Audit for Growth: Proportionality in Audit and Reporting

April 2025

Chapter 1
Executive Summary

1. We have prepared this policy paper to support the Government ahead of its consultation on the themes in the draft Audit Reform and Corporate Governance (ARCG) Bill as noted in the King's speech. We are the Association of Financial Mutuals (AFM), Building Societies Association (BSA), Quoted Companies Alliance (QCA) and UK Finance. Collectively, we represent over 1,500 members spanning banks, building societies, financial mutuals, and listed companies. Our members contribute significantly to the UK – providing mutual options in insurance, mortgage and savings products, offering competitive banking products and services and creating innovative and world leading products and services. Our members contribute nearly £100 billion in taxes each year, employ millions of people and operate across a wide range of sectors. They want to continue to do what they do best, and **we ask the Government to ensure that all regulation including the proposals for companies, directors and auditors are proportionate and support growth.**

2. The UK audit market is facing significant challenges due to regulatory and reporting complexity, barriers to competition, and disproportionate audit requirements and procedures. While regulatory oversight is essential for ensuring audit quality, this policy paper shows the significant burden of this regulatory framework on competition, choice, resilience and costs for our members, particularly small and medium sized Public Interest Entities (PIE) and Other Entities of Public Interest (OEPI).

3. We explore the causes of these problems – the regulatory "cliff edge" holding audit firms back from entering into PIE audit market, the intensive public scrutiny of the audit firms by the Financial Reporting Council (FRC), audit firms having to balance heightened risk with commercial viability, increasing complexity for auditors, overly burdensome audit processes, and most centrally, the blanket application of the PIE regime. **The PIE regime applies to all banks, building societies, Solvency II firms and Main Market listed firms regardless of their size, nature, complexity or risk of corporate failure. The Alternative Investment Market (AIM) is also negatively impacted by the inconsistencies within the OEPI regime, which creates confusion and acts as a deterrent to listing on UK markets**.

4. We propose a more proportionate approach to support growth and audit market resilience by **removing the blanket PIE application to certain sectors and moving to a risk-based PIE threshold focussed on the systemically important and truly large entities at a consolidated level**. This would then include appropriate scrutiny of entities with significant number of employees and those involved in government contracts and delivery of national infrastructure. This would respond to recent scandals and the potential lack of transparency on certain private entities and improve audit market resilience over time. With the introduction of a proportionate PIE regime, **the OEPI regime should be removed to eliminate the significant regulatory cliff edge between statutory and OEPI audit that is hampering the growth ambitions and investment attractiveness of AIM companies**.

5. **This should sit alongside a more risk-based and proportionate audit regime - regulation, supervision and enforcement - by the FRC and new audit regulator, the Audit, Reporting and Governance Authority (ARGA). Making ARGA have an over-riding ethos of growth and competitiveness, sitting alongside its desire to be an 'improvement regulator'** holds the key to underwriting the new regulator's success. This recalibration of the audit regulatory framework will not only benefit small firms currently designated as PIEs and OEPIs by making their audit work more attractive to perform but will positively impact the ability of audit firms to grow their capacity and capability for larger and more complex audits.

6. We also support calls for the Government to **not proceed with proposals for the managed shared audit of FTSE 350 firms** given that this could add significant complexity, competition and cost problems into the entire audit framework without necessarily improving challenger audit firm capability. We believe that the move to a systemic PIE status would create capacity in the audit market and after time improve audit market resilience.
7. We also recommend that **a thorough evidence-based assessment of the existing regimes for directors' accountability and enforcement before the Government considers the introduction of a duplicative regime** which could significantly impact the cost of equity and ability to attract talent into non-executive and executive roles, damaging the attractiveness of the UK as a place to do business.
8. We recommend that **the Government take the opportunity to streamline and smarten reporting requirements concurrently with the ARCG Bill** to truly reap the benefits from the latter on both companies and their auditors.
9. The Government is at a crossroads. The Government's regulatory action plan published on 17 March 2025 demonstrates the extent of the Government's ambition to use regulation as an essential tool to promote growth and investment. However, as the action plan makes clear, this can only happen when regulation is designed and implemented well. **Now is the time to seize this incredible opportunity to create the environment needed to address competition, choice and resilience issues in the UK audit market,** while also safely supporting UK companies, public, private and mutual, in their growth ambitions. In this regard, the Government should also encourage the FRC and ARGA to adopt a proportionality principle like the Competition and Markets Authority (CMA), where it is one of four pillars underscoring its regulatory work.

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Contents

1 **Chapter 1**

Executive Summary

4 **Chapter 2**

Introduction and Problem Statement

5 **Chapter 3**

Problems in the Audit Market

5 The Disproportionate Cost of Audit for Smaller PIEs
6 Smaller PIEs and OEPIs Disproportionately Exposed to Increases in Audit Costs
7 Competition, Choice and Resilience in the Small PIE Audit Market
9 Impact of a PIE audit

11 **Chapter 4**

Causes of Problems in the Audit Market

11 'True and Fair' View
12 Scope of the PIE and OEPI Regimes
13 Evolving Regulatory Landscape
14 The Audit Quality Review
15 Audit Quality and Rotation
15 Risk Appetite and Auditor Selectivity

17 **Chapter 5**

Proposals for Proportionate Audit

17 Scope of the PIE Regime
18 Retirement of the OEPI Regime
18 ARGA Supervisory and Enforcement Approach
19 Managed Shared Audit (MSA) and Audit Market Resilience

21 **Chapter 6**

Directors' Accountability and Enforcement and Reporting Requirements

23 **Appendix**

About Us

23 Association of Financial Mutuals
23 Building Societies Association
23 Quoted Companies Alliance
23 UK Finance

Chapter 2
Introduction and Problem Statement

10. This policy paper is prepared to support the Government ahead of its consultation on the themes of the draft ARCG Bill as noted in the 2024 King's Speech.[1] While some of the members of the four trade associations[2] behind this paper are large and systemically important institutions, a significant proportion are smaller organisations that face disproportionate regulatory burdens not aligned with their size, nature, or risk profiles.

11. This paper draws on publicly available information to demonstrate the impact on audit costs for our members as well as sharing insights from a range of our members on the qualitative and quantitative impacts of the audit regulatory framework on competition, choice, resilience, and trust in the UK audit market. This paper also refers to the impact that disproportionate burdens have on the growth of our members.

12. The current scope of the PIE regime is determined by primary legislation, inherited from the EU from 2006, and includes companies with transferable securities being traded on a regulated UK market, banks, building societies and insurers in scope of Solvency II. It does not include any privately held companies of any size. However, governments since 2018 have all explored and committed to bringing privately owned companies of certain sizes within the PIE regime. The scope of the PIE regime outlines certain requirements for the audit of these companies. For example - the audit is subject to stricter oversight by the FRC instead of the relevant auditing professional body, the auditor and audit firm must be PIE registered by the FRC, the audit is in scope of the FRC's Audit Quality Review (AQR) team, there is a cap on the provision of non-audit services, and enhanced documentation and reporting requirements.

