Reflections from 2018

Political landscape
Brexit took centre stage on the UK’s legislative and regulatory agenda in 2018. This included several amendments made to statutory instruments in preparation for the UK’s departure from the European Union.

Looking further afield, the geopolitical landscape underwent rapid change and efforts to protect domestic markets led to trade disputes which continue to have a worldwide ripple effect and produce uncertainty for businesses and society.

Governance framework
Corporate culture, business ethics and rebuilding trust in business were at the heart of many public policy and regulatory developments. The Department for Business, Energy and Industrial Strategy (BEIS) and The Financial Reporting Council (FRC) prioritised strengthening the UK corporate governance regime, including by: extensively updating the UK Corporate Governance Code for companies; proposing new governance arrangements for large private companies; and transposing new regulations for companies to increase transparency in areas such as executive remuneration, gender pay gap and environmental risks. These changes demonstrated a shift towards stakeholder capitalism with companies expected to take greater and more proactive consideration of a wider pool of interested parties.
Regulatory change

2018 also saw further major regulatory changes. Data protection laws were strengthened, with companies becoming subject to more stringent requirements on the use and storage of personal data. Cybersecurity and resilience requirements were also extended for certain sectors, as cyber breaches continued to concern government and businesses.

Multiple regulators also expanded their supervisory work. For example, the increased focus on data privacy led to upick in related activity from the Information Commissioner’s Office. Similarly, high profile corporate failures and their consequences for pensions led to more interventionist actions by The Pensions Regulator.
Introduction

An update on the 2019 public policy landscape

With consideration of recent developments and known regulatory milestones, four megatrends stand out as being likely to inform the public policy landscape throughout the remainder of 2019 and beyond.

The public policy areas highlighted in this report can be aligned to four overarching megatrends:

1. Geopolitical shifts

Brexit remains the primary focus on the UK’s political agenda. It is still unclear what type of deal, if any, the UK will have when/if it leaves the European Union in October 2019. Conflicting views from UK politicians, European leaders, banking institutions and other key stakeholders have increased the already high levels of uncertainty, heightening the need for businesses to prepare for multiple potential outcomes.

A rise in populist sentiment has also contributed to the uncertain geopolitical landscape. International relationships are rapidly evolving, in some cases with an impact on trade agreements. The impact on trade agreements is also influenced by a rise in populism and protectionism.

2. Fourth industrial revolution

As emerging technologies, such as Artificial Intelligence (AI), are increasingly integrated into businesses, the associated ethical concerns and labour force disruption continue to raise new challenges. Regulators have sharpened their focus on AI as they have begun examining corporate behaviours and human capital more closely.

Increased accessibility of personal data is also resulting in greater cybersecurity and data privacy concerns for businesses and regulators. The General Data Protection Regulation (GDPR) which came into force on 25 May 2018, marked the beginning of an increase in regulatory supervision over companies’ handling of data. Heightened activity from the Information Commissioner’s Office (ICO) is expected, as is additional regulation following the European Commission review of the e-Privacy Directive.

3. Rise in stakeholder capitalism

The focus on how businesses consider and engage with stakeholders continues to develop, in large part as a response to the low levels of trust recorded in business generally. Businesses’ human capital are receiving a high level of attention, following an initial round of gender pay gap reporting, the Government’s consultation on ethnicity pay reporting and growing interest in organisational culture.

Environmental issues, including climate change and sustainability, are also areas of high interest, particularly with investors who expect companies to disclose relevant non-financial information. Legislative changes are anticipated in an effort to meet global warming targets.

Evolving expectations around the social impact of business have also resulted in a growing need for businesses to demonstrate the role they play in local communities and the contribution they make to society.

4. Enhanced governance & stewardship

Corporate governance and reporting will continue to see further developments. The transposition deadline for the Shareholders Directive II (SRDII) has been reflected by The Pensions Regulator (TPR), Financial Conduct Authority (FCA) and the Financial Reporting Council (FRC), and implies increased reporting for institutional investors. It also encourages an increase in investor stewardship activities, leading to greater engagement between companies and their investors.

Public interest in and changing expectations of the audit has led to a series of Government and regulatory reviews on audit reform. Outcomes of the reviews are expected to include updates in auditing and a strengthening of regulatory frameworks, impacting the corporate and auditing ecosystem.
The potential for recent policies to quickly disrupt business is significant. This is compounded by the multiple interrelationships between the four megatrends set out in the illustration to the right. The rapid pace of change dictates that the business models of today may well be unfit for the business world of tomorrow.

