THE INVESTMENT ASSOCIATION

# IA response to the Consultation on the FRC's Audit Enforcement Process

## About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £10 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 51% of this is for overseas clients. The UK asset management industry is the largest in Europe and the second largest globally.

## Summary

The IA views the proposed updates to the Audit Enforcement Procedure (AEP) as a critical component of the UK's broader audit reform agenda. These reforms, which respond to the recommendations of the Kingman, Brydon, and CMA reviews, aim to restore trust and confidence in the audit market by strengthening regulatory oversight, enhancing transparency, and ensuring that enforcement is both robust and proportionate. The AEP changes—introducing new routes to resolution, embedding the public interest more explicitly in decision-making, and improving operational efficiency—are essential to delivering on these objectives.

We see a strong, credible enforcement regime as foundational to the success of wider reforms accompanying the transition to the Corporate Reporting Authority (CRA). Effective enforcement not only deters poor practice but also underpins investor confidence in financial reporting, which is vital for well-functioning capital markets.

The IA has consistently supported a holistic approach to audit reform, advocating for measures that raise audit quality and balance timely intervention with due process and learning, which work together to drive investor confidence in audit. In this context, the AEP proposals serve an important role by ensuring that the enforcement framework is agile and future-proof. We encourage the FRC to ensure that the AEP, and any successor procedures under the CRA, remain aligned with the evolving landscape of audit and corporate governance reform.

**The Investment Association**

10 Norton Folgate, London, E1 6DB
www.theia.org

stewardship@theia.org

| Proposed AEP Change | IA Position & Rationale |
|---|---|
| **Replace Case Examiner with Designated Officer** (senior FRC staff to oversee case assessments) | **Support.** We agree this will provide greater senior oversight and consistency in early case assessments |
| **Published Constructive Engagement (PCE)** (a new route where constructive engagement outcomes are made public) | **Support.** We welcome this addition as a proportionate alternative to full investigation for less severe cases that still warrant deterrence and industry learning |
| **Accelerated Procedure** (fast-track determination using existing evidence, instead of a full Part 4 investigation) | **Support.** We agree that where the FRC already has clear evidence of a breach, an Accelerated Procedure can yield faster resolution and remedial action |
| **Early Admissions Process (EAP)** (audit firm or auditor conducts a review and admits breaches early in an investigation) | **Support.** We believe this process can save time and resources for all parties and encourage a culture of cooperation |
| **Revised test for opening investigations** (two-stage test: (1) reasonable grounds to suspect a breach, and (2) investigation is in the public interest) | **Support.** We strongly support explicitly embedding the public interest into the Conduct Committee's decision-making criteria |
| **Timelier and more transparent publication of outcomes** (e.g. announcing the start of investigations and publishing conclusions for all routes) | **Support.** We agree that timely public disclosure of enforcement actions is vital to maintain confidence in the audit regime |

## Question 1: Comments on the proposed changes to the AEP (Chapter 3)

Overall, we are supportive of the suite of changes put forward in Chapter 3, which we believe will enhance the effectiveness and proportionality of the FRC's audit enforcement process. In particular, the introduction of new routes to resolution – Published Constructive Engagement, Accelerated Procedure, and Early Admissions Process – are a welcome expansion of the FRC's toolkit from two options to five. This graduated range of interventions should allow the Conduct Committee to better tailor its response to the circumstances of each case. This matters because an audit of a company's financial statements provides confidence to investors on the present financial health of their investment on the basis of both its quality and its timeliness. Expanding and graduating the options thus enables the FRC to choose the option that appropriately balances thoroughness and speed according to the needs of each case, supporting investment decisions that must be well informed and timely in relation to the information on which such decisions are based. We comment on each major proposal in turn:

**Replacement of the Case Examiner with a Designated Officer**

We support the proposal to remove the individual Case Examiner role and instead have a Designated Officer (DO) (anticipated to be a senior FRC staff member, e.g. Executive Director of Supervision) oversee case assessments. This change should provide more robust oversight and consistency in the early-stage decisions about whether a potential breach merits further action. Importantly, under the proposals the DO will determine if a "question of a breach" is raised and refer such cases to the Conduct Committee with a recommendation, but will not themselves decide the outcome (except the trivial case of deciding no breach question is raised). We agree with this delineation – it preserves the Conduct Committee's ultimate decision-making authority while adding a layer of senior review and advice. The additional assurance given to the Conduct Committee by having a DO should address any concerns about the consistency or quality of case assessments. We note that the DO cannot be the Executive Counsel nor a Board member, which is appropriate to avoid conflicts. Overall, this reform should strengthen governance by embedding public

interest considerations upfront (since the DO, as a senior member of the regulator, will be well-placed to gauge the public interest factors in play) and by streamlining the referral process.

