Independent Anti-Slavery Commissioner

Dame Sara Thornton DBE QPM
Independent Anti-Slavery Commissioner
5th Floor, Globe House
89 Eccleston Square
London, SW1V 1PN

SfB: +443000732073
Email: shelley.perera@iasc.independent.gov.uk

6 July 2021

By email: audit.consultation@beis.gov.uk

IASC response to the BEIS consultation: Restoring trust in audit and corporate governance: proposals on reforms

Part of my remit as Independent Anti-Slavery Commissioner is to encourage good practice in the detection, prosecution and prevention of modern slavery, including within businesses and their supply chains.

This has increasingly led me to look at corporate responsibility and how common commercial practices can impact the most vulnerable workers. Over the past two years in my role I have seen strong examples of companies striving to do better. Some are re-evaluating their entire operations around a more defined sense of purpose and social good.

However, other businesses are driven by lowest cost tendering principles, propped up by unscrupulous practices. This can put undue pressure on suppliers and result in unethical corner cutting in supply chains. Modern slavery is an extreme outcome of corporate failure but should be seen in the wider spectrum of exploitative labour practices that are impacting millions of workers in the UK and abroad.

Fuelled by criminal activity and sustained through corporate negligence, labour exploitation is a complex problem that needs to be tackled through a range of policy and legislative levers. Improving the quality of company audits is a positive step on this journey. It has the potential of raising standards of governance, providing greater accountability and responsibility at board level, and also creating more transparency for financial markets and other stakeholders.

I welcome the BEIS consultation, *Restoring trust in audit and corporate governance,* which recognises that decisive and substantial moves are needed to shake up a regime that has historically failed to improve through small incremental changes. I also agree that a holistic approach is essential, and that directors, auditors, shareholders and the audit regulator must all play their part in the reform.

Company size

Large privately owned companies should be included within the definition of a public interest entity, and therefore fall in the scope of enhanced audit requirements. As major employers with substantial supply chains, they can have devastating long term impacts on the lives of workers when mismanaged. One powerful argument for this is the Arcadia Group, which de-listed from the London Stock Exchange in 2002 and became the UK's largest privately owned retail company. The fashion giant went into administration in 2020, putting 13,000 jobs at risk, while questions remained over excessive dividends to the directors and its historic handling of the BHS pension scheme.

For similar reasons, very large companies that are listed on Alternative Investments Market (AIM) rather than the London Stock Exchange should be included within the definition of public interest entities. Some AIM-listed companies have a market value running into £billions but are not subjected to the same transparency rules as their FTSE competitors. Greater scrutiny through auditing would help to address some of the imbalances caused by the less stringent governance requirements of the AIM.

Resilience statements

I agree with the Brydon Review and the Government that reporting should provide more evidence of how directors plan to maintain resilience of their business and welcome the inclusion of more specific disclosures. An in-depth viability statement that deals in greater detail with risk scenario planning is important for guarding against sudden seismic social and economic shocks, such as the collapse of construction giant Carillion. It should help to protect workers and supply chains over the longer term.

The suggested inclusion of new reporting categories for risk, such as climate change, is also welcome. Over the longer term, I would urge the Government to consider labour exploitation as an additional risk element that could influence supply chain resilience. Legislation such as US Tariff Act, which places import bans on goods made with forced labour, is having an impact internationally, and similar trade policies and legislative levers are being developed in other parts of the world. The risk of being subjected to such a ban creates significant commercial, reputational and operational challenges for companies. International pressure for business to assess and manage this risk will increase in coming years.

Reporting on Payment practices

The Government has noted that company reporting on payment practices is currently patchy. I welcome proposals that public interest entities' annual reports provide a summary of how the company (or group) has performed with regard to supplier payments over the previous reporting year, and to comment on how this compares to the previous 12 months.

As well as the time a company takes to pay its suppliers, other areas for monitoring could include whether it has forced unfair and unnecessary discounts upon them. This tactic, as noted by the joint inquiry by the Work and Pensions and BEIS committees, was used by Carillion. Despite being a signatory of the Prompt Payment Code, the contractor was a notorious late payer, forcing standard terms of 120 days onto its suppliers. To receive earlier payment, suppliers were forced to accept a discount.