13. The scope of the OEPI regime is defined in the FRC Glossary of Terms (Auditing and Ethics) 2024 as "an entity which does not meet the definition of a Public Interest Entity but nevertheless is of significant public interest to stakeholders". The scope includes AIM listed entities with a market capitalisation of more than €200 million on a three-year average, large private companies with more than 2,000 employees **or** turnover of more than £200 million **and** a balance sheet of more than £2 billion, Lloyd's syndicates and large private sector pension schemes. OEPIs are subject to similar regulation as smaller PIEs, with auditors being subject to the FRC Ethical Standard's prohibition of non-audit services and are subject to the AQR regime.[3]

14. We welcome the commitment by the Government to remove unnecessary rules on smaller PIEs and the opportunity it presents to establish a more effective, risk-based approach to audit regulation—one that fosters competition, resilience, and growth while ensuring high-quality governance and financial oversight.

[1]King's Speech Background Note July 2024, pages 44 and 45: The Bill will (i) deliver "robust and rigorous scrutiny of large companies by auditors and greater transparency"; (ii) "replace the FRC with a new regulator – ARGA – with the powers it needs to tackle bad financial reporting and to build that trust. (iii) extend "PIE status to the largest private companies"; (iv) remove "unnecessary rules on smaller PIEs"; (v) introduce "powers to investigate and sanction company directors for serious failures in relation to their financial reporting and audit responsibilities"; (vi) create "a regime to oversee the audit market" and "build resilience"

[2]Detail biographies of each organisation can be found in the Appendix to this paper

[3]FRC, AQR Inspection Scope (with effect from 1 January 2021)

Chapter 3
Problems in the Audit Market

15. Over several years competition and choice of PIE and OEPI auditors have been at concerningly low levels for most in the audit market. Several studies have examined and found that the Big Four audit firms dominate the FTSE350 market, while challenger audit firms[4] have found it increasingly difficult to grow into this market. The most reported barrier for entry and growth of challenger firms is the regulatory cliff edge between PIE and non-PIE audits,[5] such as stricter oversight by the FRC and inclusion within the AQR inspection process. As trade bodies, our memberships stretch over 1,500 companies and firms, with a significant proportion of them caught in the scope of the PIE and OEPI audit regimes. The majority of these members are smaller and less complex but are still part of the PIE and OEPI regimes and have been disproportionately impacted by competition, choice, and resilience problems in the audit market. It is our position that this is because the audit framework is arbitrarily defined in scope. This has led to auditors not being incentivised to take risk-based approaches in their audits as the FRC's approach to supervision of all PIEs and OEPIs has contributed to an increase in the perceived riskiness of PIEs and OEPIs despite the risk profiles of these entities not changing. This has disproportionately increased the amount of work required for a smaller PIE and OEPI audit, decreased the attractiveness of small PIE audits and therefore reduced competition and choice. We outline our members' audit experiences below, highlighting problems in cost, competition, choice, and resilience.

The Disproportionate Cost of Audit for Smaller PIEs

16. Before looking at competition, choice and resilience problems across the PIE and OEPI audit markets, we outline significant evidence showing that the cost of audit is disproportionately high for smaller PIE and OEPI entities and they have been more exposed to increases than larger PIE firms.

17. The BSA published a report in June 2024 on "The Building Society Audit Market" (the 2024 BSA report[6]), which presented audit cost trends across the building society market. The breadth of the building society market is wide, covering Penrith Building Society with £130 million in assets and one single branch up to Nationwide with £269 billion in assets and more branches than the biggest banks in the UK. The 2024 BSA Report set out that in 2023, the smallest building societies were paying ten times above the sectoral average as equivalent to their asset size, as well as paying sixteen times as much as the sectoral average equivalent to their profit margin for their audits. Research showed that the audit cost for the smallest quarter of all building societies was equivalent to 9% of statutory profit before tax, with four building society audit fees costing more than 15% of their profit before tax. Taking the building society market as a demonstration of the broad range of companies currently covered by the PIE regime, it is clear that the framework does not allow for proportionate scaling of audit costs across the different sizes of PIE entities.

18. The Prudential Regulation Authority (PRA), which is the regulatory and supervisory authority of the UK's banks, building societies, insurers, credit unions and major investment firms, is in the process of delivering a more proportionate prudential regulatory framework for smaller banks and building societies. Broadly, all domestic banks and building societies with less than £20 billion of assets could be eligible for this regime. However, the audit fees of a selection of banks who could be eligible for this regime[7] shows that audit fees have grown by 380% over the course five years[8], with their audit fees ranging from £229k to £4.4 million.

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[4] An audit firm which is not Deloitte, EY, KPMG or PwC
[5] FRC Report 'Views of firms on entry growth and exit in the markets for smaller PIE audits and non-PIE audits' 1 February 2024, page 10
[6] https://www.bsa.org.uk/information/publications/research-and-reports/the-building-society-audit-market
[7] PRA, PS15/23 'The Strong and Simple Framework: Scope Criteria, Liquidity and Disclosure Requirements', 5 December 2023
[8] From the 2017/18 financial year through to the 2022/23 financial year

Audit fees are a significant component of our overall cost base. I have no doubt that our audit fees could be lower if we could move out of the PIE status, not least because a wider range of audit firms might be interested in talking to us.

- A small Solvency II financial mutual

19. The extent of high audit fees is drawn into more contrast when looking between small PIEs and comparable non-PIEs. AFM research from the 2021 accounting year showed that their mutual insurance members who were in the scope of the PIE regime were paying on average fifteen times as much as non-PIE members. Audit costs averaged £187k for those in scope of the PIE regime, rising to £325k for insurers using a Big Four audit firm, compared to £12k for a non-PIE insurer. One mutual insurer in scope of the PIE regime calculated that audit fees at that level were costing policyholders c£44 per year. One small financial mutual estimated that the PIE scope is costing them an additional £20k in actuarial fees and £10k in audit fees.

20. When comparing the smallest building societies which are all in the scope of the PIE regime to the largest credit unions which are not in the scope of the PIE regime, the cost implications are made clear. These building societies paid more than three times as much for their 2023 audit as the credit unions did (£185k and £55k respectively) and audit cost for these building societies is equivalent to 15.1% of their profit, compared to the credit unions where their audit fees are equivalent to 0.9% of their profit. The cost of audit for these building societies has increased by £95k in the past five years with these credit unions seeing an increase of £29k. This is despite both sets of firms having approximately the same asset size and offering similar financial products with customers having the same protections in failure and being broadly subject to the same principles in financial services regulation. The needs of credit unions and their members are better served by the existing non-PIE audit regime than smaller building societies are served by the existing PIE audit regime, leading us to call into question the added value of the PIE regime for small firms.

