



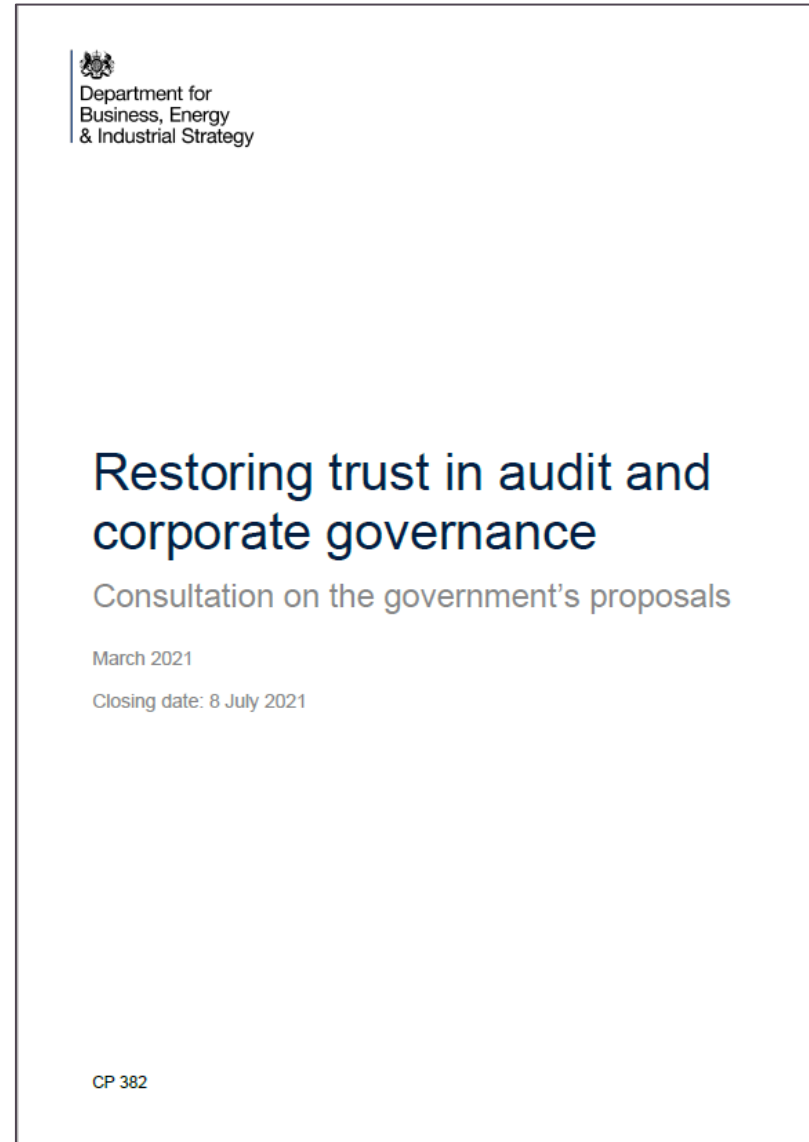
Restoring trust in audit and corporate governance



Corporate reporting and governance

Restoring trust in audit and corporate governance

- The Department for Business, Energy and Industrial Strategy (BEIS) has published its consultation, 'Restoring trust in audit and corporate governance'.
- This consultation is the next step in the process of reform and a significant milestone towards setting up a new, robust and independent regulator.
- As part of our stakeholder engagement to support BEIS' consultation, we have launched a series of webinars and roundtables so that all stakeholders can engage with and discuss the key themes of the consultation.





