

Business and Trade Committee

Oral evidence: Delivering audit reform: follow-up, HC 663

Tuesday 26 March 2024

Ordered by the House of Commons to be published on 26 March 2024.

[Watch the meeting](#)

Members present: Liam Byrne (Chair); Ian Lavery; Andy McDonald; and Mark Pawsey.

Questions 79 - 119

Witnesses

III: Kevin Hollinrake, Minister for Enterprise, Markets and Small Business, Department for Business and Trade; Mark Holmes, Deputy Director, Corporate Governance, Audit Reform and Stakeholder Rights, Department for Business and Trade; and Richard Moriarty, Chief Executive Officer, Financial Reporting Council.

Examination of witnesses

Witnesses: Kevin Hollinrake, Mark Holmes and Richard Moriarty.

Chair: Welcome to the final panel of today's hearing into the need for audit reform. I am delighted, Minister, that you have been able to join us ahead of what I know is a very busy day in the House tomorrow on Post Office. Thank you very much indeed for being here today. Mark Pawsey is going to kick off the questions.

Q79 **Mark Pawsey:** Minister, you have just heard Sir John talk about a consensus five years ago, arising from his report and that of Brydon, the Competition and Markets Authority and the work this Select Committee did at that time, about the need for change in the way we go about regulating audit. We believed that there was legislation on the way and there was a draft Bill, but we do not have any plans to proceed right now. Could you just talk us through what has happened—perhaps Mr Holmes may assist there—in terms of the thinking within the Department since those various reports came forward?

Kevin Hollinrake: Thank you for giving me the chance to answer your questions. We have made significant progress. We are not against the ARGA changes. That is something that we are keen to legislate for when we get the time to do that. That time has not appeared in this particular session, but we have made significant steps forward since this discussion started around improving the audit process in the UK.

The most important thing to say is about the work of the FRC and what it has done. We changed the leadership; we changed the board in 2018. We have seen significant improvement in audit quality since then. I think 80% of audits that are overseen by the FRC are rated as good. It was 70% five years ago, so we are seeing significant improvement.

As I say, we are not anti-regulation. We are of course always conscious about red tape and making sure that businesses are not burdened by red tape. It is important to look at some of the strengths of the UK, in terms of its business environment. We are second in Europe in terms of foreign direct investments. We were third in the EY survey for places that CEOs would like to invest in. We are third in terms of GDP growth for whatever period you want to look at since 2010. This is not a place where people are nervous about investing, but nevertheless we want to make sure audit quality is as good as possible.

Q80 **Mark Pawsey:** There does seem to have been a change of view within the Department, Minister. There was a clear understanding of the need for change five years ago, in terms of the response to our Select Committee report and the other reports I have referred to, and that is not the case today. What changed and when?

Kevin Hollinrake: There is not a change of view in terms of improving audit quality. I think we will probably see that we have made significant



HOUSE OF COMMONS

improvements without the legislation. You legislate as a last resort, not as a first resort. As I say, we have seen significant improvement.

The ARGAs changes, in terms of a statutory regulator, is something we are still keen to proceed with at the right time, but parliamentary time does not always afford the opportunities to do that.

- Q81 Mark Pawsey:** You heard the evidence in the previous session that the FRC is having to deal with “large vested interests”, having to deal with them by persuasion and is lacking in statutory powers. We would not expect that from a regulator in any other sector, so why is it acceptable to continue with that, even in the short term, on the matter of audit, where we have seen some pretty horrendous failures in recent years?

Kevin Hollinrake: It is an interesting perspective. I heard the comments that were made, but that probably does not take into account some of the changes that have been made, such as the voluntary separation. I think that was one of the things that Lord Sikka was talking about, in terms of separation. That effectively has happened on a voluntary basis, for example.

I am not as concerned about the whole situation as Lord Sikka, perhaps, but nevertheless we still have concerns, and we are still keen to see that the changes that we make do improve audit quality. That is what we are seeing on the ground, which is the most important factor.

- Q82 Mark Pawsey:** We heard from one of our witnesses in the first panel that what the Government do is down to their own priorities. Are you really suggesting to us that there is not a sufficiently strong priority within the Department to bring forward this regulation? You said it has not been put to one side and is still under consideration, but it is not a strong enough priority. Are you satisfied with the quality of audit? Are you able to weed out failure and fraud at an early enough stage?