21. Smaller PIEs are paying more for PIE audits than they likely would do in a more proportionate non-PIE regime. The gap between the cost of the audits for the smallest building societies and the largest credit unions was £130k in 2023, or 3.36 times as much. Extrapolating this for all building societies who would be in scope of the PRA's proportionate 'Strong and Simple framework' for prudential regulation, this would be the worth the same amount of capital required for around £200m of mortgage lending.[9]

Smaller PIEs and OEPIs Disproportionately Exposed to Increases in Audit Costs

22. While the cost disparity between small PIEs, the rest of the PIE audit market and that larger non-PIE is significant, smaller PIEs have had continued above-average increases in their audit costs over several years. Audit fees for FTSE 350 companies increased by 14% in 2023.[10] While this is above inflation, these companies are typically well resourced, are internationally focussed and have the significant size to deal with increases. In that same time, the audit costs for the entire PIE audit market increased by 27%, showing that PIEs outside of the FTSE 350 faced significantly greater increases in their audit cost in 2023. The costs of a smaller PIE audit remain less than for a FTSE 350 firm, however the increases have disproportionately impacted smaller PIEs as the audit costs are disproportionately high for these firms. The impact of the regulatory framework on smaller PIEs is particularly hard and creates further competition issues and has a direct impact on the growth potential of these firms.

[9] The gap between PIE and non-PIE audit costs for these firms would be £6,118k. This would meet the minimum capital requirements of 8% for mortgage lending with loan to value rates of less than 80% risk weighted at 35%

[10] FRC, "Audit Market and Competition Development", December 2024

23. The QCA published the report "It Doesn't Add Up: The Crisis of Unaffordable Audits" in February 2024 (the QCA 2024 report), which presented research on availability of auditors and audit costs for members over the five-year period between the 2017/18 and 2022/23. This report showed that Main Market, AIM and Aquis companies with smaller market capitalisations[11] saw their audit fees increase by 75% on average over the last five years, when the CPI increased by just 24.8% over that same time. The average audit costs for these smaller traded companies have jumped from £397k to £694k. When the disparity in the amount of fees charged between different companies is taken into account, the average percentage change in audit fees across these companies of this size on these markets is 127%. **The impact of regulatory burdens on audit processes, auditor risk appetite, competition, choice and resilience have directly created increasingly expensive audits for companies, diverting valuable time and resources away from their growth potential.** This has undoubtedly contributed to the decline in the number of companies on these markets as entities are no longer willing or able to bear the cost. In March 2025, AIM sunk to its lowest levels of companies since 2001, with over 70 companies leaving the market in the space of about a year. AIM now only has around 680 companies, down from its peak of just below 1,700 companies in 2007.

24. The increases are even more evident outside of quoted companies, with the 2024 BSA Report showing that over that same five-year period, the audit fees of building societies increased by 127% on average, rising to a 177% increase when the audit costs of Nationwide are excluded. Concerningly, thirteen building societies saw their audit fees more than triple over the last years five years, with three of those seeing fees quadruple and one society seeing a nearly six-fold increase in their audit fees over this same period.

25. It is clear that smaller PIEs are disproportionately exposed to higher costs and more significant increases in cost for their external audits compared to larger PIEs with little added value to justify these increases. **Accordingly, we call on the Government to remove our smaller members from the PIE and OEPI audit regimes.**

Competition, Choice and Resilience in the Small PIE Audit Market

26. The lack of competition and choice in the PIE audit market has been widely explored and recognised. The latest FRC publication shows that the Big Four audit firms earned 90% of all PIE audit fees in 2023, only marginally down from its recorded peak of 96% in 2020 and this has plateaued since 2022.[12] While the Big Four have continued to dominate across the PIE audit market, when the data is explored more closely, it appears that the Big Four are increasingly reducing their exposure to the small PIE audit market while challenger firms have not been able to sufficiently grow in larger and more complex audits.

27. The QCA 2024 report outlined that following the introduction of the PIE Auditor Registration process in December 2022, there was a reduction in both the number of PIE audit clients for the majority of top audit firms and the number of Responsible Individuals who within those firms can audit PIE clients. This process introduced an additional approval and registration process in addition to the Recognised Supervisory Body audit registration process for statutory auditors. The regulation brought additional risks and has negatively impacted capacity and resources within the PIE audit market. For example, Jeffreys Henry (now Gravita) decided not to complete the PIE auditor registration in December 2022 and had to resign from the audits of over fifteen companies on the Main Market.[13] This already followed UHY Hacker Young withdrawing from PIE audits which resulted in around ten companies losing their auditor.

[11] Main Market and AIM Companies with less than £500 million market capitalisation and Aquis companies with less than £155 million market capitalisation

[12] FRC "Audit market and competition development 2024 update", "Audit market and competition development 2023 update", and "Audit market and competition development 2021 update"

[13] Gravita has since moved to be PIE registered

28. QCA research has shown that there have been changes in audit firms for AIM companies, with BDO, RSM, and Crowe having notable increases in the number of AIM audits performed, with PwC, KPMG, Deloitte, EY and Grant Thornton all having sizeable decreases. This trend suggests a polarisation in AIM portfolios different audit firms are attracted to, likely due to a strategic re-evaluation by the largest audit firms in response to higher compliance standards set by the FRC. The polarisation of audit firms is also repeated when looking at the building societies sector, as outlined in the 2024 BSA report, where the greatest number of audits are done by Forvis Mazars, PwC and BDO, with the rest of the Big Four carrying out the remaining building society audits. However, when looking into how the proportion of audit fees is spread across the building society sector, the Big Four continue to dominate the audits for the largest building societies. While Mazars carried out nearly 29% of all building society audits they received just 9% of all audit fees, with BDO auditing 21% of all building society audits and receiving just 11% of all audit fees. This indicates the lack of competition for large and for even medium sized building societies, where the Big Four continue to dominate. Grant Thornton's move away from PIE audit engagements has been so marked that they were downgraded for audit supervisory purposes from Tier 1 to Tier 2.

29. The BSA surveyed their building society members for further qualitative feedback to establish how competitive each audit tendering process had been. A total of 27 building societies responded, providing evidence that despite the average society believing that four audit firms were capable and would have been acceptable for the audit, only two acceptable bids were actually received on average. Twelve building societies, representing 44% of the building society sector received just two bids, with three building societies, representing 15% of the building society sector received only one bid at the most recent tender. While the decision to bid for an audit is dependent on the appetite and capacity of an audit firm, BSA research showed that the largest building societies were able to receive four bids for their audit from all four audit firms they believed were capable and acceptable for the audit.

30. Taking the building society audit market as a small representative of the wider PIE audit market, it appears to indicate that the Big Four are continuing to manage down their exposure to the small PIE audit market and are focussing on larger audits, while challenger audit firms are choosing to not expose themselves to certain types of audits or they lack the resources to do those audits. It also highlights resilience problems for the building society audit market, where if one audit firm decides to pull out of the building society audit market, it could cause a crisis and leave many building societies without an auditor unless more challenger firms enter into the market. The testimonial below illustrates an experience which is not uncommon from across our members.

31. Accordingly, we call on the Government to consider competition proposals to correct the course away from focussing on competition for FTSE350 firms in the short to medium term and support audit firm competition for all listed companies and firms captured by the scope of the PIE regime.