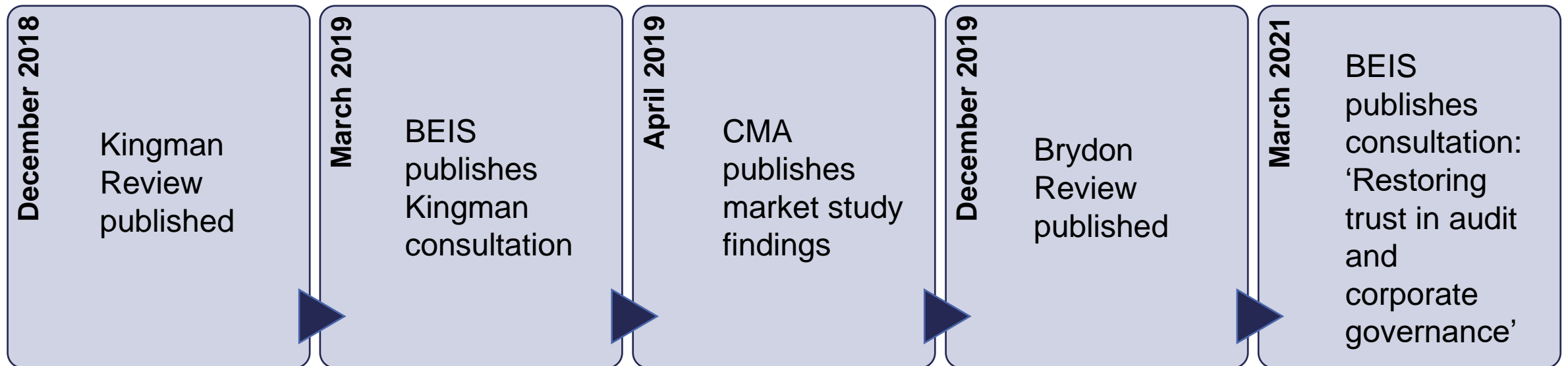
Reform objectives

The proposals aim to:

- Restore public trust in the way that the UK's largest companies are run and scrutinised
- Ensure that the UK's most significant corporate entities are governed responsibly
- Empower investors, creditors, workers and other stakeholders by giving them access to reliable and meaningful information on a company's performance
- Keep the UK's legal frameworks for major businesses at the forefront of international best practice

The journey so far

A timeline of key events



Key themes in the consultation

We are focusing on six key themes across this series of webinars and today will be focusing on:



Speakers



Kate O'Neill

Director of
Stakeholder
Engagement &
Corporate Affairs



Jenny Carter

Director of
Accounting &
Reporting Policy



David Styles

Director of Corporate
Governance &
Stewardship

Corporate reporting and governance

Resilience statement

Audit and assurance policy

Capital maintenance

Malus and clawback



Resilience statement

What is this section about:

- The Government proposes to introduce a statutory requirement on public interest entities to publish an annual Resilience Statement, consolidating and building on the existing going concern and viability statements.
- The statement will be required initially for premium listed companies only.
- The government intends to extend the requirement to provide a Resilience Statement to other Public Interest Entities within two years of it coming into force for plcs.

Resilience statements

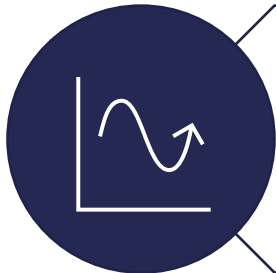
What will they cover?



Address business resilience over the short, medium and long-term



Mandatory assessment period should be five years



At least two reverse stress testing scenarios in their Resilience Statement

Resilience statements

What will they cover?

Short-term section

- Companies' existing going concern statement, including disclosure of any material uncertainties considered by management during their going concern assessment, which were subsequently determined not to be material after the use of significant judgement and/or the introduction of mitigating action.

Medium-term section

- Incorporate the existing viability statement requirements to provide an assessment of the company's prospects and resilience, and to address matters which may threaten the company's ability to continue in operation and meet its financial liabilities as they fall due.

Resilience statement

The Government proposes to require further specific disclosures in both the short and medium-term sections of the Resilience Statement.

- These might include:
 - Threats to liquidity, solvency and business continuity in response to a major disruptive event (such as a pandemic) which disrupts normal trading conditions
 - Supply chain resilience and any other areas of significant business dependency (e.g. on particular markets, products or services)
 - Digital security risks (both including external cyber security threats and the risk of major data breaches arising from internal lapses)
 - The business investment needs of the company to remain productive and viable
 - The sustainability of the company's dividend and wider distribution policy
 - Climate change risk



Audit and assurance policy

What is this section about:

- The Government proposes to introduce a statutory requirement on public interest entities to publish an annual audit and assurance policy.
- The audit and assurance policy describes the company's approach to seeking assurance of its reported information over the next three years.
- The consultation sets out some possible content for the audit and assurance policy.

Proposed timing

- The Government is minded that the Policy would be required initially of premium listed companies, and extend to other public interest entities two years later.
- In the case of quoted public listed entities, the Policy would be subject to an advisory shareholder vote at the time of its publication.



