Title: Corporate reporting obligations arising from Audit reform **IA No:** DBT010(F)-23-BF **RPC Reference No:** RPC-DBT-5271(1) **Lead department or agency:** DBT **Other departments or agencies:** FRC	Impact Assessment (IA)
	Date: 10/07/2023
	Stage: Final
	Source of intervention: Domestic
	Type of measure: Secondary legislation
	Contact for enquiries: Neil.Golborne@beis.gov.uk

Summary: Intervention and Options

RPC Opinion: GREEN

Cost of Preferred (or more likely) Option (in 2019 prices)			
Total Net Present Social Value	**Business Net Present Value**	**Net cost to business per year**	**Business Impact Target Status**
Minus £458m	Minus £458m	£53.2m	Qualifying provision

What is the problem under consideration? Why is government action or intervention necessary?

These measures aim to build trust and credibility in the UK's audit, corporate reporting and corporate governance system. Reliable corporate reporting is vital to well-functioning markets, business investment and growth. It enables all interested stakeholders to make an informed assessment of a company's performance and governance and safeguards a wide range of interests. Successive, sudden, and major corporate collapses (e.g., Carillion) have caused serious economic and social damage in the UK, calling aspects of the corporate reporting and governance system into question.

What are the policy objectives of the action or intervention and the intended effects?

The Carillion experience shows that the costs of insolvency can be substantial. The reforms aim to ensure that investors and other stakeholders have enough information so that their business terms more accurately price the risks involved in dealing with different companies. In doing so, the measures should reduce the costs of insolvency: when companies fail, they do so with less investors' capital tied up in them. This could also reduce the costs to government and the Pensions Regulator. Further, companies themselves should benefit from a clearer understanding of the risks they are taking. A relatively small change in avoided losses from a Carillion style event over the next 10 years would more than cover the costs of the reform package.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The options are: a) do nothing, i.e. do not introduce new reporting requirements for the largest companies, and b) introduce reporting requirements for the largest companies that meet a ">750 employee and >£750m turnover test". A voluntary option is unlikely to achieve the policy objectives as those companies that are most at risk of poor practice or potential for collapse would be unlikely to comply voluntarily. Nearly all these measures were recommended by the 2019 Brydon Review into the Quality and Effectiveness of Audit. The Government consulted on these measures and in its response confirmed that it would introduce these measures for the most economically significant companies.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** Five years after regulations made

Is this measure likely to impact on international trade and investment?		No			
Are any of these organisations in scope?	**Micro** No	**Small** No	**Medium** No	**Large** Yes	
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)		**Traded:** N/A	**Non-traded:** N/A		

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: Date: 17th July 2023

Summary: Analysis & Evidence

Preferred option

Description: Companies that meet the 750 test should report on a) their audit and assurance policy; b) their distributable profits and distributions; c) measures to detect and prevent fraud; and d) their resilience to principal risks.

Price Base Year 2019	PV Base Year 2020[1]	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** -457

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	78.1	2	52.8	**523.7**
High	59.2		37.2	**372.6**
Best Estimate	69.9		45.9	**456.7**

Description and scale of key monetised costs by 'main affected group

For each of the four measures, companies incur familiarisation costs. In some cases, they also incur costs related to setting up new processes e.g. resilience reporting. Ongoing costs largely relate to reporting costs or costs incurred managing data systems. Most of the costs relate to one of the measures – resilience reporting. These costs arise from requirements for stress testing and information provision from tier one subsidiaries. For all measures, where an eligible subsidiary reports to a group whose parent is eligible, or where the group collectively is above the 750-750 threshold, then the subsidiary need not report: it can rely on group reporting.

Other key non-monetised costs by 'main affected groups'

None.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional		Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate				

Description and scale of key monetised benefits by 'main affected groups'

Not quantified.

Other key non-monetised benefits by 'main affected groups'

The academic evidence suggests that higher quality financial information is associated with improved management behaviour; non-financial reporting can change corporate behaviour; high quality reporting can influence a firm's cost of capital and make investment less sensitive to cashflow, and poor company reporting by one firm may adversely influence the decisions of other firms. A relatively small change in avoided losses from a Carillion style event over the next 10 years would more than cover the costs of the reform package.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5

Key assumptions include a staggered introduction date beginning in 2025 and:

- That there are no further costs to setting up systems to detect fraud as these are incurred under the recent Failure to Prevent Fraud Offence, introduced as part of the recent Economic Crime and Transparency Bill (IA: HO0435).
- That companies have not developed some of these system development costs already, though we do include some additionality assumptions where data is available.
- Wage data used in costings taken from 2021 ASHE and deflated to 2019 prices.

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: £67.9m	**Benefits:** 0	**Net:** minus £53.2m	£265.8m

[1] Note the analysis assumes that measures begin in 2025 but to ensure consistency with the metrics on the front page the author selected the option in the IA calculator to use the same base years for the summary sheet as used to calculate the EANDCB. Note too that all analysis was conducted in 2019 prices.

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Introduction

1. This Impact Assessment (IA) covers four measures in the Government's package of audit reforms which will be implemented via secondary legislation. These include requirements for some companies to:

a. Produce, and report on, their audit and assurance policy.

b. Report on their distribution policy and distributable reserves.

c. Report on measures to prevent and detect fraud.

d. Report on their resilience to material risks.

2. These measures were all recommended [or relate to recommendations made] by the Brydon Review[1], which was one of three policy reviews[2] set up after the failure of Carillion to recommend improvements to audit and corporate reporting. The Government consulted on these measures in March 2021[3]. In its response in May 2022[4] the Government confirmed that it would proceed, on a proportionate basis, with its proposals to introduce these measures and that they would apply to companies that meet a "750 test" (defined below).

Problem under consideration and rationale for intervention

Problem under consideration

3. The Government's objectives for its wider package of audit and corporate reporting measures are to:

a. Build trust and credibility in the UK's audit, corporate reporting and corporate governance system;

b. Ensure accountability for those playing key roles in that system; and

c. To increase resilience and choice in the statutory audit market.

4. The measures in this IA focus on the first objective by improving the quality of corporate reporting provided by companies to shareholders and wider stakeholders.

5. Reliable corporate reporting is vital to well-functioning markets, business investment and economic growth. It enables all interested stakeholders to make an informed assessment of a company's performance and governance and safeguards a wide range of interests – particularly

1 https://www.gov.uk/government/publications/the-quality-and-effectiveness-of-audit-independent-review
2 The three reviews were: a) the Kingman Review that looked at the effectiveness of the regulator – the FRC; b) the CMA Review which looked at competition in the audit market and c) the Brydon Review, which looked at the audit "product" and whether it was fit for purpose. The measures in this IA arose from the Brydon Review.
3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/970673/restoring-trust-in-audit-and-corporate-governance-command-paper.pdf
4 https://www.gov.uk/government/consultations/restoring-trust-in-audit-and-corporate-governance-proposals-on-reforms

those of stakeholders. Successive, sudden, and major corporate collapses (e.g., Carillion) have caused serious economic and social damage in the UK, calling aspects of the corporate reporting and governance system into question.

6. These reforms aim to improve the quality of corporate reporting on matters that, if not managed responsibly, could cause or help cause a business to fail. Improved quality of reporting is not an end in itself, rather it offers an informational benefit to investors or other stakeholders who can therefore make better decisions. For the investor it means investing in well run companies, divesting from badly run companies and demanding that investments deliver a return that is commensurate with the financial risk being borne. **Specifically, investors, suppliers and creditors would be able to choose better governed and more resilient companies over weakly governed and less resilient companies**.

7. To make an informed choice, investors and stakeholders need access to reliable information on which to base their judgement about the company's solvency and prospects. If this information is not available or is poor quality or only available at high cost then there is a risk that poorly run companies will seek to present themselves as well run companies and therefore seek better terms, e.g. cheaper credit, than their performance merits.

8. All the measures in this IA are intended to provide markets with better information to price risk:

a. The Audit and Assurance policy will require companies to describe their internal auditing and assurance processes and policies, telling users how financial and non-financial reporting has been assured, and stating any plans for external (third party) assurance of non-financial reporting (which is largely not included in the statutory audit of the accounts).

b. The enhanced dividend and distribution disclosures will provide investors, creditors, pension trustees and other stakeholders with more information, allowing them to better judge whether company dividends put the long-term viability of the company at risk.

c. The report on measures to detect and prevent fraud will provide more information to investors and other stakeholders about which parts of a business are most at risk from fraud and show how directors are responding to issues.

d. The resilience statement will require companies to report on matters that they consider a material challenge to resilience over the short, medium and long term, together with an explanation of what mitigating action they have put in place or plan to put in place in response.

9. The next section illustrates, through a case study, how the absence of good information on risks can have substantial consequences for companies and the wider economy.

The costs of no reform

10. **The Carillion case illustrates the potential costs of no reform**. The Carillion group of companies (Carillion plc) was a British multinational company providing facilities management and construction services in the UK, Canada and the Middle East. On 15 January 2018, Carillion

declared insolvency, and its assets and contracts were liquidated. The joint BEIS and DWP Select Committee report into the collapse of Carillion, described the company's failure as "a story of recklessness, hubris and greed", and cited a "rotten corporate culture"[5]. There were claims that the board had allowed the company to take high risk debts despite trading on low margins, thus failing to manage risk appropriately. In particular:

a. Between 2001 and 2015, Carillion acquired ten businesses worth over £1 billion in total. As a result of these acquisitions, their debt increased from £242 million in 2009 to £1.3 billion in 2018 when they collapsed. However, Carillion often paid substantially more than the net assets of the companies they were acquiring[6].

b. Management sought to maximise revenue growth which meant it pursued an aggressive bidding strategy to secure contracts which reduced profit margins.

c. The company increased dividends to investors between 2014 and 2016, despite fluctuating profits. Between 2012 and 2016, they paid a total of £376m to shareholders, despite only making £159m cash[7].

d. Carillion also sought to preserve its cash flow by requiring suppliers to wait 120 days for payment: suppliers could receive earlier payment but only if they sold their invoices at a discount to Carillion's bank.

e. Further, Carillion adopted "aggressive accounting" practices, which involved management recognising revenue earlier than it should have[8]. In addition, it treated some financial obligations to banks, incurred through the early payment facility to suppliers, as liabilities to other creditors which allowed them to exclude these liabilities from total lending and from the debt-equity ratio.

11. The joint BEIS and DWP Select Committee report described Carillion's business model as an unsustainable dash for cash: "The mystery is not that it collapsed, but how it kept going for so long. Carillion's acquisitions lacked a coherent strategy beyond removing competitors from the market, yet failed to generate higher margins. Purchases were funded through rising debt and stored up pensions problems for the future. Similarly, expansions into overseas markets were driven by optimism rather than any strategic expertise. Carillion's directors blamed a few rogue contracts in alien business environments, such as with Msheireb Properties in Qatar, for the company's demise. But if they had had their way, they would have won 13 contracts in that country. The truth is that, in acquisitions, debt and international expansion, Carillion became increasingly reckless in the pursuit of growth. In doing so, it had scant regard for long-term sustainability or the impact on employees, pensioners and suppliers"[9].

12. Although concerns were raised about Carillion's accounting practices, these did not immediately translate into readily available information for the market.

5 Work and Pensions Select Committee, "Carillion," [Online]. Available: https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm
6 A. Abdullah and I. Khadaroo, "Carillion's collapse and the future of PFI," 2019.
7 S. Hajikazemi, K. Aaltonen, T. Ahola, W. Aarseth and B. Andersen, "Normalizing Deviance in Construction Project Organizations: A Case Study on the Collapse of Carillion," Construction Management and Economics, vol. 38, no. 12, pp. 1122-1138, 2020.
8 Hajikazemi, S., Aaltonen, K., Ahola, T., Aarseth, W., & Andersen, B. (2020). Normalising deviance in construction project organizations: a case study on the collapse of Carillion. Construction Management and Economics, 38(12), 1122-1138
9https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/769.pdf , page 16

a. The Financial Reporting Council (FRC) had raised concerns about Carillion's reporting in 2015: The FRC highlighted 12 potential problems with Carillion's reporting, ranging from a lack of clarity in goodwill assumptions to a non-existent explanation on the major decline in Carillion's book-to-bill ratio. Despite this, the company's accounts were not qualified by auditors until March 2017.

b. Following the collapse of Carillion, auditors were criticised for not exhibiting sufficient professional scepticism, particularly for assumptions about construction contract revenue and the intangible asset of goodwill accumulated in historical acquisitions. Especially as these assumptions were fundamental to the picture of corporate health presented in the audited annual accounts.

c. Some shareholders were able to divest early. However, this option was not available for many stakeholders who were dependent on the financial and other statements made by the company or because as passive investors they were required to follow the FTSE index. In December 2015, the Governance specialist for Aberdeen Standard Investments (ASI) met with the Chairman of Carillion to discuss company strategy. The specialist's meeting with the Chairman failed to satisfy ASI's concerns about Strategy and Governance. [10]

d. Two weeks after this meeting ASI downgraded Carillion shares from Hold to Sell. Subsequently many ASI funds began selling their shares in Carillion.

e. Carillion issued two profit warnings in 2017. The final warning in September 2017 announced a fall in profits of over £1 billion. Carillion went into liquidation in January 2018 with liabilities of nearly £7 billion and £29 million in cash.

13. The costs of Carillion's failure can be estimated using Carillion's 2017 first half yearly accounts. These were the last accounts published by Carillion and are likely to under-estimate the costs of Carillion's failure as Carillion continued to trade for several months after the accounts were published. These last accounts showed that:

a. On paper Carillion's accounts showed that it had assets of £3.7 billion. However, around £1.6 billion was intangibles which was mostly goodwill and could not be sold. This is because goodwill reflected the difference between the purchase price of Carillion's acquisitions and their actual value. This meant that at most Carillion had £2.1 billion in assets that could be disposed of.

b. However, Carillion's liabilities far exceeded this:

    i. Carillion's liabilities amounted to around £4 billion, around half of which were payments it owed to suppliers.

    ii. The liabilities included over £711m in estimated pension liabilities on an IAS 19 basis[11], however at its insolvency, the pension deficit was estimated to be £2.6 billion based on the amount an insurer would need to be paid to take over the

10 Becht M, J Franks and H F Wagner (2021), The Benefits of Access: Evidence from Private Meetings with Portfolio Firms, ECGI Finance Working Paper no 751.