As the public policy landscape continues to evolve over the remainder of the year, businesses can expect new imperatives to emerge and develop within each of the four megatrends for 2019 – imperatives that will present both risks and opportunities. In the following pages, we provide insights on themes and offer our view as to policy matters that businesses should be considering.
Selected public policy themes

- Geopolitical uncertainty
- Brexit
- Cybersecurity and data privacy
- Disruptive technology and innovation
- Climate change
- Governance and stewardship
- Social impact
- Audit market reform
Geopolitical uncertainty

Global power tensions continue to impact politics, business and the economy

Where are we now?
Globalisation is giving way to an increase in protectionist policies. For example:

- The UK, which has historically been supportive of more integrated economic ties with its trading partners is set to leave the EU, potentially without a trade deal in place.
- Subject to Congressional approval, the renegotiation of the North American Free Trade Agreement (NAFTA), now known as the US – Mexico – Canada Agreement (USMCA) reflects an effort to preserve jobs and production processes in the U.S. through rigid restrictions, for instance Regional Value Content (RAC) levels.

There is increasing linkage of economic levers to seemingly unrelated political issues. For example:

- President Donald Trump recently threatened to impose a series of incremental tariffs on imports from Mexico in response to concerns around illegal immigration. Similar threats of US tariffs were seen with the EU, where the President threatened to impose tariffs on £8.4bn of EU goods as a response to subsidies for a European aerospace and defence group.¹

Heightened macroeconomic instability poses an increase in geo strategic risks and costs to businesses. For example:

- The US’s withdrawal from India’s preferential trade agreement was reported to hit around $6bn worth of Indian goods that were previously imported into the US as duty free.²
Potential developments to watch out for:
Protectionism, extremism and the consequent rise of nationalist agendas could increasingly lead to the decoupling of key international relationships which have enabled sustained global growth in the past 70+ years. In such a scenario, business models may require significant adjustments, at huge cost.

With initiatives like the China Pakistan Economic Corridor (CPEC) which will connect Asia and Europe; and China’s Belt and Road Initiative (BRI) where over 60 countries have either signed up or indicated interest; and investment plans are reported to total US$900bn. There is potential for an increase in political and economic realignments.

Insights: what does this mean for businesses?
Companies, especially those with a global presence will need to become agile in responding to divergent political and legal systems. This will require careful horizon scanning and crisis anticipation.

Taking their global footprint into consideration, companies should carry out ‘stress testing’ to help review and understand how geopolitical shifts will impact their businesses’ revenue drivers.

Companies should also consider how potential risks will impact various areas of their business. Areas to consider include the following:

- Supply chain (e.g., how trade agreements or military conflicts require shifts to distribution channels or a review of production locations).
- Human capital (e.g., how changes to immigration policy may affect a company’s ability to attract and retain talent).
- Finance/investment: (e.g., attractiveness of capital markets) compliance and tax topics must now become even greater elements of political and business risk management.

Geopolitical uncertainty, especially when it affects international trade (e.g., leading to sharp increases in the price of oil and/or devaluation of local currencies) can potentially undermine the viability of some companies, and in exceptional cases threaten their status as going concerns (e.g., airlines). This reinforces the importance of going concern and viability reporting by companies, and raises further the public’s expectations of the auditors’ role in this regard.
Where are we now?

- The financial and political environment is arguably just as unclear as last year. Uncertainty continues to impact business decisions, and we are beginning to see the impact of Brexit on the economy. Firms still need to plan for a range of scenarios.
- Despite all the political noise, the UK leaving with a ‘No Deal’ on 31 October 2019 remains the default outcome unless a deal is agreed in Parliament, or another extension is granted by the EU.
- The risk of No Deal presents an economic risk to many companies. Bank of England Deputy Governor Dave Ramsden has argued that ‘No Deal’ and no transitional period post-exit are the biggest risks to the economy. Businesses should continue to mitigate against a No Deal Brexit in business – critical areas and monitor developments to reassess plans.

Impact on investment:

- Uncertainty around Brexit is having an impact on all EU markets.

Potential developments to watch out for:

Impact on the macro economy:

- Policymakers continue to monitor the macroeconomic impact of Brexit. The Bank of England has noted that one of the main contributing factors to the UK’s GDP growth in the run-up to March 2019 was firms stockbuilding in order to prepare for a No Deal Brexit. Its impact on the macro economy is discernible: businesses continue to operate in an economy dominated by Brexit, and should expect economic indicators to continue to reflect this disruption.

While we have observed a 13% drop in Foreign Direct Investment (FDI) into the UK in 2018 compared to 2017 (EY’s 2019 Attractiveness Survey), the UK has, nevertheless, remained the top European destination for FDI in 2018.

