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CORPORATE  
GOVERNANCE

## Corporate Governance snapshot:

### Government response on audit and corporate governance reform

In May 2022, the UK government published the response to its March 2021 consultation paper, *Restoring trust in audit and corporate governance*. It confirms that the government intends to take forward many of the reforms proposed in the consultation, in some cases in a modified form. The reforms will see the creation of the Audit, Reporting and Governance Authority (ARGA), the successor to the Financial Reporting Council (FRC), which will have an enhanced mandate to oversee corporate reporting and audit and to sanction directors for breaches of their corporate reporting duties. In addition a range of new reporting requirements and other obligations will be introduced. Steps will also be taken to reform the audit market and to further regulate auditors.

#### Key proposals impacting companies



##### Companies in scope

The reforms will primarily impact "public interest entities" (PIEs). The current definition of PIE will be expanded to include UK incorporated companies with both 750 or more employees and annual turnover of £750 million or more (the 750:750 threshold). AIM companies that meet the 750:750 threshold will also become PIEs. However certain existing audit related requirements that apply to existing PIEs, such as auditor rotation, will not apply to these new PIEs.



##### Director accountability

The new regulator will have power to investigate and sanction the directors of all PIEs for breach of their Companies Act 2006 duties and responsibilities in respect of corporate reporting and audit. This new regime will apply to all directors.



##### Audit process and internal controls

In a significant shift from the original proposals in this area, the government will invite the FRC to consult on changes to the UK Corporate Governance Code to require companies to include an explicit statement in the annual report setting out the board's views on the effectiveness of the company's internal control systems and the basis for its views. PIEs that meet the 750:750 threshold will be required to state in their new Audit and Assurance Policy whether they will seek external assurance on this statement. They will also be required to report on the measures taken to prevent and detect material fraud.



##### Resilience statement

The going concern statement and viability statement will be replaced with a "resilience statement", requiring directors of PIEs which meet the 750:750 threshold to consider short term and medium term threats to the company's resilience.



##### Audit and Assurance policy

PIEs which meet the 750:750 threshold will have to publish an Audit and Assurance Policy every three years setting out whether and how a company is planning to obtain assurance on its company reporting beyond its statutory audit. A shareholder vote on the policy will not be required but an annual implementation update will need to be published.



##### Review of annual reports

The regulator's corporate reporting review powers will be expanded to cover the entire annual report and accounts. The ARGA will not need a court order to direct a company to make changes, rectify or restate its annual report and accounts.



##### Dividends

PIEs which meet the 750:750 threshold will be required to disclose their distributable reserves (or a "not less than" figure). They will also be required to explain the board's approach to the return of value to shareholders and how that distribution policy has been applied. A formal statement about the legality of a proposed dividend will be required but not a confirmation around the future solvency of the company as had been proposed.



##### Audit market

UK incorporated FTSE 350 companies will be required to either use a "challenger" firm to conduct a "meaningful portion" of their annual audit as part of a "managed shared audit" regime, or to appoint a "challenger" firm as their sole auditor.



##### Executive pay

The FRC will consult on changes to the Governance Code to require companies to be more transparent in relation to the conditions in place to withhold or recover remuneration paid to executive directors.



##### Timing and implementation

The reforms will be implemented in a number of ways including primary legislation, secondary legislation (which may be used to introduce the new reporting requirements) and amendments to the Governance Code. It is anticipated that the reforms will be implemented over a number of years.

#### Key contacts



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