We decided not to include any of the Big 4 firms in the tender exercise carried out recently due to its expectation that fees would be even higher than those charged by our incumbent Big 4 audit firm [Firm A]. We approached all firms listed on the FRC's PIE Auditor Register other than the Big 4 firms and those with less than 3 Responsible Individuals (RIs) able to sign off PIE audits. Out of 15 firms we approached, 14 declined to submit a tender and only one submitted a tender [Firm B]. Reasons for decline were typically either that the firm did not serve the banking sector for statutory audit or a lack of resources. Several firms informally commented that the FRC's PIE regulations meant that they were unable to perform statutory audits cost effectively for smaller entities, and for some this had caused them to withdraw from serving this sector altogether. After taking up references we decided to appoint [Firm B] to carry out the statutory audit for the next year. We believe this is a matter where legislation/practice is leading to a significantly suboptimal result with overconcentration of power in the larger auditors and excessive cost on smaller entities thus reducing competition in the banking market.

- Bank, less than £500m assets

Impact of a PIE audit

32. It is important to also consider the broader impacts that competition, choice and resilience issues in the external audit market have on other crucial requirements for firms and companies. For example, the external audit market competition, choice and resilience issues create competition issues of their own for the internal audit market, as it is the same firms providing these services. Our research has indicated that smaller PIEs and OEPIs tend to wholly outsource their internal audit work to audit firms which are registered and authorised to carry out PIE audits, particularly the Big Four and large challenger audit firms. However, this further limits the supply of external audit where the firm is the outsourced internal auditor and cannot therefore provide external audit given conflict of interest rules. For example, in a survey of building societies, 85% wholly outsource and 15% partially outsource their internal audit functions to three audit firms who have little to no presence in the external building society audit market. Due to the significant problems in running competitive external audit processes, companies will carefully consider the implications of choosing an internal auditor if they have the potential to become an external auditor. This is additionally complicated for PIEs where the independence between internal and external audit has to be maintained during the financial year immediately preceding the year on which an audit report is issued, where non-PIEs are not subject to this prohibition. We believe that competition in the external audit market must be urgently addressed to allow for greater choice and competition in the internal audit market too.

33. While we support the need for independence in the provision of audit and non-audit services, all PIEs and OEPIs are subject to the same Ethical Standard requirements for the prohibition of certain non-audit services to audit clients. For PIEs, they are also subject to a 70% fee cap for non-audit services. As extended audit and assurance work closely linked to the audit work has become more complex and grown in breadth in recent years, the 70% cap has become more significant and restrictive. Only services which the auditor is required by law or regulation to provide are exempt from the non-audit services fee cap, but most of extended audit and assurance work falls outside of this and is counted towards the cap even though the work is closely related to the audit, and the auditor is the only logical provider of that service. For example, the auditor reviewing the interim financial statements of a PIE (under ISRE (UK) 2410) is counted towards the non-audit services fee cap, despite the statutory auditor being the only one who can reasonably provide that service. While the interim financial information, a clear market expectation for listed companies, is not required to be reviewed by the auditor, having it reviewed and subject to an independent auditor's review report strengthens trust in that information. We ask the Government to explore if the level and specific measures in the cap are appropriate in light of the extensive regulatory environment for all of our sectors to address independence or if a more appropriate level can be found.

An audit should be focused on the important areas of judgement and not the routine transactions, which create the underlying data. With a PIE audit we are finding the sampling sizes are significantly increasing across both the high and low risk areas, but no issues are being identified and reported to us, so we are struggling to understand why there is the need for this repeated sampling.

- Building society, less than £500m in assets

34. As audit has grown in complexity, so has the role of the finance teams of audited entities who support these audit processes and the regulatory requirements that they may be subject too. The PIE audit process appears to take up three months of the finance team's year and one month for other business areas for most PIE members. Audit firms have established audit processes which are based on auditing standards and guidance, but their actions and the robustness of their approach is largely driven by the internal processes of each audit firm in conjunction with the perceived risk of the audit and regulatory expectations. We have received feedback from members that the audit processes have become disproportionately burdensome and complex, without providing any apparent additional value to the audited entity. The experiences of members are that the processes go above an appropriate level of audit procedures, with a 'one size fits all' approach, including sampling, for the risk profile of the company or firm, with audit firms following methodologies and tick box approaches that are calibrated for higher risk clients and still commonly overrun by time and cost. This means that company internal finance functions frequently spend nearly all their time supporting the audit process instead of working on business and commercial agendas, including growth. We support audit processes which are purposeful, appropriately balance risk and deliver value for members, investors, shareholders and the wider public, but believe that the audit market, our members, and their shareholders and members would be better served by more proportionate audit processes.

35. It is clear that the current approach of the audit market disproportionately impacts smaller PIEs and OEPIs choice of auditor, as well as the resilience of that audit market, and has significant implications for audit costs, the internal audit market and broader internal capacity and burdens for firms. More needs to be done in the audit market to address these impacts by supporting growth and economic stability of PIEs, especially smaller PIEs and OEPIs while restoring trust in the audit market. The following Chapter outlines the causes of these problems further.

A technology company on the AIM market with a market capitalisation of less than £200 million experienced significant issues in relation to adhering to its regulatory requirements and obligations due to delays in the time taken to conduct its audit. The audit firm proposed an additional fee to expedite the audit process, resulting in additional costs for the company.

– AIM technology company

Chapter 4
Causes of Problems in the Audit Market

36. While it is clear to see the negative implications of various elements of the audit market, we believe that solutions can be found in looking to some of the causes of these problems. We believe that competition, choice and resilience will not be improved through heavy handed enforcement, but by calibrating the regulatory framework to the risks and challenges of the entities being audited. Specifically, this can be done by reducing the scope of the PIE regime, and the FRC actively applying an expectation of a risk-based approach to auditing with greater proportionality for smaller PIE and OEPI audit processes, which will help to apply a proportionate regulatory regime.

We have consistently had auditors push for a computer test that they want to run to prove their numbers and despite our explanation that there are flaws in their logic and that a whole stream of exceptions will be raised, those tests are run, and we are then in the position of having to explain differences. The key question of "Do these accounts show shareholders a true and fair view?" is now completely ignored.

- AIM company

'True and Fair' View

37. Section 495(3) of the Companies Act 2006 contains the requirement that a company's auditor must make a report to members on the annual accounts and must clearly state whether in the auditor's opinion the annual accounts give a true and fair view and have been prepared in accordance with relevant financial reporting framework. The relevant FRC standards and guidance[14] build on this saying that the 'auditor's objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement.' The guidance goes on to say that 'reasonable assurance is a high level of assurance' and that the auditors also 'identify and assess the risks of material misstatement of the entity's financial statements … and performs audit procedures responsive to those risks and obtains audit evidence that is sufficient and appropriate to provide a basis for the auditor's opinion'. We believe that these clear objectives are key to good quality and proportionate audits but that the current regulatory framework encourages auditors to go above and beyond these core objectives, in fact stepping away from the concepts of reasonableness and responding to specific risks arising as part of the audit engagement of an entity.

There appears to be a lack of reliance on information provided in previous years with the same areas needing to be re-evidenced with the same questions being raised and answers given, and in many cases the same supporting information..

