The City of London Law Society

The Law Society

Independent review of the Financial Reporting Council: initial consultation on recommendations

Law Society and City of London Law Society joint response

6 June 2019

Introduction

1. The views set out in this response have been prepared by a Joint Working Party of the Company Law Committees of the City of London Law Society (CLLS) and the Law Society of England and Wales (the Law Society)(together the "Committees").

2. The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

3. The Law Society is the professional body for solicitors in England and Wales, representing over 160,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

4. The Joint Working Party is made up of senior and specialist corporate lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to company law and corporate governance.

5. The Committees share the Government's desire to make the UK an attractive place to invest, employ people and do business. However, the Committees are concerned that some of the proposed reforms to the FRC could result in the UK becoming a significantly less attractive place for people to invest, employ and do business. The new statutory regulator could become a costly regulator with extensive powers to interfere in the running of a company's business, with the risk that this will detract from the responsibilities of directors, shareholders, auditors and others. It is impossible to reach a situation where the regulator will be able to prevent any large company failing but we fear that, when a large company fails, this will be seen as a failure by the regulator and there will be calls for more extensive and costly regulation in future. We are also concerned about how the powers of the new regulator will fit with the existing Companies Act legislation.

Answers to the questions

Q1: What comments do you have on the proposed objective set out in Recommendation 4?

6. The proposed strategic objective does not set out precisely which companies and professional advisers are within the ambit of the strategic objective. We assume that the reference to professional advisers is to auditors and this should be made clear. We note that the objective does not refer to holding relevant directors to account, although Recommendation 36 says that relevant directors should be held to account.

Q2: What comments do you have on the duties and functions set out in Recommendations 5 and 6?

7. We are concerned by the proposed duty to act in a way that promotes competition in the market for statutory audit services. We are unsure what this will mean in practice and how this remit will fit with that of the CMA. Importantly any such duty should not detract from the objective of enhancing the quality of audits. We are not clear whether the proposal is that the new regulatory body should be a specialist regulator with ex-ante powers or whether the proposal is that it should have full concurrent competition enforcement powers to enforce competition law within the audit market or both. If the proposal is to develop a concurrent competition regulator model the relationship with the CMA would, we assume, follow the relationship the CMA has with other concurrent competition regulators in the UK, such as the FCA, OFCOM and OFGEM. We are not sure a case has been made for this body to have full concurrent competition powers and why, if it is the case, it is thought that the new body could do better in exercising its competition law enforcement powers than the CMA could do.

8. We are also concerned by the requirement to promote brevity in corporate reporting and what this means in practice. Companies are increasingly required by law to include more information in their report and accounts and directors should take a considered view as to what is required for the accounts to give a true and fair view. We believe a focus on the quality of the reporting would be a better aim. We would recommend that accounts should be required to be concise and proportionate. Complexity cannot be ignored but companies can be expected to be clear. Financial and narrative reporting for an Aim company with a £10m market capitalisation should be allowed to be simpler than that for a FTSE 100 company.

9. We believe there also needs to be some recognition that companies falling within the remit of the regulator may also be subject to legal and regulatory requirements from other jurisdictions, and that this needs to be taken into account in the regulator's activities.

10. We also think it is important for the regulator to consider proportionality in its approach. The companies that will be subject to its remit will vary in size, complexity and resources and it is important that this is taken into account.

11. In Recommendation 6, we do not understand the reference to "apply" high corporate governance standards. It is the companies that will apply corporate governance standards, not the regulator. Also, the phrase "high corporate governance standards" might be thought to suggest that there is only one standard that applies to all companies, whereas there are various Codes that companies may follow. In bullet point three, it

would be helpful to recognise that the UK Corporate Governance Code is not the only relevant Code.

12. Bullet point three also refers to reporting on “compliance with the Code”. This suggests that it is only compliance with a Code that will constitute acceptable behaviour. However, as Codes operate on the basis of comply or explain, an explanation as to why a company has not followed a particular provision is also good practice. The functions should recognise this.

