Audit regime overhaul to help restore trust in big business

- Government will tackle dominance of ‘Big Four’ audit firms and create a new regulator to reduce the risk of sudden big company collapses, safeguard jobs and reinforce the UK’s reputation as a world-leading destination for investment
- reform is already underway, with the Business Secretary taking action today to enable the regulator to ban failing auditors from reviewing large companies’ accounts
- government commits to review corporate reporting burdens on businesses to maximise the benefits of Brexit and reduce burdens

Government will revamp the UK’s corporate reporting and audit regime through a new regulator, greater accountability for big business and by addressing the dominance of the Big Four audit firms, the Business Secretary confirmed today (Tuesday 31 May).

Effective corporate reporting and audit ensures investors and the public can assess the health of large companies. It is crucial to supporting confidence in businesses, encouraging investment and growth which in turn helps create jobs.

The reforms to improve the audit regime and corporate transparency will help prevent sudden large-scale collapses like Carillion and BHS, which hurt countless small businesses and led to job losses.

Additionally, the government has announced today that it will review wider reporting burdens on large and small businesses including those from retained EU law. This will help the UK’s companies grow whilst bolstering investment, as we take advantage of Brexit freedoms to regulate in a more proportionate and agile way that works for British businesses.

In particular, the government will update the definition of micro-enterprises. This threshold, the relic of an EU directive, could be forcing too many of Britain’s smallest businesses to spend time and money preparing accounts to a level of detail only needed for larger companies, distracting them from focusing on growth and creating jobs. Government will also consider the reporting requirements on smaller public interest entities to help attract high-growth firms, and review whether there are unnecessary restrictions on remunerating directors in shares.

Minister for Corporate Responsibility Lord Callanan said:

> Collapses like Carillion have made it clear that audit needs to improve, and these reforms will ensure the UK sets a global standard.

> By restoring confidence in audit and corporate reporting we will strengthen the foundations of UK plc, so it can drive growth and job creation across the country.

The Financial Reporting Council (FRC) will be replaced by a new, stronger regulator – the Audit, Reporting and Governance Authority (ARGA) – with tougher enforcement powers and funded by a levy on industry. Work on this has already begun, with the Business Secretary today acting to enable the regulator to ban failing auditors from reviewing large companies' accounts.

For the first time, the largest private companies – not just those listed on the stock exchange – will come under the scope of the regulator, reflecting the impact they have on the wider economy.

No extra regulations will be added to smaller businesses through the reforms: the focus is on the UK's largest companies because so many jobs, suppliers and pensions depend on them. Unlisted companies with over 750 employees and with over £750 million annual turnover will come under scope of the regulator, a threshold set following consultation to ensure the reforms are as targeted as possible and minimise unnecessary burdens.

Directors at the biggest companies who breach their legal duties to be open with auditors, or lie about the state of their firm's finances, will face sanctions such as fines, and the government will act to address 'rewards for failure' – where bosses pocket bonuses despite their company collapsing.

Large businesses will have to be more transparent about their profits and losses – not dishing out dividends while on the brink of collapse – while also providing more information to investors and the public about what they have done to prevent fraud, which company metrics have been independently checked and about the risks their company faces.

To curtail the unhealthy dominance of the 'Big Four' audit firms, FTSE350 companies will be required to conduct part of their audit with a challenger firm. The new regulator, ARGA, will also be given the power to make big audit firms keep their audit and non-audit functions operationally separate and to enforce a market cap if the state of the market doesn't improve.

The government has previously confirmed its commitment to publish a draft Bill to revamp the UK's audit and corporate reporting regime this parliamentary session.

The Department for Levelling Up Housing and Communities has today also published a consultation response on plans to strengthen the local audit framework in response to Redmond Review. The plans include establishing ARGA as the system leader for local audit, which will ensure councils and local bodies are delivering value for money for taxpayers.

The plans, which build upon the recommendations of independent reviews by Sir John Kingman, Sir Donald Brydon, and the Competition and Markets Authority, were published today (Tuesday) in the government's response to a public consultation on audit and corporate governance reform.

Reform is already under way. The government has announced its intention to publish a draft Bill, and the FRC has made good progress on many of the recommendations from the reviews. Changes in auditors' mindset and judgements will be driven by ongoing improvements to auditing standards and guidance, while professional bodies will be expected to improve qualifications, skills and training.

Today's publication also sets out the full range of measures the government is taking (a table of key measures can be found below), starting with a new Ministerial Direction issued today – an immediate step being taken to strengthen the regulator's oversight of the audit profession.

Previous corporate collapses have had a significant impact on individuals and the economy:

- 9,000 redundancies were made, 555 retail stores closed and 1,286 companies and government entities owed money following the collapse of Thomas Cook
- 11,000 jobs put at risk by the collapse of BHS
- 7,000 suppliers and contractors impacted by the collapse of Carillion

	Current regime	**Planned reform**
Public Interest Entities (PIEs)	The UK definition of PIEs is inherited from the EU: companies listed on the stock exchange, banks & building societies, and insurance firms.	Very large unlisted companies (>750 employees and >£750 million annual turnover) will also become PIEs, so the new regulator will scrutinise their reporting and audit and they will need to meet new transparency requirements.
The regulator	The Financial Reporting Council (FRC) has a complicated mixture of statutory, voluntary, and contractual functions, funded by levies that are partly voluntary.	A new statutory regulator – the Audit, Reporting and Governance Authority (ARGA) – will replace the FRC, funded by a mandatory levy on industry. It will have new powers, including to direct companies to restate their accounts without going to court.
Director accountability	The FRC has no power to take action against company directors (unless they are accountants).	The regulator will be able to investigate and sanction directors of large companies for breaches of duties around corporate reporting and audit.
Director accountability	It is often unclear under what circumstances an executive director's bonus would be withheld or clawed back.	The FRC will consult on amending the Corporate Governance Code to increase transparency around bonus clawbacks.

	Current regime	Planned reform
Accountants and the accountancy profession	The FRC has powers to investigate and sanction auditors, but in the case of other accountants it relies on voluntary arrangements with the chartered professional accountancy bodies.	The regulator will have statutory powers to oversee the professional bodies' regulation of the accountancy profession and to investigate and sanction accountants in public interest cases relating to corporate reporting.
Transparency	Companies are not doing enough to demonstrate how they are identifying and addressing future risks.	Large PIEs will have to explain how they are identifying and addressing risks, and to set out the steps taken to prevent and detect fraud. Directors of Premium listed companies will also be expected to state whether their internal controls are effective, under the Corporate Governance Code.
Transparency	Companies don't have to disclose their distributable reserves and accountancy bodies provide guidance as to what counts as 'realised' profits and losses (which is the legal basis for issuing dividends).	Large PIEs will have to publish their distributable reserves and confirm the legality of dividend payments. ARGA will issue guidance on what should be treated as 'realised' profits and losses.
The audit market	The FTSE350 audit market is heavily dominated by 4 large audit firms.	FTSE350 companies will be required either to appoint an auditor outside the Big Four or to allocate a certain portion of their audit to a smaller firm, bolstering the competition while avoiding replication of efforts. If necessary, the Business Secretary will be able to introduce a market share cap.
Audit scope	Companies do not have to state how they assure non-financial information in their annual reports (such information lies largely outside the statutory audit).	Large PIEs will have to set out how they assure the quality and reliability of information in their annual reports outside the financial statements, including on climate, risk, and internal control.