- Building society, less than £100 billion in assets

[14]Financial Reporting Council, 'Auditor's Responsibilities for the Audit', 24 September 2023

38. While an audit is based on the financial statements as presented in any one year, a more proportionate approach should be taken to address data, contracts, assets or information which are audited each year despite being lower risk to fraud or material misstatement, with no material changes to the information or to reporting requirements. It has commonly been seen across our members that auditors are not relying on information previously seen by the same audit firm only one year previous, such as historic loan agreements, so are effectively re-reviewing the same information. This is just one demonstration of audit firms going above and beyond what it requires to have a 'reasonable assurance' about the truth of the financial statements.

We estimate that our financial reporting team spends 50% of its time, throughout the year, dealing with external audit matters rather than on production and improvement to actual reporting. The two biggest contributors are from (i) the audit firm recreating models and calculations to try to reperform outcomes rather than checking robustness of internal ones. The finance team then must spend time explaining why the auditor model is not producing the same result as the internal one, when the root cause is shortfalls in the auditor model; (ii) additional costs and reduced speed of audit due to second partner and other audit firm reviews for no real added value.

- Building society, less than £100 billion in assets

Scope of the PIE and OEPI Regimes

39. The scope of the PIE regime, adopted nearly 25 years ago in 2006, has not been updated for the UK market and continues to capture entities regardless of their size, business model and complexity. Additionally, the threshold for OEPI is confusing and not equally applied across sectors. The conversion between euros and sterling adds more confusion as do the nuances of the calculation which depends on how many years the company has been trading on AIM. AIM companies and their shareholders require greater clarity than this. The strict application of the PIE inspection regime to these entities, because they meet the definition of an OEPI, has created an unnecessary and significant regulatory cliff edge between non-PIE and PIE and OEPI audits. This can most clearly be seen by the differences in audit cost in comparable organisations, as explored in Chapter 3 of this paper, but can also be seen in comparisons between sectors between Suffolk Building Society and the large privately owned hospitality group, Pret a Manger, as outlined in their 2023 annual reports:

	Suffolk Building Society	Pret a Manger
PIE or non-PIE	PIE	Non-PIE
Audit Fee £'000	250	250
Balance Sheet Total £m	867	617
Turnover £m	43	649
Profit before tax £'000	4,108	54,335
Employee Numbers	136	c8,000
Branches	9	498

40. While financial services audits can be more complex and extensive, and therefore more expensive, than the audit of a hospitality firm, apart from the scope of the PIE regime, it is difficult to find an explanation for why the audit for both these companies cost the same when Pret a Manger employs nearly 60 times as many people as Suffolk Building Society. While Suffolk Building Society is bigger than Pret a Manger on the balance sheet terms, that is due to holding mortgage balance on the balance sheet, rather than traditional fixed assets. If mortgage and capital savings balances were excluded to make a more accurate comparison, the underlying balance sheet of Suffolk Building Society would be significantly smaller than Pret a Manger. There is a great opportunity to recalibrate the PIE regime and to bring in greater simplicity and proportionality in requirements, just as the PRA's Strong and Simple framework for small domestic banks and building societies does.

An audit has become a major financial cost and a serious burden of time on the finance team. And most of it is box ticking by audit staff who don't fully understand what we do and at audit partner level, they are so scared of being found wanting that they go through multiple peer partner reviews - which often throws up conflicting opinions at their end. The auditor is now existing to serve the regulators, not the company's shareholders. Consequently, the regulatory environment is driving audit firms out of the market for AIM companies and so auditor choice is unpalatably restricted.

- AIM company

Evolving Regulatory Landscape

41. In the February 2024 FRC report, audit firms of various sizes provided detailed views on the barriers to entry and growth in the PIE and non-PIE audit market, with the regulatory 'cliff edge' between PIE and non-PIE audits categorised as a very significant barrier and the regulatory framework found to be the most unattractive feature of the PIE audit market. This is a common factor as to the issues impacting the small PIE audit markets. The audit regulatory framework for PIEs has grown in complexity in recent years meaning that both audit firms and small PIEs require greater levels of resources to produce accounts and other regulatory documents. As a result, the regulatory cliff edge between non-PIE and PIE audit will continue to grow, suppressing efforts to support greater competition in the audit market. When audit firms were asked what created a regulatory 'cliff edge' between the PIE and non-PIE audit market for a FRC study[15], firms reported a number of causes:
    a. The FRC has a different way of working, different expectations and different interpretation of auditing standards compared to the Responsible Supervisory Bodies (RSB) for auditing,
    b. The FRC was widely perceived as being relatively critical and antagonistic, compared to the RSBs who were seen as relatively helpful and constructive
    c. The FRC taking longer to carry out reviews than the RSBs
    d. The FRC raising more technical issues than the RSBs

The number of hours recorded by the auditor has increased by c.40% over the last 3-4 years logically leading to a significant increase in the hours spent by bank colleagues supporting the audit process.

- FTSE 350 bank

[15] FRC Report 'Views of firms on entry growth and exit in the markets for smaller PIE audits and non-PIE audits' 1 February 2024, page 143

42. As more reporting requirements have been added to audit processes, this has also expanded the audit product and increased the amount of work that auditors have to do, with each new requirement being applied across entire classes of companies and firms without full consideration of how it can be implemented proportionately. A QCA report 'The never-ending story of annual reports' from 2023 found that the annual reports of AIM quoted companies with valuations of less than £250 million grew in length by 51% in five years, driven by additional regulatory requirements with little to no room for proportionality for smaller entities. The burden of extending regulatory requirements has a direct impact on small PIEs and OEPIs who with comparatively small finance teams must stretch themselves further and for longer to support the growing reporting and audit process. An increasing number of instances have been observed where small PIEs and OEPIs are reporting that audit firms are conducting excessive testing or re-running calculation models to satisfy their internal risk appetite to a 'one size fits all' calibration. This leaves audit firms carrying out more work each year, restricting their own capacity, increasing costs of the audit and harming competition and choice in the PIE audit market.

We struggle overall to understand why a very small financial services organisation, which needs to have very clearly documented processes and controls in place from a regulatory perspective, and has strong risk management frameworks, needs to be reviewed with greater scrutiny than larger companies where these features are clearly lacking.

- Building society, less than £500m in assets

The Audit Quality Review

43. The FRC supervises all PIE registered audit firms but focuses on the quality of PIE and OEPI audits through the Audit Quality Review (AQR) regime, where the FRC will select a range of PIE and OEPI audit files from Tier 1 audit firms[16] across sectors to review and score, then gathering and publishing the collective score for each Tier 1 audit firm. The FRC appropriately focuses the AQR process on the largest audit firms and on FTSE 350 audits, however, the AQR Tier 1 process still covers non-Big Four audit firms and non-FTSE 350 audits. The FRC takes a more proportionate approach for Tier 2 audit firms under the scope of the AQR review where individual scores for each audit firm are not published. While we are concerned by poor audit quality in parts of the audit market and we support efforts for the FRC to support audit firms to improve the audit quality, the naming and shaming of Tier 1 audit firms makes the prospect of becoming a Tier 1 audit firm significantly riskier for Tier 2 audit firms. Additionally, we have heard feedback from some of our members that a negative AQR score has significant consequences for how attractive they are as an auditor, despite there being no indication that the audit firm is less capable of carrying out that audit compared to a different audit firm. This leads to otherwise capable challenger audit firms not increasing their presence in the PIE audit market.