13. In bullet point six, it refers to “appoint inspectors”. Should this refer to investigators rather than inspectors to be consistent with Recommendation 38? How will this function relate to the powers that the Insolvency Service has and with the power in s431 Companies Act 1985 (the " 1985 Act") for the Secretary of State to appoint inspectors?

Q3: How do other regulators mitigate the potential for conflict between their standard setting roles and enforcement roles as set out in Recommendation 14?

14. No comment.

Q4: Are there specific recommendations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

15. We suggest that a requirement for diversity of the members of the new regulator's board and other roles should be made explicit. It would also be helpful for the regulator to be required to provide information to the public about its structure, so that companies, directors, those regulated and the public can know who has authority to do something.

Q5: How will the change in focus of CRR work to PIEs affect corporate reporting for non-PIE entities?

16. We assume that the reference to PIEs in this context means PIEs as that phrase is redefined (and so may include large private companies and large unlisted public companies as well as listed companies). We think it is important that the CRR reviews should extend to large private companies and large unlisted public companies as well as listed entities. However, where a company that would be caught by the requirement is a subsidiary of another company that is subject to an obligation to report, we think there should be an exemption from the reporting requirement.

Q6: What are your views on how the pre-clearance of accounts proposed in Recommendation 28 could work?

17. We have various queries and concerns about how the pre-clearance procedure might work and welcome the proposals to pilot a procedure initially.

18. The Government response says that the service would apply to the treatment of “novel” and “contentious” matters. We are not sure that this gives companies and auditors sufficient clarity as to when the regulator will be willing to offer a pre-clearance (or whether there are other cases where a pre-clearance would be helpful eg because the company has changed its business and so has to deal with something it has not encountered before, although the point may not be “novel” to other companies).

19. We are concerned as to how many companies and auditors will wish to take advantage of this service and so what the implications will be for the regulator as to how many staff it employs to deal with this function. We assume that the fees charged will be intended to cover the cost of providing the service, but that this may differ depending on the complexity of the question asked. How will fees be determined? Will a company know in advance what the fee will be or how it will be calculated? It will be important that the fee does not make the service prohibitively expensive for smaller entities that may wish to use it.

20. From the perspective of the company or auditor, it will be important to know when they will receive a response to their query, so as to be able to fit it into their timetable for publication of financial information. Will the regulator be able to commit to responding within a given time frame? This will have implications for the number of staff it will need. What would the position of a company or auditor be if they have submitted a query, have not received a response in time from the regulator and need to publish the relevant information? Will the new regulator be empowered to engage in "hypothetical" or "no names" discussions with companies and their auditors? The FCA used to offer a similar service with regard to the application of the Listing Rules, although this service has since been stopped.

21. We assume that the regulator will be concerned about its position and will want to be able to assume that it has received all relevant information from the company and auditor. We assume any pre-clearance will be on this basis. This is relevant to the status of any query where the regulator has given a pre-clearance. What will the position be where the regulator has given a pre-clearance? We assume that immunity from challenge (if that is the intended consequence) will be limited only to the particular query and cannot, for example, mean that the accounts cannot be queried on some other basis.

22. We think it is important that any pre-clearance system does not work in such a way as to detract from the directors' responsibility for taking a view on whether the accounts give a true and fair view or from the auditors' responsibility for auditing the accounts.

23. Some questions may involve a mixture of the application of accounting standards and the requirements under the Companies Acts. An example is whether a company is required to state what its distributable profits are (where different Queens Counsel have expressed different opinions). Is it intended that the pre-clearance procedure will extend to such questions which involve company law?

24. Is it proposed that the regulator will publish an annual report (perhaps on a basis that does not refer to the relevant companies by name), setting out the sorts of queries it has dealt with and its views on the points raised? We think that would be helpful for many companies and auditors.

