



Briefing for MPs on the Business and Trade Select Committee by ICAS and ICAEW

22nd March 2024

Written joint submission - audit and corporate governance reform

Background

The Institute of Chartered Accountants of Scotland (ICAS) and the Institute of Chartered Accountants in England and Wales (ICAEW) welcome the opportunity to provide this joint written evidence to the Business and Trade Select Committee, ahead of its evidence session on 26 March 2024.

It is disappointing that six years after Carillion, there is still no primary or secondary legislation around audit and corporate governance reform, as promised by the government in its 2022 white paper. We need legislation and regulation on audit and corporate governance reform, to reduce the risk of disorderly corporate failure and to enhance governance at major UK corporates. Without this, the threat of the chaotic failure of a major British institution will continue to loom large.

The UK can do better than this, and following careful and extensive work by government, professional bodies and other stakeholders, the next steps are clear. There is broad consensus among stakeholders about the need for audit and corporate governance reform through new primary legislation.

The government recognised in its May 2022 recommendations that *'corporate failure can happen, but it should rarely be a surprise'*. This is the right focus. Corporate failure is caused by the action, or inaction, of company directors. Audit also has a vital role to play in the wider corporate governance and reporting framework, within which large corporate entities operate.

Within the first one hundred days of the next parliament, the next government should hold a consultation on new primary legislation. We believe at the core of this legislation should be a strong statutory regulator, greater director accountability, and enhanced assessment of resilience and fraud risk.

Support for reform

We all want a regulatory environment which protects the public interest, investors and makes sure that the UK is an attractive and competitive place to do business. That means a regulatory environment that is fair, proportionate and respected. Reform is essential to maintain confidence in the UK's largest businesses and the markets in their securities. We need to keep pace with international developments in sustainability reporting and assurance, to help deliver a market led solution to greenwashing risks.

New legislation would build on and underpin significant changes and improvements already made by the FRC, audit firms and professional bodies. The FRC has acted to strengthen regulation to improve audit oversight over the last six years. The largest audit firms have invested significantly in people, methodology and technology to improve capability and performance. Within firms, this has included greater use of internal technical consultations, the voluntary adoption of operational separation and other governance enhancements. Professional bodies have engaged with these issues to drive better audit quality through continuous improvement in ethics, robust CPD requirements, through thought

leadership on internal controls in the UK and on corporate fraud, and work with the FRC and others on professional judgement.

Focus for new legislation

While consultation is vital before primary legislation is tabled, we believe at its heart should be:

1. **A strong new statutory regulator.** Legislation should establish the Audit, Reporting and Governance Authority (ARGA) and give a statutory basis for its funding. A respected regulator drives respected regulation.

A strengthened regulator will also support financial reporting and audit reform at English local authorities to help them recover from the local audit crisis. The regulator should have similar powers over local authority financial statements and governance as it does over corporate financial statements and governance. Without these powers, the regulator won't be able to achieve its planned objective of 'ensuring the local audit system operates effectively'. High-quality and timely audits depend on excellent quality accounting records, internal controls, and financial statements.

2. **Greater director accountability.** Responsibility for the decisions of a Public Interest Entity (PIE) sits with its directors. Our members in senior board positions tell us that more needs to be done to enhance the role and accountability of directors. PIE company directors understand that they occupy critical positions and should be held accountable for their actions.

ARGA should have the power to take enforcement action against directors of PIEs found to be in breach of their duties for reports, accounts and audit, including the failure to provide information or explanations to auditors. These duties are currently difficult to enforce. Giving ARGA these oversight powers for all PIE directors will drive up standards and increase confidence and resilience in the marketplace.

The revised UK Corporate Governance Code (2024) has new requirements relating to internal controls reporting, which will help, even if it's not the promised legal requirement. The impact of this measure should be monitored and evaluated before further action is considered.

3. **Enhanced assessment of resilience and fraud risk.** Secondary legislation should introduce new reporting requirements on corporate resilience and the mitigation of fraud risk for PIEs. These new statements would give investors and other stakeholders greater confidence in the resilience of a business and that risks of fraud have been mitigated appropriately.

Alongside this, an Audit & Assurance Policy would require companies to be transparent on the areas where they have sought assurance. This would be a practical way to require companies to explicitly consider assurance on, for example, sustainability or cyber-resilience. Greater resilience is in the UK public interest – these regulations are ready to go.

Conclusion

The UK is known internationally for strong standards of governance and accountability. Many global institutions in accounting, governance and law have their origins in the UK. We fear this leading position is being eroded. Having initiated a far reaching and well considered debate on governance in 2018, the lack of legislative action now threatens the UK's prestigious reputation. Moreover, elements of the programme had promised solutions to support sustainability reporting and wider business resilience and in the absence of action these remain unaddressed, while other countries move ahead.

We are in the fortunate position, that following extensive consultation, the solutions are clear. We now need action to implement them.

About ICAS and ICAEW

About ICAS:

We're ICAS, a global professional membership organisation and business network for Chartered Accountants. We're also an educator, regulator, examiner and a professional awarding body. Our motto is 'seek the truth' and we've been doing so since we were founded in 1854. As the world changes, the importance of doing the right thing doesn't. As ethical leaders, the business community looks to us and our members to uphold standards and cultivate trust in everything we do. That ethos is enshrined in our respected Code of Ethics – which applies to all our members, student members and member firms – and is underpinned our Royal Charter commitment.

Our CA members form a vibrant global community of finance and business professionals united by a commitment to ethical leadership. Educated, regulated and led to the highest standards, they transform business and support one another, for the greater good. We work with our members, businesses, government, regulators, politicians and policy makers. And we strive to support, nurture and empower that community by delivering high-quality membership, connection and relevant and rigorous career-long learning.

About ICAEW

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 166,000 chartered accountant members in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.