CALL FOR EVIDENCE TO THE INDEPENDENT REVIEW OF THE FINANCIAL REPORTING COUNCIL

BY SIR JOHN KINGMAN

SUBMISSION OF RECOMMENDATIONS

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1. Introduction and preliminary remarks

1.1 Our expert group submitted a dossier of preliminary evidence to the Kingman Review on 17 July 2018 containing background and contextual materials which we believed would be of use in their deliberations. In essence, these materials contained evidence which, in our view, proves that the FRC has failed to act as an effective regulator of the auditing and accounting profession.

1.2 In the light of our preliminary submission, the purpose of this paper is to set out our views on the current and historical effectiveness of the FRC along with our recommendations for its reform so that the Review can, as it states in its request for the submission of evidence, *"…put forward proposals which aim to make the regulatory system as effective and credible as it needs to – the "beacon" called for by the Government in the Review's terms of reference."*

1.3 However, before the doing so, it is worth noting that the history of auditing and accounting standards has developed over the centuries so as to provide "general-purpose financial statements" for the protection of investors and society as a whole in response to major earlier scandals. An excellent summary of this history is set out in the early chapters of Richard Brooks' called "BEAN COUNTERS – OF THE TRIUMPH OF ACCOUNTANTS AND HOW THEY BROKE CAPITALISM" which was published in June of this year.

1.4 In addition, as Richard Murphy, one of our expert group, writes in his personal submission to the Review, *"In 1975 the then UK Accounting Standards Steering Committee… said that there were seven stakeholder groups whose needs have to be met by what are now known as general purpose financial statements."* Along with investors, these included, *"Civil society more generally, including*

taxpayers, ratepayers, consumers and other community and special interest groups including political parties, environmental protection societies and regional pressure groups."

1.5 In our view, the list set out in that document continues to be fit for purpose but the regulation and the law intended to achieve this objective has clearly failed over time, as the profession and its regulators have lost their way.

1.6 The Kingman Review needs to reinvent the regulatory system in order to achieve this central objective of auditing and accounting which was not invented for the benefit of the corporate and its executives but for the benefit of investors, tax authorities, other regulators and society as a whole. Under the Companies Act 2006 (relevant sections attached in our preliminary submission) auditing and accounting is a public duty not a private duty and to that extent it is directly in conflict with the fiduciary duties of Directors of companies whose duties are, in essence, to the shareholders and which are, therefore, private duties.

2. Current and historical effectiveness of the FRC

2.1 We do not propose to dwell at any length on this subject or to enumerate in detail the large number of corporate failures / scandals over the past decades in the UK and elsewhere in which auditing, accounting and corporate governance have either been formally found, or have been alleged and assumed by commentators, to have played a substantive role. However, it is worth listing some of the more prominent examples:-

- Alliance & Leicester
- Autonomy Corporation
- BAE Systems
- Barclays
- Barings Bank
- BCCI
- BHS
- Blue Arrow
- Bradford & Bingley
- BT Group
- BP
- Carillion
- Conviviality
- Coloroll
- Co-operative Bank
- Dunfermline Building Society

- Eurasian Natural Resources Corporation (ENRC)
- G4S
- GlaxoSmithKline
- Guinness
- HBOS
- HSBC
- Kazakhmys
- Maxwell
- MG Rover
- News Corporation
- Northern Rock
- Polly Peck
- Rolls-Royce
- Royal Bank of Scotland
- Standard Chartered
- Tesco

Of course, some of these even came before the Cadbury Report in 1992 but it is clear that that reform did not achieve its laudable objectives.