Kevin Hollinrake: It was interesting to hear Sir John Kingman give evidence that the house has been “impressively rebuilt”. He says he would like to see further foundations, and I accept that. We are making changes all the time to try to improve that. I do not think we are in a crisis situation, but nevertheless audit reform, in terms of a statutory regulator, is not off the table, but it is a matter of parliamentary time.

- Q83 Mark Pawsey:** Do you think that the inability to find parliamentary time has made another Carillion more or less likely?

Kevin Hollinrake: It is fair to say that regulation is not the answer to everything. There are plenty of scandals in our economy in very regulated sectors, such as the financial services sector. I do not think the answer to this is purely regulation. We have seen significant action taken against people involved in the Carillion situation. In terms of the auditors, there was a £21 million fine last year, and directors were disqualified. Action has been taken and action can be taken. I do not think we are making another Carillion more likely, and we are in a much better place than we were five years ago in terms of overseeing those kinds of risks.



HOUSE OF COMMONS

Q84 **Chair:** Minister, I am old enough to remember when you were a very keen advocate of audit reform and the need for statutory progress. What was it about ministerial high office that made you change your mind?

Kevin Hollinrake: As you know, Chair, my ministerial appointment has not changed or diminished my ambitions around our corporate governance and making the UK a place to do business. We have taken many actions over the last 12 months, which you participated in, not least the economic crime and corporate transparency legislation, which involves significant changes to the wider situation around corporate stewardships.

It is not fair to say my ambition has diminished at all. It is right we find the right ways to regulate. The first option we should jump to is not necessarily statutory regulation. We should not feel that is going to necessarily solve all our problems.

As I say, there has been significant improvement, in terms of the audit market. I am sure Richard will point to some improvements he sees first hand. His predecessor, Sir Jon Thompson, did a fantastic job in terms of improving the work of the FRC.

Q85 **Chair:** This Parliament is spending less time at work legislating than any other Parliament for many years. Do you not think we should have found the time to legislate for this in the way that, once upon a time, you yourself advocated?

Kevin Hollinrake: As I said before, I am not against legislating when the time affords it, but, as you know, we are busy with a number of different other pieces of legislation that have been significant.

Q86 **Chair:** You are not that busy.

Kevin Hollinrake: I am pretty busy; I promise you that now. We are taking through the Post Office legislation. We took through the economic crime legislation and there is the Digital Markets, Competition and Consumers Bill. We have taken through six private Members' Bills, all of which afford greater protections for people at work. There are two things here. We need to make sure we get regulation which is the right kind of legislation, but we also want to make sure we do not put undue burdens on businesses. It is right that we step forward carefully and make what improvements we can with the current system.

Q87 **Chair:** We have heard some of this language a couple of times—"red tape" and "burdensome". Which aspects in this reform package do you worry would create that so-called red tape or burdensome regulation? Which specific aspects of the reform package on the table create the biggest risk?

Kevin Hollinrake: It puts extra duties on directors. There is a wider duty then for directors to make sure their accounts are in the right place, for example. There are concerns around that, and we do not want to move to



HOUSE OF COMMONS

a system where we have a professional cohort of directors in our companies. Directors should be businesspeople.

There are concerns around that, but that is not to say we cannot deal with that in a proportionate way. In terms of regulation, we should step forward carefully. The system that we have already is improved. We are not against wider reform, but we are making improvements to the system we have today.

Q88 **Chair:** Which are the other things that you worry would create so-called red tape or burdensome duties on the system?

Kevin Hollinrake: Many people have expressed concerns about a shared managed audit. That is within the sector and in the wider economy. There are concerns about some of the provisions of that legislation.

Q89 **Chair:** Is there anything else? We have duties on directors and shared managed audits. Are there other aspects that you think might be burdensome?

Richard Moriarty: The main one that people have raised with me is the managed shared audit that the Minister mentioned.

Q90 **Chair:** Putting the FRC on a statutory basis is not necessarily one of those concerns.

Kevin Hollinrake: That is not a concern for me.

Q91 **Chair:** What about the powers that we might equip the FRC with?

Kevin Hollinrake: Do you mean if it became ARGA?

Chair: Yes.

Kevin Hollinrake: It would have the power to impose civil penalties, for example.

Q92 **Chair:** Do you worry that that creates red tape or burdensome problems?

Kevin Hollinrake: All regulation has a cost, and that cost is always borne by consumers.

Q93 **Chair:** I am trying to get your sense about the balance, what should go forward and what perhaps should not.