We were pleased to attract three audit firms, two Big Four and one challenger firm, for our audit tender. However, it became clear that despite being a highly credible pitch and team offered, the AQR scores of the challenger audit firm were a hurdle for other directors that they felt couldn't be overcome. The aggregated AQR results substantively drove the ultimate ranking of the process and a Big Four audit firm was selected.

- Building society, with less than £10 billion in assets

[16] BDO, Deloitte, EY, Forvis Mazars, KPMG and PwC

It is an expectation in the Minimum Standard that the Audit Committee engages with the annual AQR review of its auditor, so this is a reasonable thing to do. And it's probably more the overall observations that have the most weight than the scores. Where an AQR report says, "Given their strategic importance to the audit market, both firms must urgently address the causes of these declines and undertake significant audit quality improvement plans which will be closely monitored by the FRC." it's not unreasonable for Audit Committee members to take fright.

- FTSE 350 bank

Audit Quality and Rotation

44. We firmly support auditors producing quality reports; however, we are concerned that with the FRC not actively applying an expectation of risk-based approaches, this has an unintended consequence of leading auditors to be more legalistic and procedural in their approach instead of exercising judgement in their approach. While this approach arguably means there is a more rigorous focus on definitive proof, it also means that there is a level of rigidity in approach which elongates audit processes and likely impact on fees. We suggest that the audit firms should take a residual risk-based approach and optimise their effort based on their own assessment of residual risk while they are pursuing quality audits.

45. Members have also raised elements of auditor rotation adding complications, where PIEs will be considering the robustness of an audit firms tender on their ability to provide a quality auditor after rotation. In practice, PIEs start preparing for auditor rotation just a couple of years into the engagement to minimise any negative impacts of rotation. The five-year limit on auditors which is not proportionate for smaller PIEs, particularly in light of mandatory retendering after ten years. There may not be the same independence considerations for a smaller PIE, with a secondary benefit of providing extra scope to allow a challenger audit firm to grow more into the PIE audit market.

Risk Appetite and Auditor Selectivity

46. An audit firm's choice to bid for an audit tender is a balance of an audit firm's capability, capacity, availability, risk appetite and the commercial viability of the particular audit. The risks from a small PIE audit are disproportionately high for its size compared to large PIEs due to regulation and supervision - the same audit processes have to be followed, the same levels of internal assurance are followed, they are under the scope of the same AQR regime and are largely subject to the same supervisory approach by the FRC. This makes the audit more challenging and more resource intensive for the audit firms and the companies preparing for smaller audits. With such a significant proportion of PIEs being small entities, action must be taken to address the disproportionately high risks for audit firms of small PIE audits. The additional time and costs are fixed or semi-fixed due to the lack of proportionality.

In a concentrated market, there is a potential issue of whether audit firms can continue to bid for new large clients in industries where they already have competition for audit clients. In banking, this manifests itself in appointments to the four larger high street banks – it is unlikely a single audit firm could audit all four and many are likely to be reluctant to audit more than two. This could mean based on outcomes of other tenders there is a risk that a firm could find its choice reduced.

- FTSE 350 bank

47. There are also challenges for our larger members. The main challenge in changing auditor is to satisfy independence requirements. For banks, there can often be significant commercial and personal banking arrangements that need to be unwound. It is common for large banks to engage all the Big Four firms for consultancy (other than the incumbent) and therefore a change of auditor always represents disruption. However, despite these, our members generally do not see significant issue in having the firms available to offer themselves as auditor – in an example by one member, for the two audit tenders they have run one firm has always had to exclude itself for various reasons, meaning on both occasions the bank has only faced a choice of one audit firm from three.

48. There will also be times where even if an audit firm has the appetite, capability and capacity to bid for an external PIE audit tender, there will be complications due to the contracting of non-audit services to the same prospective clients. This further creates a division between those which offer audit and non-audit services to PIEs and will restrict the choice that the PIE has for their audit firm.

Chapter 5
Proposals for Proportionate Audit

Scope of the PIE Regime

49. We welcome the Government's commitment to proportionality in audit by removing unnecessary rules for smaller PIEs and we support the intention to address competition, choice and resilience issues.[17] This has recently also been supported by the Law Commission in the context of looking at friendly societies who are by definition within the scope of the PIE regime.[18] We believe that the most effective and most crucial step is taking the opportunity to redefine the scope of the core PIE regime by **taking away blanket application to entities and companies from specific sectors or markets and implementing a size-based definition for all sectors and markets**. While the Government has not published draft proposals for a size-based threshold, we believe that the PIE threshold needs to be simple and an easily understandable regime for everyone – across audited entities, shareholders, investors, other stakeholders, audit firms and the regulators.

50. **The Government should be ambitious and implement a threshold which focuses on systemic importance and captures those truly large firms where the PIE regime is really needed.** Good examples from other organisations that the Government could consider are (i) the PRA's threshold of £20 billion of assets for the Strong and Simple regime for banks and building societies, or (ii)[19] the EU now limiting the scope of the Sustainability Omnibus to entities with more than 1,000 employees rather than just 250 employees to support growth. This threshold should carry similar meaning across the firms to which it applies. For example, a turnover threshold would not be relevant for insurance firms which do not use the term in their accounting practices, and despite their frequent conflation, turnover cannot suitable be substituted with a firm's total premium income.

51. We believe that the current regime applies to too broad a set of companies and the number of companies caught should be reduced if more efficient auditing processes can be found. We see little value in wholly owned subsidiaries, which are themselves PIEs and produce consolidated accounts, being individually classified as PIEs. The current approach means the overall cost for PIE groups are significant with duplication of work but with limited direct benefit to them.

52. We do not believe that continuing to simply widen the scope of the PIE regime will meaningfully reduce the risk of corporate failure and that it would likely negatively impact competition and choice for smaller PIEs[20]. **It would tighten an audit market which already struggles with competition, add regulatory burdens to companies with strong growth potentials and decrease the attractiveness of the UK as a place to invest and grow. It is important that a PIE threshold is reviewed on a regular basis, unlike current legislation**, with a streamlined mechanism for uplifting it in line with inflation and other relevant risk factors if a monetary threshold is chosen, with transition provisions included. We believe this will be a step-change in allowing the audits of smaller PIEs to be done on a non-PIE and therefore a more demonstrably risk-based approach, allowing audit firms to adjust their risk appetite and simplify audit processes, while retaining the strength and audit quality.