25. If the regulator comes to a conclusion that is not the one the company or auditor is expecting, it is possible that this will have a significant effect on the company's position. For listed companies, this may result in the company having inside information and the company will need to consider whether to make an announcement under MAR as a result. In view of the sensitivity of this, it is important that the regulator appreciates that this may be the case, has good procedures to maintain the confidentiality of any requests for a clearance and liaises sensitively with the company and auditor so that the company can meet its obligations to make an announcement. This situation arises in a number of FCA/PRA engagements for regulated entities and, as such, there is precedent

for these types of procedures. It might be helpful for the regulator to discuss with one or both of the FCA and the PRA what approach would best be able to deliver this.

Q7: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

26. We support an effective regime to ensure accounts meet the requisite standard but have concerns about any proposals to move away from (or affect) the concept of collective board responsibility that applies under the current regime.

27. The general duties of directors are set out in sections 171-177 of the 2006 Act and are owed to the company. In addition, Part 15 of the 2006 Act sets out numerous obligations of the company, including a duty to keep accounting records (section 386) and, in section 393, an obligation on the directors not to approve accounts for the purposes of the 2006 Act unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss of the company or group (as appropriate). Section 414 requires that the company's accounts be approved by the board and signed on their behalf by a director of the company and, under section 414(4), if accounts are approved that do not comply with the requirements of the2006 Act (and Article 4 of the IAS Regulation, if applicable), then every director who knew that they did not comply, or was reckless as to whether they complied and failed to take reasonable steps to secure compliance with the relevant requirements commits an offence.

28. Under section 499 an auditor has a right of access at all times to the company's books, accounts and vouchers and may require any officer or employee of the company to provide him with such information or explanation as is necessary for the performance of his duties as an auditor. Section 501 makes it an offence for any person to knowingly or recklessly make a statement to an auditor that conveys or purports to convey any information or explanation which the auditor requires or is entitled to require under section 499 and is misleading, false or deceptive in a material particular.

29. As such the 2006 Act is very clear as to the duties and responsibilities which fall on the directors individually and collectively and where liability arises in respect of any failure of duty. The 2006 Act very clearly provides that each director commits an offence if he or she knew the accounts did not comply with the requisite standard or was reckless in that regard and failed to take reasonable steps to secure compliance.

30. The concept of a unitary board with collective board responsibility is a fundamental tenet of English company law and is well understood by both directors and those dealing with companies. It also reinforces the importance of each director discharging his or her own responsibilities responsibly and diligently. It is not clear to the Committee what more is needed in this regard.

31. The Recommendation that a new regulator develop proposals for a separate enforcement regime which treats certain members of the board differently from others and holds them to different standards risks undermining this key principle. It is not clear what the rationale is for any such separate regime and, in our view, it risks creating a situation where the directors do not feel equally responsible for the contents of the accounts, which may lead to board division, confusion and a less engaged approach from those not expressly within the scope of any such new enforcement regime. Further, it is unclear to us how any such enforcement regime would operate alongside the existing directors' duties regime in the 2006 Act. To have two separate, potentially

conflicting, regimes would, in our view, create confusion and uncertainty and would result in increased cost for business.

32. We note in the Initial Consultation, that, whilst the government welcomes the proposals to review and enhance the sanctions regime for audit and for directors, it recognises that changes to this regime will require careful consideration of how any new policies interact with the existing enforcement framework. We would also be keen to understand better how this "new" regime would be intended to work alongside the existing liability regime in the Act and, if helpful, to work through with you and your colleagues possible constructs.
33. We would welcome a review of how any new regime is working in practice 3 years after the regime comes into force.

34. We are also unsure how the role of the new regulator will fit with the powers of the Secretary of State in section 477 of the 1985 Act to require the production of certain documents and information. Will this become a power of the regulator? Will the protections in section 448A in relation to certain disclosures also be replicated and related provisions also be transferred to the new regulator?

35. Recommendation 25 recommends that the regulator be given power to direct changes to accounts rather than having to go to court to achieve this. In our view, any change to the formal procedure by which directors can be required to revise accounts needs to contain appropriate checks and balances.