Kevin Hollinrake: I am not against any of the reforms that we have set out. We are not backtracking from what we said we would do. We are simply improving what we can, while we can, while waiting for the legislation to be acted upon.

Q94 **Chair:** Are there things that you think could be advanced through secondary legislation?

Kevin Hollinrake: We are taking some measures now in terms of the corporate governance code and internal controls through the FRC. There



HOUSE OF COMMONS

are actions we are taking now. It is fair to say the FRC is widely regarded as a much more effective regulator.

I am a big fan of leadership, Chair; you will know all about that in the position you are in today, as the Chair of the Committee. It is really important that the efficacy of any organisation is really generally attributable to its leader. The leadership of the FRC has been much more fit for purpose since 2018.

Q95 Chair: Richard Moriarty, do you think there are particular powers that could be given to you through secondary legislation if we are not going to get an audit reform Bill this side of the election?

Richard Moriarty: The FRC has come a long way in the five years. We have implemented all of the recommendations that Sir John Kingman directed to us, and audit quality has risen as a result. I would direct the Committee to five things that are serious gaps in our regulatory toolkit.

The first is that the definition of public interest entity has not caught up with modern commerce in this country. Some of the cases that have come before the Committee in recent years, such as Wilko and P&O, are privately held businesses rather than PLCs. Sir John Kingman and the Government recognised that that definition of private interest entity ought to be modernised as a result.

The second thing for me is the point that the Minister made about directors being held to the same standards as members of the accountancy profession when it comes to financial wrongdoing and failings.

The third for me is a simple but very powerful point. At the moment, I am beholden to the voluntary provision of information by those that I regulate. Having regulated other sectors such as aviation and legal services, I can compare and contrast, and this is a very anomalous position.

The fourth thing for me is the funding issue that Sir John mentioned. It is anomalous that I effectively have to beg for 40% of my income in a voluntary way. Finally, there is this point about competition powers. We have no powers in relation to competition.

I absolutely resolve to do our best with our current toolkit. We have seen real improvements in the last five years. Sir John uses the analogy of a house; I use a slightly different one, which is, at the moment, I am sheriff for only half the county because of the PIE definition, and my arsenal is weaker than other regulators would have.

Q96 Chair: Which of those five things could be introduced through secondary as opposed to primary legislation?

Richard Moriarty: I have to say I am not an expert on the machinations of primary and secondary legislation. We would stand ready to support



HOUSE OF COMMONS

our colleagues in Government, given any opportunity to bring those forward.

Q97 **Chair:** Minister, do you think any of those five things could be introduced through secondary legislation?

Kevin Hollinrake: It is probably a better one for Mark. What can you do through secondary legislation, Mark, in those five?

Mark Holmes: Most of the things that Richard has outlined would require primary legislation. There are some provisions in the CAICE Act—I cannot remember exactly what the acronym stands for—that enable some degree of statutory funding for the FRC through secondary legislation, but they require some conditions that are not currently met. It is not an easy fix. There are limitations in the way that that power works, which is why, in the White Paper and in the Government response in 2022, the Government set out that their preferred approach was to introduce a new statutory levy regime through primary legislation.

Q98 **Chair:** We have a very good list now, so perhaps you could undertake to write to the Committee and just let us know your view on what would need primary legislation and what would need secondary.

Kevin Hollinrake: Yes, absolutely.

Q99 **Chair:** That is very kind, thank you. Minister, from that list that you have heard, are there any elements in that list that you would worry would be, in your language, burdensome or contribute to too much red tape?

Kevin Hollinrake: They would all contribute to red tape, but nevertheless they are all contained within the proposals for ARGA, so we are against none of those things in principle.

Q100 **Chair:** From your point of view, it is simply a case of providing that parliamentary time.

Kevin Hollinrake: That is right.

Q101 **Andy McDonald:** Minister, given that Mr Moriarty said he is sheriff for half the county, we still have a long way to go. I would not say we are backpedalling, but do you not think the slowdown in embracing legislation is therefore somewhat worrying if that regulatory opportunity is going to be missed?

Kevin Hollinrake: As I say, we have made significant improvements, and we are keen to build on those improvements. We are making changes today, but in a way that is proportionate. That is our position. As I say, we are keen to make sure that Richard has all the tools he needs to be able to properly regulate the market.

Q102 **Andy McDonald:** We heard from that list that he has not. That is the grave concern there. I note the progress made, but it seems that there is an awful lot more still to do.



