[Business Secretary launches major overhaul of UK’s audit regime in wake of big-name company collapses]

- Government consults on plans to break up dominance of “Big Four” audit firms and require large businesses to be more transparent about their finances, helping to avoid company failures and safeguard British jobs
- proposed reforms to strengthen UK’s position as a world-class destination for investors by improving the quality of corporate reporting and sharpening focus on long-term success of large companies
- Business Secretary Kwasi Kwarteng: “Restoring business confidence, but also people’s confidence in business, is crucial to repairing our economy”

Major new reforms to the UK’s audit regime will aim to safeguard British jobs, avoid company failures and reinforce the UK’s reputation as a world-leading destination for investment, the Business Secretary has announced today (Thursday 18 March).

The UK is consistently placed as one of the leading destinations for foreign investment in Europe and around the world, but in recent years, investor and public confidence in how businesses are governed has been undermined by large-scale company failures, such as Carillion, Thomas Cook and BHS, leading to severe job losses and the British taxpayer picking up the bill.

To improve corporate transparency and strengthen the UK’s position as a world-class destination for investors, the government is launching a consultation on wide-ranging reforms to modernise the country’s audit and corporate governance regime, targeting the UK’s biggest businesses and ensuring markets work effectively.

Robust and rigorous scrutiny of large firms provided by auditors, as well as greater transparency and trustworthy information, is essential to ensuring that investors, employees and consumers have an accurate picture of the health of the company – underpinning a thriving, pro-enterprise business environment in the UK.

To unleash competition in the audit market, the government’s proposals would see the creation of a new audit profession overseen by a new regulator, which will aim to drive up quality and standards in the market and increase choice for businesses, while breaking up the dominance of the so-called “Big Four” firms. Last year, almost a third of FTSE 350 audits inspected were in need of improvement.

Business Secretary Kwasi Kwarteng said:

> Restoring business confidence, but also people’s confidence in

business, is crucial to repairing our economy and building back better from the pandemic.

When big companies go bust, the effects are felt far and wide with job losses and the British taxpayer picking up the tab. It's clear from large-scale collapses like Thomas Cook, Carillion and BHS that Britain's audit regime needs to be modernised with a package of sensible, proportionate reforms.

By restoring trust in our corporate governance regime and encouraging greater transparency, we will provide investors with clarity and certainty, cement the UK's position as the best place in the world to do business, and protect jobs across the country.

As part of the government proposals to improve the audit market:

- large companies would be required to use a smaller "challenger" firm to conduct a meaningful portion of their annual audit, watering down the supremacy of big-name auditors that put markets at risk whilst boosting jobs and growth of smaller audit firms across the country
- the Big Four could also face a cap on their market share of FTSE 350 audits if competition in the sector does not improve.
- a new regulator, the Audit, Reporting and Governance Authority (ARGA), which could oversee the largest unlisted companies as well as those on the stock market, will also have the power to impose an operational split between the audit and non-audit functions of accountancy firms, to reduce the risk of any conflicts of interest that may affect the standard of audit they provide

To reinforce investor and public confidence in audit:

- new reporting obligations would be introduced on both auditors and directors around detecting and preventing fraud, with boards required to set out what controls they have in place and auditors expected to look out for problems
- audits will also be able to extend beyond a company's financial results to look at their wider performance, including against key climate targets, to ensure investors and other interested parties are fully informed and can hold companies to account as the UK seeks to eliminate its contribution to climate change by 2050
- the new regulator will be backed by legislation, funded by a mandatory levy on industry, and given much stronger powers to enforce standards. For instance, where serious problems occur, ARGA would be able to order companies to go back and redo their accounts without having to go through the courts.

Plans also aim to make directors of the country's biggest companies more accountable if they have been negligent in their duties – reflecting the level of responsibility that comes with holding such a position:

- directors of large businesses could face fines or suspensions in the most serious cases of failings – such as significant errors with accounts, hiding crucial information from auditors, or leaving the door open to fraud

- under the UK's Corporate Governance Code, companies could be expected to write into directors' contracts that their bonuses will be repaid in the event of collapses or serious director failings up to two years after the pay award is made, clamping down on 'rewards for failure'
- large businesses would need to be more transparent about the state of their finances, so they do not pay out dividends and bonuses at a time when they could be facing insolvency. Directors would also publish annual 'resilience statements' that set out how their organisation is mitigating short and long-term risks, encouraging their directors to focus on the long-term success of the company and consider key issues like the impact of climate change

The proposals, which will ensure the UK's markets are at the cutting-edge of global best practice, come alongside the government's wider work to ensure the UK is a world-class destination for investment, including the Hill Review on listings and Kalifa Review on fintech, as well as the Plan for Growth, which sets out how infrastructure, skills, and innovation will help drive the UK economy.