- EY’s Brexit tracker has found that 23 companies monitored have announced a transfer of assets out of the UK to Europe. Not all firms have publicly declared the value of the assets being transferred, but the EY Brexit Tracker has followed public announcements worth around £1 trillion, up from £800 billion.
Impact on consumers:

- As political uncertainty trickles down to the consumer, companies will need to pay attention not only to developments in parliament and the macro-economy, but also to indicators of consumer sentiment.

Insights: what does this mean for businesses?

Monitoring and planning for Brexit remains as much of a priority as it was last year. Horizon scanning needs to encompass parliamentary developments, economic indicators, consumer confidence, and investor sentiment. Responsiveness remains the watchword.
Cybersecurity and data privacy

Regulatory and public attention grows, as the threat increases

Where are we now?
Regulators and citizens are taking the handling of personal data increasingly seriously. As a result, companies are under even-greater scrutiny.

Cybersecurity is a prime concern for boards. 17% of companies say that their No. 1 concern is the loss of customers’ information, according to EY’s 2019 Global Information Security Survey (GISS). There is a pressing need to meet regulatory and public demands, and to manage the risk of data breaches.

From a regulatory perspective, the General Data Protection Regulation (GDPR), which came into effect on 25 May 2018, represented a paradigm shift in how regulators police the handling of EU citizens’ data. The potential fine for a data breach stands at €20m or 4% of gross annual turnover, whichever is higher. Regulatory pressure, and the costs of error, are more significant than ever.

In 2018, The Information Commissioners Officer (ICO) published their Regulatory Action Policy for 2018/19. Examples of their regulatory activity in terms of monitoring and supervising data protection include:

- Overseeing data protection impact assessments.
- Conducting assessments of compliance with the Data Protection Act and GDPR.
- Conducting data protection audits of data controllers and processors.
- Issuing enforcement notices, warnings, reprimands, practice recommendations and other orders requiring specific actions by an individual or organisation to resolve breaches (including potential breaches) of data protection legislation and other information rights obligations.

Companies should be mindful of their obligations to the Data Protection Act and the ICO’s regulatory priorities which includes:

- Large scale data and cyber security breaches involving financial or sensitive information.
- AI, big data and automated decision making.
- Web and cross device tracking for marketing (including for political purposes).
- Privacy impacts for children (including Internet of Things connected toys and social media/marketing apps aimed at children).
- Facial recognition technology applications.
- Credit reference agencies and data broking.
- Use and sharing of law enforcement data, including intelligence systems.
- Right to be forgotten/erasure applications.

The imperative to ensure compliance is creating challenges for companies: Some organisations are concerned they may not have adequately skilled resources available. According to EY’s 2018 GDPR survey more than 60% of the organisations described this as the biggest challenge when performing GDPR compliance activities.

At the same time, cyber threats have continued to mount. There is a sense of a constant threat:

1,946,181,599 records containing personal data were compromised between January 2017 and March 2018, according to EY’s 2019 GISS.

When a data breach occurs, the financial cost to a company can be very significant. In 2018, the global average cost of a breach stood at US$3.86m. This does not account for intangible costs such as the damage to a company’s reputation and loss of public trust.

Cybersecurity is therefore a growing area of risk; companies remain concerned about preparedness, and pressure is mounting from regulators, consumers, and criminals.
Potential developments to watch out for:

Regulation on the free flow of non-personal data
The European Commission has issued regulation on a framework for the free flow of non-personal data in the EU. The regulation which came into effect as of May 2019 aims to remove obstacles to the free movement of non-personal data across EU member states and IT systems in Europe. Member states must review their existing laws by May 2021 and remove anything that limits the processing of non-personal data, or ensure that any limit is justified under the public security exception.

EU e-Privacy Directive
The EU e-Privacy Directive is expected to be released in the later half of 2019. The draft regulation aims to establish clearer rules on online tracking technologies including cookies.

The Centre for Data Ethics and Innovation (CDEI) consultation on online targeting approaches
The Centre for Data Ethics and Innovation is reviewing online targeting approaches. The review will focus on the impacts of online targeting on individuals, organisations, and society. In particular, how targeting approaches can undermine or reinforce the concept of autonomy – that is, the ability to make choices freely and based on information that is as full and complete as reasonably possible. A final report including recommendations will be published in December 2019.

Increased strategic focus from regulators
The ICO have said in their 2018-2021 Technology Strategy that cybersecurity will remain a top priority for them in terms of enforcement and policy. This will be reflected in their activities in 2019 and beyond. Additionally the UK Cyber Security Breaches Survey 2019 was released in April 2019. The report will inform Government policy on cybersecurity moving forward.

