession with other sectors. However, we also accept the government's assessment that this step may be redundant given the tendency, in the few cases that it occurs, for whistleblowers to approach the regulator directly instead of the audit firms. As a consequence, to encourage more whistleblowers to come forward we recommend that the government establish an independent audit whistleblower function housed with ARGA to act as a first point of contact for auditors wishing to make a complaint regarding their employer's conduct. The function would be given the powers to develop arrangements that facilitate whistleblowing within the audit sector and enshrine legal protections for individuals coming forward. In addition, the function would develop industry-wide whistleblowing standards such as requiring audit firms to have in place clear whistleblower policies and procedures as well as providing regular training to employees at all levels on their responsibilities under the rules.

ABOUT TRANSPARENCY INTERNATIONAL UK

Transparency International (TI) is the world's leading non-governmental anti-corruption organisation. With more than 100 chapters worldwide, TI has extensive global expertise and understanding of corruption.

Transparency International UK (TI-UK) is the UK chapter of TI. We raise awareness about corruption; advocate legal and regulatory reform at national and international levels; design practical tools for institutions, individuals and companies wishing to combat corruption; and act as a leading centre of anti-corruption expertise in the UK.

We work in the UK and overseas, challenging corruption within politics, public institutions, and the private sector, and campaign to prevent the UK acting as a safe haven for corrupt capital. On behalf of the global Transparency International movement, we work to reduce corruption in the high risk areas of Defence & Security and Pharmaceuticals & Healthcare.

We are independent, non-political, and base our advocacy on robust research.

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