

Restoring trust in audit and corporate governance: Summary of Government response

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United Kingdom

Corporate

The UK Government has published its long-awaited [Response Statement](#) following the White Paper published in March 2021 on audit and corporate governance reform (see our briefing [here](#) which outlines the proposals set out in the White Paper).

The proposed changes, some of which depart from the original proposals in the White Paper, include:

- Amending the definition of Public Interest Entities (**PIEs**) so that very large private and unlisted companies with more than 750 employees and annual turnover in excess of £750 million will also become PIEs. This essentially means that the new regulator will scrutinise their reporting and audit and they will need to meet enhanced transparency requirements.
- Establishing a new regulator, the Audit, Reporting and Governance Authority (**ARGA**) to replace the Financial Reporting Council (**FRC**). ARGA will have certain enhanced powers in relation to corporate reporting, including to direct companies to restate their accounts without a court order.
- The new regulator will have powers to investigate and sanction directors of large companies personally for breach of duties in relation to corporate reporting and audit.
- To promote greater transparency, entities within the new definition of PIEs will have to explain how they are identifying and addressing risks, and to set out the steps taken to prevent and detect fraud.
- Directors of Premium listed companies will be expected to state whether their internal controls are effective, under the UK Corporate Governance Code. The proposals for US style Sarbanes-Oxley measures in relation to director confirmations with possible external assurance have not been taken forwards and only premium listed companies will be directly impacted by the proposed measures around internal controls.
- PIEs will have to publish their distributable reserves and confirm the legality of dividend payments. ARGA will issue guidance on what should be treated as 'realised' profits and losses.
- In relation to the audit market, companies in the FTSE 350 will be required either to appoint an auditor outside the "Big Four" firms, or to allocate a certain portion of the group audit to a smaller "challenger" firm.
- PIEs will have to set out how they assure the quality and reliability of information in their annual reports outside the financial statements, including on climate, risk, and internal control.

Read our summary of the [Government response here](#), which also sets out which of the proposals set out in the White Paper have been taken forwards.

We are reviewing the detail of the proposals and will continue to monitor updates including the draft bill, when available, and will provide further comment and analysis of the implications of the proposed reforms for large private and listed companies.

Comment

The recent announcement by the Government to implement proposed reforms in relation to audit, corporate governance and reporting, which have been in the pipeline for a long time, is a positive development. However, the FRC is not alone in seeing the Government's decision not to take forward proposals to introduce "UK Sarbanes-Oxley" as a missed opportunity. There remains much uncertainty around the effectiveness of the alternative approach to deal with internal controls through the UK Corporate Governance Code (and only for the largest companies). However, given the costs of implementing a Sarbox regime and the challenges businesses face following Covid, Brexit and current economic conditions, it is perhaps not surprising that the Government

has heeded calls from businesses in this regard. In the current challenging economic climate, a more limited definition of “Public Interest Entity” than one of the options outlined in the 2021 White Paper will also be welcomed by business, as companies will be mindful of the additional obligations and regulation that this brings.

Where there is consensus is that the Government must now move quickly to implement the reforms it does intend to take forward as further delay is not in the interests of business, auditors or investors and will seriously undermine the Government’s stated objective of restoring trust.

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