2.2 The indisputable fact is that it is almost universally accepted by independent commentators, the media and well-informed members of the investor community and general public, that when it comes to auditing and accounting and corporate governance, "There is something rotten in the state of Denmark". We would say that it is a "res ipsa loquitur" (a matter that speaks for itself) or a QED that auditing, accounting and corporate governance has fundamentally failed the stakeholders who it is required to protect. There is an obvious gap between what stakeholders are entitled to expect of auditing, accounting and corporate governance and what is, in fact, delivered. Auditing does not do "what is says on the tine". Indeed, the FRC's own Audit Inspection Unit has concluded, over the years in which it's work has been made public, that the quality of auditing is unacceptable and, even in its latest report, after all the recent criticisms, it has concluded that matters and not improving.

2.3 In response to these obvious and numerous instances of failures in auditing and accounting and corporate governance, no adequate steps have been achieved by the regulatory system (i.e. the FRC and the ICEAW) which is supposed to set the appropriate rules and standards as well as to carry out effective oversight and enforcement to prevent such failures happening again and again. This is proved conclusively by the latest failure of Carillion.

2.4 Of course, it should be noted that corporate failures always have multiple victims. Damage of a severe nature is caused to the State (through reduced tax and national insurance revenues as well as the general shock to the economy), investors, suppliers, employees and expectant customers.

2.5 The FRC's response in such circumstances has essentially been the same "It's not our fault. Auditing, accounting and corporate governance is what it is and there's nothing we can do about it. It doesn't provide the protection that stakeholders think it does and we have no power, in the circumstances, to do anything about it. But, if you give us more powers we might be able to do something about it. Anyway, we have learned our lessons now and will be more vigilant in the future."

2.6 This is a completely inadequate response. To be effective and credible (a "beacon") any regulator, when faced with circumstances of continuous failure and constant criticism by its stakeholders as well as the media, will change the rules and standards that apply, will increase the rigour of its oversight and launch investigations and enforcement actions to hold firms accountable for failures and to create the deterrent to prevent similar failures happening again. And, if the regulator in question doesn't have the existing powers to do so (which, in our view, the FRC did), it makes absolutely sure that it gets them post-haste from the political powers that be.

2.7 In our submission of preliminary evidence, we have set out in some detail our views on the failures of the FRC in relation, in particular, to the application of auditing, accounting and corporate governance standards to HBOS. Specifically, we draw attention to their failure to investigate the KPMG audit of HBOS as well as the other advisory work that they carried out even though the FRC, as the primary regulator, has the duty to investigate potential misconduct when it is a matter of public interest. It should not be forgotten that not only did KPMG audit HBOS but it also provided supposedly independent advice and sign off in relation to both the "atypical credit risk management within the Corporate Division" but also in relation to loan loss provisioning as well as the investigation of Paul Moore's allegations that he was dismissed by James Crosby, the then CEO, for raising Protected Disclosures.

Other than the role of PwC in relation to RBS, what could be more of public interest than the failure of HBOS, requiring as it did substantial taxpayer liquidity and recapitalisation? Frankly, it is extraordinary that the FRC has had the hubris to resist, on three separate occasions, the demands for a public interest investigation into KPMG's role. It is particularly disconcerting, when, right in the middle of the "fray", following a meaningless consultation, the FRC raised the "hurdle" before which it would launch a disciplinary investigation from simply "below the standards expected" applicable to "significantly below the standards expected". Most people would say that this was acting in bad faith. Indeed, many commentators have alleged and have evidence that the FRC has taken decisions and acted in a dis-ingenuous fashion or, maybe, even in breach of the civil and criminal law.

2.8 To cap it all, we should not forget the obvious conflicts of interest that exist within the FRC in relation to its close connection to the accounting profession and, in particular, the Big Four accounting firms as well as big business. Given the allegations that have constantly been made in relation to the financial reporting, its auditing and corporate governance at HBOS, how could it come to pass that a prior Chairman of Lloyds Banking Group, after its acquisition of HBOS, could be appointed as the Chairman of the FRC? It is literally beyond belief. Many commentators might say that the FRC is run by a Cabal of the establishment whose intention, despite an outward appearance of being a regulator, is to protect / offer public relations for, rather than set appropriate standards for, or conduct rigorous oversight of, the accounting profession or big business. This is wholly unsatisfactory. It acts more like a trade association than a regulator.