36. As you will be aware, the current procedure for the revision of defective accounts and reports is set out in Chapter 11 of the Companies Act 2006 (the "2006 Act"). Sections 455 and 456 of the 2006 Act first require the Secretary of State to give notice to the directors indicating the respects in which the accounts or reports do not appear to comply with the requirements of the Act, specifying a time of not less than one month for the directors to provide an explanation of the accounts or reports or prepare revised accounts or reports. After this time, if it appears to the Secretary of State that the directors have not provided a satisfactory explanation or revised the relevant documents, then the Secretary may apply to the court for a declaration that the accounts or report do not comply with the requirement of the Act and requiring the directors to revise them. Section 457 of the 2006 Act also permits the Secretary to make an order authorising other persons to apply to the court under section 456. The Conduct Committee of the FRC is so authorised and must exercise its authority pursuant to its published operating procedures.

37. This current process ensures that directors and companies producing accounts are subject to a clear, transparent and proportionate regime should the Secretary of State believe that the accounts in question are defective in some way.

38. The Review recommends that, in future, powers be given to the new regulator to direct changes to reports and accounts without the need to seek a court order. This raises a number of important issues.

39. First, is the intention that the current provisions of the Act regarding revision of defective accounts will be removed from the Act and incorporated in a new rulebook published by the new statutory regulator? If so, what will be the status of the relevant rules as a matter of law? Is it proposed that the power in section 454 for directors to prepare revised accounts on a voluntary basis will remain in the Act?

40. Secondly, the requirement to seek a court order to revise defective reports or accounts where the directors in question are regarded as not having taken appropriate action

ensures that there is a careful and independent assessment of the circumstances by the court. The removal of any such "check and balance" must be undertaken with care and, to the extent that the power to direct that reports or accounts are corrected is to be given to a new regulator, it will be important to ensure that the statutory powers and objectives of such regulator are clear and transparent and that there is an obligation on the regulator to act in a manner which is proportionate to its stated objectives. In this regard, Recommendations 1 (Category 3 recommendation) and 5 (Category 2 recommendation) are helpful, requiring that the regulator be given clear statutory powers and objectives and that it should be required to act in a way which is proportionate, having regard to the size and resources of those being regulated and balancing the costs and benefits of regulatory action. We believe it is critical that these recommendations be adopted with equal force and effect if this proposal is to be implemented. We also think that there should be a clear process of appeal for a company to use (in the same way as a company could appeal against a court ruling). Is it proposed that any regulatory rules will include a provision equivalent to section 457 (Other persons authorised to apply to court)?

41. Will the regulator be required to take account of any other obligation on the company as to information in the report and accounts (eg as a result of a listing in another jurisdiction)?
42. It is proposed in Recommendation 29 that the corporate review process should extend to the entire annual report, including corporate governance reporting. We assume that this is not intended to detract from the comply or explain approach to corporate governance. Nor should it detract from the important stewardship role of investors. We are not sure if the regulator will have any responsibility for determining the quality of any explanation given. If so, how will this fit with the FCA's responsibilities under the Listing Rules and DTRs for listed companies?

43. We are not clear whether Recommendation 38 that director disqualification should rest with the Insolvency Service will always be appropriate. Will there be cases where a company is not insolvent but the regulator wishes to disqualify a director? The CMA also has a power to disqualify directors, so it will be important to consider how the regimes would fit together.

Q8: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

44. We are not clear whether it is proposed that the power to require rapid explanations from companies (as set out in Recommendation 46) is intended to apply only to PIEs or to a broader range of companies. For listed companies or companies subject to other regulatory requirements this process could give rise to questions about whether the company has an obligation to make a public announcement about the process. The regulator should be mindful of this and it would be worth it discussing the proposed approach, eg to confidentiality and how the regulator will apply any such process with the FCA.

