Written submission to the Business & Trade Select Committee

Deloitte LLP – March 2024

The continued need for reform

1. The investigations that followed the collapse of Carillion in 2018 highlighted a broad range of issues with the UK's system of corporate governance, reporting, auditing and regulation. Addressing these will improve trust in business, build confidence in the UK as a leading capital market and strengthen the UK's position in the global economy.

2. So far, only a limited number of changes have been implemented. Whilst significant in their own right – such as Operational Separation at audit firms (whereby firms' audit practices and non-audit practices have separate governance arrangements and cross-subsidisation between the two is prevented) – they do not fully address the recommendations that were accepted by the then Department for Business, Energy and Industrial Strategy (BEIS).

3. For its part, Deloitte moved quickly to implement changes to our firm. We were the first firm to put in place a separate Audit Governance Board with independent non-executives providing external challenge and oversight of the audit business, audit quality and audit partner remuneration. We also implemented the Operational Separation of our audit practice three years ahead of the mandated deadline. Our annual Transparency Report provides significant detail on the benefits of this model.

4. In the absence of further reforms, though, another major corporate collapse risks repeating the extraordinary loss of confidence that followed Carillion. It could even set back the whole programme of reform if there was a widespread perception that the previous recommendations (with which we largely agreed) were flawed.

5. Despite the work of the Select Committee, commitments to reform being included in both major parties' election 2019 manifestos and the inclusion in two Queen's Speeches, the process remains incomplete. Whilst we recognise the wider political context over the last six years, it is disappointing that reform appears to have been pushed down the list of priorities.

6. In our view the need for system-wide reform remains just as urgent as it was in 2018, and the opportunity remains just as significant.

What still needs to change?

7. In our responses to BEIS, and consistent with the views we have presented to your Committee, we have argued that, with so many recommendations affecting multiple players in the system (companies and their boards, auditors, investors and wider stakeholder communities that actively engage on governance issues, and those who regulate all of these bodies), reform needs to be system-wide, driven by a joined-up vision for corporate governance, reporting, auditing and regulation.

8. Without a compelling vision, there is a danger that stakeholders will not engage fully with the changes required and that reform activated are piecemeal and siloed in nature. As result, stakeholders may be disengaged from the process of reform and choose to do the minimum to comply, rather than embrace the potential opportunity that the Government intended.

9. Our vision is for a system that generates greater trust and provides transparency to all stakeholders, helping them make informed decisions about who they invest in, lend to, work for, and co-operate and transact with. Key elements that should be incorporated in the framework include:
    a. Defining an overall high-quality, improvement-focused regulatory regime with joined-up oversight of corporate Britain. With the Audit, Reporting and Governance Authority (ARGA)at its heart, this would:
        i. Provide early warning of potential issues, in a similar way to the Prudential Regulatory Authority (PRA) in financial services.
        ii. Define and assess quality on a more meaningful basis and put in place appropriate enforcement and disciplinary checks and balances. At the moment, good auditors are disincentivised from providing assurance over the companies where risks are likely to be highest.
        iii. Ensure that, in the event of failure, accountability is apportioned across the system appropriately and proportionately (and, where applicable, with regulators coordinating on which of them should take the lead).
        iv. Create a safe environment to encourage voluntary reform and market-led best practice.
    b. Strengthening the internal controls framework at UK companies, with independent assurance over the directors' statement of internal controls and enforced through rigorous regulatory oversight.
    c. Reinforcing the responsibilities of directors in the prevention and detection of fraud, and auditors in the detection and reporting of fraud.
    d. Clarifying the Government's approach on wider assurance services, including how they should be regulated, and how investors and other stakeholders should be engaged on them, supported by the Audit and Assurance Policy (AAP).
    e. Addressing the regulatory and civil liability regimes. Currently these inequitably allocate accountability between parties and deter the participation of challenger audit firms. This damages the resilience of the audit market and the attractiveness of the audit profession.
    f. Putting in place effective mechanisms to provide greater choice and resilience in the audit market. We have argued that market share caps are likely to be more effective than managed shared audits, though once implemented, any mechanism will take many years to have a significant impact on market shares.

10. Consistent with this vision is the continued need for auditors to strive continually for high quality – high quality audits are critical to build and maintain trust. At Deloitte quality is our highest priority and the most important criterion we use to assess our people in the audit practice.

11. We recognise concerns that implementing this vison will create red tape and could damage the competitiveness of British business. We don't think this need be the case: in the US, there is a widespread view that the reforms that followed the collapse of Enron have helped to significantly improve the business environment.

12. At Deloitte we are committed to change and we are actively engaging with the FRC and others to explore how to create the vision described above. Whilst some individual elements of reform can be – and have been – achieved through regulation and voluntary measures, legislative change and a joined-up system-wide vision remain essential to achieving the objectives of the inquiries and proposals that followed Carillion.