2.9 Yes, it is true to say that, since the Carillion failure and the announcement of the Kingman Review, the FRC has engaged in a "flurry of activity" to give the appearance that it is changing its approach. However, we are confident that the review team will conclude, as we and all reasonable and independent commentators have done, that this is just "too little, too late" and solely to give the appearance of reform to protect its position and the reputation (and excessive remuneration which is in contravention of its duties as a "Public Body") of its executive and non-executive leadership.

2.10 So, in conclusion, no reasonable person or tribunal could arrive at any judgement other than auditing, accounting and corporate governance does not do "what it says on the tin" and that the current regulatory system has done nothing to prevent this over very many years. The FRC is fundamentally flawed and inadequate, both in design as well as implementation, in relation to its strategy, culture, personnel, structure, the rules and standards it sets and its approach to oversight and enforcement. It has failed and will continue to fail. It has totally lost the confidence of its key stakeholders. It needs to be abolished and replaced with a regulatory system that is fit for purpose and which will achieve the objectives of this review.

2.11 As Paul Moore wrote in his letter to David Andrews dated 12 January 2012 (Document 6.1 in our preliminary submission): –

General comments

It goes without saying that the accounting profession is absolutely crucial to the proper workings of society and we need to be extremely careful as to how we re-organise its regulation to ensure that we do not give the message that the current status quo is satisfactory.

Of course, we all want less regulation and, to that extent the intention behind the proposals to reform the FRC is both right and good. Of course, we do not want over-lap between what the FRC does and what the other "institutes" do e.g. ICAEW.

But the trouble is that there really is a very great deal that needs to be done to reform the way the accounting profession works – including its regulation and supervision – before we "tinker" at the edges with structures, scope and focus of what the FRC does. To repeat the well-known clichés – the proposals to reform the FRC, feel a bit like re-arranging the deck chairs on the Titanic or fiddling while Rome burns. In fact, in my opinion, I would say that the current proposals increase the risks to society associated with the accounting profession by giving a distinctly wrong message of "lightening up" regulation and supervision when, in fact the opposite is actually required.

The heart of the problem here is about culture, responsibility and ethics – just like economics generally and probably society as a whole.

*It seems to me that, in any civilised and developed society, if we cannot be satisfied **so that we are sure** that we can trust and rely on the competence, integrity and independence of our professionals – the very people who are supposed to be the best educated, brightest and most honest people in society - we are in real trouble."*

2.12 We strongly recommend that the review team does not waste its energy, time and focus on a blow by blow exercise in proving that the FRC has failed. That can be taken as read. This is understood and accepted by all key stakeholders other than the FRC and the accounting profession itself. The protestations, loud though they may be, of these constituents are self-serving.

3. Recommendations for a new regulatory system

3.1 **The crucial importance of the right leadership and personnel -** Before setting out our proposals for an effective and credible regulatory system for auditing, accounting and corporate governance, it is important to emphasise that, without the right leadership and other personnel, no new system will be effective. And, this is a very difficult "nut to crack" as has been seen with other regulators. For example, appointing the ex-Senior Partner of KPMG as the chairman of The Financial Conduct Authority, when KPMG have failed in its auditing responsibilities of many of the banks, was bound to cause criticism and to ensure that the authority was on the back foot when it came to inspiring confidence in its stakeholders.

On the one hand, it is vital to have personnel with the requisite technical knowledge but, on the other, it is even more important that conflicts of interest are avoided. In these circumstances, it is better to appoint leadership who understand the principles and values and culture required as regulators rather than those who have the greatest technical knowledge in auditing, accounting and corporate governance. Indeed, a good deal of what is required to be effective from a technical standpoint is as much about common sense as it is about current technical knowledge. It is often the case that those who have been steeped in the status quo of the technicalities of the subject are, in fact, unable to "think out of the box" and set the appropriate rules and standards which the ordinary stakeholder would consider obvious.