45. We have considerable concerns about Recommendation 47 which recommends the regulator be given powers to commission a skilled person review. We think the test as to when this will be appropriate is not sufficiently clear. When would the regulator conclude that there is a significant interest arising from its strategic objective? How would the potential cost of a review be factored into any decision? We note that the FCA has very detailed rules about when it can require a skilled person review and how this would work. We think the regulator would need to have something equivalent.

46. We assume that a skilled person's report might include information that is commercially sensitive or confidential and that it should be possible for such information not to be published. It should be clear in what sort of cases it would be thought to be in the "public interest" to publish a report. How would a balance be struck if there is a conflict between the interest of shareholders or creditors on the one hand and the interests of the public more broadly on the other hand? If it is thought publication might jeopardise, eg discussions to refinance the company, how would this be taken into account?

47. We think that a skilled person's report could impose significant burdens on a company, both as to cost and the time to be spent by management dealing with the review. This could make the UK significantly less attractive, particularly if the cases in which such a review is likely to be started are not clearly limited.

48. We are not clear what is meant in Recommendation 49 by the regulator having power to require a company to "procure additional assurance" on the viability statement. There is a risk that, if this is seen to cast doubt on the company's viability, it could have a significant effect on the company's ability to continue trading, even where the regulator does not have doubts about that. This risk will need to be managed carefully. Similarly a requirement for the board to respond formally on risks to financial viability could result in more companies becoming insolvent or failing to restructure in the most beneficial way.

49. In Recommendation 50, what tests will determine "the most serious cases" referred to here? Before the regulator issues such a report, will there be a process for the company and relevant directors to provide their view and relevant information? We assume that any such report would set out the basis on which the regulator had reached its conclusions. Again, this may need to deal with confidential information and it is possible that the publication of such a report could involve inside information.

50. The UK's corporate governance regime is a globally recognised asset which, in our view, enhances the reputation of the UK as an attractive place to conduct business. With regard to Recommendation 51, we would urge BEIS to proceed with caution when considering any steps which might risk adversely affecting the UK's attractiveness as a place to invest or to establish or publicly list companies, for example, by the introduction of a regime similar to that of the US Sarbanes-Oxley regime, which is often regarded as an unduly burdensome and costly regime.

51. There are a number of existing requirements that require boards of UK-incorporated and listed companies to establish procedures to manage and oversee the company's internal controls and to report on their robustness. Recent reforms have also bolstered the corporate governance compliance and reporting regime for large private companies.

52. Recent legislative changes to the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 require qualifying UK-incorporated companies to provide a statement of their corporate governance arrangements in their directors' report in respect of financial years starting on or after 1 January 2019. A company "qualifies" for these purposes if it has (i) more than 2,000 employees; or (ii) a turnover of more than £200 million and a balance sheet total of more than £2 billion. The corporate governance statement must state (a) which corporate governance code, if any, the company applied in the relevant financial year; (b) how the company applied any such code; and (c) if the company departed from such code, the respects in which it did so and its reasons for so departing. If the company has not applied any corporate governance code for the financial year, the statement must explain the reasons for that decision and explain what arrangements for good governance were applied for that year.

53. The Wates Corporate Governance Principles for Large Private Companies were published in December 2018 and the government has publicly stated its hope that many large private companies will adopt these Principles (although at this stage in the reporting cycle it is too early to see whether this will in fact be the case). Principle 4 (opportunity and risk) states that "*A board should promote the long-term sustainable success of the company by identifying opportunities to create and preserve value, establishing oversight for the identification and mitigation of risks*". Supporting guidance recognises the need for the board to both establish an internal control framework and agree an approach to reporting, including frequency and the points at which decisions are made and escalated. The requirement for large private companies to report expressly on their governance arrangements is relatively new and should be given time to properly bed down before any further major changes are proposed.

54. Listed parent companies that meet the threshold referred to above are excluded from the above requirement where they are required to make a corporate governance statement under the DTRs (see below).