[17] King's Speech: Background Notes, July 2024
[18] Law Commission 'Review of Friendly Societies Act 1974 and 1992', Consultation 270, Paragraph 5.121
[19] Proposal for a Directive amending the Audit Directive, Accounting Directive, Corporate Sustainability Reporting Directive, and the Corporate Sustainability Due Dilligence Directive - Omnibus I - COM(2025)81
[20] Law Commission 'Review of Friendly Societies Act 1974 and 1992', Consultation 270, Paragraph 5.123

53. The Government should take comfort in other regulatory requirements continuing to be applied which provide greater scrutiny of audit. For example, banks, building societies, designated investment firms, Solvency II firms, the Society of Lloyd's and managing agents are required to have an audit committee and meet the requirements set out in the Statutory Audit Directive, regardless of the PIE scope.[21] This would immediately allow processes to be streamlined, reducing resources required on both sides to carry out an audit and increasing capacity for other enhanced reporting from companies. We also believe this would improve the risk appetite of other Tier 2 audit firms to bid for and take on the audits of smaller PIEs they do not currently have the risk appetite or capacity to take on. Additionally, the audit quality review would not be within the AQR inspection process but would instead be overseen by accounting and audit professional bodies, like the ICAEW and ICAS, who carry out large operations each year to evaluate the quality of statutory audits.

Retirement of the OEPI Regime

54. **We believe that the current OEPI regime is not proportionate nor effective for use on AIM** and we believe that bringing forward a size-based proportionate PIE regime (as proposed above) negates the need for the OEPI regime, **and it should be removed**. The lack of clarity for AIM companies and the significant regulatory cliff between the statutory audit and the OEPI audit for any quoted company is hampering the growth ambitions of UK quoted companies due to arduous regulatory burdens making UK quoted markets less attractive. Should smaller PIEs be taken out of the PIE regime and included in the OEPI regime, this would yield similar results in hampering attractiveness and growth. This is particularly the case with the scope of the AQR inspection process, as this will not shift the attractiveness or riskiness of these audits to the extent needed to create a more proportionate and growth focussed audit regime.

ARGA Supervisory and Enforcement Approach

55. While the roll out of a risk-based PIE regime will significantly improve the proportionality of the audit regime, **it is important that ARGA does more to ensure that PIE audits are carried out proportionately and not calibrated to the biggest and most risky audits.** The complexity of the audit for a monoline mortgage lender is different to that of a multinational retail group and ARGA should ensure that their regulation and supervision of these audits is not calibrated to the risk exposures of the largest firms. **ARGA should be incentivising auditors to approach audits proportionately, implement guidance and supervise accordingly.**

56. The Government should ensure appropriate reporting, monitoring and scrutiny of ARGA against FRC's recently reinvigorated growth and competitiveness objectives, similar to the process started by and for the banking regulators, the PRA and Financial Conduct Authority (FCA), in meeting their secondary growth and competitiveness objective. ARGA would be strengthened by the adoption of a proportionality principle like the CMA, where it is one of four pillars underscoring its regulatory work.

57. We believe that the FRC's current enforcement regime is not consistent with the aim of becoming an improvement regulator. To drive audit market resilience and competition, ARGA should make its improvement regulator credentials more emphatic by articulating their meaning and setting out how it will measure success.

Previous consultations appear to rest on the assumption that the Big 4 firm would "make up" any quality difference by doing its own work in relation to MSA. This just implies a straight cost penalty to the audited firm to essentially pay the Big 4 firm to deliver the group audit in full and separately pay a smaller firm to complete some work which is then largely ignored.

– FTSE 350 bank

[21] PRA Rulebook, 'Audit Committee' Part

58. The Kingman Report explicitly recognised that the principal objective of audit regulation (the preservation of high standards of audit quality) is best secured through the creation of an environment of 'improvement regulation', in which audit firms can learn and demonstrate 'best practice'.

59. Part of ARGA's focus should be on how it carries out enforcement action. In our view, the FRC's current enforcement regime is overly burdensome and militates against challenger firms taking part in PIE audit activities. Our understanding is that ARGA's obligations in the enforcement field are governed by the Statutory Auditors and Third Country Audit Regulations 2016 (SATCAR). Those Regulations are written in permissive terms so that ARGA can 'pitch' its requirements of auditors as it sees fit. Currently, its 'Audit Enforcement Procedures' (AEP) pitch the threshold for disciplinary action against audit firms at the level of simple error, rather than 'professional misconduct' as other regulators do, which in turn renders audit firms and auditors personally liable to peril at an unfeasibly low level of inculpatory conduct. There is ample evidence of disincentive, both to young and experienced auditors, of the AEP regime, which in turn is adversely affecting the auditing profession. ARGA's early attention should be to this issue. In our view, **ARGA having an over-riding ethos of growth and competitiveness, sitting alongside its desire to be an 'improvement regulator'** holds the key to underwriting the new regulator's success.

Managed Shared Audit (MSA) and Audit Market Resilience

60. It is important that other policies are not brought forward which can undermine efforts to improve competition. **The introduction of a managed shared audit regime to develop the challenger audit firms would add significant cost and complexity to the audit process without increasing the level of competition**. We believe the argument that MSA will drive improved audit market resilience does not sufficiently outweigh the immediate and future negative impact on costs, competition and choice. By requiring that challenger audit firms step into the FTSE 350 market without organically growing their capacity, this would result in challenger PIE audit firms diverting that resource away from smaller PIEs. This is while there is no resolution to address regulatory barriers which hinder the registration of new PIE audit firms. In addition, some of UK Finance's FTSE 100 members have given feedback that sometimes challenger audit firms can lack the depth and specialist skills required to review large, listed corporates e.g. complex areas like valuations or impairment. We encourage the Government, the FRC and ARGA in the future to undertake work to make the non-Big 4 audit firms, the next tier of firms, more competitive and let them grow organically.

61. When it was considering the resilience of the audit firm market several years ago, the Competition and Markets Authority (CMA) suggested that challenger firms' capabilities would be hugely enhanced by their access to the latest data-enabled auditing processes. Though that suggestion was not accepted by the Government at the time, the advent and pace of growth of AI techniques has only served to underscore the original CMA suggestion. Whereas the largest audit firms have the scale and resources to have the latest audit software, less-substantial firms do not generally have that flexibility. If the largest audit firms were encouraged to licence or sub-licence their IT capabilities to challenger firms, doing so could assist the latter in the achievement of high-quality and uniformly sustained audit quality, providing substantial additional resilience across the breadth of PIE audit firms at a stroke.

We engaged with a number of the challenger firms over recent years, including in connection with our audit tender process, and are concerned with the ability of these audit firms to invest in the capabilities to provide a meaningful contribution to the audit of a complex financial services group in the short-to-medium term. There are significant practical barriers that such firms would need to overcome to build the capabilities needed, meaning the regime may not be truly effective for decades. If shared audits are mandated, there is a real risk that audit quality would suffer and auditor choice may not be significantly improved.

As part of a recent audit re-tender process, we engaged with a number of challenge firms with a view to them undertaking an element of the audit. Following the tender process, management were (i) unanimous in their scepticism that shared audit would drive greater quality, (ii) concerned at the depth of expertise and resource required to staff the audit, (iii) felt that challenger firms lacked knowledge of the bank and had immature practices.

- FTSE 100 bank

We operate on a centralised basis with many of our staff responsible for accounting, reporting and governance matters having responsibilities across the entire group. It would be burdensome for those staff to have to interact with two sets of auditors. We are also concerned that in an MSA arrangement the demands on the auditor who would sign the group opinion, whether imposed by Auditing Standards or the firm's own risk management processes might lead to duplication of work and a longer drawn-out reporting process.

