Understanding the BEIS consultation

‘Restoring trust in audit and corporate governance’

Non-Executive Director (NEDs) focus group: Increased accountability for directors and audit committees

Increased accountability for directors and audit committees – NEDs were largely supportive of change but concerned about the impact enhanced risk could have on willingness to be an NED

On 18 March 2021, the Government (BEIS) published its long-awaited consultation on reforms aimed at ‘restoring trust in audit and corporate governance’. It is a significant consultation with 98 consultation questions covering almost all 155 recommendations from the Kingman, CMA and Brydon reviews. The deadline for responses to the consultation was 8 July 2021.

PwC focus groups

During the consultation period PwC convened a series of focus groups to serve as an open forum for NEDs to discuss the Government’s proposals. On 17 May 2021, three groups met to talk about the proposal for increased accountability for directors and audit committees.

These focus groups were conducted under the Chatham House Rule so quotations in this article are unattributed.

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Some of the key questions around increased accountability discussed were:

Do you think these proposals will change the behaviour of boards?

A number of participants voiced their support for the proposals to enhance director accountability for corporate reporting and audit, believing that it would improve reporting and increase boards' interest in the detailed work of their audit committees. Several others questioned whether the proposals constituted much of a change from the set of duties that directors already face in well run companies.

"The new proposals could result in better record keeping but won't necessarily change behaviours, particularly if people were already doing a rigorous, professional job."

Several participants highlighted the complexity in relation to striking the right balance between executive and non-executive accountability. It was broadly assumed that NEDs will require more, or different, management information to provide them with greater comfort to discharge their responsibilities under the proposals. There were questions as to whether this could lead to NEDs becoming more involved in the running of the business, impacting their independence by acting as a "quasi-executive".

Several participants suggested the proposed strengthened regime for internal controls will go some way to providing directors with the additional confidence they'll require, and highlighted the value to them of having independent assurance over the new regime. The work that will be required to underpin the new resilience statement, proposed in the consultation, was also suggested as an additional process that would assist all directors in becoming more comfortable with their enhanced accountability.

Will the proposals impact on the attractiveness of becoming a NED?

Many participants raised concerns that the proposals could significantly increase the risks associated with being a NED, negatively impacting on the attractiveness of the role and reducing the talent pool. While some believed increases in remuneration would help compensate NEDs for the additional risk and workload, several participants were sceptical as to whether this would be enough to balance the threat of enforcement.

A number of participants raised concerns about the impact that enhanced accountability might have on the diversity of boards, as the resulting demand for experience might limit the opportunities for younger, less experienced directors.

"There is a risk it squeezes out the diversity we've just started to build."

Concerns were raised by several participants that increased accountability for NEDs might also lead to a "flight to safety" where companies deemed higher quality and less risky would attract the best talent, while start-ups and other smaller organisations might struggle to get the experience and expertise that they needed to grow. Participants highlighted that companies experiencing, or with a history of issues could also struggle to keep their directors.

"You run the risk of directors resigning en masse if something isn't quite right with the company, which doesn't solve the problem."

A few others however did not believe the changes would lead to a shortage of people wanting to join boards. It was suggested that these proposals might instead lead to an increase in the size of boards as NEDs are brought on to help manage the burden of enhanced accountability.

What additional support would be required for board members?

A number of participants highlighted the need to ensure the pipeline of NED talent is adequately trained and has the necessary experience to meet the enhanced accountability requirements. One suggestion included the creation of associate boards or board apprenticeships to develop young talent before appointment to boards.

Some participants also suggested that the proposed changes might lead to an increase in the number of specialist advisors to the board being recruited, rather than seeking specific skills and experiences when recruiting directors – such advisors would not be captured by the new regime.

Several participants drew comparisons between the proposals and the provisions introduced through the Senior Managers and Certification Regime (SM&CR) for the financial services sector, highlighting that experience of this regime, whilst positive, has demonstrated how directors' development plans will need to adapt to respond to the enhanced accountabilities.

Based on the current proposals, where all directors are equally accountable, it was noted that: "You will have those people who are not qualified accountants who will do as much as they can and read everything thoroughly but, despite best efforts, will really struggle."

Do you have any views about the proposed enforcement powers of the regulator?

Several participants agreed there should be regulatory oversight of NED performance, with strong support for a principles rather than rules-based approach to implementation. A principles-based approach was viewed as preferable from a proportionality standpoint, but was understood to put more onus on the regulator and make it harder for it to take regulatory action if, or when required.

At the same time, a number of participants called for appropriate checks and balances on the regulator - highlighting the risk of having one body serve as “judge, jury and executioner”.

Concerns were also raised about the potential gaps in the structure, capacity and experience of the new regulator (ARGA) to manage the proposed enforcement regime. Several participants expressed concern that the consultation proposed giving the regulator significant powers without establishing a full understanding of how it will use them.

A number of participants considered a judgemental (principles) based approach would be more appropriate than a rules-based (‘tick box’) approach to assess culture and behaviours at a board level. However, participants were clear that those identified to conduct such assessments would need to demonstrate an appropriate level of skill, knowledge and credibility to be effective.

“We’re in danger of giving this regulator absolute carte blanche without really knowing how it’s going to operate.”

Several participants questioned whether there should be different standards for Executive and Non-Executive Directors. Others believed that personal fines were undesirable, and that the emphasis should instead be on collective responsibility of the board.

“It should be a firm issue rather than an individual...we need to have a learning experience rather than a brutalising experience.”

Participants raised questions about the support that would be available to NEDs required to represent themselves if pursued by the regulator, and what the appeals process would entail. Others suggested that there should be a legal cap to non-executive liability.

Are there any areas that need to be considered in terms of how the proposals will be implemented?

Clarity on how the ‘patchwork’ of different regimes would knit together was called for.

Participants from the financial services sector were concerned about the interaction between ARGA and other regulators, and their differing powers. While non-UK based directors who are not currently subject to the Companies Act but are to the UK Corporate Governance Code and Listing Rules were concerned about how the regime will be applied to them. A number of participants raised the need to ensure international equivalence was thoroughly addressed prior to implementation so that the regime would be practical and pragmatic for organisations impacted.

Do you agree that these proposals are proportionate?

Participants did express a desire for greater clarity about the ultimate objectives of the whole package of reforms with comments noting: “these reforms are designed to cover a multitude of sins.” It was suggested that clearer objectives would enable greater understanding of which organisations should be ultimately captured, and how the proposals should be implemented.

Specific concerns were raised about the proportionality of the proposed expansion to the Public Interest Entity (PIE) definition. Charities were highlighted by a number of participants as potentially being unnecessarily adversely affected by the proposed expansion.

Participants also suggested that if the proposed expansion was adopted then there would be strong benefit to introducing a sliding scale for implementation, especially for smaller businesses.

Concerns were expressed by some about how manageable the cumulative effect of the changes would be.

Conclusion

There were varying degrees of support for the proposed enhancements to director accountability. It was clear that participants believed the changes would improve the quality of reporting and boards' interest in the detailed work of their audit committees but that care would need to be taken to make sure this didn't impact NED independence. An overarching sentiment was around the potential for increased risk associated with enhanced accountability and how this might impact the attractiveness of becoming a NED and also whether it might mean companies struggle to find the right NEDs for their boards.

There were also clear concerns about the proposed stricter regulator enforcement regime, with several calling for appropriate checks and balances on the regulator to be carefully considered and that the proposals will be implemented in an appropriate, proportional way.

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