11 IAS 19 is the international standard used to value pension liabilities on company accounts. The source for the reported figure is here: https://www.rns-pdf.londonstockexchange.com/rns/2047S_1-2017-9-29.pdf. On a net pension liability after tax basis the deficit was £587m

liabilities[12]. So, the pension liabilities after insolvency were nearly £1.9 billion higher.

iii. This gives total liabilities after insolvency of at least £5.9 billion, and net liabilities of at least £3.8 billion.

14. Some large companies will always fail. For example, in England and Wales between 2015 and 2017 around 40 in every 10,000 enterprises with more than £50m turnover entered insolvency each year.[13] But the misleading information about the viability of Carillion meant that firms continued to supply it and investors continued to provide capital to it on terms which did not reflect the risks they were running. Not all had the resources of ASI to determine what was going on. Hence once Carillion failed, the consequences were very substantial indeed:

a. Around 7,000 first-tier suppliers and contractors were impacted by Carillion's collapse[14]. At the time of collapse, the 84 Carillion Group companies of which the Official Receiver is liquidator disclosed over £2.5 billion of debt. However, proofs of debts have subsequently been received totaling approximately £4.5 billion[15].

b. According to a survey by industry bodies, small businesses were owed £141,000 by Carillion on average; medium-sized businesses £236,000; and large businesses £15 million. A small proportion of these creditors had insurance against bad debts, and the Association of British Insurers said that approximately £31 million would be paid out because of Carillion's collapse[16]. The locations of Carillion's creditors can be seen in Figure 1, which shows how widespread the impact of their collapse was.

Figure 1: The locations of Carillion's creditors are distributed across the UK.

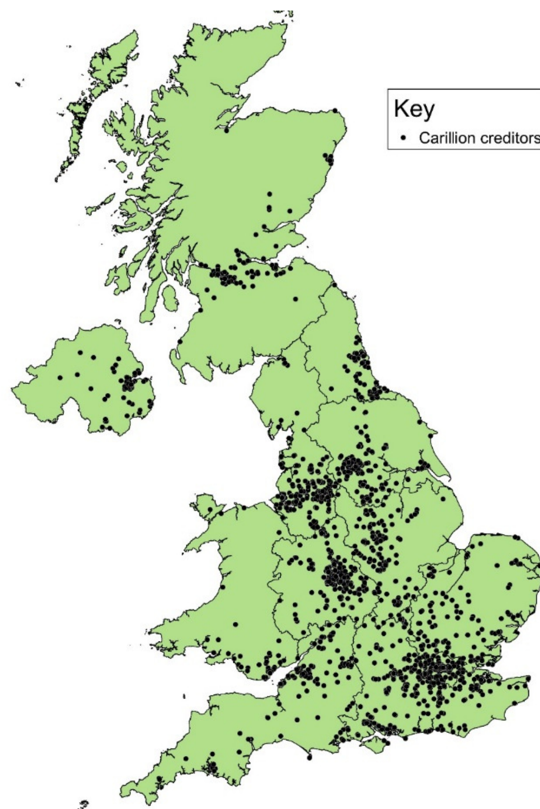
[12] Work and Pensions Select Committee, "Carillion," [Online]. Available: https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm. £2.6 billion was the provisional estimate made as to the deficit of the schemes on a section 75 basis, which is the size of the deficit according to how much would be paid to an insurance company to buy-out the liabilities. Although the section 75 debt will not be met as there were insufficient assets left in the company, that is the figure that becomes due on insolvency.

[13] https://www.gov.uk/government/statistics/corporate-insolvencies-by-size-age-and-location-2015-to-2017 Note that the statistics refer to enterprises not companies. An enterprise can consist of more than one company, in the same way that Carillion was a group containing many companies.

14 A. Qamar and C. Simon, "Part B Carillion's Collapse: Consequences," 2018.

15 The Insolvency Service, Management Information. It should be noted that this may include an element of double counting where proofs for jointly held liabilities have been lodged against two or more companies.

16 BBC, "Carillion collapse: Insurers pay out £30m to suppliers," January 2018. [Online]. Available: https://www.bbc.co.uk/news/business-42811707



Sources: The Insolvency service, Office for National Statistics licensed under the Open Government Licence v.3.0; Contains OS data © Crown copyright and database right 2021; Contains Royal Mail data © Royal Mail copyright and database right 2021

c. As of December 2021, the UK government estimated it had paid out over £52 million gross in redundancy payments from 13 of Carillion's companies[17]. Carillion employed approximately 43,000 staff globally, 19,000 of whom were based in the UK, many of these jobs were put at risk. The Official Receiver managed to find employment for over 11,000 staff, thus minimising the impact on job losses[18].

d. In addition to the redundancies, there was a pension liability of £2.6 billion following the collapse of Carillion. As a result of this, it was estimated that 27,000 members of their defined benefit pension scheme would have their pensions reduced by approximately 15%[19]. These pensions will be paid from the Government's Pension Protection Fund[20].

15. To assess the impact on other companies of the failure of Carillion, the Insolvency Service has carried out an analysis of construction sector insolvencies to determine whether there was an increase in insolvencies in the construction industry following the collapse of Carillion. Using an interrupted time series analysis[21] (Box 1) it found that there was a significant increase in the

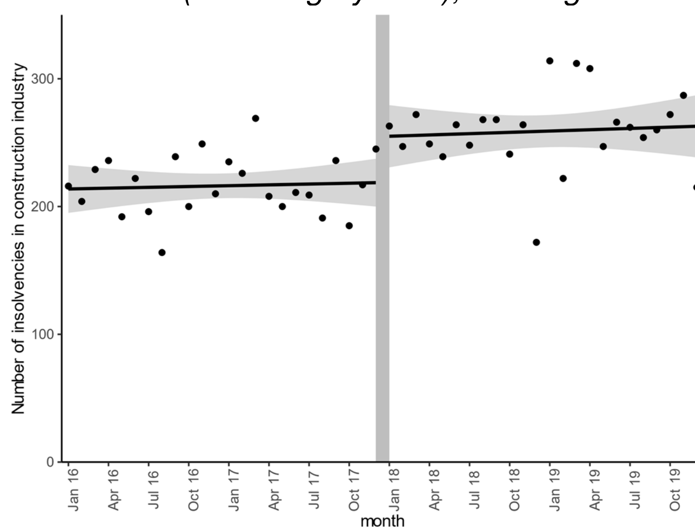
17 The Insolvency Service, Management Information.
18 T. Sasse, C. Britchfield and N. Davies, "Carillion: Two years on," March 2020. [Online]. Available: https://www.instituteforgovernment.org.uk/sites/default/files/publications/carillion-two-years-on.pdf
19 A. Qamar and C. Simon, "Part B Carillion's Collapse: Consequences," 2018.
20 Work and Pensions Select Committee, "Carillion," [Online]. Available: https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76903.htm .
21 Interrupted time series analysis is a quasi-experimental technique which controls for any pre-existing trends (such as generally increasing insolvencies over time) to determine if there is a larger than expected change following a specific event. The data consisted of the number of insolvencies in the construction industry (Standard Industrial Classification (SIC) 2007 code F), as reported in the Insolvency Service Official Statistics, in the 24 months before the collapse of Carillion (January 2016 to December 2017) and the number of insolvencies in the 24 months that followed (January 2018 to December 2019). As this was count data, with a larger variance than mean, a quasi-Poisson linear model was fitted to the data. The data met all assumptions for linear regression (linear relationship; homoscedasticity; normality; independence of residuals). In addition, although the data were time-series, tests found that they were not autocorrelated. A difference in difference test could not be incorporated into the model as a suitable control group could not be found.

number of insolvencies in the construction industry (p=0.0292, β = 0.152) after the collapse of Carillion (from January 2018). In addition, there was no significant change in the trend in the number of insolvencies in the construction industry in the 24 months following Carillion's collapse (p=0.948, β=0.000322), suggesting the increase in insolvencies was sustained, and had still not returned to normal levels by 2020. As an illustration and whilst not causal, this is consistent with a long-term impact from Carillion's collapse on the construction sector. Both the increase in insolvencies following the collapse, and the lack of reduction in the following 24 months can be seen in the black lines in Figure 2.

Box 1: Interrupted time series analysis

According to the Magenta Book, Interrupted Time Series Analysis (ITSA) is a quasi-experimental method to establish the causal effect of an intervention. ITSA does not require a control group and is particularly useful when an intervention is implemented at population level and when there is a clear time point of introduction. ITSA analysis allows three important tests: (a) whether there is an ongoing change over time; (b) whether there is a significant change at a specific time point; (c) whether there has been an ongoing change after the specific time point[1]. Due to these multiple tests, ITSA has been described as one of the strongest evaluative designs when randomisation is not possible. By considering the change over time, the analysis can control for secular trends, unlike a 2-period before and after test. Furthermore, by considering the trend after the intervention it can assess the longitudinal impact of an intervention, unlike with a randomised control trial. Another strength is clear and easy to interpret graphical results. Non-analysts can easily identify when the change occurred, what happened before the change, and what happened immediately after the change as well as in the longer term.

Figure 2: Numbers of insolvencies in the construction industry before and after the collapse of Carillion (shaded grey area), with regression lines and standard errors.



Source: The Insolvency Service

Rationale for intervention

16. There are two rationales for intervention, which the measures in this IA aim to address. The provision of information on corporate performance by companies is potentially characterised by high degrees of market failure. At its heart is a ***principal-agent problem***. Companies are meant to provide the best information possible to allow shareholders and creditors to make informed decisions about whether to invest or offer credit. But accounts information is primarily backwards looking, and companies are likely to have better information about a company's prospects than shareholders and creditors. Specific areas where the Brydon Review felt that better information would be beneficial were:

- There was widespread confusion between assurance, audit and statutory audit. And that audit as an overall concept is synonymous, in the corporate world, with a narrower statutory audit, focused primarily on financial statements. But there is increased demand from shareholders for other forms of assurance and that the audit and assurance policy would bring clarity by setting out what is assured (and how) and what is not.
- Companies Act requirements that dividends must be paid only out of distributable reserves were not being fully respected. The issue – that some dividends may be being paid out of non-distributable reserves – arises because there is no requirement for financial statements to distinguish between the realised and unrealised elements of profit or capital.
- There was both confusion and a gap between the reality and the expectations of performance of auditors in fraud discovery. If an auditor is giving an unmodified opinion, then he or she is stating effectively that they have obtained a "high level" of assurance that the financial statements are "true and fair" or "presented fairly in all material respects". But the Review noted how some would challenge the "true and fair judgement" if there has been a material fraud. The Review noted that the extent to which fraud can be detected is dependent on the quality and timeliness of management reporting, and the openness of the corporate culture, and Audit standards stress that management and the Board are responsible for preventing and detecting fraud. The Review therefore recommended that directors should report on the actions they have taken to fulfil their obligations to prevent and detect material fraud against the background of their fraud risk assessment.
- There was ample room to improve existing risk management, going concern and longer-term viability reporting requirements. Respondents to the Review argued that the current going concern assessment (based on accounting standards) sets the bar too high for directors having to disclose any 'material uncertainties' relating to a company's ability to continue as a going concern, by allowing proposed mitigating action to be considered, and that strengthening related requirements for auditors will not address this underlying weakness.

Further as we show in the benefits section there is evidence that higher quality financial and non-financial reporting is associated with improved management behaviour.

17. There are also issues of ***moral hazard*** which arise from limited liability as companies have separate legal personality. Owners are therefore only liable for losses up to the value of their paid-up share capital, their liabilities in the event of business failure will be much less than the amount owed to creditors. Additionally, poor information provision has the potential to create ***externalities*** or spill-overs. The lack of information can lead to poorer decision making by investors and other related parties, e.g. suppliers. As a result, investors and related parties face increased risk of losses in the event of corporate failure. And where corporate failure occurs, it can have adverse consequences for other firms (as in the case of Carillion).

18. The question arises whether companies are, following Carillion, already providing comparable and full information to the market either voluntarily or at the behest of shareholders or other stakeholders. Evidence set out in the Government response published in 2022 suggests that this has not been the case. For example, even four years after Carillion:

- It was generally accepted that existing disclosures under the viability statement often lacked specificity and sufficient detail to provide confidence that a company had robust plans in place to prepare for business shocks while also delivering sustainable value[22].
- A large majority of respondents across all stakeholder groups supported the introduction of the Audit and Assurance Policy[23]. Many individual businesses welcomed it as providing an opportunity to demonstrate to shareholders and other interested parties how companies assure the quality of their corporate disclosures. Many investors said that investment decisions increasingly depended on matters reported by companies that are not assured during the statutory audit of the financial statements, including reporting on environmental, societal and governance issues, and how a company's strategy and risk management address such issues[24].
- Investors and auditors expressed support for a directors' statement about the *legality* of dividends. Investors pointed to examples of shareholders being asked to approve dividends retrospectively because the company had paid out dividends without the distributable profits being available at the group level[25].
- 120 out of 159 responses (75%) expressed support for at least some elements of the Government's proposed response to the Brydon Review's package of reforms relating to fraud[26].

19. The measures in this IA, together with supporting guidance, will provide a consistent framework for reporting and address inconsistencies in reporting by ensuring that companies report comparably on these issues. The regulations therefore provide a degree of standardisation which will mean that shareholders and other stakeholders will have comparable information on which to evaluate different companies' performance and relative attractiveness. In the absence of the regulation, we expect information to be less available and be less comparable between companies, especially for those companies at greatest risk of failure. It is for this reason that we do not propose a non-regulatory option.