The EU Cybersecurity Act
The EU Cybersecurity Act came into force on 27 June 2019. The new regulation:

- Strengthens the EU Agency for Cybersecurity (ENISA), which will improve the co-ordination and co-operation in cybersecurity across EU member states and EU institutions, agencies and bodies.
- Establishes an EU-wide cybersecurity certification framework for ICT products, services and processes. The certification framework will allow companies to certify their products, processes and services once and obtain certificates that are valid across the EU.

Insights: what does this mean for businesses?

The Non-Personal Data Regulation: businesses should review their systems and processes in information management to ensure that the non-personal data it handles will not have to be GDPR-compliant.

Cybersecurity risks are not confined to data breaches, Companies must also be mindful of the growing compliance risks, as well as the associated reputational risks. Companies should continuously review their cybersecurity strategy to map their data ‘crown jewels’ and assess where they need to strengthen their cybersecurity capabilities.

The regulatory pressure is likely to result in even more strategic focus being given to cybersecurity at board level, and greater investment. Firms are growing more aware of the gaps in their preparedness. 39% of contributors to EY’s 2019 GISS said that less than 2% of their total IT headcount work solely in cybersecurity, and 55% or organisations do not yet make ‘protecting’ a part of their strategy, suggesting that there is still much work to be done to confidently mitigate the cyber threat.
Disruptive technology and innovation

Artificial Intelligence (AI), Ethics and the Future of Work

Where are we now?
The speed of new technology is developing at pace and brings opportunities, growth and new capabilities. For example, recent advancements like 5G technology will offer new benefits such as: operating machinery more remotely through 4K resolution, Augmented Reality (AR) and Virtual Reality (VR). It will also enable smarter and automated transportation (e.g., electric and self-driving cars).

Additionally, the Government intends to continue to invest in AI in order to drive growth in the economy. According to its Industrial Strategy, AI could add a further £630bn to the UK economy by 2035.

As AI embeds into the world of work, ethical implications are becoming an increasing concern for regulators. Disruptive technology poses challenges — both in terms of responding to the pace of change and judging how to appropriately regulate without stifling innovation.

Workforce training and skill requirements will also need to change in order to keep up with the advancement of technology. Research carried out by CIPD shows that 61% of employers reported that staff whose jobs are affected by AI and automation need more skills and knowledge as a result.

Potential developments to watch out for:
Regulators’ and stakeholders’ concerns about the ethics of AI could result in an increased focus on corporate and ethical behaviours.

Policymakers are expected to increase their focus on governing the ethics and use of AI. Although AI can be used by businesses to innovate and enhance what they do, they risk losing trust if it remains unregulated and/or misused. For example, AI solutions are seen as ‘black-boxes’ which means a human can’t easily understand how they make their decisions. Therefore, it is hard to ensure they are ethical and this specifically will mean regulators have to pay more attention to them and their impact.

- The Centre for Data Ethics and Innovation (CDEI) is carrying out a review on Bias in Algorithmic Decision making. This is to make sure that algorithms do not make
decisions based on attributes which may act as proxies for other demographic characteristics. The review will look at four sectors where algorithms are likely to be used more frequently: financial services, crime and justice, recruitment and local government. CDEI issued a call for evidence which closed in June 2019. An interim report will be issued in summer 2019 and recommendations made to Government by March 2020.

Regulatory oversight of AI is developing:

- The Financial Conduct Authority (FCA) has published a call for input to explore whether a cross-sectoral sandbox or similar initiative is needed to ensure a consistent and efficient approach to emerging technologies. Given the cross-sectoral nature of the proposal, this consultation will be of interest to a wide range of stakeholders including:
  - FCA regulated firms that use emerging technologies to facilitate business models spanning at least one other regulator.
  - Firms which are subject to a UK regulatory authority and diversifying their business model into the financial services sector.
  - Governmental bodies, policymakers and Think Tanks.
  - Regulators and other authoritative bodies.
  - Consumers and consumer organisations.

The Call for input closes on 30 August 2019.

Insights: what does this mean for businesses?

Embedding various forms of AI into companies can disrupt established business models. Companies will need to review and assess how the adoption of AI will affect their workforce and consider areas where their employees will need to retrain and upskill. This assessment will enable companies to be more forward-looking.

Biases in machine learning could potentially be a problem. AI tools reflect the data that drives them, therefore potential bias in a company’s data may be amplified when AI is applied to it. Companies will need to make sure they put appropriate risk monitoring and management controls in place to prevent this from happening.
Climate change

Growing recognition of the financial risks associated with climate change lead to increasing demands for climate action and reporting

Where are we now?
The risks that climate change poses to business operations are well known. According to the World Economic Forum 2019 Global Risk report, global business leaders ranked ‘failure of climate change mitigation and adaptation’ number 2 out of their top 10 global risks both in terms of likelihood and impact.