HOUSE OF COMMONS

Mr Moriarty, what has driven the FRC's streamlined approach to reforming the UK corporate governance code?

Richard Moriarty: We undertook the largest ever consultation on the corporate governance code. We spoke to about 5,000 people across 50 events. The code has been enhanced. We have not scaled back the actual code. It has been enhanced through the insertion of a transparency and accountability provision in relation to internal controls.

There were some earlier proposals that we consulted on that we did not take forward. Partly that was because, when we spoke to our stakeholders, including investors and large and small businesses, they all said to us the thing to home in on was the importance of internal controls, because that would drive good-quality governance. That is what we did.

It is fair to say that the revision of the code is actually an enhancement, not a scaling back, because of that addition of internal controls, accountability and transparency.

Q103 **Andy McDonald:** Mr Wright and Mr Cartwright's organisations described the decision as a slashing of core reform proposals, with less than half of the proposed reforms making it into the final version. They noted, "A strong corporate governance regime with high-quality financial and non-financial reporting that is aligned with international standards such as the OECD revised principles is in investors' and other stakeholder interest. Watering down these aspects of corporate governance reform is a missed opportunity, as is the Government's continued reluctance to provide the FRC with the powers it requires to become ARGAs, as recommended in the light of the collapse of Carillion".

Are you saying that those comments no longer obtain and in fact the streamlining has strengthened, and that the institute's remarks are off-beam?

Richard Moriarty: It is our role to balance proposals to enhance governance with a broader contribution to UK economic growth and competitiveness. It is not a one-way ratchet. It is really important that we get that balance right, which is why we consulted 5,000 people, businesses, investors and NGOs. Some of the earlier proposals that we consulted on fell into the category of desirable but not essential.

Q104 **Andy McDonald:** Does that include reporting on the material risk of fraud? That was withdrawn.

Richard Moriarty: In relation to fraud, we have really beefed up the auditing standards that pertain to fraud. I know this is something this Committee has held the previous FRC to account for. That has been done in the last couple of years. We did not want duplication in the code.

Q105 **Andy McDonald:** Is there a similar process under way in terms of the stewardship code? Where are we with that?



Richard Moriarty: It is. Having closed the book on the review of the governance code, we were very keen to take a fresh look on the stewardship code, mainly to ask ourselves and engage with stakeholders on whether it is driving the right type of good-quality stewardship and taking it back to first principles. We are really keen to avoid boilerplate reporting. We really want to drive the right type of conversations between investors and boards that is going to contribute to UK economic growth and competitiveness.

Q106 **Mark Pawsey:** Mr Moriarty, I just wanted to ask you about the standards of accountants undertaking these various orders and the powers that you have to discipline them in the event of inappropriate behaviour by the auditors. It has been suggested that your powers in that area could do with beefing up, and I do not think that was included in your five. Where are you on that, and how can that be improved?

Richard Moriarty: I think the third point I mentioned in my list of five goes to this point, which is we are beholden to firms and individuals to voluntarily provide information to us. This can be really debilitating to us in the course of an investigation. Having run other regulators, being able to compare and contrast, they all have statutory powers to demand and request the provision of information. At the moment, I am beholden to the good will of firms and individuals to provide that information.

Q107 **Mark Pawsey:** Do you think that, on occasions, that might be deliberately withheld from you because the auditors are not doing their work to the required standard?

Richard Moriarty: I would not wish at this stage to impute a motive for why it is withheld from us.

Q108 **Andy McDonald:** What is the likelihood?

Richard Moriarty: I would just note that, in my other regulatory experience where I have had such statutory powers, that information has been furnished to us a lot quicker.

Q109 **Mark Pawsey:** Would the acquisition of that statutory power be at the top of your list in terms of priorities for change?

Richard Moriarty: I wanted to help the Committee by prioritising on the top five, and I would not put one above the other, but it is certainly in the top five. If you were to speak to other regulators and ask them what are the bread-and-butter powers they need to be a proper regulator, all of them will say the ability to request and demand information on time.

Q110 **Mark Pawsey:** Are you able to have any impact on the professional qualifications of auditors, or is that a matter for the professional body?

Richard Moriarty: It is largely a matter for the professional body, but because we have a role overseeing the professional body, it is something that we talk to them about. We also set standards that the auditors have to meet.