20. In some areas we have identified changes in corporate practice, which would affect the amount of effort that corporates need to expend to comply with these regulations. Or to put it another way, in these areas the counterfactual for the regulations is not a pure do nothing counterfactual. To account for this, we use "additionality" factors which reduce costs in proportion to the amount of effort that companies already expend. These additionality factors have been informed by FRC lab[27] studies related to corporate reporting. We use the factors for example to estimate costs related to stress testing and capital maintenance disclosures as there seems to have been an increase in the use of these since Carillion or even before. This approach allows

[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1079594/restoring-trust-in-audit-and-corporate-governance-govt-response.pdf, page 48.

[23] A majority of both business and investor respondents were nonetheless opposed to introducing a mandatory shareholder vote on the Audit and Assurance Policy, and this was dropped from the Government's final proposals.

[24] Ibid, page 56.

[25] Ibid, page 43.

[26] Ibid, page 95.

[27] The FRC Lab (the Lab) was launched in 2011 to provide an environment where investors and companies can come together to develop pragmatic solutions to today's reporting needs. Companies can use the Lab to test new reporting formats with investors, and investors can indicate areas where management can add greater value through the information they provide. The Lab's focus on gathering and sharing evidence from the market provides the broader corporate community with feedback from shareholders on the value that new reporting formats bring.

us to use a common do nothing counterfactual for all measures, making the information in this IA easier to understand.

Entities in scope

21. The reporting requirements fall on companies, not their auditors, as it is the responsibility of company directors to take the necessary steps to ensure that companies are well-run. The new reporting requirements will therefore apply to companies whose scale is such that poor practice or potential for collapse would be likely to have widespread consequences for many stakeholders. These new reporting requirements will therefore apply only to companies with 750 or more employees and £750 million or more in annual turnover. Further only companies, as defined by the Companies Act, are in scope of the reporting requirements[28].

22. To eliminate duplication of reporting within a group structure the Government intends to allow subsidiaries to be able to rely upon any reporting undertaken by the group, where the parent meets the 750 test, or where the group as a whole meets the 750 test.

23. To estimate the population in scope we adopted the following search strategy:

- Using FAME we identified current Public Interest Entities (PIEs)[29] that were Companies Act entities and met the 750 test. As more than one PIE can report to the same parent[30], the list was de-duplicated using the parent's name. Therefore, what remains is a unique count of parents of existing PIEs where that PIE is eligible to report under Audit SI.
- Again, using FAME, we identified entities that met the 750 test and were not current PIEs. These were filtered to identify Companies Act companies only. The list is then de duplicated using the parent's name. What remains therefore is a unique count of parents of companies where that company meets the 750 test.
- The two lists of companies were then combined and then in turn de-duplicated using the parent's name. This produces a consolidated list of parents that either own a current PIE, an eligible non-PIE or both. At the end of this process, we identified 750 parents of companies that are in scope of the regulations. Of these, 219 were parents of PIEs and 531 were parents of non-PIEs.
- Of these parents, around 640 are eligible Companies Act entities. The remainder are individuals, charities or Government bodies, or are located in Crown Dependencies and Overseas Territories, or are not companies (e.g., they may be LLPs or LPs). In these cases, we would not expect the parent to report but as they are parents of at least one subsidiary company that exceeds the 750 test, we would expect at least one of those subsidiary companies to report.
- For this reason, we estimate that there are likely to be around 750 companies, parents or subsidiaries, who would be required to report against the proposed regulatory measures.

[28] The reporting does not extend to equivalent-sized LLPs.

[29] Based on a list produced by the FRC dated April 2022.

[30] We use the Domestic Ultimate Owner variable in FAME to identify the UK parent. Note in many cases the parent of the company will be either a PIE or a non-PIE that meets the 750 test.

24. One weakness of this approach is that it starts with companies that pass the 750 test and identifies the parents of those companies. It is possible that a group headed by a parent has an aggregate turnover that meets the 750 test, but individually the parent and any subsidiaries do not as they produce unconsolidated accounts[31]. None of these parents or subsidiaries would be caught by our original search. However, the regulation requires the parent company to produce the additional statements[32] if the group, *in aggregate*, meets the 750 test so we need to determine how many additional companies might be caught through aggregating unconsolidated revenues and employment of parents and subsidiaries.

25. Annex A describes the approach taken to identify these additional companies. There were substantial data gaps and it was impracticable to identify all companies in ownerships chains, that when aggregated, might require the parent company to comply with the regulations. However, by focusing on those parents that narrowly missed the 750 test, where the greatest chance of a false negative was likely, we are able to show that there are relatively few parents filing unconsolidated accounts who would qualify based on the combined activities of their global subsidiaries. For this reason, we do not include these companies in our estimate of companies in scope.

31 For example, because the UK group benefits from a Section 401 exemption, arising because the UK companies report to a foreign group.
32 There is one difference though: if the parent produces unconsolidated accounts the reporting relates to the parent company and not the group as a whole.

Approach to assessing impacts

26. This section briefly sets out our approach to assessing impacts. It covers direct and indirect impacts as well as the constraints we have faced in gathering evidence. We set out that we will test the evidence and assumptions in this IA in future post-implementation reviews.

Direct and indirect impacts

27. Under current better regulation rules, impacts can be either direct or indirect. Direct impacts are, in an economics sense, first order, i.e. they have an immediate impact on the company such as a regulatory requirement for a company to complete an administrative form. Indirect impacts typically require some form of second round effect to make the impact occur i.e., for regulation to deter innovative effort, then an opportunity to innovate would need exist e.g., a change in market demand creates an innovative opportunity.

28. Our approach to classifying impacts is as follows:

- The costs of compliance, assessed using the opportunity cost of time, are direct impacts.

- There is the potential for indirect impacts, where it is not clear whether they could be costs or benefits. For example, compliance costs might deflect managerial effort from developing a new innovation; however, the process of testing market resilience could also prompt companies to become more innovative if it felt that its future resilience were under threat.

- The benefits of the measure, identified later, are indirect. For example, if the act of reporting improves management capability, then it also likely depends on other company actions, e.g. recognising that there is an opportunity to build human capital; or if it depends on avoided insolvency it requires potentially many actions by many market players.

29. Given the challenges with *ex ante* understanding indirect effects we believe these should be covered in the post implementation review as companies may find them to easier to identify ex post.

Evidence and assumptions used in this IA

30. Given the many imponderables associated with indirect impacts, we have focused on trying to estimate the direct impacts, the direct costs of compliance. We do include sensitivity analysis for indirect benefits where they can inform a judgement on the effectiveness of the policy (see section on Benefits).

31. Despite producing a consultation IA, which was published alongside a policy consultation, and analyst participation in many stakeholder events it has proved very difficult to get usable data to inform our evidence for costs. We suspect that this was because the regulatory requirement is very new with no obvious comparator, and at the time of consultation there was no obvious model, e.g. draft legislation, for companies to use to assess costs.

32. To address this limitation we adopted the following approach:

- Firstly, we identified the process that a “reasonably efficient” company might adopt to gather and assess information required to comply with a reporting requirement.

- Secondly, we considered the seniority of staff that might be involved for each task in each process, recognising that senior, including board level, involvement would be necessary for what would be a public statement by the company.

- Thirdly, adopted the general principle that senior staff would delegate and provide clearances, implying that junior staff would tend to put in more hours than senior staff.

- We also took into account some feedback from the consultation e.g. where our time cost or wage estimates were considered too low.

33. This means that the costs presented in this IA are estimates rather than predictions. And we will test the accuracy of these estimates in the first Post Implementation Reviews by:

- Using qualitative interviews to test the regulatory journey assumed in this IA.

- Using a quantitative survey to gather data on time costs incurred at each stage of the journey and by whom.

34. Cost estimates were derived separately for each reporting obligation. We considered this to be the best approach given that they are distinct reporting requirements involving distinct tasks. However, the question arises whether this introduces a degree of duplication in the cost estimates. In our view if any duplication exists it is likely to occur in discussions at Board level if Boards choose to discuss the reporting requirements together rather than individually. However, as we had no insight into how individual Boards, let alone 750 Boards, might structure their agendas we used a conservative assumption that there were no synergies between reporting requirements.

Audit and Assurance policy

Policy objective

35. Historically, the users of company reporting information – existing and potential shareholders, and wider stakeholders – have been primarily interested in company financial information, and in the assurance from statutory auditors that this information provides an accurate and reliable assessment of a company's position. Whilst this continues to be the case, in recent times shareholders have shown an increasing interest in companies' non-financial reporting, or the "front end" of annual reports (the "back end" comprising the audited accounts). The main areas of interest are the strategic report, the directors' report and, in the case of quoted companies, the corporate governance statement. These areas cover disclosures related to the companies' business model and corporate strategy, its approach to assessing and managing risks, and information on how it complies with requirements to report its corporate governance arrangements, among other non-financial matters.

36. Statutory audits provide formal assurance over company financial statements and some sections of the director's remuneration report. The rest of the annual report is subject only to legal compliance checks and to check that there are no significant inconsistencies between matters presented in these sections and in the company's financial statements. For example, under sections 496-497A of the Companies Act, auditors are required to state whether, based on their knowledge of the company, there is any material inconsistency with the director's statement that the annual report, taken as a whole, is fair, balanced and understandable.

37. This consistency checking does not meet the standard of 'reasonable assurance' that auditors are required, under auditing standards, to apply to company financial statements[33], and results usually in no more than a couple of sentences in the statutory auditor's report. However, given the heightened investor interest in non-financial information, there is a corresponding heightened interest in understanding how companies are assuring the quality and reliability of such information, whether internally, externally or both.

38. Against this backdrop, the Brydon Review suggested that there is room for improvement in the dialogue between audit committees and the users of corporate reporting information, on the scope of company audits and all related matters[34]. The Review noted that there was considerable variability in how auditors interpreted their responsibility to assess the congruence of directors' declaration that the annual report is fair, balanced and understandable and the accounts presented, and therefore, in how they treat this responsibility within, and between, firms[35]. This places practical limitations on the impact of these assessments. Indeed, the Review found that auditors invariably declare that they have nothing to report in this regard[36], further highlighting these limitations.

39. Moreover, the variability in auditors' interpretation of the requirement translates into a lack of clarity for users of this information around the assurances that auditors are required to provide on non-financial information. The wider implication of this is that users of this information may

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33 International Standard on Assurance Engagements (ISAE) 3000 recognise two types of assurance opinion – limited assurance and reasonable assurance.
34 The Brydon Report paras 10.0.1 and 10.0.2 indicated, an improvement in dialogue and clarity around audit issues could be achieved using a measure that functioned in a similar way to the 2013 requirement for director's remuneration reporting.
35 Brydon Report para 10.1.2
36 Brydon Report para 10.1.1

assume that the non-financial areas have been audited, where in fact it has not, and users may therefore factor this incorrect assumption into their decision-making.

40. To address this issue, the Review recommended the introduction of a requirement for audit committees (or the board of directors, if a company does not have an audit committee) to prepare and publish an Audit and Assurance Policy, akin to the directors' remuneration policy requirement introduced in 2013[37]. This policy is expected to provide greater clarity to investors and other stakeholders and to go beyond the narrow scope of financial information assurance. The policy will:

- provide a statutory report for demonstrating whether companies have planned further assurances on any areas or process of reporting that might be of further interest to the users of this information or to the company itself, beyond the statutory audit of the accounts.
- allow companies to provide clarity, to users of corporate reporting information, about the disclosures that have been assessed and assured, and the process by which this was done (whether via internal audit, statutory audit, or other independent audit); and
- allow users of this information to track how the company has changed its approach to assurances over time in response to changes in circumstances, as well as how the company has considered their needs where the integrity and reliability of reporting is concerned.

41. The Review recommended that this policy be produced on a three-year rolling basis, and that it should be subject to a shareholder advisory vote at the Annual General Meeting (AGM).

42. The Government supported the Review's recommendation for an Audit and Assurance Policy, and by extension, a framework through which companies can consider and respond to heightened user expectations for assurances on all aspects of company annual reports. Specifically, in the White paper consultation, the government proposed that public interest entities should publish an Audit and Assurance Policy (AAP) which sets out a company's approach to assuring the quality of the information it reports to shareholders beyond that contained in the financial statements. The White Paper invited views on whether the AAP should be published annually or every three years, and whether it should be subject to an advisory shareholder vote. Views were also invited on the following proposed minimum content for the AAP:

- an explanation of what independent assurance, if any, the company proposes to seek over its Resilience Statement (in whole or part) or over the effectiveness of its internal control framework;
- a description of the company's internal auditing and assurance process, which might include how management conclusions and judgements in the annual report can be challenged and verified internally.
- a description of the company's policies in relation to the tendering of external audit services, including whether a company is prepared to commission non-audit services

37 The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013

from its statutory auditor; and

- an explanation of whether, and if so how, shareholder and employee views have been considered in the development of the AAP.

Government response and decision

43. The Government decided in 'Restoring Trust in Audit and Corporate Governance[38]' that large public and private companies will be required to publish an AAP at least once every three years, with an annual update on how the policy is being implemented. The AAP will be a new corporate report within companies' annual report and accounts.

44. Based on the regulation, and accompanying guidance, companies in scope of the new requirement will include the following in their AAP:

- An explanation of the company's plans for assuring the quality and reliability of all statutory and voluntary corporate disclosures in its annual report and accounts over the next three years. This should include a description of the company's internal auditing and assurance processes and governance, and an explanation of how management conclusions and judgements in the annual report and accounts can be challenged and verified internally. It should also state whether, and if so how, the company is proposing to strengthen its internal audit and assurance capabilities over the next three years.

- An explanation of what external assurance, if any, the company intends to obtain in the next three years in relation to the annual accounts and annual reports. This should include specific commentary on whether, and if so how, the company intends to obtain any external assurance over:

  - the company's Resilience Statement in whole or part, and other disclosures related to risk;

  - the effectiveness of the company's internal controls over financial reporting;

- The explanation should also identify whether any planned external assurance:

  - is 'reasonable' or 'limited' assurance as defined in the FRC's glossary of terms (which in turn is based the International Auditing and Assurance Standards Board glossary of terms), or whether it involves an alternative form of engagement or review as agreed between the company and the external provider.