Audit and assurance policy

The Government is inviting views on whether the policy should include the following new disclosures at a minimum



An explanation of what independent assurance, if any, the company intends to obtain in the next three years in relation to the annual report and other company disclosures beyond required by statutory audit.

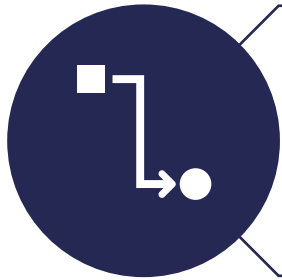


This should include an explanation of what independent assurance, if any, the company plans to obtain in relation to:

- The company's Resilience Statement in whole or part, and other disclosures related to risk
- The effectiveness of the company's internal controls framework

Audit and assurance policy

The Government is inviting views on whether the policy should include the following new disclosures at a minimum



A description of the company's internal auditing and assurance processes. This might include how management conclusions and judgements in the annual report and accounts can be challenged and verified internally and whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years.



A description of what policies the company may have in relation to the tendering of external audit services (for example, whether the company is prepared to allow the external company auditor to provide permitted non-audit services).



An explanation of whether, and if so how, shareholder and employee views have been taken into account in the formulation of the audit and assurance policy.



Capital maintenance

What is this section about:

- This section sets out and seeks views on proposals for strengthening the law on dividends and capital maintenance in a proportionate way.
- The Government's proposals include:
 - Assigning responsibility for defining realised profits and losses to ARGA and enhancing the legal status and enforceability of the definition
 - Introducing some new statutory reporting requirements.

Capital maintenance

In regards to defining realised profits, the Government proposes the following two alternative reform options:

1. Giving ARGA a duty to prepare guidance on what should be treated as realised profits and losses in accordance with generally accepted principles prevailing at the time.	2. Giving ARGA powers to make binding rules as to the meaning of realised profits and losses with which preparers would have to comply.
This guidance would be given authoritative status by providing in the Companies Act 2006 that, in interpreting what are realised profits and losses according to generally accepted principles, regard should be had to the guidance produced by the regulator.	The rules would be established by reference to the prevailing generally accepted principles. Before making the rules, ARGA could also be required to obtain the consent of the Secretary of State for what is being proposed.

- Disclosure of the distributable reserves in the financial statements
- Disclosure of estimates of a group's dividend-paying capacity
- A new directors' statement about the legality of proposed dividends and the effects on the future solvency of the company

New reporting requirements

The consultation proposes introducing some new statutory reporting requirements

Capital maintenance

In regards to disclosure of the distributable reserves in the financial statements:

- This proposal would involve individual companies (or, in the case of a group, the parent company only) within the agreed scope disclosing, in their annual report, the total amount of reserves that are distributable.
- This disclosure would help users identify the headroom between a proposed dividend and the distributable reserves and provide some insights into the company's ability to pay dividends in the future.
- It would also help with assessments of the legality of proposed dividends.
- The inclusion of the distributable reserves figure in the financial statements would mean that they would be subject to audit which would provide further reassurances about compliance with the rules on dividends.
- Where it is impossible to calculate the figure exactly, for example where a company's profit history goes back many years, it is envisaged that companies will be permitted to report a 'not less than' figure for its distributable reserves.
- Any proposed dividend payment would not be allowed to exceed the known figure.

Capital maintenance

In regards to disclosure of estimates of a group's dividend-paying capacity:

- In some group situations, the disclosure of the parent company's own distributable profits (as proposed above) would understate the potential overall capacity to pay future dividends. This would arise, for example, when significant profits are earned by subsidiaries and that profit has not yet been passed to the parent company and is therefore not yet available for distribution by the parent.
- The Government's second proposal would address this weakness by, in addition, requiring a parent company to estimate and disclose the amount of potential distributable profits across the group that could, in principle, be passed to the parent company for the purpose of paying future dividends to shareholders.
- Narrative disclosures would be provided to explain any major constraints on the ability of a subsidiary to pay its distributable reserves to the parent. These disclosures would also be a part of the financial statements and therefore subject to audit.
- The Government envisages the reporting requirement giving companies a degree of discretion about how to present these estimates.
- The regulator would be expected to consider issuing guidance, in due course, on the most effective ways of meeting the new reporting requirement.
- The new proposed disclosure requirements will be of value primarily to external investors who will, as a result, have more information about the legality and potential future sustainability of dividends. The Government therefore envisages the requirements applying to listed and AIM companies only.