In these circumstances, we would strongly recommend that the leadership of any new regulator knows more about regulation (i.e. setting the right principles, rules and standards; carrying out rigorous risk-based oversight and assurance; conducting forensic investigations in the face of wrongdoing; enforcing and disciplining actual wrongdoing) than the technicalities of auditing, accounting and corporate governance. A leader with this type of regulatory expertise can be supported by a broad range of technicians, including academics, as well as individuals who represent all key stakeholders as set out in the 1975 paper as referred to above who can provide input that specifically relates to the needs of the various stakeholder groups.

3.2 **Auditing, accounting and corporate governance now needs statutory regulation -** So far as the constitution of any new regulator is concerned and the legislation under which it is set up, we see no other choice but that it should be statutory in the same way as The Financial Conduct Authority or The Prudential Regulatory Authority. The legislation should be similar to the enabling legislation for The FCA and PRA. It should set out specific broad objectives for the new regulator and give it the powers to set rules, standards and guidance subject only to preliminary work setting out a cost benefit analysis. So, for example, the statutory objectives for the FCA are to maintain market confidence, protect consumers, educate consumers and fight financial crime. A new auditing, accounting and corporate governance regulator (The AACG Authority) would certainly have an objective to protect the stakeholders as set out in the 1975 paper referred to above as well as to maintain market confidence.

There are arguments to remove responsibility for regulating corporate governance from the same regulator that oversees auditing and accounting. However, in our view, auditing and accounting is, in fact, a crucial part of corporate governance, the aim of which should principally be to ensure a proper separation and balance of power between the executive and all other constituents of the organisation which are responsible for the "checks and balances" i.e. internal control functions (risk,

compliance and internal audit), non-executive directors, external auditors, shareholders and regulators. In these circumstances, we recommend that any new regulator, along with auditing and accounting, is also responsible for both setting the rules and standards relating to corporate governance as well as to supervising them.

3.3 **The new regulatory system must ensure personal accountability of senior managers to act in accordance with high-level standards of conduct -** We recommend that any new regulator of auditing, accounting and corporate governance implements a similar set of "Principles for Business" and "Senior Managers and Certification Regime" to ensure personal accountability of those in positions of responsibility for wrongdoing and failure e.g. audit engagement partners as well as the managing partners of the relevant audit firm. For ease of reference for the review team, we copy below three sections that explain the FCA Senior Managers and Certification Regime in summary:-

FCA objectives

ENTERPRISE LEARNING

"Firms' senior managers have a crucial role in demonstrating that they are accountable and responsible for their part in delivering effective governance. This includes taking personal responsibility, being accountable for their decisions and exercising rigorous oversight of the business areas they lead. **We want all firms to develop a 'culture of accountability' at all levels** and for senior individuals to be fully accountable for defined business activities and material risks."

"The SM&CR aims to:

- encourage staff to take personal responsibility for their actions
- improve conduct at all levels
- make sure firms and staff clearly understand and can demonstrate who does what"

FCA FINANCIAL CONDUCT AUTHORITY

Regimes in overview

1. **Senior Managers Regime**
   a) Prescribed Senior Manager Functions and responsibilities
   b) All SMF holders will need prior approval from FCA
   c) All SMF holders should be "suitable" to do their jobs and 'certified' by firm annually
   d) All SMF roles to have a Statement of Responsibilities provided to FCA on appointment and on any "major change" to responsibilities
   e) Requirement to submit Responsibilities Map to FCA regularly
   f) All SMF roles to be subject to "Duty of Responsibility"
   g) Handover Procedures to cover transition when senior manager leaves or changes role
   h) NEDs: all covered by Conduct Rules, Fit and Proper Checks and Regulatory References. Some will be SMFs.