**Published Constructive Engagement (PCE)**

We welcome the introduction of Published Constructive Engagement as a new route to resolution. Under current AEP, Constructive Engagement (CE) is a private process for less serious cases, with no public visibility. The new PCE route will operate similarly to CE – FRC's Supervision team working with the audit firm on remedial actions – but with public transparency of the process and outcome. We believe this is a sensible middle-ground response for cases that are not serious enough to require full investigation and sanctions, but still raise issues where a public record and deterrence is desirable. Publishing the fact that a firm is undergoing constructive engagement and a summary of the issues and actions at the end will have several benefits: it provides a deterrent effect (firms will want to avoid public exposure of shortcomings), it helps inform investors and other stakeholders that a particular issue has been identified and addressed, and it allows peer firms to learn from those issues, improving audit quality across the market. We welcome the FRC's confirmation that PCE statements will *not name the audited entity or individual auditors* involved as this offers valuable information to the market whilst maintaining commercial confidentiality for the firm involved in the PCE. The focus is rightly on encouraging improvements within a firm for less serious concerns.

One aspect of PCE that we wish to comment on is the payment of costs. The consultation notes that in PCE, the FRC may require the audit firm to pay the FRC's costs (capped at the audit fee for the relevant year). We support this principle: if a firm's work was sub-par enough to warrant regulatory intervention, it is appropriate that the firm bear the cost of that intervention (at least in part), as this incentivises firms to invest in audit quality proactively. We recognise that the FRC *lacks statutory power to compel payment* in a purely supervisory engagement (unlike in an investigation where sanctions can include fines). Nonetheless, making cost reimbursement a condition of the firm's consent to PCE is reasonable. We would expect firms to consent and comply – if a firm refused to pay costs or to participate, the Conduct Committee could instead escalate the matter to a full investigation where financial sanctions are available.

In summary, we strongly support PCE as it fills a gap by providing a public but non-punitive resolution. It serves the public interest by increasing transparency of the FRC's actions as an *improvement regulator*. We also appreciate the FRC's acknowledgment (during outreach events) of investor support for publishing thematic findings – indeed, where multiple such engagements reveal common themes, the FRC might consider publishing anonymised thematic reviews to further share lessons learned across the market (we elaborate on this in our response to Question 4).

**Accelerated Procedure**

The proposed Accelerated Procedure will allow certain cases to be resolved more quickly, without opening a formal investigation under the new Part 4, by using evidence the FRC already holds to establish breaches and impose sanctions. We support this addition to the enforcement toolkit. Investors often observe that enforcement actions (whether by FRC or other regulators) can take several years to conclude, during which confidence in the audit process and ability of the regulator to deliver timely outcomes may suffer. We acknowledge the FRC has improved within the bounds of the current process and that these efforts have culminated in the design of these proposals to further build on this. Where strong evidence of auditor failings is already available (for example, from an audit inspection or a corporate collapse inquiry), it makes sense to leverage that evidence to accelerate the enforcement outcome, rather than duplicating effort. This should lead to timelier accountability – auditors being sanctioned or required to take remedial steps sooner – which in turn should help protect investor interests and financial markets more promptly.

We note the consultation's description of how the Accelerated Procedure would work in practice. Importantly, the Conduct Committee still must apply its two-stage test (reasonable suspicion of a breach, and that it's in the public interest to act) before choosing this route. In other words, the Accelerated Procedure is not a shortcut around the decision threshold for enforcement; it is simply a quicker route once

that threshold is met and sufficient evidence is in hand. We agree with this approach – it ensures that Accelerated cases are appropriately scoped (clearly deserving of enforcement).

