



Restoring trust in audit and corporate governance

Director responsibilities for the detection and prevention of fraud

It can be challenging to keep up to date with continuous change in regulation and the impact it has on your business and directors. Whilst in some instances, changes can have minimal ramifications, the Government's consultation paper and subsequent proposals on '*Restoring trust in audit and corporate governance*' is one that needs your attention. In addition to likely changes and an associated increase in costs in relation to how companies report on their governance and finances, the Government is proposing to impose further liabilities on directors in relation to audit and reporting, in particular in relation to the detection and prevention of fraud.

Why has this consultation come about?

The consultation paper, released on 18 March 2021, sets out 150 recommendations aimed at improving and strengthening the UK's audit, corporate reporting and corporate governance systems. It is predominately about increasing transparency to provide investors with certainty and to ensure the stability and good governance of companies.

The consultation paper recognises that corporate failure can happen, but it should rarely be a surprise. In recent years, we have seen an increase in major and sudden corporate collapse from the likes of Carillion to BHS and Thomas Cook. This started raising questions from stakeholders, investors and the public about the credibility of statutory audits, internal governance and reporting. In addition, a long-standing question mark has remained over the perceived lack of competition in the audit market and the potential for this to destabilise transparency. To improve the quality of corporate reporting and success, the Government commissioned three independent reviews:

- The Kingman Review of the Financial Reporting Council (FRC)
- The Competition and Markets Authority's Statutory audit services market study
- The Brydon Review into the quality and effectiveness of audit

Following the reviews, the Government commissioned the consultation looking at new measures in relation to directors, auditors and audit firms, shareholders and the audit regulator.

Who will be caught by the proposals?

The proposals primarily apply to companies that fall within the definition of Public Interest Entities (PIEs). These are public companies listed on regulated markets, credit institutions and insurance undertakings. In order to increase public trust in UK businesses, this definition is being reviewed by the Government with a possible extension to include:

- Lloyd's Syndicates;
- AIM listed companies with a market capitalisation over €200m; and
- large private companies with either as the first option more than 2,000 employees or a turnover of more than £200m and a balance sheet of more than £2bn, or as a second option companies with both over 500 employees, and a turnover of more than £500m.

PROPOSED CHANGES IMPACTING DIRECTORS IN RELATION TO FRAUD?

Tackling fraud – The consultation recognises that directors are responsible for approving the company's annual accounts, having satisfied themselves that they give a true and fair view of the company's financial position and performance. Directors are also responsible for safeguarding the assets of the company and expected to take reasonable steps to prevent and detect any material fraud. This includes:

1. Undertaking an appropriate fraud risk assessment and responding appropriately to identified risks
2. Promoting an appropriate corporate culture and corporate values
3. Ensuring appropriate controls are in place and operating effectively

To improve transparency in respect of the measures directors are taking in relation to fraud, the Government proposes to legislate to require directors of Public Interest Entities to report on the steps they have taken to prevent and detect material fraud.

Additionally, the Government intends to legislate to require auditors of Public Interest Entities, as part of their statutory audit, to report on the work they performed to conclude whether the proposed directors' statement regarding actions taken to prevent and detect material fraud is factually accurate. This will involve close scrutiny of the measures undertaken by the directors in relation to fraud and a formal opinion on the directors' assessment of the effectiveness of the internal control systems.

Fraud costs UK businesses and individuals more than £137 billion a year. The consequences of being the victim of or having employees/associated individuals investigated for suspected fraud often has disastrous consequences for a business. As a result, a company could suffer significant reputational damage and the threat of law enforcement/regulatory investigations as a consequence of a failure to detect fraud in the early stages. It is therefore imperative that companies have in place adequate measures to prevent and detect fraud.

Additionally, auditors for companies that fail to have in place adequate fraud prevention and detection measures will be unable to provide an unqualified opinion.

There can also be significant consequences for individuals, particularly for directors who sign off on a company's report on the steps taken to prevent and detect fraud, if fraud is later discovered. There are proposals to make key changes relating to directors' wrongdoing by creating a new audit regulator (ARGA) and giving it the powers to sanction directors' breaches of statutory duties dealing with corporate reporting and company audits. They are also considering remuneration changes by strengthening malus and clawback mechanisms in the event of directors' serious misconduct, misstatement of results or error in performance calculations and failures of internal controls and risk management.

How we can help you?

Whilst there is still a debate ongoing as to whether each proposal will be implemented, it is clear that the Government are positioning increased regulation and more accountability for senior individuals and directors within affected companies with a view to restoring trust and improving governance. Having effective internal control and risk management systems in place at the outset is critical. The prevention and detection of fraud will form a key part of any new changes and investing resources at the outset is invaluable to prevent and detect fraud, therefore preventing adverse publicity, financial failures, misconduct, and any personal liability that comes with it.

At Howard Kennedy, we have a team of specialist fraud and compliance lawyers that have experience working with clients to develop stringent internal controls and process to ensure they are effective and limit exposure within their business. The team can assist with:

- Undertaking a tailored fraud and financial crime risk assessment
- An independent internal audit/review of your internal controls, including a review of existing policies and procedures
- Providing recommendations to ensure internal controls and risk management systems are robust and effective
- Assisting companies and directors in relation to any identified risks including advice on how to respond properly

Why Howard Kennedy?

- Recognised by Chambers and Partners and Legal 500 as one of the top UK firms for Financial Crime, Regulatory and Professional Discipline work
- A team of specialist financial crime lawyers who have represented senior individuals and companies in the most high-profile financial crime cases over the last 20 years
- The team is easy to work with, combining technical expertise with experience and commercial awareness
- We currently advise businesses on their processes and responsibilities in respect of financial crime compliance including anti-money laundering, anti-bribery and corruption, facilitation of tax and fraud
- We undertake internal investigations where risk/misconduct has been identified and where necessary, our media and crisis management teams work closely with our investigation lawyers to help safeguard the reputation of the company
- A team experienced with liaising with regulators and law enforcement, ensuring that where necessary the appropriate level of cooperation is given so that the best possible outcome for the company is achieved



Very down to earth and hard working team. They are great to work with. They are always on top of the brief and show great judgement'.

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About Howard Kennedy

We are a London based law firm specialising in providing straightforward advice to entrepreneurial businesses and individuals on domestic and international matters, whatever the legal challenges they face.

Working with us you'll have a team behind you who are easy to work with. Who are there whenever you need them, taking the stress out of difficult situations. We simplify what others complicate, giving useful advice in language you understand. We look to complete projects and deals quickly and efficiently so that you don't miss out on important opportunities.

Whoever you are, we'll give you the straightforward advice you need to get from where you are to where you want to be.

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