IFA REPRESENTATION 07/22

Funding the Audit, Reporting and Governance Authority

The Institute of Financial Accountants welcomes the opportunity to comment on the Consultation published on 29 July 2022.

We would be happy to discuss any aspect of our response and to take part in any further consultations in this area.

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Established in 1916, the Institute of Financial Accountants (IFA) is an internationally recognised professional accountancy membership body. Our members work within micro and small to medium-sized enterprises or in micro and small to medium-sized accounting practices advising micro and SME clients. We are part of the Institute of Public Accountants (IPA) of Australia Group, the world's largest SME-focused accountancy group, with more than 49,000 members and students in 100 countries.

The IFA is a full member of the International Federation of Accountants (IFAC) the global accounting standard-setter. We are recognised by HM Treasury to supervise our members for the purposes of compliance with the Money Laundering Regulations, and by the Financial Services Authority in the Isle of Man.

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General comments

1. We note that 2023/24 is ‘the year in which [the Financial Reporting Council expects] ARGA will be created and the first year of statutory funding’.[1] The IFA welcomes the opportunity to comment on the published proposals in respect of the funding of the Audit, Reporting and Governance Authority (ARGA). However, the nature of this Consultation is that our comments cannot be concerned with funding in isolation.

2. In May 2022, the Government published its response to the consultation on Restoring trust in audit and corporate governance, setting out the full range of measures it will be taking and proposing a ‘holistic approach’ to tackling the problems identified.[2] We note the intention of the Government that ARGA - the successor to the Financial Reporting Council (FRC) - will be provided with new statutory powers in relation to the accountancy profession, including statutory oversight of some of the professional accountancy bodies. Although a clear interpretation of ‘professional accountancy body’ in this context is yet to be determined, under the Government’s revised proposals, it is understood that the IFA will be one of the accountancy bodies within the scope of ARGA’s oversight.

3. The IFA is supportive of the Government’s latest proposals, as limiting oversight to the Chartered accountancy bodies would have risked a public misconception that the technical and professional standards of those bodies were, in some way, superior to those of other professional accountancy bodies. This would have been contrary to the interests of professional accountants and consumers. Nevertheless, there are various ways in which the current proposals could result in a two-tier system, and the FRC must guard against this risk.

4. Proportionate and effective oversight of the IFA by ARGA will recognise the high professional standards to which IFA members are held, and the wider public will benefit from the recognition of those high standards. ARGA oversight will also be expected to recognise the value of ‘self-regulation’ by a professional accountancy body, which gives rise to innovation and healthy competition. We are mindful (as is the FRC) of the fact that the professional accountancy bodies are already subjected to statutory oversight from bodies such as the Office for Professional Body Anti-money laundering Supervision (OPBAS). In overseeing anti-money laundering supervision by the professional body supervisors (PBSs), OPBAS must, inevitably, review the PBSs’ wider regulatory arrangements.

5. We recognise that the workload of ARGA in respect of general accountancy services (as opposed to audit and corporate governance, for example) will be a relatively light. Nevertheless, costs will be incurred, which must be with due regard for proportionality and the avoidance of regulatory overlap. In this regard, the FRC and Government must remain mindful of ongoing projects led by HMRC (to raise standards in tax advice) and HM Treasury (on anti-money laundering supervisory reform), and identify opportunities to work together.

6. Appropriate and necessary costs must, of course, be allocated fairly among the professional accountancy bodies. The risk of public harm is greater where a body has a large number of members and/or low technical and professional standards. Therefore, we expect the larger professional accountancy bodies (in terms of membership in the UK) to carry the highest burden of funding ARGA, while recognising that there is a fixed cost associated with the oversight of a professional body, and that a professional accountancy body should not share the costs of remedying the shortcomings of another body.

7. Any additional costs to the IFA as a result of ARGA oversight must, of course, be borne by IFA members and, ultimately, by clients and employers. The IFA is responding to the current funding Consultation in support of the public interest, but also recognising the uniqueness of the IFA and its membership. In our response to this Consultation, we should like to underline the importance of avoiding any unnecessary regulatory overlap, and to emphasise the high professional standards required of IFA members.