Climate change poses effective threats to businesses, most likely to hit within the next five years. A recent survey by the Carbon Disclosure Project (CDP) highlighted that the world’s biggest companies, representing nearly $17 trillion in market capitalisation, have valued the climate risks to their businesses at almost $1 trillion.

Growing demand for useful climate-related financial information by investors continues. For example in the UK, stewardship reporting consistently emphasises the importance of climate change to long term growth and value creation. Additionally more than 340 investors with nearly $34 trillion in assets under management have committed to responsibly engage with the world’s largest corporates on climate risk to strengthen their climate-related disclosures, by implementing the Taskforce on Climate-related Financial Disclosures (TCFD) recommendations as part of Climate Action 100+.

There is growing concern that environmental policies and efforts to mitigate the impact of climate change have been inadequate. Urgent and innovative change is needed in order for the goals of the Paris Agreement to be met. A recent report by the Intergovernmental Panel on Climate Change (IPCC) warns limiting the increase in the global average temperature to a maximum of 1.5°C “requires rapid and far-reaching transitions in energy, land, urban and infrastructure systems (including transport and buildings), and industrial systems.”

Pressures from both investors and regulators continue to be seen:

- The Streamlined Energy and Carbon Reporting (SECR) regulations came into force on 1 April 2019. Businesses will have to report on energy use and greenhouse gas emissions (through the annual report, for financial years starting on or after 1 April 2019. The first publication of reports is therefore expected to be filed with Companies House in 2020. The new rules affect quoted companies, large unquoted companies and large LLPs. Additionally the Government is also working with the FRC to help facilitate digital reporting of SECR disclosures and to ensure the information is more accessible for external stakeholders.

- Additionally the Network for Greening the Financial System (NGFS) have issued six recommendations aimed at facilitating the role of the financial sector in achieving the objectives of the Paris Agreement.
Potential developments to watch out for:

More probing questions and detailed requests for information from investors can be expected with an increase in demand for climate-related financial information.

Revisions to the Climate Change Act 2008

The statutory instrument (SI) called The Climate Change Act 2008 (2050 Target Amendment) Order 2019 was passed through Parliament and came into force on 27 June 2019. The SI increases the UK’s 2050 net GHG emissions reduction target under the Climate Change Act 2008 from 80% to 100%.

The Governments Green Finance Strategy

The Government published its report, ‘Green Finance Strategy, Transforming finance for a greener future’ in July 2019. The Strategy refers to ‘greening finance’, where the Government would like to ensure that current and future financial risks and opportunities from climate and environmental factors are integrated into mainstream financial decision-making and that markets for green financial products are robust. Examples of the main actions that the Government will take to green finance include:

- Setting out its expectation for all listed companies and large asset owners to disclose in line with the TCFD recommendations by 2022.
- Developing TCFD guidance for pension schemes. The Government and the Pensions Regulator have jointly established an industry group to develop TCFD guidance for pension schemes. The Pensions Regulator is expected to consult on this guidance in late 2019 with a view to putting it on a statutory footing during 2020 as part of the Governance Code required by the Occupational Pension Schemes (Governance) (Amendment) Regulations 2019.

Finance Regulators joint statement on climate change

On the same day as the publication of the Government’s Green Finance Strategy, the financial regulators (i.e., the Financial Conduct Authority, Financial Reporting Council, The Pensions Regulator and Prudential Regulation Authority) issued a joint declaration on climate change, which welcomes the Green Finance Strategy and recognises the relevance of climate-related financial factors to the regulators’ mandates and the importance of a collective response.

Similarly, the FRC issued a separate statement emphasising the responsibility of boards of UK companies to consider their impact on the environment and to address and report on the effects of climate change. The FRC will monitor how companies and their advisers fulfil their responsibilities as follows:

- Review whether companies are complying with the statutory disclosure requirements of the strategic report (including reporting on principal risks and uncertainties) as well as any financial statement implications of climate change.
- The FRC’s Financial Reporting Lab will provide practical guidance later in 2019 on how companies can best consider and report on climate related risk and opportunities.
- The FRC’s project on the Future of Corporate Reporting will also consider the need for improved non-financial/sustainability information from companies. A report is expected later this year.

Insights: what does this mean for businesses?

Companies will need to demonstrate to their stakeholder groups (investors, customers, regulators, communities, etc.) that they have identified and assessed the climate-related risks and updated their business models to protect their abilities to generate sustainable performance and long-term value. Failure to adequately reflect this could pose potential reputational damage for businesses.