  - will be carried out in accordance with the International Standard on Assurance Engagements (ISAE) (UK) 3000 Revised (covering information other than audits or reviews of historical financial information) and/or any other internationally recognised assurance standard which is adopted by

38 Please see Government Response, Restoring trust in audit and corporate governance, pages 58-60.

the regulator.

- A description of the company's policies in relation to the tendering of external audit services, including whether the company is prepared to allow the audit firm of the statutory auditor to provide permitted audit-related or non-audit services.

- An explanation of how shareholder views have been considered in the formulation of the AAP, and whether – and if so how – other stakeholder views have been considered.

Options considered

45. There was broad support across all stakeholders' groups for the introduction of an Audit and Assurance Policy. We consider two options for the final stage Impact Assessment:

- **Option 1- do nothing**: the government will not pursue the ''do nothing'' for the reasons set out in in the Government's response.

- **Option 2 – require those in scope to report on Audit and Assurance policies.**

Assessment of monetised and non-monetised costs for chosen option

46. The new AAP will come into force on 1 January 2025 for companies whose equity capital is traded on a UK regulated market; and apply for any financial year which commences on or after that date. For any other company the new AAP will come into force on 1 January 2026.

47. Costs are assessed over a 10-year appraisal period against a do nothing counterfactual. In the table below, we set out the type of costs we expect to be incurred by businesses and the regulator for each of the new requirements and distinguish between one-off costs and ongoing cost of compliance. As it is a wholly new requirement, we assume that the audit and assurance policy is a wholly additional requirement for all 750 companies. Of these, we estimate that around 180 have equity capital traded on a UK regulated market and which would therefore report from 1 January 2025.

48. Of the 750 companies in scope, we estimate that 219 companies will have Audit Committees (because they are current PIEs or because they are parents of PIEs) and 531 companies have no legal requirement to have one. Given data limitations we assume that where companies do not have an audit committee where there is no legal requirement to have one. We relax this assumption later and assume that all companies have an audit committee. The increase in costs is marginal. This means that there are:

- 180 PIEs, with an audit committee, that must report on or after 1 January 2025,
- 39 PIEs, with an audit committee, that must report on or after 1 January 2026, and
- 531 other companies, without an audit committee, that must report on or after 1 January 2026.

Table 1 –Tasks involved to comply with the new audit and assurance policy

Requirement	Year of implementation	Main tasks involved	Cost type	Audit Committee present	No Audit Committee present	FRC
Guidance on new reporting requirements and advice on how companies can document compliance	Year 1	To draft and publish new guidance	One-off	X	X	√
To publish Audit and Assurance Policy at least once every three years	Year 1	To understand new reporting requirements for Audit and Assurance Policy	One-off familiarisation	√	√	X
		To collect and analyse information about existing levels of internal and external (if any beyond the statutory audit) assurance across all company's disclosures. To identify possible gaps/enhancement to company's disclosures To discuss findings about existing level of assurance and gaps To discuss and decide whether to commission further internal/external assurance on agreed areas	One-off review costs	√	√	X
	Year 1 Year 4 Year 7 Year 10	Draft narrative for Audit and Assurance policy for inclusion in Strategic report	Ongoing (every three years)	√	√	X
		Board to approve narrative to be included in Strategic report	Ongoing (every three years)	X	√	X
		Audit Committee to review and approve narrative to be included in Strategic report	Ongoing (every three years)	√	X	X
To provide an annual implementation report on the policy	Years 1-10	Draft narrative for annual update	Annual – ongoing	√	√	X
		Board to discuss and approve narrative to be included in Strategic report	Annual- ongoing	X	√	X
		Audit Committee to review and approve narrative to be included in Strategic report	Annual- ongoing	√	X	X

Costs to the regulator

49. FRC will develop new guidance[39] in relation to the new reporting requirements as well as advice on how companies can document clearly within their annual report the different kinds of assurance or review that have been carried out. This would include the existing review carried out by the statutory auditor of information in the annual report that sits outside the financial statements. As with the other corporate reporting measures, we use an FRC estimate that developing and issuing guidance for regulated companies will impose a one-off cost of £100,000[40]. For the purposes of this assessment, we assume that the new draft guidance be produced before the regulations come into force.

39 Please see para 3.2.16, page 60.

40 Although FRC recoups all its costs from a levy raised on businesses, the better regulation framework at the time of writing excluded levies from the EANDCB. FRC costs are therefore not treated as a direct cost to business but are included in the Net Present Social Value calculation.

Costs to companies in scope

50. Companies will need to collate information on current audit and assurance policies, determine whether these are sufficient and whether there are any areas where further assurance is need. This is likely to cover aspects of financial and non-financial reporting. We assume that the bulk of the work falls to a central team with oversight of the different types of reporting providing by the company. It would at least include individuals from finance, sustainability and investor relations functions. Therefore, we assume that there is: :

a. A core project team of corporate staff who work ultimately at the direction of the CEO or CFO and Audit Committee (where one is present). This team consists of 1 administrative level employee, 2 managerial level employees, 3 professionals.

b. Where there is an Audit Committee, the Audit Committee provides a steer and sign off and consists of 3 non-executive board members and an Audit Committee chair.

c. Where there is not an Audit Committee, the Board provides sign off and has 6 non-executive or other executive (e.g. CFO) board members[41].

One-off costs

51. All members of the project team (except administrative staff) and all Board members, whether sitting on Audit Committees or sitting on Boards, are expected to face familiarisation costs from assessing and understanding requirements for the Audit and Assurance policy. Familiarisation and review costs are one-off costs, and these apply in year 1 of implementation.

52. Familiarisation costs are based on the time spent on reading the guidance. Therefore, our estimates are based on the hourly remuneration rate of senior managers, and professional accounting staff (see Tables below), Audit Committee members, Chief Executive Officers (CEOs), and Chair and the Board[42].

53. We have assumed that the FRC will issue one set of guidance, about 25 pages long with them also referring to illustrative examples and professional literature of similar length. As in the BEIS' Climate-related financial disclosures IA, we have assumed that each page takes 6 minutes to read and understand[43]. The length of the guidance is based on insights obtained from FRC staff.

54. In addition to familiarisation, we also expect companies to incur costs to review arrangements about existing levels of assurance across all company's disclosures. As part of this work, we would expect:

- Each company to collect and collate information that will inform their first AAP.

41 We estimate that a company's board is made of seven members - executive and non-executive directors. This is based on data from the BoardEX database (as downloaded on 24 September 2022) - the total number of board members at FTSE 350 companies is 2,445, an average of 7.27 members per company. We round the figure to 7 as some of the entities in scope for AAP measure will be smaller in size than FTSE 350 companies. We use this assumption throughout the IA.

42 The hourly rate for non-Executive Board members is pegged to the Hourly rate for the Chief Financial Officer. Source: Deloitte: Total Compensation CEO salary taken from Deloitte director's remuneration guides for FTSE 250 (2021). Audit committee chair and members' remuneration based on non-executive director base fees and audit committee additional fees provide in Deloitte's 2021 director remuneration guides for FTSE 250 companies, median pay.

43 This assumes a relatively slow reading rate for an average reader given that the guidance is technical and has legal consequences - https://swiftread.com/reading-time/100-pages.

- Companies to identify possible gaps and any enhancements they wish to make to their existing arrangements.
- Most of the information required for the development of the AAP to be readily available at no additional cost.

55. We estimate familiarisation costs at around £7,000 per company and review costs are between £10,800 and £11,100 depending on whether an Audit Committee is in place or not, giving total one off costs of between £17,000 to £18,000 per company.

Table 2 – Companies with an Audit Committee one-off costs[44] [45] (2019 prices)

Familiarisation	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)	If all have audit committee
Audit Committee	Audit Committee Chair	1	2.5	£ 363	907	
	Audit Committee Member	3	2.5	£ 341	2,555	
Company	Professional	3	2.5	£ 40	302	
	Corporate Managers	2	2.5	£ 57	285	
	Directors (Board) including CFO	2	2.5	£ 319	1,594	
	CEO	1	2.5	£ 547	1,366	
Total familiarisation costs per entity					**£7,008**	**£7,008**

Review costs/next steps	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)	If all have audit committee
Audit Committee	Audit Committee Chair	1	2	£ 363	£ 725	
	Audit Committee Member	3	2	£ 341	£ 2,044	
	Admin staff	1	2	£ 22	£ 45	
Company	Admin staff	1	3	£ 22	£ 67	
	Professional	3	30	£ 40	£ 3,619	
	Corporate Managers	2	10	£ 57	£ 1,139	
	Directors (Board) including CFO	2	2	£ 319	£ 1,275	
	Chief Executive Officer	1	4	£ 547	£ 2,186	
Total review costs per entity					**£ 11,100**	**£11,100**

Table 3 – Companies without an Audit Committee (2019 prices)

Familiarisation	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Company	Professional	3	2.5	£ 40	£ 302
	Corporate Managers	2	2.5	£ 57	£ 285
	Directors (Board), including CFO	6	2.5	£ 319	£ 4,782
	Chief Executive Officer	1	2.5	£ 547	£ 1,366
Total familiarisation costs per company					**£6,734**

Review/next steps	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Company	Admin staff	1	3	£ 22	£ 67
	Professional	3	30	£ 40	£ 3,619
	Corporate Managers	2	10	£ 57	£ 1,139
	Directors (Board), including CFO	6	2	£ 319	£ 3,826
	Chief Executive Officer	1	4	£ 547	£ 2,186
Total familiarisation costs per company					**£10,836**

Ongoing costs of preparing and publishing the AAP

44 This Impact Assessment uses the 2021 ONS Annual Survey of Hours and Earnings (ASHE), table 14.5a, data for hourly and yearly gross wage costs for Administrative staff, Accountants, Finance Professionals, Business and research professional. We apply a 18.6% UK non-wage labour costs uplift to reflect the total costs to businesses.
45 We developed our estimates of CEO, CFO and other board members hourly remuneration using the median remuneration of CEO and CFO given in Deloitte's 2021 Director's Remuneration Report for the FTSE 250 market cap band.

56. We expect in-scope companies to incur costs from the ongoing requirement to prepare the AAP every three years and from the requirement to provide an annual implementation report. We expect that the associated activities will be delivered in-house[46] by companies' audit committees (where companies are required or otherwise choose to have them), directors, and their project teams.

57. As with one-off costs for the AAP, we estimate costs separately depending on whether an Audit Committee is in place or not. In developing our estimate, we assume the following:

- That the additional cost of seeking employees and shareholders' views on the AAP would be negligible. These discussions would occur, on an as needed business, during existing engagement activity. We also assume no associated costs for shareholders. The proposal to include a shareholder vote on the AAP was not included in the Government's response. And if these groups do engage then that would be because they consider that the benefits exceed the costs.

- Given the proposed annual reporting frequency, companies will need only to make incremental changes, if necessary, to the AAP to account for changes in approach that arise in that reporting year – as opposed to collecting and collating an entirely new body of information.

- We expect ongoing publication costs to be small, since reporting templates and formats would not need to be changed from year to year.

- Reporting templates and formatting arrangements would not need to be updated and the refresh every three years would only need to cover aspects of the AAP that change from one reporting period to the next.

- The AAP will need to be refreshed every three years. We expect the costs of each refresh to be the same as those occurred in the first year.

- Most of the information required for updating and providing an annual implementation report on the AAP is readily available at no additional cost to the company.

58. Where an Audit Committee exists, we have assumed that most of the work required to prepare the Audit and Assurance Policy every three years is overseen by the Audit Committee for the Board - see Table 4 below. Where an Audit Committee does not exist, we assume the work is overseen by the CFO and CEO only (Table 5). We assume that either the Audit Committee or the full Board discusses the AAP before work begins on it and when work is complete.

Table 4 – Companies with an Audit Committee – recurrent costs

46 As with familiarisation costs, we consider this a reasonable assumption, given audit committees current engagement with this area and the policy developments within it.

Tasks	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)	If all PIEs have an AC
Drafting of Audit and Review Policy	Audit Committee Chair	1	1	363	£ 363	
	Audit Committee Member	3	1	341	£ 1,022	
	Admin staff	1	3	22	£ 67	
	Professional	3	5	40	£ 603	
	Corporate Managers	2	3	57	£ 342	
	CFO	1	2	319	£ 638	
	Chief Executive Officer	1	1	547	£ 547	
Review and Publication of Audit and Assurance Policy in 1st year and every 3 years	Audit Committee Chair	1	1	363	£ 363	
	Audit Committee Member	3	1	341	£ 1,022	
	Admin staff	1	3	22	£ 67	
	Professional	3	2	40	£ 241	
	Corporate Managers	2	2	57	£ 228	
	CFO	1	2	319	£ 638	
	Chief Executive Officer	1	1	547	£ 547	
Total reporting costs per company (every 3 years)					**£6,686**	**£6,686**

Tasks	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)	If all PIEs have an AC
Drafting of annual implementation report	Audit Committee Chair	1	1	363	£ 363	
	Audit Committee Member	3	1	341	£ 1,022	
	Admin staff	1	1	22	£ 22	
	Professional	3	2	40	£ 241	
	Corporate Managers	2	2	57	£ 228	
	CFO	1	1	319	£ 319	
	Chief Executive Officer	1	1	547	£ 547	
Review and Publication of annual implementation report	Audit Committee Chair	1	1	363	£ 363	
	Audit Committee Member	3	1	341	£ 1,022	
	Admin staff	1	1	22	£ 22	
	Professional	3	1	40	£ 121	
	Corporate Managers	2	1	57	£ 114	
	CFO	1	1	319	£ 319	
	Chief Executive Officer	1	1	547	£ 547	
Total reporting costs per company (every year)					**£5,249**	**£5,249**

Table 5- Companies without an Audit Committee – recurrent costs

Tasks	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Drafting of Audit and Review Policy	Admin staff	1	3	22.5	£ 67
	Professional	3	5	40.2	£ 603
	Corporate Managers	2	3	56.9	£ 342
	CFO	1	2	318.8	£ 638
	Chief Executive Officer	1	2	546.5	£ 1,093
Review and Publication of Audit and Assurance Policy in 1st year and every 3 years	Admin staff	1	3	22.5	£ 67
	Professional	3	2	40.2	£ 241
	Corporate Managers	2	2	56.9	£ 228
	Directors (Board)	6	1	318.8	£ 1,913
	Chief Executive Officer	1	1	546.5	£ 547
Total reporting costs per company (every 3 years)					**£5,738**

Tasks	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Drafting of annual implementation report	Admin staff	1	1	22.5	£ 22
	Professional	3	2	40.2	£ 241
	Corporate Managers	2	2	56.9	£ 228
	CFO	1	1	318.8	£ 319
	Chief Executive Officer	1	1	546.5	£ 547
Review and Publication of annual implementation report	Admin staff	1	1	22.5	£ 22
	Professional	3	1	40.2	£ 121
	Corporate Managers	2	1	56.9	£ 114
	Directors (Board)	6	1	318.8	£ 1,913
	Chief Executive Officer	1	1	546.5	£ 547
Total reporting costs per company (every year)					**£4,073**

59.The annual per entity reporting costs are between £5,800 - £6,700 for the Audit and Assurance policy statement and between £4,000 - £5,200 for the annual implementation report. The costs are slightly higher for companies with an Audit Committee as we assume they would be closely involved at the start and end of the process; further members of the Audit Committee

also receive higher pay rates to reflect extra allowances received for their work on the Audit Committee. Whereas, if only Board approval is sought, we assume that the Board will challenge and review the products after they have been drafted by executives.