[1] *Financial Reporting Council: 3-Year Plan 2022-25*, March 2022, page 3
[2] *Restoring trust in audit and corporate governance: Government response to the consultation on strengthening the UK’s audit, corporate reporting and corporate governance systems*, May 2022, page 15

8. It is in the public interest that all those professional bodies that have robust regulatory policies and procedures are recognised by ARGA, and so there must be scope for ARGA to extend its oversight to more professional bodies in future. This would provide greater clarity for consumers by including within ARGA's oversight a wider range of professionals who are entitled to call themselves 'accountants'. It would also help to spread the financial burden of regulatory oversight.

9. It will not be possible for ARGA's oversight to extend to accountants who are not affiliated to any professional body – those currently supervised by HMRC for anti-money laundering compliance. Although this will be seen as a limitation to the value of ARGA's new statutory powers, it will, in fact, better equip clients and employers to identify those accountants who are held to high technical and professional standards by a professional body. However, this will require effective communication to promote public awareness of the role of ARGA.

Questions raised in the Consultation

Question 1: Do you have any comments on the proposed guiding principles for ARGA's overall funding arrangements?

10. We support the claim, made in the Introduction to the Consultation, that the current proposals are 'based on the core principles of fairness, transparency and proportionality' and that there 'should be a clear line of sight between ARGA's objectives, its annual plan and budget and the amounts levied from each funding group'.[3] We also welcome the commitment made in the Introduction to ARGA's compliance with the Regulators' Code.

11. We note the four regulatory principles to which, it is proposed, ARGA should have regard, namely:

    - promoting innovation in statutory audit work, corporate reporting, corporate governance and actuarial work;
    - promoting brevity, clarity and usefulness in corporate reporting;
    - working closely with other regulators in the UK and internationally; and
    - anticipating emerging corporate governance, reporting, professional regulation, actuarial or audit risks by being forward-looking and acting proactively where possible.

    However, these are not high level, with the result that it is difficult to see how they are likely to be relevant to the statutory oversight of professional accountancy bodies such as the IFA. Section 3 of the Consultation goes on to discuss funding to 'provide resources to meet all ARGA's objectives', including initiatives on corporate culture, Environmental, Social and Governance (ESG) and the response to climate change, promoting best practice and responding to technological and other developments. Professional accountancy bodies are membership organisations that apply their own resources in these areas. The principles of proportionality and fairness require that professional accountancy bodies are not expected to fund activities beyond the statutory oversight of those bodies.

12. The principle of fairness, as articulated in the Consultation, states that the ARGA funding model should be funded by 'persons or bodies to which ARGA's activities directly relate or which otherwise benefit from those activities'.[4] The IFA, its members and their clients and employers will only benefit to the extent that ARGA oversight gives rise to reputational benefits relative to those not subject to ARGA oversight. More significant is the benefit enjoyed by clients, employers and the wider public in their ability to identify trusted professionals that are held to high technical and ethical standards. When incurring and recovering costs, ARGA must be able to identify a direct line from initiatives in areas such as corporate culture, ESG and technology through to the benefit to be enjoyed by the general public as a result.

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[3] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 2
[4] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 9

13. Subject to the above, we strongly support the three principles that are intended to underpin the ARGA funding model. With regard to proportionality in particular, we trust that the impact of ARGA oversight and the recovery of costs will recognise that the IFA and other professional accountancy bodies are already aware of their obligation to uphold the public interest.

14. We welcome the statement that '[t]he amounts required from each funding group … should not have any ***significant*** adverse impact on growth and competition' [emphasis added].[5] However, *any* adverse impact on growth and competition would be contrary to the public interest and must be avoided.

15. The Regulators' Code requires regulators to base their regulatory activities on risk. Therefore, the statement in paragraph 3.13 of the Consultation that levy contributions should not be adjusted to reflect the risks associated with individual sectors or entities appears contrary to the Regulators' Code and the principle of fairness.