Minister for Corporate Responsibility Lord Callanan said:

> Audit failure isn't an abstract problem, it has real life consequences. Thousands of jobs have been lost in the wake of collapses like Carillion, and many more lives impacted, while wider confidence in big business is undermined.
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> Auditors and rogue directors who have been asleep at the wheel must be held accountable. So, as part of our plans, we will look to ensure the new regulator is fully equipped to take action where serious lapses have occurred.
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> We are grateful for the work of Sir John Kingman, Sir Donald Brydon and the Competition and Markets Authority, whose inquiries provided much insight and made clear the case for reform.

The government's consultation takes forward the vast majority of recommendations made by 3 independent reviews into auditing and corporate reporting:

Sir Donald Brydon said:

> I welcome the government's consultation and am pleased that they have accepted the core principles and the majority of the recommendations of my 2019 Review. I would urge all participants to engage with the important detail in this paper. The need for progress on these reforms remains urgent.

Sir John Kingman said:

> Since my 2018 report, much has already been done to strengthen regulation of UK audit, reporting and governance under new leadership at the FRC. The critical missing piece is to fix the regulator’s legal status and powers. I therefore very much welcome the government’s consultation, and look forward to seeing this followed through with legislative action as soon as possible.

Andrea Coscelli, Chief Executive of the Competition and Markets Authority, said:

> We welcome the government’s commitment to restoring trust in audit through these reforms. The consultation contains many good proposals, which reflect the CMA’s recommendations and – if they become law – will help improve the health and quality of the audit market.
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> Ultimately these reforms must be judged on their results, so we are also pleased that the government intends to take reserve powers to go further than the current proposals, if these do not deliver the deep change that is needed to fix this broken market.

Chris Cummings, CEO of the Investment Association said:

> This consultation is an important next step in implementing much-needed audit reform, helping deliver better quality audits for shareholders, who rely on their quality and robustness when making investment and stewardship decisions. Investment managers have an important role to play in holding companies to account on their audit quality, and our members are committed to playing their part to drive up standards and improve transparency from auditors and companies. We look forward to working with government and industry in our role as secretariat to the new Audit Users Review Board to improve audit quality.

In light of the current challenges to the UK economy, the consultation period will run for 16 weeks.

The government will work to ensure reforms are implemented in a way that does not prove burdensome to businesses, and is actively investigating ways to make it simpler for companies to report on their performance, for instance by consolidating existing requirements.

The consultation will ask businesses and the public for their views on a wide range of issues, including:

- whether companies should be obliged to set out their approach to audit through a published policy, on which shareholders would vote
- whether shareholders should have a formal opportunity to propose to the audit committee where the auditor should focus more closely
- whether to establish a new set of enforceable principles for corporate auditing

Subject to the outcomes of this consultation, the government will bring forward primary legislation to take forward the proposed reforms when parliamentary time allows.

The main proposals contained in the government's consultation include the following.

Addressing Sir Donald Brydon's recommendation for a new audit profession

- a duty for auditors to take a wider range of information into account, and powers for the regulator to set enforceable principles for auditor conduct
- new reporting requirements for larger companies on anti-fraud measures and the level of independent scrutiny given to their published reports
- a voluntary scheme for the audit and assurance of more non-financial information over and above the statutory audit
- encouraging audit and assurance professionals to work towards a new audit profession, rather than a subset of the accountancy profession as now

Addressing the CMA's findings that the "Big Four" firms dominate the audit of FTSE350 companies, harming audit quality and undermining market resilience

- growing the capacity and capability of challenger firms by giving the regulator powers to operate a managed shared audit regime (in which a subsidiary company audit is done solely by a challenger firm) and, to follow if needed, a managed market share cap reserving a proportion of listed company audits for challenger firms
- new powers for the regulator to set and enforce standards for FTSE 350 companies' audit committees; new powers to impose an operational split between the audit and non-audit functions parts of accountancy firms; and new powers to monitor the resilience of the largest audit firms, together with improved powers to monitor the broader audit market

Addressing Sir John Kingman's recommendation that the current audit regulator, the Financial Reporting Council, is not well equipped to tackle these and other challenges and should be replaced

- replacing the FRC with the Audit, Reporting and Governance Authority (ARGA), a regulator whose objectives, governance and funding will be underpinned by legislation

- expanding the definition of “Public Interest Entity” to include some very large non-listed companies, which will have to meet more stringent reporting and audit requirements (addressing issues arising from BHS and other failures) – recognising their economic importance and how this should be reflected in their responsibilities. The government will also consider an option to exempt newly listed firms from requirements associated with becoming a PIE to ensure the UK stays competitive on listings
- new directors’ duties relating to internal controls and risk management in a way that builds upon the UK’s existing framework, with the government’s initial suggested option less burdensome than the US Sarbanes-Oxley system and providing companies and shareholders greater flexibility
- new powers to hold directors of large companies to account in relation to their reporting and audit obligations
- improved powers to review companies’ corporate reporting, including proposals to extend those powers to the whole annual report
- stronger oversight of the accountancy and actuarial professions
- improved powers to monitor the quality of audits including powers to publish inspection reports in full