Capital maintenance

The Government proposes that directors should, in proposing a dividend make a statement covering the following:

Confirmation that in proposing the dividend, the directors have:

- (a) satisfied themselves that the dividend is within known distributable reserves; and
- (b) have had regard to their general duties under s172(1) of Companies Act 2006 (including the need to have regard to the likely consequences of any decision in the long term) and their wider common law and fiduciary duties.

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 in the light of the risk analysis undertaken and the directors' knowledge of the company's position at the date the dividend is proposed.

Where relevant, directors should also confirm that the dividend is consistent with the Resilience Statement.



Malus and clawback

What is this section about:

- Giving the new regulator stronger powers to take enforcement action against company directors for breaches of their existing statutory duties.
- The consultation suggests that the Government will initially ask the regulator to consult on changes to the UK Corporate Governance Code to include provisions which recommend that certain minimum clawback conditions or “trigger points” are included in directors’ remuneration arrangements and that these have a minimum period of application of at least two years after an award is made.
- Following a review, the Government will then consider whether there is a need to further extend this to all listed companies, potentially through the Listing Rules.

- The ability to recover remuneration already paid to directors (clawback) or to withhold pending awards (malus) are important mechanisms in directors' remuneration arrangements.
- Outside of the financial services sector there are no mandatory requirements for companies to include clawback provisions in directors' remuneration arrangements.
- However, the UK Corporate Governance Code states that for premium listed entities, directors' remuneration policies should "include provisions that would enable the company to recover and/or withhold sums or share awards and specify the circumstances in which it would be appropriate to do so."

Malus and clawback

Some background information

Malus and clawback

What the consultation proposes

- The Government proposes to strengthen malus and clawback arrangements to provide better reassurance against rewards for failure.
- Government is clear that companies should be able to and should actively consider adding to these minimum conditions to reflect company-specific circumstances. The following are proposed as minimum conditions within which clawback provisions can be triggered:
 - material misstatement of results or an error in performance calculations;
 - material failure of risk management and internal controls;
 - misconduct;
 - conduct leading to financial loss;
 - reputational damage; and
 - unreasonable failure to protect the interests of employees and customers.



Any questions?

What's next?

The next steps in the process

Webinars and roundtables

Details of all other webinars and roundtables across the six workstreams can be found on [our website](#)

Roundtables on corporate reporting and governance

For investors: Thursday 25th May, 14:00 – 15:30

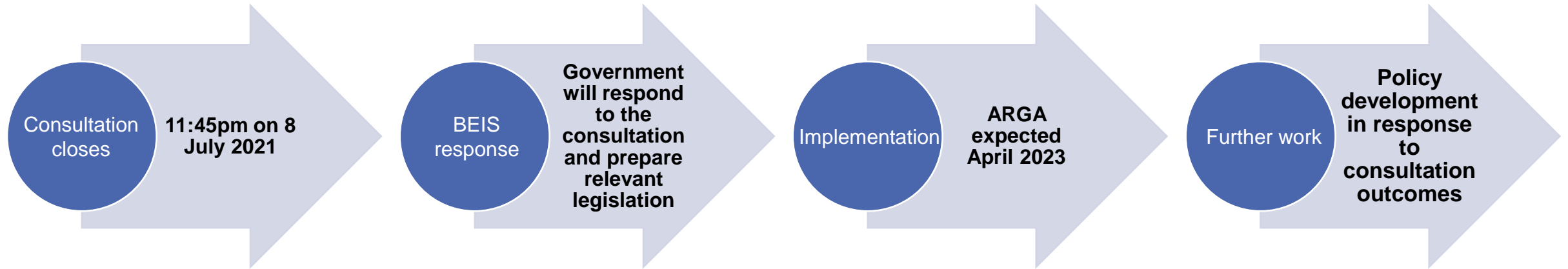
For companies and boards: Thursday 27th May, 09:30 – 11:00

For auditors, audit firms & professional bodies: Thursday 6th May, 10:00 – 11:30

For all other interested parties: Thursday 29th April, 09:30 – 11:00

To register for roundtables, please email stakeholderengagement@frc.org.uk.

Next steps



Responses can be submitted either via the [gov.uk](https://www.gov.uk) website, or by email to audit.consultation@beis.gov.uk.



Thank you