16. While we understand the policy that any financial sanctions imposed under the ARGA enforcement regimes should pass to Government, this is nevertheless at odds with the fairness principle – that ARGA should be funded by market participants. We suggest that the Government has a part to play in delivering proportionality with regard to a funding model operated 'on a basis that is cost-effective and, as far as possible, stable from the perspective of ARGA's levy-payers'.[6] This would take the form of the Government underwriting any shortfall in funding in any particular year.

Question 2: Do you have any comments on the proposals for setting ARGA's annual funding requirement?

17. We note that 'ARGA will apportion overhead costs in proportion to the direct costs of each activity - unless an alternative allocation provides a fairer basis for allocating the costs'.[7] While this appears to be the fairest approach, it is to an extent arbitrary. Therefore, we welcome the commitment expressed in paragraph 4.6 to avoid cross-subsidies between different activities, and provide transparency regarding the allocation of overheads.

18. The Government intends that the scope of the proposed enforcement regime for accountants will extend to members of all the professional accountancy bodies, but be limited to cases that relate to corporate reporting (principally by Public Interest Entities) and which give rise to public interest concerns.[8] ARGA will face a challenge due to the diversity of professional accountancy bodies falling within its oversight. For example, a professional body whose members are typically sole practitioners and employees in SMPs will have a significantly smaller proportion of members who would fall within the enforcement regime for accountants. Thus, it will be challenging to justify allocating any core costs of the enforcement team (such as the costs of maintaining policies and procedures) to such a body.

19. In the paragraphs that discuss the funding of ARGA's enforcement activities, there is little said about the recovery of enforcement costs directly from those who are subjected to the enforcement processes. Please also refer to our earlier comments regarding the stability of cost allocation and the role of Government. We would not support the use of 'top-up levies' in the event of underbudgeted costs or the pooling of funds levied.

20. In our opinion, a funding cycle that publishes the funding requirement and proposed levies in January does not provide sufficient time for considered responses and subsequent analysis if the levies are to be collected from the following April.

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[5] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 10
[6] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 10
[7] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 12
[8] *Restoring trust in audit and corporate governance: Government response to the consultation on strengthening the UK's audit, corporate reporting and corporate governance systems*, May 2022, page 151

Question 3: Do you have any comments on the proposed approach to setting ARGA's annual levies?

21. The Consultation recognises the fact that some entities will fall within more than one activity block and more than one funding group. There is little mention of the allocation of overheads in the Consultation, but this will be complex given these overlaps. It is important that the funding approach does not place an unfairly high financial burden on a professional body (such as the IFA) that falls into only one funding group.

22. We are concerned by the narrative against the document 'ARGA Funding Principles', which is intended to set out the policies 'underpinning' ARGA's levies. We recognise that further scope changes are likely to include extending the scope of accountancy oversight to additional professional bodies, which we would support to enhance standards in the public interest. However, underpinning policies should not change, and we are unclear what is meant by 'regulatory activities phased in following the establishment or ARGA'.

23. We have no comments regarding the proposed 'ARGA Funding Rule Book', except that it appears unnecessary to include the levy rates within the Rule Book itself. We believe there is value in having a Rule Book that has a greater degree of permanence.

Question 4: Do you have any comments on the proposed approach to setting ARGA's annual levies for its responsibilities in relation to audit?

24. The IFA is neither a Recognised Supervisory Body for audit regulation nor a Recognised Qualifying Body, and has little to say in relation to this section of the Consultation. However, it would demonstrate the principles of fairness and transparency for ARGA to be seen to be applying levies directly to each professional body, rather than transferring that responsibility to the CCAB bodies.

Question 5: Do you have any comments on our proposals for funding ARGA's responsibilities in relation to accountants and their professional bodies?