55. DTR 7.1 requires listed issuers to establish an audit committee where a majority of members (including the chair) are independent, at least one member must have competence in accounting or auditing, or both, and the members of the committee as a whole must have competence relevant to the sector in which the issuer operates. DTR 7.1.3 requires the audit committee to monitor the effectiveness of the company's internal quality control and risk management systems, and, where applicable, its internal audit regarding the financial reporting of the issuer.

56. In addition, DTR 7.2.5 requires issuers to prepare a corporate governance statement containing a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process. Under section 497A of the 2006 Act, the company's auditor must, in their report on the company's annual accounts, state whether (i) in their opinion, based on the work undertaken in the course of the audit, the information given in the DTR 7.2.5 statement is consistent with the accounts and has been prepared in accordance with applicable legal requirements; and (ii) in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, they have identified materials misstatements in the information in the statement (and indicate the nature of any such misstatements).

57. The obligation is further supported, in the case of premium listed companies, by the requirement of the UK Corporate Governance Code (July 2018) that the board establish procedures to manage risk and oversee the internal control framework (Code Principle O). The Code also contains recommendations regarding the establishment of an audit committee and goes further than DTR 7.1 by recommending that it comprise solely independent non-executive directors. The audit committee's primary responsibilities should include reviewing the company's internal financial controls and internal control and risk management systems (Code provision 25) and the FRC has published Guidance on Risk Management, Internal Control and Related Financial and Business Reporting (September 2014) and Guidance on Audit Committees (April 2016) to support boards and audit committees in their activities. Whilst companies report on a "comply or explain" basis against the Code, most invariably comply due to investor pressure to be seen to be maintaining appropriately high standards of corporate governance.

58. Recommendation 51 suggests that BEIS should look to strengthen these existing requirements, learning any relevant lessons from operation of the Sarbanes-Oxley regime in the US.

59. Two key elements of the Sarbanes-Oxley Act of 2002 ("SOX") were to: (i) require public companies to strengthen their corporate governance by the creation of audit committees made up of board members independent from management; and (ii) define and place responsibility for the company's financial statements with the CEO and CFO, requiring public companies to include in their annual reports a report of management on the company's internal controls over financial reporting. The report is required to include (i) a statement of management's responsibility for establishing and maintaining adequate internal control over financial reporting for the company; (ii) management's assessment of the effectiveness of the company's internal control over financial reporting; (iii) a statement identifying the framework used by management to evaluate the effectiveness of the company's internal control over financial reporting; and (iv) a statement by the company's auditors that they have issued an attestation report on management's assessment of the company's internal control over financial reporting (the "Section 404(b) requirement"). Alongside the requirement for management to issue this report, SOX introduced stiff penalties for executive officers who falsely issue such certifications.

60. As indicated above, the requirement in SOX for public companies to establish an audit committee comprised of board members independent from management, already exists as part of the UK corporate governance regime with any departure from that approach having to be explained to investors and other stakeholders. We are not aware of any compelling rationale for turning this into a strictly statutory obligation.

61. Equally, those provisions of SOX placing liability for the financial statements and related internal controls on the executives (as opposed to the board as a whole) raise similar concerns to those discussed above in relation to Recommendation 36 regarding collective board responsibility for the company's accounts and reports. Any reform which introduces an enforcement regime which treats certain members of the board differently from others and holds them to different standards risks undermining the principle of collective board responsibility and thereby potentially weakening, rather than strengthening, good corporate governance. It is also worth noting that, although in the UK the CEO and CFO are typically board members, this is less commonly the case in the US and this distinction should be kept in mind when comparing the UK and US regimes.

62. It is also importance to recognise the costs and regulatory burden that the SOX regime placed on small business, which ultimately led to the introduction of the Jumpstart Our Business StartUps (JOBS) Act in 2012 to alleviate some of this burden. In particular, the JOBS Act reduced the number of companies subject to the Section 404(b) requirement by establishing a new class of issuer called the emerging growth company ("EGC"). Under the JOBS Act, certain regulatory requirements are phased in for EGCs during a five-year period, giving these newly public companies time to develop before subjecting them to the full burden and cost of SOX compliance.