HOUSE OF COMMONS

Q111 **Mark Pawsey:** Have many accountants been disbarred from carrying out audit practice in recent years?

Richard Moriarty: I am very happy to put this in a note to the Committee, but I think, in the last few years, the investigations that we have undertaken have led to something like 30 being effectively disbarred from carrying out audit.

Mark Pawsey: It would be useful to know that as a proportion of the total. In isolation, the number is fairly meaningless. It would be useful to understand, because if auditors know that their inappropriate behaviour is robustly dealt with, that may be one way in which we can improve audit standards.

Q112 **Chair:** Can I just push you on this, Mr Moriarty? What risks are we running because you do not necessarily have the power to acquire the information you need as quickly as you like? Why is that a risk to the health of the UK economy?

Richard Moriarty: I think this goes to the point that the Committee is concerned about in terms of trust and confidence in audit and governance. If it takes us an inordinately long time to conclude an investigation, naturally memories fade. It is less current. Although it is really important that our investigations are just and efficient, there is also an element of deterrence and holding people to account so the public, markets and other stakeholders can take comfort from that. At the moment, these investigations take too long because we are beholden to the voluntary exchange of information.

Q113 **Chair:** Do you accept the argument that pursuing audit reform on a statutory basis could contribute to red tape and a growing burden on business?

Richard Moriarty: I am reasonably sceptical of this argument. It is absolutely right and proper that we look at it, and it was looked at in detail by the Government when they put these proposals forward. There were lots of impact assessments, et cetera. The five things that I have asked for would bring the FRC into line with other regulators. I am not asking for much more than what other regulators have today.

Q114 **Chair:** Nonetheless, the Minister has said all regulation is regulation, and all regulation has a cost. What do you think those costs would feel like, and are there any aspects of the package that you have set out that you think would be more burdensome than others?

Richard Moriarty: Naturally, there will be burdens from new regulations. I completely support the Minister on this point. It will help to change behaviours. For me, this is about whether the benefits outweigh the costs, and I think the benefits of the enhanced trust, transparency and confidence to invest in the UK would outweigh what I perceive from my five points as relatively minor extra cost. I believe there is a compelling vision there for change, as the Government set out in their work.



HOUSE OF COMMONS

Q115 **Chair:** Let us just go through those positives again. You said trust.

Richard Moriarty: Yes, and confidence. The fact that the UK is seen as a beacon for good governance and audit attracts investment into this country.

Q116 **Chair:** What do you think are the real-world economic upsides that those things unlock?

Richard Moriarty: All regulators have an interest in contributing to UK growth and competitiveness. I think that is a common endeavour that we all share.

I would also like to make the point that it is very easy to see the work of the FRC as focusing on large business and the City of London, but actually, when things go wrong, it is real people and real communities that are affected by failure. If you look at some of the failures of the past, jobs were lost and communities were disrupted. This is not just about growth and competitiveness. As important as that is, it is also about protecting the public interest and the jobs and the livelihoods that are lost as a result.

Q117 **Chair:** When you have been out talking to your industry about what has happened and why this regulation and this Bill has not come forward, have you heard sighs of relief? Have you heard people in the industry say, "Thank heavens for that. We could have really done without that"?

Richard Moriarty: No. It is very much the opposite. Similar to the view that Sir John Kingman raised earlier, there is a good deal of consensus for this as a way forward. Timing must be for this House and the Government, but I have not yet come across a set of major stakeholders that would take a different view on the actual vision.

Q118 **Chair:** There is not a whole load of people lobbying the Business Council in Number 10 to try to stop this in its tracks.

Richard Moriarty: No. Being a relatively new CEO of the Financial Reporting Council, I have asked this question of everyone I have met. I have asked them, "Are you supportive of reform?" I have been pleased with the degree of consensus out there for it.

Q119 **Chair:** That is interesting. Minister, we have a general election fast approaching at some point. Who knows? You could be a Minister in the next Government too. When you have heard the arguments that you have heard today, would your advice to new business Ministers in the next Parliament be that here is a set of reforms where the benefits do appear to outweigh the risks, and that this perhaps should be something that should be prioritised in the next King's Speech?

Kevin Hollinrake: Yes. I have never been against the legislation. It strikes the right kind of balance. It is the right kind of thing to do.

Chair: That happy note of consensus is a good place to draw this panel



HOUSE OF COMMONS

to a conclusion. Thank you very much indeed for your evidence today. That has been extremely illuminating. Thank you very much.