25. The claim that ARGA's oversight will 'cover all aspects of [the professional] bodies' regulatory functions other than those where separate statutory oversight arrangements already exist'[9] (which includes anti-money laundering supervision) is welcome. However, given the current supervisory approach of OPBAS, set out within the OPBAS Sourcebook, this will require ARGA to rely heavily on OPBAS's supervision of the professional body supervisors in areas such as the professional bodies' governance arrangements and enforcement policies and procedures.

26. It is proposed that the area of enforcement (reference B2) will relate only to cases that relate to the public interest. Although all cases of enforcement brought to a Conduct Committee of the IFA are brought in the public interest, we believe this is not what is meant. Therefore, ARGA must be transparent regarding the definition of a public interest case and, on the assumption that many professional bodies will rarely have such cases, recover costs only from those that do. In light of the principle of fairness, we are concerned by the statement that: 'All the professional bodies in scope will be required to contribute to the costs of the oversight and enforcement regimes.'[10]

27. With regard to the independent oversight of the professional accountancy bodies' regulatory functions, we would expect those bodies that are not subject to oversight in respect of statutory audit services, and do not benefit from the other activities of ARGA, to be accountable for only a very small proportion of ARGA's overheads. Nevertheless, a fixed element to the levy would meet the fairness principle. The remainder should be based on professional body membership in the UK, relative to the

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[9] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 20
[10] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 20

aggregate number of professional body memberships throughout the UK (bearing in mind that some accountants hold more than one professional accountancy body membership).

Question 6: Do you have any comments on the proposed approach to setting ARGA's annual levies for its responsibilities in relation to corporate reporting?

Question 7: Do you have any comments on the proposed approach to setting ARGA's annual levies for its responsibilities in relation to corporate governance?

Question 8: Do you have any comments on the proposed approach to setting ARGA's annual levies for its responsibilities in relation to investor stewardship?

Question 9: Do you have any comments on the proposed approach to setting ARGA's annual levies for its responsibilities in relation to public interest actuarial work?

Question 10: Do you have any initial comments on the metrics that should be applied to determine the appropriate share of the costs of actuarial regulation between the proposed funding groups?

28. We have no further comments in relation to Questions 6 to 10.

Conclusion

29. Equally as important as the fair allocation of costs is the proportionate incursion of costs, and ARGA would be expected to recognise the value of 'self-regulation', which encourages innovation and high standards. We note the statement that 'ARGA's expenditure and funding arrangements should operate in line with the Government's Managing Public Money principles'.[11]

30. While we are supportive of professional accountancy bodies being subject to ARGA oversight, which will help clients and employers to identify trustworthy professionals, there is the risk of an unintended consequence – that regulated accountants will be regarded by consumers as carrying a heavy and expensive regulatory burden. This could result in regulated accountants appearing less attractive to consumers, as well as a perception that unregulated accountants are attractive to criminals. Therefore, it is important that the funding of ARGA is fair and that regulatory costs are minimised and seen to be incurred only in the course of proportionate regulation.

31. Central to the principle of proportionate regulation is the need to avoid significant regulatory overlap. Therefore, ARGA would be expected to collaborate with other regulators, including OPBAS (or its successor under a new AML supervision framework).

32. The FRC must be alive to the remaining risk that the current proposals could result in a two-tier system. There must be scope for ARGA to extend its oversight to more professional bodies that are perceived by the public to have members providing accountancy services.

33. The IFA is recognised as a professional accountancy body whose members work in SMEs and micro enterprises, including accounting practices that advise SMEs and micro clients. These businesses contribute fundamentally to the UK economy. Any additional costs to a professional accountancy body as a result of ARGA oversight must be borne by that body's members and, ultimately, by clients and employers. Therefore, disproportionally high regulatory costs are contrary to the public interest and must be avoided.

Contact details

Should you wish to discuss this response further, please contact Ian Waters, Director of Professional Standards, by email at ianw@ifa.org.uk

[11] *Funding the Audit, Reporting and Governance Authority - Consultation on the Financial Reporting Council proposals*, July 2022, page 6