63. When the requirement for CEO and CFO certifications was first introduced as part of SOX, many CEOs and CFOs sought independent legal advice on the robustness of the internal controls systems they had put in place in order to provide them with additional comfort in the context of providing the required certifications. Similarly, the need to formalise many internal policies before the auditors were prepared to issue their report on the company's internal control systems was seen as particularly burdensome, especially for smaller issuers.

64. We are firmly of the view that, as noted in the Recommendation itself, any changes to the current regime must be both proportionate and risk-based, having regard to the size and resources of those being regulated. Equally, it is important to consider whether adopting aspects of the SOX regime would in fact improve auditing standards and

accountability in a meaningful way rather than simply resulting in greater costs and administrative burden. We note with approval the government's recognition in the Initial Consultation that this is a detailed and complicated issue and its intention to bring forward a separate consultation in due course before seeking to implement extensive changes.

Q9: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

65. Recommendation 57 recommends that the regulator should not allow staff, board or committee members ever to work on any regulatory functions relating to a past employer. There is no time period suggested as to when this should apply. However, this may not be consistent with Recommendation 68 that the regulator should develop a pool of former or retired senior executives and experts. In any case, we think it is unrealistic and unnecessary to require staff, board and committee members never to work on functions relating to a past employer. We think if this were limited to not working on functions relating to a firm that had been an employer within a stated period, this would be sensible. We also think that it may be appropriate to differentiate between different members of staff. For example, those involved in monitoring and enforcement may need to be subject to stricter requirements than other staff and board and committee members. We note that the UK Corporate Governance Code has a presumption against independence where a director has had a material business relationship within the last three years. If there is a blanket ban, there is a real risk that the regulator will deprive itself of the experience and abilities of individuals who would otherwise make a significant contribution to the regulator. We suggest that there should be further consultation on this policy at a later stage as to the relevant time periods appropriate for different responsibilities.

66. Recommendation 60 recommends the regulator should monitor trends in complaints received by, and regarding, professional bodies. We assume this is limited to professional bodies relating to auditing firms, but this should be made clear.

Q10: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

67. It is proposed that BEIS should put in place a statutory levy, but it is not clear who will have to pay this levy. It would be helpful for BEIS to clarify how any fees charged in relation to the pre-clearance of accounts link to this levy. In particular, would any such fees be in addition to the levy?

Q11: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

68. We are concerned that the regulator will not necessarily have the right skills available to it to meet its proposed competition role. We think there is a real risk of duplication between this regulator and the CMA and that this will impose further costs on companies and others.

Q12: Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?

69. No comment.

Q13: What evidence or information do you have on the costs and benefits of these reforms?

70. As stated before, we are concerned that there is a real risk that the costs of the proposed reforms could be considerable, could increase over time and will not necessarily be outweighed by the potential benefits. In particular we think there could be considerable costs if a regime similar to SOX is adopted and individual CEOs and CFOs may incur additional costs in taking their own advice before giving any certificates. We assume that information is available from US companies as to the amount of costs typically incurred. We assume that companies that have been subject to skilled person review can also provide information on the costs they have incurred.

Q14: What further comments do you wish to make?

71. We firmly support the objective that the UK should remain an attractive place to do business and it will therefore be important that there should be a reasonable prospect that the costs of the proposed new regulator will be justified by the benefits of its activities. We think there is a real risk that, if a significant company fails after the introduction of the new regulator, this will be assumed to be a failure by the regulator and that it will be given more powers and responsibilities, incurring more costs itself and imposing more cost and more regulation on companies, without a reasonable prospect that this will avoid further problems in future or deliver meaningful benefit. This could lead to the UK becoming an unattractive place to do business. There are parallels with the establishment of the Financial Services Authority and its replacement by the Financial Conduct Authority. There is also a risk that the establishment of a regulator will lead to a mindset that the public and shareholders are entitled to rely on the regulator to prevent problems and the responsibilities of directors, shareholders, auditors and those who deal with companies will be undermined.