Total monetised costs

60. Our total monetised costs for this option capture one-off costs incurred in the first year of implementation and ongoing compliance costs for businesses. We estimate a total PVC of approximately £44 million over the 10-year appraisal period, with an EANDCB of £5.1 million.

Differences with Consultation Impact Assessment

61. The consultation stage IA estimated an EANDCB of £3.1m in 2016 prices or £3.3m in 2019 prices for Option two for the audit and assurance policy. This is the closest option to the policy presented in this IA. The main causes of the higher costs in this IA are:

- An increase in unit costs driven by a change in wage rates. Based on feedback from the consultation we uprated hourly remuneration rates for company staff to the 90th percentile[47], up from the 75th percentile, and used data from Deloitte to estimate hourly rates for company directors and members of the Audit Committee.
- Changed how the policy is modelled.
    a. Previously implementation was delayed meaning that only two updates were needed over the ten-year appraisal period. Further we added a one-off cost for reviewing existing audit and assurance practices, prior to making the first policy statement, for each company in scope and an annual implementation report to be included in the Strategic Report.
    b. The consultation IA did not include the production of an annual implementation report.
- The increase in costs was partially offset by a reduction in the number of entities in scope for the AAP measure from 1,945[48] to 750. This reduction is due to the change in the threshold used for identifying companies in scope (i.e. the 750 test) and the requirement for only parents to report.

Risks and uncertainties

62. In this assessment, we assume that most of the information required for preparing AAP every three years and for providing an annual update would be readily available to audit committees, senior managers and directors at no additional cost. However, we recognise that due to variable practices across companies (and their audit committees), some companies may face some costs from having to collect this information. This could mean that companies may face higher costs than our estimates suggest.

63. Further in our assessment, we have assumed that some companies have no Audit Committees. Although there is currently no requirement for private companies and companies

47 Where 90th percentile data is unavailable for the specific, e.g. 4th digit, SOC code we uprated the 75th percentile figure by the ratio of the 90th to 75th percentile for the SOC code above i.e. 3rd digit SOC code.
48 See Regulatory measures arising from proposals for audit and corporate reporting reform in the UK, Impact Assessment, para 331, page 88.

traded on AIM to have an Audit Committee[49], we note that the FRC's research report on use of the Wates principles found several examples of private companies having an Audit Committee[50]. If we assume that all companies have an Audit Committee then the cost is slightly higher with an EANDCB of £5.7 million.

49 Current PIEs are required to have an Audit Committee.
50 Please see FRC (2022). The Wates Corporate Governance Principles for Large Private Companies. The Extent, Coverage and Quality of Corporate Governance Reporting.

Appendix: Audit and Assurance inputs into BIT calculator

One off costs

Familiarisation costs				
	Reporting year	**Number**	**Unit costs**	**Total**
Listed PIEs	2025	180	£18,109	£3,259,545
Non-PIEs	2026	531	£17,570	£9,329,813
Unlisted PIEs	2026	39	£18,109	£706,235
				£13,295,593
If all have an audit committee				
	Reporting year	**Number**	**Unit costs**	**Total**
Listed PIEs	2025	180	£18,109	£3,259,545
Non-PIEs	2026	531	£18,109	£9,615,659
Unlisted PIEs	2026	39	£18,109	£706,235
				£13,581,439

Recurrent costs (£m)

3 yearly costs														
Reporting costs					1	2	3	4	5	6	7	8	9	10
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£1.20			£1.20			£1.20			£1.20
Non-PIEs	2026	531	£5,738	£4,073		£3.05			£3.05			£3.05		
Unlisted PIEs	2026	39	£6,686	£5,249		£0.26			£0.26			£0.26		

3 yearly costs if all have an audit committee														
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£1.20			£1.20			£1.20			£1.20
Non-PIEs	2026	531	£6,686	£5,249		£3.55			£3.55			£3.55		
Unlisted PIEs	2026	39	£6,686	£5,249		£0.26			£0.26			£0.26		

Annual costs														
Reporting costs					1	2	3	4	5	6	7	8	9	10
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94
Non-PIEs	2026	531	£5,738	£4,073		£2.16	£2.16	£2.16	£2.16	£2.16	£2.16	£2.16	£2.16	£2.16
Unlisted PIEs	2026	39	£6,686	£5,249		£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20

Annual costs If all have an audit committee														
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94	£0.94
Non-PIEs	2026	531	£6,686	£5,249		£2.79	£2.79	£2.79	£2.79	£2.79	£2.79	£2.79	£2.79	£2.79
Unlisted PIEs	2026	39	£6,686	£5,249		£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20	£0.20

Total recurrent costs														
Reporting costs					1	2	3	4	5	6	7	8	9	10
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£2.15	£0.94	£0.94	£2.15	£0.94	£0.94	£2.15	£0.94	£0.94	£2.15
Non-PIEs	2026	531	£5,738	£4,073	£0.00	£5.21	£2.16	£2.16	£5.21	£2.16	£2.16	£5.21	£2.16	£2.16
Unlisted PIEs	2026	39	£6,686	£5,249	£0.00	£0.47	£0.20	£0.20	£0.47	£0.20	£0.20	£0.47	£0.20	£0.20
Total					**£2.15**	**£6.62**	**£3.31**	**£4.52**	**£6.62**	**£3.31**	**£4.52**	**£6.62**	**£3.31**	**£4.52**

Total recurrent costs if all have an audit committee														
	Reporting year	**Number**	**3 yearly cost**	**Annual cost**										
Listed PIEs	2025	180	£6,686	£5,249	£2.15	£0.94	£0.94	£2.15	£0.94	£0.94	£2.15	£0.94	£0.94	£2.15
Non-PIEs	2026	531	£6,686	£5,249	£0.00	£6.34	£2.79	£2.79	£6.34	£2.79	£2.79	£6.34	£2.79	£2.79
Unlisted PIEs	2026	39	£6,686	£5,249	£0.00	£0.47	£0.20	£0.20	£0.47	£0.20	£0.20	£0.47	£0.20	£0.20
Total					**£2.15**	**£7.75**	**£3.94**	**£5.14**	**£7.75**	**£3.94**	**£5.14**	**£7.75**	**£3.94**	**£5.14**

Capital maintenance and distribution policy

Policy objective

64. The Companies Act 2006 sets clear distribution and capital maintenance rules which determine the amount of a company's earnings that can be distributed in dividends, and the source of dividend payments. The Act requires that:

- distributions can only be made from a company's accumulated "realised profits" less its accumulated "realised losses"[51] (s830);

- public companies must apply a net asset test[52] (s831); and

- in paying dividends or making other distributions, company directors have regard to their statutory duties[53] to exercise care and due diligence and promote the success of the company, and their common law duty to act in the company's best interest.

65. However, high profile examples of companies paying out significant dividends shortly before profit warnings and, in some cases, insolvency, have raised questions about the extent to which the distribution and capital maintenance rules are being respected and enforced. So too, there have been examples of some prominent listed companies inadvertently making distributions in excess of the distributable profits available and having to take corrective action subsequently with shareholders[54]. Moreover, this issue was raised by several respondents[55] during the Brydon Review consultation, which has compounded the questions raised about the robustness of the legal framework. There are three key issues which potentially limit the effectiveness of the current framework:

i) The rules are based on the concept of realised profits and realised losses, but these definitions are not fixed[56]. They are subject to change in line with the evolution of generally accepted accounting principles applicable at the time of reporting. Therefore, there is a lack of clarity around how profits recorded for accounting purposes should be separated into distributable and non-distributable profits. There are also questions about how the generally accepted principles should be identified – guidance currently used by companies in doing this[57] sets out the generally accepted accounting principles of the time, but lacks legal status, and companies have no obligation to follow them exactly – and who should be responsible for defining when profits are realised.

ii) Current legislation makes no explicit requirement under company law or accounting standards for financial statements to disclose the total amount of profits that are distributable. This transparency issue arises as companies adopt accrual accounting (using IFRS[58] Accounting Standards or UK GAAP[59]), which does not recognise the

51 Section 853 takes realised profits and realised losses as those that are so defined under generally accepted accounting principles at the time the company's accounts are prepared.
52 Companies may only make a distribution if its net assets is greater than the sum of its called-up share capital and non-distributable reserves.
53 Under Companies Act 2006 s174 and s172(1), respectively.
54 See for example: https://investors.dominos.co.uk/system/files/clean_circular.pdf
55 Brydon Report, para 19.1.
56 See definition in footnote 1 above.
57 TECH 02/17BL, Guidance on Realised and Distributable Profits under the Companies Act 2006.
58 International Financial Reporting Standards, which are issued by the International Accounting Standards Board (IASB) and adopted for use in the UK by the UK Endorsement Board (UKEB).
59 Generally Accepted Accounting Principles refers to the financial reporting standards issued by the FRC, which the main standard is FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland.

concept of realised or unrealised profits. As such, profits recorded in their annual accounts do not necessarily equate to realised, distributable profits. In effect, beyond taking it on trust, shareholders are not able to know with any certainty whether dividends are being paid from distributable profits, or whether there is any headroom between the total dividend and the company's total distributable reserves.

- Current accounting practice and the focus of the current framework are backward looking and concerned only with companies' historical performance. Whilst this focus allows companies to present a view of performance at a given point in time, they do not allow for the future financial requirements or performance of the company to be assessed. Directors are required to have regard to their statutory duties under Section 172 Companies Act 2006 – promoting the success of the company, including over the long term, and considering the company's future financial needs – when declaring a dividend, but there is no requirement for them to demonstrate how they have done so within the current legal framework.

66. Whilst the Brydon Review made no specific recommendations for addressing these issues, it suggested some measures that would assist in ensuring that companies act with due regard for the legal framework, and their statutory and common law duties:

- in proposing a dividend, directors should prepare a statement that the dividend is within known distributable reserves and would not pose any risks to the existence of the company. In so doing, they should also confirm that the statement is consistent with the information in their Resilience Statement and has been subject to the appropriate level of assurance (in accordance with their Audit and Assurance policy).
- in cases where it is likely that distributable reserves are found to be similar in size to a proposed dividend, the dividend should only be recommended by the directors if the level of the distributable reserves is known, and payment of that dividend is consistent with the company's Resilience Statement and other Companies Act 2006 directors' obligations. These distributable reserves should also be subject to audit.

67. The Government supports the view that strengthened disclosure related to dividends and capital maintenance would be of value to investors and wider stakeholders[60]. The White Paper sought views on the following proposals[61] for strengthening the law on dividends and capital maintenance[62]:

- giving the new regulator responsibility for defining what should be treated as "realised" profits and losses for the purposes of complying with the Companies Act 2006 through either: (a) a power to make binding rules; or (b) a power to issue statutory guidance.
- requiring companies (or, in the case of a group, the parent company only) to disclose their distributable reserves and potentially making this figure subject to audit. In the case of a parent company with several companies in its group, the White Paper also proposed that the parent should disclose an estimate of the dividend-paying capacity of the group as a whole; and

60 Responses to the Government's Insolvency and Corporate Governance consultation also suggested that there is a demand for this information from companies.
61 These options also consider responses to the 2018 Government consultation on Insolvency and Corporate Governance and recommendations made by BEIS Select Committee following the 2019 Future of Audit Inquiry.
62 Please see pages 50-59 of the Restoring trust in audit and corporate governance consultation.

- requiring directors to make an explicit statement confirming that a dividend is legal and that paying it would not be expected to jeopardise the solvency of the business over the next two years.

68. The White Paper asked whether the new disclosures and statement should apply to listed and AIM companies only. The White Paper also asked whether companies should be required to disclose more about their overall distribution and capital allocation policies to set dividends in a wider context but suggested that recently introduced reporting requirements and pressure from the investment community might be sufficient to ensure that this happened without further legislation.

Government response and decision

69. In its Response paper on 'Restoring Trust in Audit and Corporate Governance[63], the Government confirmed its intention to strengthen the current framework of rules governing dividend payments. The Government has decided to proceed with the following:

i. Give the regulator formal responsibility for issuing guidance on what should be treated as "realised" profits and losses for the purposes of section 853 of the Companies Act 2006. This will need to be taken forward in primary legislation.

ii. Require companies or, in the case of a UK group, the parent company only, to disclose their distributable profits at the beginning and end of the financial year together with a summary of the changes which have occurred to the distributable profits during that year. However, if the calculation of distributable profits would involve unreasonable expense or delay companies may provide a minimum or "not less than" figure. Figures will be included as a note in the annual accounts and be subject to audit.

iii. Require directors, as part of the Directors' report, to provide a policy statement setting out their approach to capital allocation and their policy towards the amount and timing of distributions to shareholders and the purchase of own shares during the short and medium term as defined in the resilience statement. The policy will also set out the key risks and constraints relevant to implementing and sustaining the distribution policy and how the Directors' policy has been implemented in the financial year being reported on.

iv. Require directors to describe how, in implementing the policy, they have considered and taken into account the availability of distributable profits disclosed in the note to the accounts (see (ii) above).