Under the Accelerated Procedure, the Executive Counsel would draft a Proposed Decision Notice with breaches and sanctions, which the subject can choose to settle (with the Independent Reviewer/Tribunal safeguards still applying to the outcome). If settlement cannot be reached, the case can be handed back to the Conduct Committee to consider another route (likely a full investigation). These safeguards ensure that the subject's due process rights are maintained – they are not forced to accept a decision without an investigation if they dispute it. We also expect that the FRC will rigorously verify the evidence before relying on it to conclude a case. The consultation indicates the Executive Counsel will take steps to validate evidence and can still use information-gathering powers if needed, which we find reassuring.

Overall, we believe an Accelerated Procedure can be very effective for cases such as, hypothetically, where an audit failure is obvious from an investigation by another authority or from a company's restatement. In such scenarios, skipping straight to sanctions can free up FRC resources to tackle other cases and bring swifter remediation.

**Early Admissions Process (EAP)** We support the introduction of the Early Admissions Process for cases where an investigation has been opened. This proposal effectively invites the audit firm or auditor under investigation to "come to the table" early – perform their own review of the issues (to an agreed scope and standard) and admit any breaches identified, in exchange for a more efficient resolution. From our perspective as investors, what matters is that audit deficiencies are identified and rectified, and that those responsible are held to account. If the auditors themselves, under the watchful eye of the Executive Counsel, can pinpoint what went wrong and accept responsibility, that can achieve our objectives faster than a drawn-out investigation.

The increased discount to financial sanctions (<60%) creates a strong incentive for firms and auditors to proactively engage and demonstrate accountability. In principle, investors are comfortable with higher sanction discounts if it means problems are acknowledged and fixed sooner. The safeguards described appear sensible: EAP is not available if criminal conduct is suspected or in cases of serious integrity concerns, where a "self-review" by the wrongdoer would obviously be inappropriate. We support the broader safeguard that the firm's final report is subject to review by the Executive Counsel, who can reject it as insufficient, demand further work, or terminate the EAP and revert to a normal investigation if needed.

**Reworded test for investigations (public interest criterion)**

The FRC proposes to **revise the threshold test for opening an investigation**, replacing the current wording ("good reason to investigate") with an explicit two-stage test: (1) reasonable grounds to suspect a breach, and (2) the matter appears to be in the public interest to investigate. We fully agree with this change. While it is in part a codification of existing practice, making the public interest component overt is valuable. It provides transparency and reassurance that enforcement resources will be focused on cases that matter – i.e., those with potential to impact public confidence, investor interests, or significant stakeholder harm.

From an investor's perspective, examples of public interest factors that we would expect to carry weight include: the size of the company or audit in question (e.g., Public Interest Entities affecting wide stakeholder groups), the severity or extent of the suspected audit failure, potential financial loss or risk to shareholders and creditors, and any indications of wrongdoing or gross negligence. We note that the FRC's Annual Enforcement Review already outlines many such factors (e.g., whether vulnerable parties are affected, whether there's a need for deterrence in the particular context, etc.). Embedding these into the AEP test ensures a clear, principled basis for enforcement decisions.

The FRC's proposal to make two announcements for investigations – one at the commencement (where the Conduct Committee deems it in the public interest to announce the fact of an investigation) and one at conclusion – seem appropriate. As investors, we find value in knowing *early* if an audit of a major company is under investigation; it can be a material signal about the company's reporting or the auditor's performance.

We acknowledge there is a balance to strike – premature publicity of enforcement can pose fairness issues. We note that in other regulatory domains (for instance, the Financial Conduct Authority's enforcement process), there has been caution around announcing investigations too readily, to avoid unfair prejudice if the investigation ultimately finds no wrongdoing. In the audit context, however, we believe the public interest arguments for transparency are especially strong, given the critical role of audit in ensuring confidence in financial reporting.

### Question 2: Do you agree with the proposed amendments to the AEP?

We have no further comments.