Prompt and fair payment is the foundation of healthy supply chains, whereas sharp practice can starve smaller companies of critical cashflow, leading to their unnecessary demise. This can also impact on workers. In 2017, the Federation of Master Builders published a survey of 350 SME construction companies. Due to payment being delayed or withheld for no good reason, 30% of SMEs were delaying paying their own suppliers, and 5% had been forced to delay paying wages to staff.

Other factors that audits could consider include the frequency with which a company makes late cancellations or changes orders. If it does this without financially reimbursing its suppliers, it can cause severe financial hardship. This practice has been endemic in the global fashion industry for years. It came to global attention during the Covid-19 pandemic.

In April 2020 global fashion brands cancelled orders in Bangladesh worth US$3 billion, putting 2 million jobs at risk.

Public interest statements

The Companies Act requires directors to have regard for the interests of other stakeholders, and to make disclosures on matters of interest to society as a whole. This includes the impact of the company's operations on the community and its environment and the likely consequences of any decision in the long term. Reporting must be supported by a range of non-financial information, including greenhouse gas emissions and gender pay gap reporting.

The Brydon Review suggests that companies go further, reporting on what they perceive to be their responsibilities to the public interest in addition to their statutory and regulatory obligations. The Financial Reporting Council is separately consulting on the potential future of a public interest report.

I note the Government's concerns that mandating company reporting on self-determined public interest responsibilities would not produce consistent and rigorous reporting. However, such statements could be a powerful way of helping companies publicly articulate their purpose and long term strategy. Encouraging such reporting should remain a long term aspiration, even if formal proposals are not being considered at this stage.

Influencing the corporate reporting framework

There is a compelling need for companies to produce reports in precise, comprehensible formats that are more useful for investors and other stakeholders. Higher quality data will help to drive company performance in a number of environmental, social and governance areas, and could also fuel the development of tools and frameworks for benchmark and comparison.

I welcome the proposals that the regulator ARGA makes company reports more accessible in digital machine readable formats. This will help investors and other stakeholders navigate company reports at scale. I also agree that the regulator should have a stronger role in influencing corporate framework, reporting to Government on whether it is serving interests of users.

Company directors

Poor leadership and governance, resulting in serious corporate failure, should not be rewarded. I welcome Government proposals to strengthen the malus and clawback arrangements that would facilitate the retrospective retraction of bonuses or payment from directors in cases where behavioural standards have been severely breached.

The Government is considering widening the application of malus and clawback beyond misstatement of results or errors in performance calculations. The principle could be expanded to reputational damage or failure of risk management. This is a welcome step. One new category that the Government is considering is *unreasonable failure to protect the interests of employees and customers.* To this I would add workers in supply chains and wider communities. This could cover serious breaches that have resulted in environmental or human rights disasters that undermine the financial or social stability of regions. Corporate negligence can fuel poverty, displacement and mass migration in wider communities, creating vulnerabilities that could result in modern slavery.

The involvement of shareholders and investors

The Brydon Review recommended that audit committees invite shareholders to set out their views on particular risks and identify areas of emphasis that they would like the auditor to address. It added that directors should provide shareholders with their latest statement on emerging and principal risks, to help inform shareholder suggestions.

The Government is also inviting the regulator to revise its guidance to audit committees to encourage questions from shareholders about the company audit at company AGMs.

I welcome mechanisms that would make it easier for shareholders and investors to engage with businesses. Across the financial community, there is a growing appetite for closer engagement on environmental social and governance (ESG) issues. This could support the drive towards more purposeful investing, sustainable business models and healthily functioning markets.

Strengthening the regulator

I agree with the Government's proposals that the regulator's objectives should extend beyond shareholders to include wider public interest, and that ARGA's general objective should be "to protect and promote the interests of investors, other users of corporate reporting and the wider public interest."

Conclusion

As the Government has observed, reliable corporate reporting is vital to well- functioning financial markets. I broadly support the proposals and hope that the reforms encourage a more purpose-led and socially responsible business ecosystem that protects the most vulnerable and enables society to flourish.

Yours sincerely,

Independent Anti-Slavery Commissioner