Options considered

70. There was strong support across all stakeholders' groups for the proposals to strengthen the law on dividends and capital maintenance in the White Paper consultation. Some respondents however opposed some elements of the options that were consulted on and flagged concerns

63 Please see Government Response, Restoring trust in audit and corporate governance, pages 45-47.

about costs, complexity of the proposals and practical implementation considerations.[64] This has led to some revisions to the options considered in the White Paper and to combining elements of different options into the Government's final approach.

71. For this final stage Impact Assessment, the two options are:

- **Option 1- do nothing**: the government will not pursue the ''do nothing'' option as it would do nothing to address the high-profile examples of companies paying out significant dividends shortly before profit warnings and insolvency.
- **Option 2 - strengthened law on dividends and capital maintenance** as described above.

Assessment of monetised and non-monetised costs for chosen option

72. The new measure will come into force for any financial year that commences on or after 1 January 2025 for around 180 companies that have equity capital traded on a UK regulated market. For the remaining companies the new measure will come into force for any financial year that commences on or after 1 January 2026.

73. The cost of complying with these measures are assessed over a 10-year appraisal period against the do-nothing counterfactual. We consider it unlikely that costs will materially differ across companies in scope given the revenue and employee thresholds adopted for the dividends and capital maintenance disclosures. However, the requirements are unlikely to be wholly additional for all 750 companies. The FRC noted in 2015 that 28 FTSE 350 companies made enhanced distribution disclosures[65]. And in a subsequent report in 2017, the FRC identified 132 FTSE 350 companies which had made some form of enhanced distribution disclosure[66].

74. We expect costs to be incurred by the FRC as well as entities in scope. In the table below, we set out the type of costs we expect to be incurred for each of the new requirements and distinguish between one-off costs such as familiarisation and ongoing costs.

Table 6 –Type of cost incurred for each new requirement (i)-(iv)

Requirement	Description	Costs for entities in scope	Cost for regulator
(i) Regulator to issue guidance on the reporting requirement	Clear guidance required on the reporting requirements that are included.	They will need to familiarise themselves with guidance.	Cost of issuing new guidance is likely to be a one-off cost.
(ii) Companies in scope to disclose their distributable	There is currently no requirement for companies to	Companies should already be familiar with existing guidance on distributable	NA

64 Please see Government Response, Restoring trust in audit and corporate governance, Issue arising from consultation, pages 41-44.

65 https://www.frc.org.uk/getattachment/96ac6006-7a5a-4c69-8c30-010191139ec4/Lab-Project-Report-Disclosure-of-dividends-policy-and-practice.pdf

66 https://www.frc.org.uk/document-library/financial-reporting-lab/2017/dividends-implementation-study

reserves or a minimum, ‘’not less than’’ figure if would involve unreasonable expense or delay to be included in notes to accounts and therefore subject to audit.	disclose distributable reserves. So, the introduction of a requirement is likely to result in some additional costs for entities in scope.	reserves e.g., TECH 02/17BL as there is a legal requirement in CA2006 that distributions should be made from realised profits. Ongoing costs to comply with guidance in annual reports in every fiscal year	
(iiii) Companies to provide a statement explaining the board’s short and medium-term policy towards the amount and timing of returns to shareholder.	We expect the FRC to produce guidance to underpin requirement.	One- off familiarisation costs to understand requirement and how to comply with it. Ongoing costs to produce policy statement in annual report	As i).
(iv) Directors to describe how, in implementing the policy, they have considered the availability of distributable profits disclosed in the note accounts (see (ii) above.	We expect the FRC to produce guidance to underpin the requirement.	One- off familiarisation costs to understand requirement and how to comply with it. Ongoing costs to produce policy statement in annual report	NA

Costs to the regulator

Cost of developing and issuing guidance

75. Based on discussions with the regulator, we assume that developing and issuing guidance for companies will impose a one-off cost of £100,000 and that this cost will apply in the first year of implementation only[67].

Costs to companies in scope

One-off familiarisation costs

76. We expect that companies would already be familiar with existing ICAEW guidance on realised and distributable profits as there is already a legal requirement to ensure that distributions are made from realised profits. However, all companies in scope are expected to face familiarisation costs in understanding and interpreting the guidance related to new reporting requirements. We expect familiarisation costs to apply as one-off costs in the first year of implementation only. The estimates below are based on the time spent on reading the guidance by company staff that are most likely to be responsible for preparing the required disclosures. Therefore, our estimates are based on the hourly remuneration rate of Chief Executive Officer[68], Chief Financial Officers (CFOs)[69], company directors[70], senior managers, and professional accounting staff[71] (see Table 7 below).

77. We have assumed that the FRC will issue one set of guidance concerning the reporting requirements totalling 25 pages. As in BEIS’ Climate-related financial disclosures IA[72], we have assumed that each page takes 6 minutes to read and understand. The length of the guidance is

[67] Although FRC recoups all its costs from a levy raised on businesses, the better regulation framework at the time of writing excluded levies from the EANDCB. FRC costs are therefore not treated as a direct cost to business but are included in the Net Present Social Value calculation.
68 We developed our estimate of CEO hourly remuneration using the median total remuneration CEO figure given in Deloitte’s 2021 Director’s Remuneration Report for FTSE 250 companies.
69 We developed our estimate of CFO hourly remuneration using the median total remuneration CFO figure given in Deloitte’s 2021 Director’s Remuneration Report for FTSE 250 companies.
70 For company’s directors we use the hourly remuneration figure for CFO we derived from Deloitte’s 2021 Director’s Remuneration Report for FTSE 250 companies.
71 We use the 90th percentile of hourly wages in ONS ASHE (2021) table 14.5a for senior managers, professional accountants and admin staff, with a non-wage uplift of 18.6%.
72 https://www.legislation.gov.uk/ukia/2022/13/pdfs/ukia_20220013_en.pdf

based on the length of previous FRC lab reports on disclosure of dividends which included good practice examples.

78. We have assumed that the guidance will be read by a handful of employees - Chief Financial Officer and a core team of two professional accounting staff - including the company's board[73]. We estimate the one-off cost to be approximately £6,300 per company.

Table 7 – One-off familiarisation costs to companies in scope (2019 prices)

Type of staff	# Employees required	Time needed (hr)	Wage (£/hr)	Total cost
Chief Financial officer	1	2.5	£319	£797
Accounting professionals	2	2.5	£39	£197
Company Directors	5	2.5	£319	£3,985
Chief Executive Officer	1	2.5	£547	£1,366
Total cost per company				**£6,345**

Ongoing cost of preparing disclosures

79. We expect companies in scope to face some additional ongoing costs from the requirements to:

- provide information on their distributable reserves in their annual financial statements.
- make an explicit statement confirming the legality of proposed dividends and any dividends paid in year.
- provide a narrative explaining the board's long-term policy towards the amount and timing of returns to shareholder.

80. In Table 8 below, we identify the tasks that companies are likely to carry out to comply with these new requirements.

Table 8 –Main tasks required to comply with the new requirements.

Requirement	Main tasks involved
(ii) Companies in scope to disclose their distributable reserves (or a ''not less than'' figure if impracticable) to be included in the notes to the accounts and subject to audit.	Initial examination of company internal financial records Calculate distributable reserves figure. Distributable figure and calculations to be reviewed internally, including by CFO. Audit of distributable reserves figure, leading to higher audit fee
(iii) Companies in scope to provide a statement explaining the board's short/medium-term policy towards the amount and timing of returns to shareholder. (iv) Directors to describe how, in implementing the policy, they have considered the availability of distributable profits disclosed in the note accounts (see (ii) above.	Draft statement for the board to consider. Board to approve statement to be included in Director's report.

81. For requirement (ii), we expect parent companies to calculate the distributable profit figure or a ''not less than figure'' and to have it reviewed internally. This is **not** a consolidated figure for the group and therefore does not require inputs from subsidiaries. Respondents to the consultation thought that distributable profits were figures that directors should already have available and would not amount to a new burden[74] especially as some companies already disclose this figure on a voluntary basis. Further, feedback during the consultation indicated that

73 We have assumed that a company's board is made of seven members- executive and non-executive directors. Our assumption is based on data from the BoardEx database (as downloaded on 24 September 2022) which estimates the total number of board members at FTSE 350 companies to be 2,445, for an average of 7.27 members per company, We round the figure to 7 as some of the entities in scope for the capital maintenance and dividend measures will be smaller in size than FTSE 350 companies.

74 Please see Government Response, Restoring trust in audit and corporate governance, Disclosure of distributable reserves, page 42. Also see: https://transactions.freshfields.com/post/102hqmp/audit-and-corporate-governance-in-the-context-of-corporate-failures-uk-governmen

investment trusts are required to distribute a minimum percentage of their income to preserve their tax status. However, as we do not have precise figures we adopt the following approach, which assumes that:

- at least 150, out of 750 companies already calculate their distributable profits and do not need to do any more to meet the regulatory requirements. This is based on the number of companies that the FRC Lab identified as making some form of enhanced disclosure[75]. The FRC study indicated that 132 of 313 (42%) FTSE 350 companies made enhanced disclosures with the incidence greatest in the FTSE100 (58%). We have opted using a lower percentage who already comply with requirements given the large number of private companies in the affected population, who are less likely to feel the need to make a public disclosure to their private shareholders. Given that we estimate that there are 180 listed companies in scope, we are effectively assuming that most listed companies in scope are making a disclosure.

- The remaining 600 must calculate their distributable reserves based on current and historic accounting records. This is a one-off cost as it is relatively straightforward to revise the figure in subsequent years.

Table 9 – One off cost of estimating distributable reserves (2019 prices)

Type of staff	# Employees required	(hr)	Wage (£/hr)	Total cost
Chief Executive Officer	1	5	£547	£2,733
Chief Financial Officer	1	5	£319	£1,594
Accounting professionals	2	40	£39	£3,153
Administrative staff	2	20	£22	£899
Audit cost				£1,676
Total cost per company				**£10,054**

82. We recognise that by virtue of including the distributable profit figure in the notes to the accounts, which are subject to audit, this would lead to additional audit costs for those companies that are having to produce the figure for the first time. For these companies, we assume that the additional audit costs are around 20% of the costs of producing the disclosures in the first year when the groups historic distributable reserves are calculated. In subsequent years, we expect the additional costs to fall within the range of normal variations in the scale of work that auditors could reasonably expect during a large company audit. For those companies that are not already disclosing, or have not calculated, their distributable reserves we estimate additional costs of around £10,000 per company.

83. For requirements (iii) and (iv), we note that companies in scope are already preparing a Directors' report, but they would need to produce additional narrative explaining the board's short and medium-term policy towards the amount and timing of returns to shareholder along with a description of the risks and constraints relevant to implementing and sustaining the distribution policy. We have assumed that producing this narrative would require inputs from the Chief Financial Officer and that company's directors would need to approve it.

Table 10 - Cost of preparing ongoing director's report disclosures (per company) (2019 prices)

[75] https://www.frc.org.uk/document-library/financial-reporting-lab/2017/dividends-implementation-study.

Type of staff	# Employees required	Time needed (hr)	Wage (£/hr)	Total cost
Chief Financial Officer	1	2	£319	£638
Company Directors	5	1	£319	£1,594
Chief Executive Officer	1	1	£547	£547
Accounting professionals	2	5	£39	£394
Administrative staff	1	1	£22	£22
Total cost per company				**£3,195**

Total monetised costs

84. Our total monetised costs for this option capture one-off costs incurred in the first year of implementation and ongoing compliance costs. We estimate a total PVC of approximately £25 million over the 10-year appraisal period, with an EANDCB of £2.9 million.

Differences with Consultation Impact Assessment

85. The options presented in this final IA are not directly comparable to the option considered in the consultation White paper. The final option presented in the Government response is a combination of elements of options 1-3 presented in the consultation IA. The most expensive option in the Consultation IA had an EANDCB of £2.2 million (2016 prices) or £2.3 million in 2019 prices. However:

a. We increased hourly remuneration rates for directors, CFO, CEO and updated remuneration data from the ONS for senior managers, professional accountants and administrative staff.

b. We also increased the amount of time required following consultation feedback – e.g. costing tasks related to estimating distributable reserves.

c. Compared to the consultation IA, there are fewer entities in scope, at 750 compared to 1,422. This in part mitigates the cost increase from changes in time spent and wage rates.

Risks and uncertainties

86. The policy is intended to instil greater responsibility for dividend decisions and payments in company directors. A possible impact of the measures proposed here, therefore, could be a reduction in dividends, as directors subject to greater accountability might adopt a more cautious approach and lower dividend payments to limit their risk in the short run. This is not a cost under the better regulation framework – it is a change in the allocation of profits between retained and distributed income and one which is unlikely to persist over the long-term.

87. Furthermore, we note that our cost estimates might not be accurate due to the following factors:

- Some companies are already calculating distributable profits, disclosing the figures and their figures are already subject to audit. Other companies whilst calculating the figures already, do not disclose them. Further: in principle, all companies should already know the value of their distributable profits to be sure that any distribution complies with the law. Whilst we have tried to take this into account in the one-off costs for estimating distributable profits, the assumed number of companies already doing this is based on old data. The costs associated with publishing a figure may therefore be lower than anticipated. For example, if the proportion of companies calculating distributable reserves was 40%, not 20% as we assume, then the 1st year costs of estimating

distributable reserves would fall from £6m to £4.5m, implying a modest fall in the EANDCB.