The Government said it wanted to be the first major economy to legislate for a net-zero emissions target (by 2050) through the CCA 2008. It has now become the first G7 economy to achieve this. However such a target is only credible if policies are introduced to match. Therefore, business should expect and prepare for significant disruption across many sectors; notably energy, transportation and housing.
Governance and stewardship

Increase in disclosure and reporting requirements to strengthen accountability, shareholders’ rights and stakeholder engagement

Where are we now?

Corporate governance reform
A new package of legislative reforms on executive pay, directors’ duties and governance of the largest private companies was introduced in 2018 by the Department for Business Energy and Industrial Strategy (BEIS). The measures apply to periods beginning on or after 1 January 2019. They aim to improve how companies are run and strengthen engagement not just with shareholders, but also wider stakeholders: employees, customers and suppliers. Changes include:

- A ratio of CEO pay to full-time employees for quoted companies with >250 employees.
- A requirement for ‘large’ companies to publish a statement describing how directors comply with S.172 of the Companies Act 2006 (CA2006) and how they take into account other stakeholders’ interests; and for companies >250 UK employees to state how they engage with employees.
- A requirement for any company (including private and subsidiaries) above a specific threshold to explain its governance arrangements, if and how they apply a governance code and if no code is applied, what other arrangements are in place. Exceptions apply (e.g., companies already required to produce a corporate governance statement).

Legislation has been accompanied by non-regulatory measures, including: a revised UK Corporate Governance Code, which now includes a Guidance on Board Effectiveness; the Wates Corporate Governance Principles aimed primarily at large private companies required to comply with the new disclosure requirements; a revised FRC Guidance on the Strategic Report and a joint ICSA/Investment Association Guidance on Stakeholder Voice in Board Decision Making.

Shareholder Rights Directive (SRD II)
A number of measures introduced by the Shareholder Rights Directive (SRD II – which amends SRD 2007/36/EC of 2009) came into force on 10 June 2019. In particular:

- Executive pay measures: The Government has converted the new measures into UK law. The changes are not significant to the UK framework, as it already meets the core requirements for public companies and provides many of the transparency provisions in SRD II around the potential and actual award of fixed and variable pay to directors. Companies with a June year-end will need to comply with the new measures on remuneration policies to be submitted to vote at AGM in the Autumn.
- Stewardship and long termism: new transparency requirements on asset owners, asset managers and proxy advisors were implemented by the Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP). The FCA has also implemented the Directive disclosure requirements on traded companies concerning related party transactions.
- Prompt Payment Practices: The Government’s focus on strengthening prompt payment practices led the Cabinet Office to write to over 10,000 of its suppliers advising them of new rules applying from 1 September 2019: suppliers who bid for government contracts above £5 million per year should be able to demonstrate that they are paying 95% of invoices within 60 days.
Potential developments to watch out for:

**Shareholder’s Right Directive – Chapter 1a**
BEIS will bring plans forward in due course to implement Chapter 1a of SRD II, covering facilitation of shareholders identification, transmission of information and voting confirmation, which has a implementation deadline of 3 September 2020.

**Revisions to the UK Stewardship Code**
The FRC published a consultation on the draft\(^2\) 2019 UK Stewardship Code, which closed on 29 March 2019. The new Code aims to increase demand for more effective stewardship and investment decision-making, aligned to the needs of institutional investors and clients. Changes to the Code includes signatories being required to report in two parts:
- A Policy and Practice Statement upon signing the Code.
- An annual Activities and Outcomes Report.

The FRC expects to publish the final version of the Stewardship Code later in 2019.

The FRC and the FCA have also published a discussion paper on Building an effective regulatory framework for stewardship\(^2\). The paper aims to advance the discussion about what effective stewardship should look like, expectations for financial services firms, and how this can be best supported by the UK’s regulatory framework. An FCA Feedback Statement is expected later in 2019/20 which will highlight next steps.

**Corporate Transparency and Register Reform**
BEIS launched a consultation\(^4\) in May, which closed on 5 August 2019, seeking proposals to enhance the role of Companies House, increase the transparency of UK corporate entities and help combat economic crime. The consultation considers reform to the information we require companies to disclose, increasing the checks on this information and measures to improve the exchange of intelligence between Companies House and UK Law Enforcement bodies.

**UK Capital Maintenance Regime**
Reviews of the UK audit market/product have led to calls to resolve a specific issue within the UK’s capital maintenance regime. The CA2006 requires that companies should only pay dividends out of realised profits, although reporting and auditing standards allow companies to make disbursements out of accrued income. The reviews and BEIS Select Committee are seeking to stop this practice, implying changes to reporting and auditing standards. See the Audit Reform section for more detail.

**BEIS Green Finance Strategy**
BEIS published the government’s Green Finance Strategy, Transforming finance for a greener future, on 2 July 2019, which proposes to introduce requirements for listed companies and large asset owners to make disclosures in line with the TCFD’s recommendations by 2022. See the Climate Change page for more detail.

