To: Audit Consultation@beis.gov.uk

My responses to questions posed in chapter 2 of Restoring Trust in Audit and Corporate Governance are below. These views are my personal views and also the views of my company Risk Oversight Solutions Inc. I would be happy to respond to any questions you may have via e-mail or video conference. I have dedicated a significant portion of my career researching, writing about, working in, and teaching in the audit and governance areas covered in your paper.

12. Is there a case for strengthening the internal control framework for UK companies? What would you see as the principal benefits and disbenefits of stronger regulation of internal controls?

Tim Leech: I believe the time has come to stop talking about "internal controls" and focus on improving the overall risk governance capabilities of public companies. "Internal controls" is a term invented by the external audit profession that should now be considered legacy. Requiring more internal and/or external auditors provide expensive binary opinions on whether they believe a company has "effective" or "ineffective" internal controls is absolutely and unequivocally not the way forward. They regularly prove to be wrong. The U.S. experience with Sarbanes Oxley continues to prove that both management and external auditor binary opinions whether internal control over financial reporting is effective/ineffective in accordance with the 2013 COSO internal control framework is expensive and simply does not work very well. The worst of both worlds. A short post I authored on this issue is available at https://bit.ly/3tFaAP1.

What needs to be significantly strengthened in the UK and around the world is the ability of boards to oversee and take strong steps to ensure they are receiving materially reliable and timely information on the current state of risk linked to a company's top value creation and value preservation objectives. Ensuring a company publishes reliable financial disclosures is one of the top value preservation objectives that boards should be fully accountable for overseeing. Few boards today receive concise information on the risk/certainty the company is, in fact, likely to publish/publishing reliable financial statements/disclosures. It is important to note that on a broader plane the roots of the world's really big risk governance crisis, including the 2008 global financial crisis, and more recently companies like Wells Fargo and scores of others lies in a company's strategic/value creation objectives. A key element of the solution is how boards of directors see their "PURPOSE". Boards need to disclose to stakeholders what they think is the Board's "PURPOSE". Ideally boards believe that they are responsible for overseeing and taking steps to ensure the company is pursuing its most important value creation and preservation objectives while operating with a level of residual risk/certainty acceptable to the board. Few boards clearly and plainly acknowledge that they are responsible for overseeing that management is pursuing top strategic/value creation and value preservation objectives while operating with a level or residual risk acceptable to the

board. This board responsibility/purpose should be stated clearly not via a long list of steps the Audit Committee or Audit and Risk Committee or similar claim they are doing. Purpose should disclose what will be different as a result of the existence/funding of the board. A post I authored on this subject is available at https://bit.ly/3d0oyUZ.

13. If the control framework were to be strengthened, would you support the Government's initial preferred option (Table 2)?
Are there other options that you think Government should consider? Should external audit and assurance of the internal controls be mandatory?

TL: See above. It is not the "internal control framework" that should be strengthened. It should be about the broader risk management framework a company uses to manage certainty it will achieve it's top most important value creation and value preservation objectives while operating with a level of residual risk/certainty acceptable to the board is what is needed. (also called "sufficient certainty") Reliable financial statements should be just one element of an effective enterprise risk management framework. Dredging up old regulatory solutions to solve problems that prior attempts to fix a company's "internal controls" that have never worked very well is absolutely not something the UK should do. In 2011 I authored a fairly rigorous analysis that looked at repetitive and ineffective regulatory responses to successive waves of unreliable financial reporting around the globe. It would seem to me that UK via the proposals in this paper is now considering becoming one more country to throw old solutions that have never worked very well at the persistent problem of unreliable financial disclosures. The paper I co-authored with my daughter Lauren Hanlon published in a well recognized academic journal **"Preventing the next wave of unreliable financial reporting: Why US Congress should amend Section 404 of the Sarbanes – Oxley Act** offers what I think is still, ten years later, a superior alternative to the solutions being considered in your discussion paper. Although pdf files are discouraged a copy of the paper is attached for your information as the paper is quite rigorous and fairly lengthy. I encourage you to consider what I said in my analysis ten years ago.

The other option I think the UK should consider is described in detail in a new training module on how to apply objective centric risk and certainty management to assessing and reporting on the objective of producing reliable financial disclosures I have recently authored and published. I believe that boards need concise risk/certainty information on the macro level objective of producing materially reliable financial disclosures and, at a more granular level, which line items/note disclosures have the highest residual risk/uncertainty they are reliable. Few boards receive that information today. To do that companies need to adopt the most modern generation of assurance methods described in the COSO 2017 ERM framework and the 2020 Institute of Internal Auditors THREE LINES MODEL – objective centric risk and certainty management. Objective centric assurance is considered by the IIA to be "Fifth Generation" internal auditing. From a risk management perspective I view objective centric risk management as the newest 3rd Generation of risk management. The generations of internal

audit per IIA's Sawyer's 7th edition and my take on generations of risk management are shown below:

Sawyer's 7th Edition IA Generations
1. 1941 - the Internal/External Auditor
2. 1970 - the Internal Control Process Auditor
3. 1990 - the Risk-Based Auditor
4. 2000 - the Risk Management-Based Auditor
5. 2015 - the Objective-Based Auditor (see IIA 2020 THREE LINES MODEL)

RM Generations
1. 1940s - insurance/hazard focus
2. 2000/2008 - regulator driven risk list focus
3. 2017- strategy/objective centric RM linked to performance per COSO ERM 2017

The goal should be to ensure the board and a company's external auditor are aware of which parts of a company's financial disclosures have the highest residual risk/lowest certainty so both can steps the steps necessary to compensate. I have attached as a pdf my recent training module how to apply objective centric risk and certainty management to the objective of reliable financial disclosures.

Another option the UK should consider is requiring both accountants and internal auditors within companies and external auditors opining on a company's financial statements take advanced certification in reliable financial statements. Some years ago while contract research director at the Institute of Management Accountants I developed detailed curriculum for advanced skills training on reliable financial reporting that I would be happy to share with you if there is interest at your end and the IMA agrees. The training linked to producing reliable financial statements currently required by accounting/audit institutes is, in my opinion, grossly inadequate in the area of producing reliable financial disclosures. More and better training for accountants and auditors would reduce the current relatively high rate of materially wrong financial disclosures.

I hope you find my suggestions useful.

Sincerely,

Tim Leech FCPA

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