- We have used hourly remuneration rates for Boards based on FTSE 250 companies. Whilst the entities in scope include FTSE 250 companies, there are also companies which are smaller in size than FTSE 250 and whose remuneration for the Board may differ from FTSE250. Therefore, the remuneration rates used might not be an accurate representation of the remuneration of directors across all companies in scope.

Appendix: Capital maintenance inputs into BIT calculator

One-off costs

Familiarisation costs				
	Reporting year	Number	Unit costs	Total
Listed on LSE	2025	180	£6,345	£1,142,139
Not listed	2026	570	£6,345	£3,616,775
				£4,758,914

Costs of estimating distributable reserves				
	Reporting year	Number	Unit costs	Total
Listed on LSE	2025	30	£10,054	£301,633
Not listed	2026	570	£10,054	£5,731,021
				£6,032,654

Note: based on FRC research we estimate that 150 listed companies already estimate distributable reserves.

Recurrent costs (£m)

Annual costs													
Reporting costs				1	2	3	4	5	6	7	8	9	10
	Reporting year	Number	Annual cost										
Listed on LSE	2025	180	£3,195	£0.58	£0.58	£0.58	£0.58	£0.58	£0.58	£0.58	£0.58	£0.58	£0.58
Not listed	2026	570	£3,195		£1.82	£1.82	£1.82	£1.82	£1.82	£1.82	£1.82	£1.82	£1.82
				£0.58	£2.40	£2.40	£2.40	£2.40	£2.40	£2.40	£2.40	£2.40	£2.40

Reporting on measures to prevent and detect fraud

Policy objective

88. Fraud in the UK amounts to between £130 – £190 billion per year[76]. Fraud has featured heavily in the news both nationally and internationally. For instance, in 2019, the FRC began investigating the audit of Patisserie Valerie following the discovery of fraud worth £40m at the company[77]. Moreover, in 2020, Wirecard's auditors were criticised for failing to detect the major fraud that led to the company reporting inflated revenues, profits, and assets for many years.

89. A company's directors are responsible for approving its annual accounts and safeguarding its assets, including taking steps to prevent and detect material fraud.[78] Auditors also have responsibilities around the detection of fraud. However, these responsibilities can appear vague and unclear. Directors typically acknowledge their responsibility to prevent and detect material fraud in annual reports but do not report on the related actions they took. Such actions may include undertaking an appropriate fraud risk assessment and responding appropriately to identified risks; promoting an appropriate corporate culture and corporate values; and ensuring appropriate controls are in place and operating effectively.

90. The Brydon review noted that, among the topics examined, fraud and auditors' related responsibilities were "the most complex and most misunderstood in relation to auditors' duties"[79]. For example, the Business, Energy and Industrial Strategy Committee (BEISCOM) were told that, because fraud is difficult to detect, the public should not expect auditors to find it[80], and that auditors operate under a 'mythology'[81] whereby they do not believe they are likely to find fraud.

91. While it is very clear that management and the Board have primary responsibility for preventing and detecting fraud, the Brydon Review recommended that all would benefit from much more communicative reporting and a clarified auditing standard.

92. In the White Paper, the Government consulted on a set of new reporting obligations for both directors of large private and public companies and their auditors:

- Option 1: require directors to issue a statement outlining the action taken to prevent and detect material fraud.

76 Crowe. (2019). The Financial Cost of Fraud 2019.
77 FRC, 21 November 2018. Investigations in connection with the financial statements of Patisseries Holdings Plc. https://www.frc.org.uk/news/november-2018/investigations-in-connection-with-the-financial-st
78 Companies must also keep adequate accounting records, and directors commit an offence if a company fails to comply with that duty (Companies Act 2006, ss 386 and 387). It is also a criminal offence to make false statements to auditors (Companies Act 2006, s 501).
79 Brydon review, p.65. para. 14.0.1
80 House of Commons, (2019). The Future of Audit, p. 15 para 30. Available at: https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1718/1718.pdf
81 Ibid, p. 16 para 30.

- Option 2: require directors to issue a statement outlining the action taken to prevent and detect material fraud and require auditors to report on the factual accuracy of the directors' statements.

Government response and decision

93. There was strong support for some elements of the options proposed in the White paper consultation. A significant majority of respondents supported the proposal for a directors' statement on fraud, acknowledging that the primary responsibility for preventing and detecting fraud[82] rests with the board and management. However, there was some opposition to the proposal that auditors should report on the factual accuracy of the directors 'statement with some expressing concern about potential for confusion and that 'factual accuracy' was not a recognised form of assurance.

94. Having considered the feedback received, the government has decided to proceed with a new requirement for directors of large public and private companies to describe the main measures that they have in place, or are proposing, to prevent and detect material fraud, this to be accompanied by a summary of the directors' assessment of the risk of material fraud[83]. The Government decided, however, that no additional legal requirement is needed to ensure that auditors report any concerns they might have with the factual accuracy of the new statement. Auditors already have a clear obligation to review "other statutory information" and that this obligation would extend to the director's fraud statement. Under the ISA (UK) 720 audit standard, auditors would be required to read the fraud statement and consider whether any of it is: materially inconsistent with the financial statements; materially inconsistent with the knowledge obtained during the audit; or materially misstated in the context of the applicable legal and regulatory requirements.

95. The SI defines "fraud" as behaviour falling within sections 2 to 4 of the Fraud Act 2006. This covers false representation, the failure to disclose information and the abuse of position. It is therefore a broader definition of fraud than the one used in ISA 240 which focusses on the use of deception. It is intended to encompass fraud committed both by and to the company and to extend to fraud which may not have any immediate effect on the financial statements. The SI states that fraud should be considered material if it could be expected to influence that a reasonable shareholder would take in connection with their shareholding.

96. The Economic Crime and Corporate Transparency Bill[84], introduced a failure to prevent fraud (FTPF) offence which applies to around 25,000 large, as defined by the Companies Act, corporate bodies and partnerships. Where a fraud was committed by an employee or associate, which benefitted the corporate body or partnership, the corporate would be open to prosecution for failure to prevent fraud unless it had taken reasonable steps to prevent the fraud from occurring. Reasonable steps will be defined in Government guidance but based on other 'failure to prevent' offences they are likely to include: conducting a risk assessment, communicating policy to staff and staff training. There is therefore a clear link between this regulatory measure and the statement of fraud which we explore further below.

82 Please see Government Response, Restoring trust in audit and corporate governance, paras 6.2.4-625, page 95.
83 Please see Government Response, Restoring trust in audit and corporate governance, pages 97-98.
84 https://bills.parliament.uk/bills/3339/publications

Options considered

97. For this final impact assessment, we considered the following two options:

- **Option 1- do nothing**: the government will not pursue the ''do nothing'' for the reasons set out in the White Paper and in the Government response.
- **Option 2 -** require directors of those companies in scope to report on **the steps that they have taken to prevent and detect material fraud in that financial year,** as part of their annual Directors Report.

Assessment of monetised and non-monetised costs for chosen option

98. As discussed above, the impact assessment associated with the Economic Crime and Corporate Transparency Bill quantified the costs of introducing failure to prevent fraud as an offence. In quantifying the compliance costs, the IA assumed that large corporate bodies and partners would undertake the following tasks and activities[85]:

- Familiarisation, which included activities such as reading guidance; planning and mobilising resources; defining stakeholders and the scope of the project; identifying information sources and allocating responsibilities. It also includes setting control objectives and risk approach.
- Risk assessment: This included developing and populating a risk register. It also includes prioritising risks and testing risks against the companies control framework.
- Communications: These included one-off costs from a statement to external audiences via a website and costs every year where the management and Board set out their anti-fraud policies to staff.
- Training: all staff, existing and new, received on-line training from a commercial training provider.

99. One difference between the FTPF measure and the fraud measure in this IA is that FTPF only applies to frauds that benefit the corporate body. However, many of the anti-fraud measures could apply to frauds against the corporate body e.g., through internal control procedures. Therefore, in this impact assessment, we treat the FTPF policy as our baseline for estimating the costs for reporting on measures to prevent fraud. This means that we only estimate the additional costs of reporting in the Directors' report on the actions taken by directors to detect and prevent fraud. For reference, the EANDCB for the largest corporates and partnerships to comply with the FTPF offence was £98.5 million.

85 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149596/Impact_Assessment_for_Failure_to_Prevent_Fraud__Home_Office_.pdf

Costs to companies in scope

100. We assume that the new requirement to report on actions taken to prevent and detect fraud will come into force for any financial year that commences on or after 1 January 2025 for around 180 companies that have equity capital traded on a UK regulated market. For the remaining companies the new requirements will come into force for any financial year that commences on or after 1 January 2026. The costs of complying with this measure are assessed over a 10-year appraisal period against the counterfactual. We have also assumed that the average cost of producing the statement will not vary by the size of company. We consider it unlikely that costs will materially differ across companies in scope given the revenues and employees thresholds adopted for this measure.

101. We expect companies in scope to incur costs from the ongoing requirement to prepare a statement on the action they have taken to detect and prevent fraud in that financial year. As directors, corporate managers, and other professionals will already be familiar with their obligations arising from the FTPF offence there will be no additional cost involved in familiarising with these activities. However, we assume that companies familiarise themselves with 25 pages of regulator guidance on the reporting requirement and that this costs the FRC £100,000 to produce.

Table 11 – One off familiarisation cost (2019 prices)

Familiarisation costs - one off	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Familiarisation with FRC guidance	Admin staff	1		22	£ -
	Corporate Managers	1	2.5	57	£ 142
	Directors (Board), including CFO	6	2.5	319	£ 4,782
	Chief Executive Officer	1	2.5	547	£ 1,366
Total familiarisation costs per company (one off)					**£6,290**

102. Further, it is possible that documentation related to the entity's FTPF policy would be treated as 'other information' under ISA (UK) 720. In this case, auditors would be required to check that the policies were not materially inconsistent with the information in the financial statements; inconsistent with the knowledge gained by the auditor during the audit or that the other information has been materially misstated. To estimate these costs, we assume that an auditor reviews 100 pages of material. This is a reasonable estimate for the range of documents that would need to be reviewed. These include company fraud policies, risk assessments, evidence of training and other actions undertaken, and material used in staff communications. At six minutes per page this equates to ten audit hours. This is in addition to the work auditors must already do to detect fraud under ISA(UK) 240[86] which was strengthened in May 2021 to, amongst other things, require auditors to demonstrate more professional scepticism about potential fraud, be readier to consider the use of specialist expertise and to consider both the qualitative and quantitative aspects of fraud[87].

[86] https://www.frc.org.uk/getattachment/e48499f2-b69b-4f45-8bef-762583eab1cd/ISA-(UK)-240-Final.pdf

[87] ISA(UK)315 (Identifying and Assessing the Risks of Material Misstatement) was also revised with effect from December 2021 to include, amongst other things, requirements for auditors to develop a stronger understanding of clients' systems and controls, including IT systems, relevant to the audit." Systems and controls are a vital part of preventing and detecting fraud.

Table 12 – Cost of preparing Fraud statement in directors report in each reporting year – (2019 prices).

Costs of producing annual disclosure in Director's report	Type of staff	# of staff	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Drafting of disclosure	Admin staff	1	2	22	£ 45
	Corporate Managers	1	5	57	£ 285
	CFO	1	1	319	£ 319
	Chief Executive Officer	1	1	547	£ 547
Review and Publication of disclosure	Admin staff	1	2	22	£ 45
	Corporate Managers	1	1	57	£ 57
	Directors (Board)	6	1	319	£ 1,913
	Chief Executive Officer	1	1	547	£ 547
Review of materials by auditor	Accountant	1	10	39	£ 394
Total familiarisation costs per company (every year)					**£4,150**

103. Our estimates are based on the time taken to prepare the required statement in each year by directors[88] sitting on the board, corporate managers, and admin staff[89]. We quantify the annual costs of reporting to be around £4,000 for each company in scope with a further £6,300 of one-off familiarisation costs. We estimate a total PVC of approximately £25 million over the 10-year appraisal period, with an EANDCB of £2.8 million.

Costs to the regulator

104. We expect costs from guidance (£100,000), plus there are likely to be some additional costs from training and additional time taken to review the additional corporate reporting. Ultimately, the costs of the FRC are recouped by a levy on businesses and this levy does not constitute a direct cost under the better regulation framework. Given this, the uncertainty over any additional costs and their likely small size we do not estimate the additional FRC costs.

Differences with Consultation Impact Assessment

105. The consultation IA estimated an EANDCB for option 1 – directors report without attestation – of 0.8m (2016 prices) or 0.85m (2019 prices). Feedback on the consultation stage IA was that we had underestimated costs:

- Respondents noted that the cost of the statement was only a small part of the compliance costs and that there could be other costs such as a fraud risk assessment, fraud training and company organisation and culture. As noted above these were considered in the FTPF IA which forms the baseline for the cost estimates in this IA.
- We have also slightly increased the number of hours to reflect two stages involved in publication – drafting and clearances – changing the composition of the team to include more corporate manager and less administrative time.
- As noted in other sections in this IA we were encouraged to use more realistic wage rates. For example, for senior managers and administrative staff we have used 90th percentile labour cost estimates in the ONS ASHE 2021 survey. Additionally, we used figures from Deloitte's FTSE 250 Annual remuneration report (2021) to derive estimates of hourly remuneration for the board of directors.

88 This Impact Assessment uses the 2021 ONS Annual Survey of Hours and Earnings (ASHE), table 14.5a, data for hourly and yearly gross wage costs for Administrative staff, Accountants, Finance Professionals, Business and research professional, and Directors. We apply a 18.6% UK non-wage labour costs uplift to reflect the total labour costs to businesses in scope.
89 We developed our estimates of CEO, CFO and other board members hourly remuneration using the median remuneration of CEO and CFO given in Deloitte's 2021 Director's Remuneration Report for the FTSE 250 market cap band.

- Partially offsetting these upwards cost pressures, we have fewer entities in scope – 750 compared to 1,945 in the consultation IA.

106. The combined impact of these changes has been to increase the EANDCB[90] of the measure by around £1.9 million in 2019 prices[91].