### Question 3: Do you have any general comments on the amended AEP?

One general point we wish to make is that the success of these changes will depend on the FRC having the capability and capacity to implement them efficiently. We note that the FRC plans for the revised AEP to take effect from 1 July 2026. We support this swift timeline – it gives adequate time to prepare internally and externally (about six months after the consultation feedback is digested) without undue delay. We also note the commitment to review the effectiveness of the new routes after a period (no earlier than 2028) and to introduce relevant Key Performance Indicators for case handling. We welcome this. In general, we encourage the FRC to monitor and disclose metrics such as: average duration of cases from opening to conclusion, the proportion of cases going down each route, and whether the introduction of these new processes is in fact reducing backlogs and accelerating resolutions. Stakeholders (including our members) will be keen to see evidence that cases are moving more quickly and appropriately through the system and the extent to which this is leading to more timely resolution of cases and information to the market.

The AEP's sanctions (fines, reprimands, non-financial measures like ordering training or quality improvements) remain unchanged. We support the continuation of strong sanctions for serious cases – meaningful penalties are key to deterrence. The addition of cost recovery in PCE and higher discounts in EAP tweak the incentives but do not reduce the ultimate punishments available.

**Clarity and Guidance:** As a general comment, we encourage the FRC to provide clear guidance and examples alongside the rule changes. Given the technical nature of some processes (especially Accelerated Procedure and EAP), guidance will help auditors and companies understand what to expect. It could be useful to publish, say, a flowchart of the new enforcement decision process, or hypothetical scenarios illustrating when the Conduct Committee might choose each route.

### Question 4: Do you have any other comments on the issues raised in this consultation?

In addition to our responses above, we have a few further comments and suggestions related to the consultation:

- **Publication of Thematic Findings:** As noted earlier, we strongly support the introduction of Published Constructive Engagement. Building on that idea of sharing lessons learnt, we encourage the FRC to consider publishing periodic thematic reports or summaries drawing from issues seen in *private* Constructive Engagements as well. We understand that not every matter will be made public (nor should they be, if very minor), but there is still value in aggregating insights. For example, if several audit firms each had a Constructive Engagement (CE) on a similar topic – say, improvements needed in auditing impairment of goodwill – the FRC could publish an anonymised commentary on how firms have sought to address this and the regulators expectations on areas for improvement. The FRC's Audit Quality Review function already does this on the basis of a sample drawn from the total population of audits, and insights drawn directly from the subset that underwent new AEP could compliment or be integrated into this publication. This would not name any firm or case, but would amplify the regulatory feedback to the whole market. We were pleased to hear in direct engagement with the FRC that it had heard this from others and saw merit in it. It would be a further embodiment of the FRC's "improvement regulator" ethos, ensuring that even private supervisory actions have a public benefit in raising standards.

- **Cross-Border Collaboration:** While the consultation itself does not propose changes on this front, we want to briefly note the importance of regulatory cooperation in cross-border cases. With increasingly global businesses, an audit investigation may require coordination between the FRC and foreign regulators or between the FRC and parent company oversight bodies. We encourage the FRC to continue strengthening its relationships with overseas audit regulators to ensure that enforcement does not hit a jurisdictional wall. Efficient cross-border enforcement aligns with investor interests, because capital markets are global – a failure in one jurisdiction can have repercussions elsewhere. We appreciate this is largely outside the scope of the current AEP update, but this aspect should form part of the review of the new procedures in due course.
- **Alignment with Broader Audit Reforms:** This AEP update is one piece of a larger jigsaw of audit reforms in the UK, many of which stem from the Government's response to the Kingman, Brydon, and CMA reviews. We support the holistic reform agenda – including establishing the CRA with stronger powers, expanding the definition of PIEs, enhancing auditor reporting, and strengthening internal controls (as noted in previous IA submissions). A strong enforcement function is a cornerstone of that agenda. We see the AEP changes as complementary to anticipated statutory changes (for instance, if/when the regulator gains direct powers over directors in enforcement, or a new regime for auditing quality of non-financial information emerges, etc.). It might be beyond this consultation's scope, but we encourage the FRC to ensure that the AEP (and any successor CRA enforcement procedures) are ready to incorporate new responsibilities.

Our members ultimately want to trust that financial statements are reliable. Robust audit enforcement is a key pillar of that trust. These proposals, in our view, strengthen that pillar. We appreciate the opportunity to comment on the consultation and are happy to discuss any of our feedback in more detail.