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Darren Jones MP
Chair; Business, Energy and Industrial Strategy Select Committee
House of Commons
London
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Sent via online form

1st September 2020

Dear Mr Jones,

<u>Response to Future of Audit inquiry</u>

I am writing to respond to BEIS Select Committee's inquiry into the future of audit on behalf of ShareAction, a registered charity established to promote transparency and responsible investment practices by institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters.

Over the past 18 months two reviews: one of the Financial Reporting Council (FRC) and on the future of audit have taken place, the recommendations from which have the potential to drastically improve understanding, reporting and integration of the social components of Environmental, Social and Governance factors (ESG factors). Sir John Kingman's review of the FRC made various wide-ranging recommendations to Government for reform of the regulator, while Sir Donald Brydon's review made several recommendations to improve the quality and effectiveness of audit. These reports are timely and, given the long-term impacts of the pandemic, provide a valuable opportunity for the Government to take meaningful action to support a more resilient and long-term focussed economy. The Government has already broadly welcomed the recommendations and some work has begun to take them forward, for example preparations to transform the FRC into the Audit, Reporting and Governance Authority (ARGA). These steps are welcome and further concrete action is needed.

We recommend decisive action from the Government to take forward these recommendations, with focus on:

- **Ensuring ARGA's stewardship function is adequately resourced and holds Stewardship Code signatories to account.**
- **Compelling Company directors to publish a new resilience statement.**
- **Compelling Company directors to publish an annual Public Interest Statement.**

<u>Responding to the Kingman and Brydon reviews: next steps</u>

Company directors should publish a new resilience statement.

The Brydon review recommended that **company directors should be required to publish an annual Resilience Statement**.[1] This would incorporate a going concern opinion for the short-term, a statement of resilience in the medium-term and a consideration of the risks to resilience in the long-term. Brydon also notes the long-term component would provide an opportunity for directors to set out how they intend to position the business strategically to address 'potential existential threats'. This is even more pertinent in the context of Covid-19 and would strengthen corporate resilience and enable investors to better understand their exposure to such risks. This boost to corporate transparency would shine a light on 'S' issues while giving shareholders and other stakeholders an opportunity to drive them up boards' agendas.

Company directors should publish an annual Public Interest Statement.

Brydon also recommended directors explain their view of the company's view of its obligations to the public interest, 'whether arising from statutory, self-determined or other obligations' and how the company had sought to meet that public interest over the previous 12 months. Companies themselves outlining their obligations to the public interest is an excellent way to communicate perceived 'S' issues, both as they *impact on a company* as well as the *impact of the company* on society. This should represent the beginning of a wider conversation about the role of business in society and better enable all stakeholders to understand the positive and negative impact of companies on society and help to enhance or mitigate these as appropriate.

ARGA's stewardship function is adequately resourced and holds Stewardship Code signatories to account.

The Kingman review highlighted stewardship as a key area of focus for the new regulator:

*'A fundamental shift in approach is needed to ensure that the revised Stewardship Code more clearly differentiates excellence in stewardship. It should focus on **outcomes and effectiveness, not on policy statements**. If this cannot be achieved, and the Code remains simply a driver of boilerplate reporting, serious consideration should be given to its abolition*.'[2]

The FRC responded to this concern with the new Stewardship Code that launched in January 2020. The Code describes stewardship as 'the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society' and includes audit firms amongst the list of key stakeholders to stewardship reporting.

We support a well-resourced regulator placed on a statutory footing that can take on the challenges of corporate governance and investor stewardship. In particular, BEIS should ensure the new FRC board is equipped to continue **to strengthen ARGA's stewardship capacity, and the regulator itself should consult on the framework it will use to hold Code signatories to account** regarding the 'outcomes and effectiveness' of their stewardship activities. The Code is new, and it is right the focus should be to drive up signatories, but it is equally important firms do not use it as a marketing exercise. **The Government and ARGA should therefore consider how ARGA undertakes oversight of Code reporting** and the extent to which non-compliance with its principles should result in sanctions.

Yours sincerely,

Fergus Moffatt
Head of UK Policy, ShareAction

[1] The Brydon Review (December 2019), p. 10. Available online at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852960/brydon-review-final-report.pdf [accessed 1 September 2020].

[2] The Kingman Review (December 2018), p. 10. Available online at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf [accessed 1 September 2020].