In order for the MSA approach to lead to the increased resilience in the market, the second auditor must be engaged in significant parts of the audit and effectively act as principal, rather than acting on the instructions. It is not clear to us that this would be practical, without significant additional costs and equally significant calls on our internal resources.

While the appointment of a smaller firm as an alternative to MSA has been proposed, this could only be justified where the audit firm has sufficient appropriate resource and resilience and a sufficiently mature audit approach to be able to provide an effective audit, given the size, complexity and regulatory exposure of the entity. It would not be appropriate for directors to be left with a choice between two alternatives, neither of which provide a sufficient assurance

- FTSE 350 bank

Chapter 6
Directors' Accountability and Enforcement and Reporting Requirements

62. We consider that a thorough evidence-based assessment of the existing regimes for directors' accountability and enforcement is needed before implementing a new regime where ARGA is responsible for both investigating and enforcing. This would also make the UK an outlier and potentially impact on UK growth. We believe that further consideration needs to be given to the consequences of proceeding with the introduction of directors' accountability and ARGA enforcement powers. **We do not disagree that directors should be subject to regulation and enforcement, but we have concerns over this being a requirement for all company directors**. With ARGA having wide discretionary powers to investigate and enforce these requirements it could significantly impact the attractiveness of the UK as a place to do business and the ability to attract diverse talent into non-executive and executive director roles. Uncertainty created by regulatory change with a regulator who has a wide range of discretionary powers will impact the cost of equity.

63. Given the existing powers of other regulators, for example, the FCA, which already has powers to take enforcement action against directors of regulated entities in respect of breaches of their duties under the FCA Listing Rules, FCA Transparency Rules, or the Market Abuse Regulation, it is essential that ARGA's powers do not overlap with those of the FCA (and other relevant regulators). Care must be taken to avoid duplication between them and to promote transparency of regulatory oversight.

64. Importantly, it would be improper for this power to be given over sectors which are already tightly regulated by the PRA and the FCA with relevant senior managers already having responsibilities which would cross over with the proposed ARGA powers. For example, the Senior Managers and Certification Regime already sets out additional responsibilities for senior managers of banks, building societies and mutual insurers for conduct, skill, care and diligence, with the FCA and PRA having powers to investigate and penalise breaches. Banks, building societies and mutual insurers are also included within the scope of PRA's operational resilience requirements, which require adequate control frameworks and control environment. It is important that as the Government brings forward this proposal, it is done in a proportionate and measured way, aimed at the relevant skilled person, and avoiding any duplication or overlap with existing regulation. In this regard, the Government should encourage the adoption of a proportionality principles by ARGA, like the CMA where it is one of four pillars underscoring its regulatory work.

Any extra burden on directors will make the role unattractive and may result in experienced potential directors declining the role.

- AIM company

65. It is crucial that as the Government considers the merits of proceeding with previous corporate reporting proposals such as the audit and disclosure of distributable reserves, the audit and assurance policy (AAP) and specific statements on fraud and resilience, the Government must consider the greater impact it has on growth. The Government should consider looking at the fragmentation of the current UK disclosure framework which has led to many different thresholds which are difficult to understand, contributing to challenges in strong quality audits. We support a significant simplification of the disclosure framework and believe a single threshold would create a strong framework that is easier to understand for all parties involved.

66. We therefore **recommend that the Government take the opportunity to truly smarten and streamline corporate reporting requirements concurrently alongside the ARCG Bill** to make this an efficient and effective transformation process for audit firms and audited entities alike.

67. We also believe **the Government should not proceed with proposals to require legally privileged material reviewed as part of the audit to be disclosed to ARGA without full consideration of impact on all audited entities.** In our view, disclosure of privileged material is disproportionate and unnecessary as auditors use the privileged material in a limited way and they do not assess the legal advice itself, auditing the process for the legal process rather than reviewing the legal advice itself. The privileged information belongs to the audited entity, not the auditors themselves, but it may often be the case that the audited entity could provide some alternative means, without the potential loss of privilege through disclosure, to enable ARGA to understand the importance of the information. It is difficult to envisage how a strictly limited disclosure to ARGA could be achieved if sharing also makes it available to other regulators of enforcement bodies. The ability for ARGA to see privileged information would stand it apart from law enforcement authorities and other regulators and may create an unwelcome precedent. **Interference with the principle of legal privilege would be damaging and have a chilling effect on the ability and confidence of companies seeking to understand their legal responsibilities.**

Directors should be judged on reasonable expectations - different standards can be applied to different directors without cutting across the idea of a unitary board. With accounting for material long-term contracts, it is likely that at least one non-executive director (NED) would have the background to enable them to challenge assumptions on level of completeness, costs to complete, project risk etc. Equally at least one NED would have the background to challenge the technical accounting and presentation aspects of the transaction. It is unlikely to be the same person, except in exceptional circumstances. The board of directors need to have a reasonable level of confidence from them, but it is not unreasonable for them to take the lead from the 'expert', and any regulatory regime that suggests otherwise will have an adverse impact on the willingness of people to be appointed as NEDs.

- FTSE 350 bank

Appendix
About Us

Association of Financial Mutuals

The Association of Financial Mutuals (AFM) represents mutual and not-for-profit insurers, friendly societies, and financial mutuals across the UK. AFM members manage 10 million policies, generate £3 billion in annual premium income, and hold over £40 billion in assets. As member-owned organisations, financial mutuals prioritise customers over shareholders, reinvesting profits to enhance services. AFM advocates for a proportionate regulatory environment, ensuring a strong, competitive, and sustainable financial mutual sector.

Building Societies Association

The Building Societies Association (BSA) represents all 42 UK building societies and both mutual-owned banks, as well as 7 credit unions. Building societies have total assets of almost £525 billion and together with their subsidiaries, hold residential mortgages of over £395 billion, 24% of the total outstanding in the UK. They also hold £399 billion of retail deposits, accounting for 19% of all such deposits in the UK. Building societies account for 40% of all cash ISA balances. They employ around 52,300 full and part-time staff and operate through approximately 1,300 branches, a 30% share of branches across the UK.

Quoted Companies Alliance

The Quoted Companies Alliance (QCA) champions the UK's 1,000+ small and mid-sized publicly traded businesses and the firms that advise them. Representing 91% of the quoted sector, these companies employ 2.1 million people and contribute over £25 billion in taxation annually. QCA advocates for proportionate regulation to support growth while maintaining investor protections. The QCA Corporate Governance Code is widely followed by AIM companies, reinforcing transparency. QCA's mission is to ensure a thriving public markets ecosystem that enables businesses to grow, innovate, and create long-term value.

UK Finance

UK Finance is the collective voice of the banking and finance industry, representing around 300 firms across the sector. It works to enhance competitiveness, support customers, and drive innovation, ensuring a strong, responsible, and sustainable financial services industry. Financial services play a crucial role in helping individuals and businesses achieve their ambitions, from home ownership and business growth to retirement savings. UK Finance champions this impact by promoting industry efforts to support customers, combat economic crime, and finance the net zero transition.