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Big Changes to Audit Regulation coming and FRC to be abolished

There is a widespread perception that auditors provide insufficient challenge to companies and this has led to unhappiness with the market and its high-level regulator, the FRC. The Government has, despite its other pressing priorities, acknowledged this and two major reports have just been published[1] which promise major change. For those practising in D&O work, regulation and commercial litigation, please see below a summary of key the points:

- The FRC is to be replaced by a new regulator – the Audit, Reporting and Governance Authority (ARGA)- which should be "*respected by those who depend on its work, and where necessary feared by those whom it regulates*" with a healthy budget, strong powers and well paid and capable staff.
- Responsibility for oversight of actuaries should be transferred to the PRA.
- ARGA is to take a pro-active approach, promoting both competition for statutory audit services and better-quality audit and reporting standards, as well as regulating and registering the audit profession.
- ARGA's board itself should have the power to take decisions on whether to launch audit investigations in cases where there is significant concern (some might say this has the risk of politicising investigations).
- ARGA should have the power to approve and register firms conducting audits on public interest entities (PIEs) - quoted businesses - and other large businesses. In theory, ARGA could use this to deprive a firm of its right to conduct audit work, but its powers should be expanded to include requiring firms to implement actions, temporary bans on tendering for new work and requiring enhanced quality control.
- ARGA should have the same powers over accountants as it does over auditors, insofar as they deal with PIEs.
- ARGA should have the power to regulate directors of PIEs to ensure that they prepare and approve true and fair accounts and corporate reports and deal with auditors openly and honestly. This is a substantial extra liability for directors and officers.
- Auditors should report to ARGA where they have concerns about the viability of a PIE (currently this duty only extends to banks and insurers).
- ARGA should be able to direct a skilled person review and implement recommendations, when PIEs are causing concern.
- The new regulator should scrutinise auditor appointments to ensure there is sufficient emphasis on quality and challenge.

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[1] One by Sir John Kingsman at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/765622/frc-independent-review.pdf and the other by the CMA at https://assets.publishing.service.gov.uk/media/5c17cf2ae5274a4664fa777b/statutory_audit_services_market_study_update_paper.pdf

- FTSE350 audits should be carried out by two firms, at least one of which is outside the Big Four, to help build capacity in the audit market.
- Firms should have their audit functions split from advisory functions, with separate legal, managerial and financial operations.

The Government has indicated it will take Sir John's recommendations forward, whilst the CMA is still consulting. This promises to be a major shake up to the world of audit, accountancy and large business regulation. Auditors, accountants, directors and officers, and those who insure these persons, should pay careful attention – they are likely to face a powerful and assertive new regulator.

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