2. **Certification Regime**
   a) Covers roles not included in SMR whose jobs mean they can have a big impact on customers, markets or the firm.
   b) Requirement to certify "at least annually" that they are suitable to do their job

3. **Certification Regime**
   a) Covers SMF and Certification roles and all other roles (except ancillary jobs)
   b) Code of Conduct and responsibilities
   c) Role holders need to understand be educated
   d) Poor conduct must be notified to regulator
   e) More prescription around provision of 'regulated references'

More prescription; increased duties for firms; very wide coverage of people

Conduct Rules

	First Tier – Individual Conduct Rules
1	You must act with integrity
2	You must act with due care, skill and diligence
3	You must be open and cooperative with the FCA, the PRA and other regulators
4	You must pay due regard to the interests of customers and treat them fairly
5	You must observe proper standards of market conduct
	Second Tier – Senior Manager Conduct Rules
SC1.	You must take reasonable steps to ensure that the business of the firm for which you are responsible is controlled effectively
SC2.	You must take reasonable steps to ensure that the business of the firm for which you are responsible complies with the relevant requirements and standards of the regulatory system
SC3.	You must take reasonable steps to ensure that any delegation of your responsibilities is to an appropriate person and that you oversee the discharge of the delegated responsibility effectively
SC4.	You must disclose appropriately any information of which the FCA or PRA would reasonably expect notice

3.4 **The new regulatory system could adopt many of the approaches which have already been developed by the FCA and PRA -** Whatever many commentators may say about the operation and effectiveness of the FCA and PRA, in our view this is much more about implementation than it is about strategy, structure, process or powers. For example, the FCA's approach to The Principles for Business and the new Senior Managers Certification Scheme as well as the risk-based approach to day-to-day supervision and oversight (referred to by the FCA as the ARROW process which results in a firm specific RMP (Risk Mitigation Plan), if carried out appropriately, is highly effective. Thus, there is no need to reinvent the wheel.

However, the approach to investigation, prosecution and enforcement is currently ineffective. There are inadequate resources both in terms of quantity as well as quality, the process takes too long, too many documents are reviewed and too many interviews are conducted. The unlimited financial resources of the firms under investigation and their "magic circle" lawyers currently run rings around the regulators and are given the opportunity to do so by the process. It is also absurd that such investigations and enforcement actions are subject to the Maxwellisation process. This doesn't happen in civil or criminal judicial processes. It should not happen in regulatory investigations and enforcement actions. Either the investigation was comprehensive and fair in the first place, in which case a successful "conviction" will be obtained or it wasn't and won't be. Why should a "defendant" be entitled to control the process of investigation and enforcement by effectively running its entire defence during the course of the investigation process as opposed to during the trial process? This does not happen in criminal or civil proceedings. The current process permits the defence to "swamp" the regulator with papers, delay the process by engaging in complex rebuttal process during the course of the investigation and have yet another "bite at the cherry" during Maxwellisation. For example, the final report by The Prudential Regulation Authority and The FCA into The failure of HBOS published in November 2015 ws required the FCA to review whether senior executives at HBOS should have been subject to enforcement and disciplinary actions. This work has still not been completed almost three years later and The FCA has stated that it has been provided with "millions of documents" to review. This is simply an inadequate process.

3.5 **The new statutory regulatory system must separate / ring-fence policy, standards, rule-setting and day-to-day risk-based supervision and oversight from investigation and enforcement -** We have seen the problems that occur when day-to-day operational regulatory activity (policy setting and day to day, risk based, supervision) are carried out within the same organisation as investigation, enforcement and disciplinary action. Understandably, those who work at the regulator and who have to deal with member firms on a day-to-day basis need to develop close working

relationships with those that they regulate even though they must always retain their independence and objectivity. However, those who conduct investigations and work on enforcement actions not only do not, but must not, have such close relationships. It is their job to get to the bottom of the evidence irrespective of whether it upsets the regulated firm or its leadership and staff.