**Insights: what does this mean for businesses?**
The Government’s focus on strengthening accountability and restoring trust in businesses has been the main drive behind most of the recent reforms on reporting, transparency and stewardship frameworks. The new measures and potential developments impact on a wide variety of companies, depending on their size, legal status, economic thresholds and reason of business.

The current reviews could lead to further significant changes on how businesses operate. Boards, audit committees and companies secretaries will need to bring themselves up to speed and be ready to respond as developments evolve.
Social impact

Increasing demand for business to show how they contribute to a better society

Where are we now?
Businesses are more likely to be trusted when they are seen to operate in a way that is good for society as a whole.

Shareholder vs Stakeholder: There continues to be a push away from shareholder primacy in favour of companies working to achieve positive outcomes across a wider set of stakeholders.

Employees: Social impact can have an effect on businesses’ workforce both in terms of employee engagement and retaining new talent:

- According to a 2018 report by the Institute of Business Ethics, 64% of UK employees agree with the statement ‘my organisation lives up to its stated policy of social responsibility’ down from 78% in 2012. This is likely to present challenges in attracting and retaining talent.

- A recent study by Cone Communications found that 76% of millennials consider a company’s social and environmental commitments when deciding where to work, and that 64% indicate they will not accept a job if a potential employer lacks strong corporate social responsibility practices.

The Environment: 96% of respondents to the EY 2018 Global Climate Change and Sustainability Investor Services survey agreed that Environment, Social and Governance (ESG) information plays a pivotal role in their investment decision making. Stewardship reporting from investors is also beginning to reflect this trend.

Wider Society: Businesses that take into account a wide range of stakeholders’ interests, build a better reputation for themselves, are more able to become a force for good and reinforce their license to operate in society. The Edelman 2019 Trust Barometer revealed that currently 52% of the British public believe that the way businesses work today is not good for society, with 68% believing that businesses think making a profit is more important than looking after people.
Insights: what does this mean for businesses?

There is a demand for greater accountability of the decisions and actions taken by boards (i.e., impact on the environment and/or society). Boardroom agendas will increasingly need to take account of these growing stakeholder priorities.

Companies should review areas within their businesses that could deliver stakeholder outcomes in turn increasing trust and supporting the generation of long term value. Some examples include:

- **Disclosures and Reporting:** The FRC draft 2019 Stewardship Code now makes explicit references to ESG factors. Signatories are expected to take into account material ESG factors, including climate change, when fulfilling their stewardship responsibilities (see Governance and Stewardship section for more detail). As investors increasingly integrate ESG factors into their decision making, the measurement of companies’ impact on the environment and society will only grow more important. Companies should review and consider the frameworks they use to ensure their non-financial disclosures are clear and transparent. Companies should also consider what type of assurance they should obtain over such disclosures.

- **Purpose-Led Strategy:** Companies should review how their purpose is reflected in their strategy. Research shows that purpose-driven businesses in general are better at attracting and retaining talent and navigating disruption. Purpose-led strategies can also be used as tools to drive the innovation and creativity necessary to sustain growth and realign business with the achievement of positive stakeholder outcomes.

- **Stakeholder Engagement:** Companies need to understand the stakeholders that are most critical to the delivery of their strategy.

- **Culture and Talent:** Changing workforce demographics and the use of new technologies impact how, where and why people work. Additionally, economic inequality and social mobility themes inform employee expectations. Companies need to actively monitor their cultures and assess how they are supporting under-represented groups to develop a workforce that can support the strategic objectives of the business.
Audit market reform

Audit expectation and delivery gap and the evolution of the UK regulatory framework

Where are we now?
Public concern and changing expectations on the purpose and quality of audit has led to a review of corporate governance, reporting and auditing.

Three key reviews examine different aspects of the audit ecosystem:

1. Regulatory framework:
The Independent Review of the Financial Reporting Council (FRC), by Sir John Kingman, sought to enhance the regulation of corporate governance, reporting and auditing by assessing the FRC’s transparency, independence and reputation. It has also focused on strengthening the regulator’s structures, culture, processes, oversight, accountability, powers, impact, resources and capacity to ensure that it is fit for the future. Sir John Kingman published a series of recommendations in December 2018 upon which BEIS has consulted. One of the recommendations proposed includes replacing the FRC with a new regulator (the Audit, Reporting and Governance Authority), with new powers to investigate issues relating to companies and their reporting and governance. This takes a lead from the impact of the US’s Sarbanes Oxley regime, and with greater responsibilities placed upon the auditors (e.g., a duty to alert the new regulator on concerns about the viability of companies).

