

Submission to the Sir Donald Brydon Independent Review from James Kirkup of the Social Market Foundation

The Social Market Foundation is an independent think-tank based at Westminster and concerned with the promotion of fair markets in goods, services and labour. We are a registered charity ultimately governed by a board of trustees that includes parliamentarians from the Conservative, Labour and Liberal Democrat parties.

This submission is made in my name in my role as chief executive of the Social Market Foundation. It reflects my views and not those of the SMF's trustees, who have no involvement in the publications of the charity.

This submission should be seen primarily as a response to Q7 of the call for evidence: What should be the role of audit within wider assurance?

1. The historic purpose of audit arises from the separation of ownership and management. The job of an auditor is to verify that the management of a public company is using the owners' capital in a way that is consistent with the law.
In the words of the ICAEW: *"The purpose of the statutory audit is to provide an independent opinion to the shareholders on the truth and fairness of the financial statements, whether they have been properly prepared in accordance with the Companies Act 1985, and to report by exception to the shareholders on the other requirements of company law such as where, in the auditors' opinion, proper accounting records have not been kept. Directors are delegated responsibility for managing the affairs of the company and the audit is an important mechanism that helps owners of companies assess the stewardship of directors, and in so doing provides an important stimulus for directors to place a proper emphasis on their fiduciary responsibilities."*¹
2. Audit also has a function in the context of public interest and the law. Parliament has legislated to allow the owners of public companies to limit their liability. That is a privilege that is accompanied by responsibilities to the wider public whose authority underpins all law.
3. There have been changes in both the laws to which public companies must adhere, and the more nebulous sense of public expectation around the responsibilities of public companies. I am interested here primarily in the legal changes.

¹ <https://www.icaew.com/-/media/corporate/files/technical/audit-and-assurance/audit-quality/audit-quality-forum-fundamentals/fundamentals-audit-purpose.ashx>

4. In s172 of the Companies Act 2006, Parliament placed a new “duty” on the director of a company to act with regard to the interests of several groups, as well as “the environment” and wider society. Yet there has never been a clear regime of mechanism of enforcement for that law.
5. The Companies (Miscellaneous Reporting) Regulations 2018 requires directors of larger companies to report how they have had regard to that duty, effective for financial years beginning on or after 1 January 2019.
6. That timetable means there is no meaningful evidence of the consequences of that reporting requirement. However, even in the absence of that evidence it is possible to say that there remains a significant disparity in the way that the directors of public companies are required to adhere to the law.
7. As captured in that ICEAW account, directors’ adherence to the law as it relates to the accuracy of financial reporting is subject to audit, a system of independent verification and checking. Yet directors’ adherence to the law in s172 of the Companies Act 2006 is not subject to such verification. That inconsistency should be removed. Compliance with s172 should be subject to statutory audit in the same way that directors’ responsibilities are.
8. My first argument for this change is one of principle: if Parliament passes a law requiring something to be done (in this case, for directors to uphold a duty to take account of the interests named in s172), then that law should be upheld and mechanisms put in place to ensure that it is.
9. My second argument is about consistency. If other duties set out in company law are sufficiently important to require independent audit, s172 should be accorded the same importance.
10. My third argument is a speculative about the changes in company behaviour – and thus, public confidence in public companies – that might result from a regime of s172 auditing. I contend that a new regime of independently audit of directors’ compliance with the law as it relates to companies’ duties to wider society would help to address concerns about

company behaviour and the loss of trust in business and the general economic settlement of the UK.²

11. I make no recommendation on what manner of companies or entities should carry out the s172 audits I propose here. I am concerned with the nature of audit, not auditors. It is possible to conceive of an outcome where such auditing is added to the work of existing financial auditing firms. It is also possible that this role could be carried out by other organisations.

12. I make no recommendation on how these proposed s172 auditors should be registered and recognised. The existing framework of registration via the ICAEW and other bodies could be amended to accommodate new forms of audit, or a new system of registration, regulation and professional standards could be established.

James Kirkup

5th June 2019

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² See, for instance: <https://www.edelman.co.uk/wp-content/uploads/Edelman-Trust-Barometer-UK-2019.pdf>