Naturally, when day-to-day supervision and investigation and enforcement are mixed together in one organisational structure, there are a natural tensions between what one might call the "community police" and the "fraud squad". The "community police" will wish to be more lenient given their need for good ongoing operational relationships but those who do investigation and enforcement should have no such objective.

In these circumstances, we strongly recommend that these two crucial aspects of any new regulatory system are separated either divisionally or constitutionally and have their own operational executive leadership teams, boards and appropriately qualified and experienced staff even though they may ultimately report in to a Minister of State. This will mean that those who work in the policy and day-to-day supervision setting side of the regulator must be legally obliged to refer any matter where there is a case to answer of a material regulatory breach or other wrongdoing to the investigation and enforcement division.

3.6 **Regulatory enforcement tribunals must also be separate and entirely independent of both the regulatory policy-making/day-to-day supervision unit as well as the investigation and enforcement unit -** Currently, all regulatory systems combine law-making, day-to-day policing, investigation and enforcement, prosecution and trials within the same organisational structure. This is tantamount to giving one organisation executive, legislative and judicial powers. In our view, this is inappropriate and the three functions should be separated. So, policy / rule setting and day-to-day supervision should be separate from investigation / enforcement / prosecution and both these functions should also be separate from the ultimate judging tribunal.

3.7 **The need to conduct regulatory enforcement tribunals in public -** Currently, all regulatory systems hold their formal enforcement and prosecution "trials" in private. This allows for no public (including media) scrutiny of the process. Regulatory wrongdoing is often tantamount to criminal activity. It is certainly as serious as civil litigation. In these circumstances and, as justice not only must be done but must be seen to be done, we recommend that regulatory "trials" which are held after a rigorous investigation and independent prosecution process are held in public.

4. The need for a complete review of all policy, rules, guidance and day to day supervision and oversight

4.1 The Kingman Review is focused on the regulatory system itself rather than the actual policy, rules, guidance etc that should apply to auditing, accounting and corporate governance. Accordingly, that is what our submissions relate to. But that should not be taken to mean that we, in any way, accept the current rules that apply are, in any way, adequate. Indeed, we take completely the opposite view and, at the appropriate time and after the new regulatory system has been set up, will feed into that debate vigorously. In our view, the entire system needs a fundamental review. We recommend that the Kingman Review acknowledges this.

4.2 Having said that, there are a few important pointers which we would like to bring to the attention of the Review team even at this early stage.

4.3 Auditing and effective corporate governance is crucial in any developed economy. It is a public good. The depth, breadth and rigour of auditing needs to be substantially improved so the quality and effectiveness of these "general-purpose financial statements" achieve what they are supposed to achieve i.e. the protection of the stakeholders as set out in the 1975 paper referred to above. Any change must include a revised "true and fair view" opinion along with the prescriptive rules and standards that apply to arriving at it. This may well require a change to company law as set out in The Companies Act 2006 (see relevant extracts in our preliminary submission). Where the audit in question is of a regulated firm (as so many are), the terms of engagement of the audit (including the audit work plan and resourcing) should be agreed with the relevant regulator on the basis of the risk that the regulator considers that the firm poses to its regulatory requirements. The auditor should have private meetings throughout the audit with the regulator and must be required under new and much broader statutory duties to disclose to the regulator any matters of relevance to the regulators objectives or the production of financial statements.

There should be a mandatory requirement that no statutory auditor can be removed from their office by the organisation which they audit without the approval of the regulator and without setting out precisely and fair reasons. A provision of this nature will enable and facilitate auditors to speak up and report regulatory and other risks (i.e. to blow the whistle).

In order to implement new requirements for broader, deeper and much more rigorous statutory auditing, it may be necessary, at the same time, to review the maximum legal liabilities that should apply to auditing firms.

