

## Insights

# GOVERNMENT PROPOSALS TO REFORM CORPORATE REPORTING AND GOVERNANCE

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## SUMMARY

The Government has published its long-awaited White Paper on the reform of the UK's audit, corporate reporting and corporate governance system including a package of measures aimed at improving the UK's audit, corporate reporting and corporate governance systems in the wake of recent accounting and corporate governance scandals. Under the proposals, the regulator would have new powers to hold directors of large businesses to account, directors' remuneration could be withheld and/or recovered in the event of serious director failings and the laws around the payment of dividends would be strengthened.

This White Paper represents possibly one of the most significant shake-ups in the UK's corporate governance framework and whilst the proposals have not gone as far as mirroring the Sarbanes-Oxley standards in the US, they do seek to make a number of significant changes.

The proposals are likely to be welcomed by many industry bodies and regulators including the FRC, Competition and Market Authority and Sir John Kingman, all of whom published independent reviews which contributed to these proposals.

## SUMMARY OF KEY PROPOSALS

### **Widening the scope of companies that qualify as Public Interest Entities (PIEs)**

The audits of PIEs (currently companies with securities admitted to the Main Market, credit institutions and insurance undertakings) are currently subject to a number of additional regulatory measures.

However, to provide further protection to the public and investors and in light of recent accounting failures at non-PIEs, the Government proposes to expand the definition of PIEs to include large

companies, within certain limits, regardless of whether they are admitted to trading on a regulated market. This will ensure that certain large private companies fall within the new definition.

The paper identifies a couple of proposals for identifying which companies this could include but any new definition would automatically include AIM companies with a market cap above €200m (bringing into scope around 105 AIM companies).

The proposals in this paper largely focus on the largest companies through this revised definition of PIEs and the Government proposes either a significant lead-time (unspecified) for introducing the new PIE definition or a phased introduction.

## **Company directors**

The Government proposes to give the new regulator ARGA, which will replace the FRC and have more extensive powers, investigation and enforcement powers to take civil enforcement action against PIE directors for breaches of the existing directors' duties relating to corporate reporting and audit including any new duties introduced as part of this consultation exercise. This would be in addition to existing powers of other enforcement agencies for offences and/or breaches under the Companies Act 2006 and the FCA Rules.

To strengthen these proposals and in the event of serious director failings including serious misconduct, material misstatement of results or an error in performance calculations and failures of internal controls and risk management, the Government is proposing, by changes to the UK Corporate Governance Code ('Code'), that contractual provisions in directors' remuneration arrangements contain mandatory malus (withholding of pending awards) and clawback conditions for at least two years after an award is made.

The changes to the Code will apply initially to premium listed companies but the Government will consider, at a later date, whether this should be extended to all listed companies through changes to the Listing Rules.

## **Dividends and capital maintenance**

There are currently no explicit requirements under company law and/ or accounting standards for financial statements to disclose the total amount of distributable profits. The Government's proposals are:

- for companies to disclose the total amount of distributable reserves in the financial statements. This figure would provide some insights into the company's ability to pay dividends in the future and assist with assessments of the legality of proposed dividends. In the case of a group, the parent company should estimate and disclose the amount of potential distributable profits across the group which could, in principle, be passed to the parent company for the purpose of paying future dividends to shareholders;

- for directors to confirm, in proposing the dividend, that the dividend is within known distributable reserves and confirmation that it is the directors' reasonable expectation that payment of the dividend will not threaten the solvency of the company over the next two years. The rationale behind this proposal is that it would provide an improved focus for boardroom decision-making and help build external confidence that the dividend and capital maintenance rules are being respected; and
- the Government envisages that these new requirements will apply to listed companies (including AIM companies) but asks for views on whether they should be extended to all PIEs.

## **Directors' accountability for internal controls**

Opinion is being sought on a range of options for strengthening internal company controls, but the Government's initial preferred option is for the directors to carry out a review annually of the effectiveness of their company's internal controls and make a directors' statement, as part of the annual report, as to whether they operated effectively. The decision about whether any such statement should be assured by an external auditor would be a matter for audit committees and shareholders.

This is in contrast to the US's approach under the Sarbanes-Oxley Act 2002 which mandates external auditor attestation and which places responsibility for a company's financial statements and internal controls clearly with the CEO and CFO.

## **New corporate reporting – Resilience Statement**

The experience of the pandemic has increased investor appetite for fuller and more meaningful disclosures by companies about how they are planning for potential future challenges.

The Government is therefore proposing an annual 'Resilience Statement' setting out how directors are assessing the company's prospects and addressing challenges to its business model over the short, medium and long-term, including risks posed by climate change. The statement would apply initially to premium listed companies but will be extended to other PIEs within two years.

## **Audit – 'true and fair view'**

The Government is not taking forward Lord Brydon's proposals to change the 'true and fair view' requirement for approval of the accounts with 'present fairly, in all material respects', which is recognised internationally. Instead, the Government believes a new user guide to audit will prove more effective in improving user understanding.

## **Audit and Assurance Policy**

The Government proposes to introduce a statutory requirement on PIEs to publish an annual Audit and Assurance Policy describing directors' approach, over a rolling three year forward looking

period, to seeking internal and external assurance of the information they report to shareholders. The Policy would be subject to an advisory shareholder vote at the time of publication. Initially this requirement would apply to premium listed companies but will be extended to PIEs.

The consultation closes on 8 July 2021.

[Government White Paper](#)

## RELATED CAPABILITIES

- M&A & Corporate Finance
- Securities & Corporate Governance
- UK Public Company

## MEET THE TEAM



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