The first consultation closed in June 2019 with others expected in the autumn of 2019, focusing on a UK equivalent to Sarbanes Oxley (SOX), the definition of a public interest entity and corporate failure.

2. Competition and choice:
The Competition and Markets Authority (CMA) launched a market study into the supply of audit services in the UK. The UK Government reviewed the CMA’s recommendations published in April 2019, and responded with a consultation issued in July 2019.

The CMA’s recommendations include:
- Audit committees being regulated more closely, to include their appointment of audit firms and assessment of audit processes.
- The introduction of mandatory joint audits to increase opportunities for smaller firms to audit larger companies.
- The Big Four split their operations between audit and non-audit work (e.g., separate leadership, governance and finances).
- The audit market is reviewed again in five years’ time, with the potential for more reforms if competition and choice has not improved (e.g., break-up of the Big 4 firms).

3. Effectiveness of audit:
The Independent Review by Sir Donald Brydon into the Quality and Effectiveness of Audit focuses on enhancing the audit product itself. Call for Views closed in June 2019 with a report expected in the towards the end of the year.
The BEIS Committee Inquiry into the Future of Audit

BEIS Select Committee published the final report\(^2^7\) on its ‘Future of Audit Inquiry’ which closed in April 2019. The Committee offered recommendations applicable to the CMA, Kingman and Brydon reviews. The Government intends to address the Committee recommendations in its responses to the above reviews by the end of the year.

Insights: what does this mean for businesses?

The final outcomes of the three reviews remain uncertain; however, businesses can be confident that change is coming. Below are examples of potential areas that boards should consider:

- The new regulator will focus on increased accountability for all directors.
- The implementation of a strengthened framework around internal controls e.g., UK Sarbanes Oxley (UK SOX).
- Expanded audit committee reporting and regulatory review.
- Increased investor engagement, possibly similar to that with the remuneration committee.
- Management’s time is increased by coordinating two auditors on mandatory joint audits, management of peer reviews and increased requirements on regulatory compliance.
- Depending on what the outcome is from Brydon, companies in the future may have more scope on what the audit might cover e.g., fraud investigation, forward looking information in the annual report and accounts.
- Greater focus on going concern and the viability statement and the auditor’s opinion on the model that is used by a company when issuing its viability statement.
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End Notes


2. Financial Times June 2019: [https://www.ft.com/content/e339daee-8846-11e9-a028-86cea8523dc2](https://www.ft.com/content/e339daee-8846-11e9-a028-86cea8523dc2)


End Notes


27. UK Government: Green Finance Strategy, Transforming finance for a greener future  

28. Joint Statement on Climate Change by Prudential Regulation Authority (PRA), Financial Conduct Authority (FCA), Financial Reporting Council (FRC) and the Pensions Regulator (tPR), July 2019  

29. FRC Statement on the Government’s Green Finance Strategy, July 2019  

30. Business Secretary Greg Clark’s speech at the launch of the Committee on Climate Change ‘Net Zero’ report: May 2019  

31. UK Legislation, The Companies (Miscellaneous Reporting) Regulations 2018  

32. Financial Reporting Council, UK Corporate Governance Code 2018  

33. The Wates Corporate Governance Principles for Large Private Companies 2018  

34. FRC Guidance on the Strategic Report 2018  

35. FCA Proposals to promote Shareholder engagement: Feedback to CP19/7 and final rules May 2019  

36. FRC Proposed Revisions to the UK Stewardship Code 2019  

37. FRC and FCA Discussion Paper: Building a regulatory framework for effective stewardship, April 2019  

38. Government Consultation on Corporate Transparency and Register reform  

39. Institute of Business Ethics: Ethics at Work, 2018 survey of employees Europe  

40. 2016 Cone Communications: Millennial Employee Engagement Study  
https://static1.squarespace.com/static/56b4a4a7472bb8ddee3df5b7013/t/5819e8b30396e3016ca0d9c/1478092981243/2016+Cone+Communications+Millennial+Employee+Engagement+Study+Press+Release+and+Fact+Sheet.pdf

41. The Edelman 2019 Trust Barometer survey  
https://www.edelman.com/trust-barometer

42. EY 2018 Global Climate Change and Sustainability Investor Services survey  

43. The Independent Review of the Financial Reporting Council (FRC) 2018  

44. The Competition and Markets Authority: Statutory audit market study 2019  
https://www.gov.uk/cma-cases/statutory-audit-market-study

45. Independent Review by Sir Donald Brydon into Quality and Effectiveness of Audit 2018  

46. House of Commons Business Energy and Industrial Strategy Select Committee Inquiry into the Future of Audit  
https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf
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