4.4 Professional firms that provide statutory auditing services **must be banned** from providing any other advisory services at all, whether these be called "consultancy services" or "assurance services". The fundamental problem with this is that the business models of the large firms of accountants that do provide auditing services will not work unless they provide the more profitable other types of advisory services. This creates obvious and systemic conflicts of interest because, if the firm does not sell other non-audit services, it will make an operating loss.

In these circumstances, if the business models of the large firms that have, hitherto, been able to recruit the brightest and most competent young professionals will not work without the right to provide other advisory services, this will inevitably lead to further poor auditing work. This means that it will have to be accepted that the scope and cost of audits of large publicly quoted companies will have to increase substantially. Having said that, the additional cost, even if it was to increase twofold or more would still be de Minimis in the operating expense of these large companies. For example, how could a professional firm be expected to audit a bank the size of HBOS, for example, about £5 million? And, even if you multiply that by two, it would only represent a miniscule percentage of the HBOS annual operating expense.

4.5 The whole approach to setting accounting standards needs to be reviewed. It needs to become wholly separate and independent of the big firms of auditors and the finance directors of large companies. If, the CFO of HBOS until the end of 2007, took the view that some of the key accounting standards that applied to the calculation of the P&L and balance sheet of that bank were "accounting standards designed for a different purpose", the point is made. The setting of accounting standards needs to involve a broad range of stakeholders including academics, shareholders, regulators, independent think tanks and well-informed members of the general public.

4.6 There are many other areas, especially of corporate governance, the need to be reviewed. Executive pay and remuneration is one of them. As The Parliamentary Commission on Banking Standards concluded, in relation to HBOS, "…corporate governance of HBOS at board level serves as a model for the future… It represents a model of self-delusion, of the triumph of process over purpose." This statement could probably be applied to most large companies. It is purely a tick box exercise which doesn't achieve the purpose of creating an adequate separation and balance of power in the boardroom. Powerful "alpha male" executives run rings around the finance function,

the control functions, the non-executive's and the auditors. This has to be changed if we are to achieve control of huge societally important corporations with balance sheets the size of sovereign governments and who put profit before principles, public good and people. A good start would be to make the fiduciary duties of directors include mandatory three "public duties" by making a simple change to section 102 of The Companies Act 2006.

Paul Moore has written extensively on this subject and submitted detailed papers to The Walker Review as well as to The Treasury Select Committee on the personal request of the then Chairman, Andrew Tyrie MP. At the appropriate time, of these papers can be made available.

4.7 There are numerous other specific areas where new rules and standards will be required. These can be identified when the new regulatory system has been set up.

5. Conclusion

5.1 In conclusion, auditing, accounting and corporate governance has failed far too often since the Cadbury Report. It is a self-evident truth, therefore, that the regulation of auditing, accounting and corporate governance has also failed.

5.2 The entire system of regulation needs complete reform. The FRC should be abolished and replaced with a statutory system of regulation modelled on current financial services regulation. It needs to be principles-based and impose severe accountabilities on both audit firms and the engagement partners responsible for individual audits. It must include a Senior Managers and Certification Regime.

5.3 All the underlying rules and standards relating to auditing, accounting and corporate governance will need to be reviewed following the constitution of the new regulatory system with the objective of protecting all key stakeholders with a general purpose financial statements that are understandable and with corporate governance and auditing that makes sure they are genuinely true and fair. Accounting standards will need to be reviewed accordingly and be subject to proper challenge by representatives of all key stakeholders including academics.

5.4 In the new regulatory system the three key functions must be organised and managed separately i.e.:-

- Policy, principles, standards, rule setting and day to day risk-based supervision.

- Investigation, enforcement and prosecution.

- The “tribunal / court” which determines the application of the regulatory requirements and the facts so as to judge innocence or guilt.

In addition, the third stage of the enforcement process i.e. the trial hearing should be held in public to enable public and media scrutiny.

5.5 Our expert group would be keen to engage in a face to face meeting with the review team to explain and elaborate on any of the matters set out above and in its preliminary submission.

Briefing paper prepared by

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3rd August 2018