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Aiming For Resilient Businesses In A Post-Pandemic Future

As we find our way out of this pandemic, all those with a vested interest in the integrity of company oversight and reporting will be acutely aware of the implications of the UK government's recent proposals aimed at improving the quality of corporate reporting, governance, audit and stewardship. The buzzword is the need for 'resilience'.

"The resilience of a business is its ability to absorb stress and shocks arising in an uncertain and constantly changing operating environment, while continuing to function and meet directors' duty to promote the success of the company. The concept of resilience covers sudden, unforeseen shocks, such as pandemics, as well as long-term, gradual threats to business model sustainability - for example, the need for energy companies to adapt their business models to climate change risks and mitigation requirements" says the government consultation impact assessment in March, 2021. "Companies' ability to assess and manage risks to their survival is, therefore, paramount to their resilience" it goes on to say.

The ensuing consultation launched a week later on March 18, 2021 by the Department of Business, Energy and Industrial Strategy (BEIS) contains proposals to introduce assessments of financial controls and reporting procedures and associated directors' responsibilities and liabilities. The proposals have important implications for all audit committees and boards and will increase the assurance they require.

In theory, the proposed introduction of a statement in the annual report on the effectiveness of internal control and risk management systems, as well as an associated public reporting requirement for auditors on the efficacy of the system of controls, should primarily be a disclosure issue. The assurance points, one might assume, would already be captured by the audit committee's existing remit as well as by external audit. But now, under these proposals, the need for a public confirmatory statement on which investors can rely, will increase the pressure for assurance and verification.

Audit committees will need to adapt in a number of ways, rapidly. Introducing an annual resilience statement based on a five year forward view of the company's position and risks, and in particular addressing climate change, will extend the period currently assessed for going concern and viability statements as well as the scope of reporting. The resilience statement is seen as an explanation of the directors' approach to maintain and strengthen the company's resilience in the short, medium and long term. These measures will increase the scale of the uncertainties about which the board will need to report, requiring more time to be spent by the audit committee and the board getting comfortable that they have come to a reasonable judgement in relation to the outlook.

For businesses, the introduction of a new audit and assurance policy and a requirement to consult with shareholders on risks and audit planning will require long-term planning, meaning the annual schedule of work will need a complete rethink, starting earlier in the year.

"Businesses will be expected, under the proposals, to discuss the approach the company plans to take over the next three years to seeking assurance of its reported information beyond the current required statutory audit", states the government.

New dividend and capital maintenance disclosures will put a greater emphasis on forward looking assessments of affordability compared to the current backwards looking statement on fact, i.e. are there enough distributable reserves in the last accounts? Audit committees as well as the wider board will then need to look at these forward-looking statements before recommending and making distributions to shareholders.

The proposed new sanctions regime in the pursuit of better corporate governance includes director disqualification and wider malus and clawback measures. Here it will fall to remuneration committees to ensure that malus and clawback provisions don't just cover financial irregularities, but other failings that impact the company, such as reputational risk or actions that are contrary to shareholder interests.

With the pandemic commonly expected to lead to greater regulatory, parliamentary, media and wider stakeholder interest in how companies are thinking about and preparing for the future - as the government has acknowledged with the launch of these proposals - boardrooms will remain in the spotlight. The next two to four years are likely to see a staggered introduction of agreed reforms, and the largest companies will be first.

The audit and corporate governance reform proposals will mean a step change for many businesses in reviewing internal controls and examining their transparency when it comes to risk.

They would all be well advised also, to reassess the strength of their audit committees, as diversity of background rises in importance. As governance professionals come under pressure with these changes, they will need to guide their boards and audit committees on updated terms of reference to reflect the expanded remit with a revised annual work plan.

The government's proposals acknowledge that the aim for better quality information will require more time and effort than current reports, and also additional review by senior staff and directors. Additional resources will be needed to conform to the new standards, and early thinking and preparation will be needed to ensure timely and effective implementation.

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