Risks and uncertainties

107. We have assumed that the directors' statement reports on a risk assessment, training and other measures to reduce the risk of fraud. It does not require directors to develop new systems to prevent and detect fraud. Directors may decide they need to do more based on the risk assessment, which would of course lead to greater costs on business, but they would only likely do so if they thought that the benefits would exceed the costs.

108. The costs may vary if companies delegate the statement to the Audit Committee to oversee and approve.

90 The total costs only capture the ongoing cost of reporting on an annual basis. We have assumed there are no familiarisation costs for companies in scope.
91 Please see Table 39 of the Consultation IA.

Appendix: Fraud reporting inputs into BIT calculator

One off costs

	Reporting year	Number of companies	Cost per company	
Listed	2025	180	£6,290	£1,132,282
Not listed	2026	570	£6,290	£3,585,559
Total				£4,717,841

Recurrent costs (£m)

	Reporting year	Number of companies	Cost per company	1	2	3	4	5	6	7	8	9	10
On LSE	2025	180	£4,150	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Not on LSE	2026	570	£4,150		2.37	2.37	2.37	2.37	2.37	2.37	2.37	2.37	2.37
Total				0.75	3.11	3.11	3.11	3.11	3.11	3.11	3.11	3.11	3.11

Resilience Reporting

Policy objective

109. 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 longer-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. Companies' ability to assess and manage risks to their business is, therefore, paramount to their resilience.

110. Existing and potential investors, regulators and wider stakeholders, place considerable importance on reassurances about a company's resilience, and there is also a clear public interest in how companies can reduce the risk of disorderly corporate failure, and more widely, the economic shocks that could result from failure. Directors of all companies are required to undertake an assessment of the ability of the company to continue as a going concern when preparing annual accounts and are required to disclose the conclusion. If management concludes that material uncertainties exist, accounting standards for medium and large sized companies require disclosure of those material uncertainties. Accounting standards for small companies using UK GAAP do not directly require disclosure of material uncertainties in respect of going concern, but in practice the general obligation that the accounts present a true and fair view creates an expectation that material uncertainties need to be disclosed by all companies. Other relevant disclosures include:

- All large and medium sized companies, both private and listed, must include disclosure of principal risks and uncertainties in their Strategic Report under s.414C of the Companies Act 2006; and
- Premium listed companies are required to prepare a Viability Statement in accordance with the UK Corporate Governance Code[92], underpinned by the UK Listing Rules[93].

111. The Brydon Review noted that, in preparing going concern and viability statements, company directors must consider varying risks and challenges and make judgements about the future, but the context in which these issues are considered, and judgements are made, is not always made clear to stakeholders. It concluded that providing information about this context and how directors have exercised their judgement would be of considerable value to stakeholders.[94]

112. In the main, respondents to the Review's Call for Views indicated that there was room to improve current going concern and viability reporting requirements:

- Current going concern requirements arguably do not provide for the disclosure of material uncertainties that are no longer considered material due to mitigating action and/or the use of significant judgement.

92 https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code

93 https://www.handbook.fca.org.uk/handbook

94 Brydon Report, para 18.0.1

- Whilst current viability statements provide useful information, they are not fit for purpose as they do not provide robust analysis of the companies' future viability – companies tend to produce limited detail on budget and cashflow covering only three years in the typical case.

113. The Review noted further that shareholders demand more meaningful information on the risks to the survival and success of companies further into the future, where internal and external operating conditions are subject to greater uncertainty. This has been heightened by the COVID 19 pandemic, which has resulted in greater regulatory, investor, parliamentary, media and wider public interest in how companies are thinking about and preparing for future financial, operational, and business continuity shocks.

114. To address these issues, the Review recommended the introduction of a new Resilience Statement, which would *build on and incorporate* the Viability Statement and Going Concern statement in giving clarity on companies' approach to assessing and managing challenges, and building business resilience, over the short, medium, and longer term. We note that such a statement would also address a key recommendation of the Independent Review of the FRC – that the existing viability statement should be strengthened or abolished[95].

115. Moreover, the existing reporting requirements stem from multiple sources, which limits the extent to which users of the reports can develop a coherent picture of companies' risk assessment and management, and resilience planning. A Resilience Statement that integrates these areas across the short, medium and longer term could be an effective way of addressing this, as it would provide better clarity on resilience planning and highlight links to the company's annual risk report and risk management, and internal control processes.

116. In the White paper consultation, the government proposed that the Resilience Statement should report on risks and uncertainties over:

- *the short term* – building on the Going Concern Statement through disclosure of material uncertainties and whether mitigating action has been proposed or undertaken; and whether this has resulted in any uncertainties no longer being material.
- *the medium term* – a report that captures tests of plausible but severe stress scenarios that go beyond the standard of current viability reporting; and
- *the long term* – no mandatory reporting elements were prescribed for long term reporting, however, the Review highlighted climate change as a key area that could be addressed.

Government response and decision

117. The Government confirmed in its Response paper on 'Restoring Trust in Audit and Corporate Governance[96]' that entities meeting a 750 test will be required to produce an annual Resilience Statement.

95 Recommendation 52, Independent Review of the Financial Reporting Council (2019).
96 Please see Government Response, Restoring trust in audit and corporate governance, pages 50-55.

118. The Resilience Statement is intended to describe the risks facing a company over the short, medium and long-term and the action being taken by directors to address these risks to ensure the company and its business model remain resilient. It will be within the existing strategic report and will incorporate the existing going concern statement required in law and under accounting standards.

119. Companies in scope will be required to disclose material uncertainties in matters that they consider the principal risks to resilience over the short, medium, and long term, together with an explanation of how they have arrived at this judgment of materiality. In doing so companies will be required to enhance reporting for each time horizon.

- The short-term reporting time-horizon would correspond with the company's going concern period, and directors would be obliged to state whether, in their opinion, the company will have access to the necessary financial resource to ensure its survival over this period.

- Directors must choose and explain the length of the period chosen for medium term reporting and how the period aligns with the company's strategy, business and investment cycles.

- The period for long-term reporting would be determined individually by each reporting company. Directors would be required to set out what they perceive to be the potential long-term threats to the business – for example, the impact of climate change on the company's business strategy and financial planning, and the impact of wider long-term changes in demographics, technology, consumer preferences – and to explain their assessment of resilience in the face of these threats and the systems in place, or in planning, to enable the company to effectively mitigate them[97]

120. The regulations do not prescribe how the statement should be structured. This allows companies to have flexibility over where and how to set out their risk reporting within the strategic report, including both reporting required by the resilience statement and any future reporting on sustainability risks, currently being considered by the International Sustainability Standards Board. The regulations require Resilience Statements to include the following key content:

- Summary of company's approach to managing risk, and building (or maintaining) resilience, including with brief reference to strategy, business model and internal governance.

- Summary of why directors believe it appropriate to continue to adopt the going concern basis of accounting (including specifying the going concern period chosen).

- Identification of the company's principal risks, including supporting information on likelihood, impact, any mitigating action and the time period over which the risk is expected to continue.

- An assessment of the company's prospects over the medium-term (with the company to define and explain the time period chosen for the medium-term), and a reverse stress test.

[97] Regarding the impact of climate related risks on the company's business model, the Government considers that it should be included in the Resilience Statement only to the extent that this is not already addressed by the company in other statutory reporting.

- A summary of long-term trends and factors which could represent a threat to the company's business model or operations.

121. The regulations introduce a requirement for reverse stress-testing. Some financial institutions are already required to do reverse stress testing by the Bank of England Prudential Regulation Authority (PRA) [98] and by the Financial Conduct Authority[99]. This requirement will be adapted and extended in a lighter touch way to companies in scope of the Resilience Statement. Company directors would be required to prepare a statement outlining a combination of adverse circumstances in which the business would fail and commenting on the likelihood of this and whether any mitigating action has been taken in light of the test. The medium-term report would document the board's assessment of the resilience of the company considering the findings of this testing, and this documentation will be available to the regulator to review on request.

Options considered

122. Following strong support for the Resilience Statement in White Paper consultation, the following two options have been considered for the final stage Impact Assessment:

- **Option 1- do nothing**: the government will not pursue the ''do nothing'' option as this does not address concerns that existing risk and viability reporting by many companies – including the viability statement produced under the UK Corporate Governance Code – lacked sufficient detail and specificity and is not long-term enough in outlook.
- **Option 2 –**Companies in scope will be required to produce a Resilience Statement meeting the requirements described above.

Assessment of monetised and non-monetised costs of chosen option

123. The new measure will come into force for any financial year that commences on or after 1 January 2025 for around 180 companies that have equity capital traded on a UK regulated market. For the remaining companies the new measure will come into force for any financial year that commences on or after 1 January 2026.

124. The cost of complying with these measures are assessed over a 10-year appraisal period against the do-nothing counterfactual. We consider it is unlikely that costs will materially differ across companies in scope given the revenue and employee thresholds adopted for the disclosures.

125. The Resilience statement will build upon existing reporting requirements: the Viability Statement, Companies Act requirements for companies to set out their principal risks and uncertainties and the Going Concern statement. This raises obvious questions about the extent to which some companies already comply, all or in part, with the Resilience statement obligations. We assume that:

a. All companies in scope will incur costs for familiarisation with the new reporting requirements, e.g. understanding the Regulator's new guidance.

98 Please see https://www.bankofengland.co.uk/stress-testing for a description of reverse stress testing for UK banks, building societies and insurers.
99 Please see https://www.handbook.fca.org.uk/handbook/SYSC/20/2.html?date=2021-12-31 for further details.

b. The high-level narrative and short-term assessment map on to existing Companies Act requirements and Going Concern requirements, which all companies in scope should already comply with. The new requirements will therefore be rooted in Companies Act requirements and existing accounting standards. The latter already requires Directors to make an assessment as to whether the company can operate as a going concern for at least 12 months[100]. A recent review of the going concern statement suggests that implementation of existing requirements is insufficient. It found that “going concern disclosures lacked sufficient detail to enable a reader to assess whether the assumptions used were consistent with those applied in other areas of the financial statements”; and that the regulator: “identified several circumstances where information in the financial statements indicated that significant judgement may have been applied in determining whether the company was a going concern or whether there was a material uncertainty in respect of going concern to disclose, yet no significant judgement disclosures were presented.”[101] The new resilience statement may require companies to do more, but this additional reporting should be considered primarily as enabling shareholders and other interested parties to better understand how companies are already managing their risks, as currently required, rather than the introduction of new obligations.

c. The most substantial additional change is the requirement for a medium-term assessment. As the medium-term assessment requires reverse stress testing implying additional cost. Data on the extent of reverse stress testing is patchy but a recent FRC review based on a relatively small sample[102] suggests that perhaps a third of all main market and AIM companies currently have a capability to do reverse stress testing and we use this to inform our best estimate of costs.

d. The closest analogue to medium term reporting is the Viability Statement which is a requirement of the Corporate Governance code which applies to premium listed companies. In our data there are at least 160 premium listed parents that meet the 750 test and who therefore already produce a medium-term assessment – most commonly covering a three-year period.

e. Long-term reporting is a wholly new obligation on companies in scope and therefore an additional cost.

Costs to the regulator

126. We expect costs to the regulator to stem from preparing and issuing guidance. Given that this option mandates reporting for a high-level narrative and three time-horizons, each having different core requirements, we have assumed that companies will need to familiarise themselves with the reporting requirements.

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[100] In the case of companies reporting against IFRS it is 12 months from the date of the balance sheet; for those companies in scope of UK GAAP it is 12 months from the date of approval of the financial statements.

101 https://www.frc.org.uk/getattachment/2b213ba8-b950-49e4-838d-d919cbcbd6e6/Going-Concern-and-Viability-Review.pdf

102 https://www.frc.org.uk/getattachment/2b213ba8-b950-49e4-838d-d919cbcbd6e6/Going-Concern-and-Viability-Review.pdf. This found that 21 out of 30 companies had carried out stress analysis for the viability statement and 14 had carried out stress analysis using scenarios. Only 5 however had carried out reverse stress testing (p 19). However, around a third of the 30 companies had used reverse stress testing for the going concern statement suggesting that the capability to do reverse stress testing was more widespread than the numbers using it for the viability statement implied.

127. We treat costs related to guidance and standards as one-off costs applying in the first year of implementation only. We have assumed that the FRC will issue one set of guidance on reporting requirements. The estimated cost to the regulator from preparing and issuing guidance and standards is £100,000[103].

Costs to businesses

One-off costs

128. In the first year of implementation, we expect companies in scope to incur:

a. Costs from familiarisation with new reporting requirements, reading the FRC's guidance on reporting requirements. In addition, the Board meets to discus the approach to enhanced reporting and give guidance on stress testing.

b. Costs from identifying areas that are not covered in their current reports, principally the long-term statement, and from the additional work required in preparing the resilience statement in accordance with the requirements, including developing models for reverse stress testing. We assume that this work is guided by the Audit Committee and is finally signed off by the full Board.

129. Familiarisation costs are the one-off costs for **all** companies that fall in scope to familiarise themselves with relevant guidance produced by the FRC and other relevant bodies. The guidance will be read by the CEO, the Chief Financial Officer (CFO), members of the Audit Committee and the project team that reports to the CFO. The Board meets to discuss the findings (one hour meeting plus one hour reading time) in a paper drafted by one of the project team.

130. The estimates below are based on the time spent by company staff to read the necessary guidance, draft a paper or actively participate in a Board discussion. Estimates therefore use the hourly wage rate for administrative staff, Accountants, Finance Professionals, Business and research professionals, CFO and Directors, including members of the Audit Committee[104], and the CEO[105]. As in the BEIS' Climate-related financial disclosures IA[106,] we have assumed that that the guidance consists of 25 pages and each page takes 6 minutes to read and understand. In total, we expect the cost of familiarisation with the incoming requirements to total around £11,000 per company in scope.

Table 13: Expected Familiarisation costs (2019 prices)

[103] The FRC's costs are recouped by a levy on business so ultimately the costs of guidance are borne by business. But levies are outside the scope of the current better regulation framework. These costs are therefore not considered to be a direct cost and are out of scope of the EANDCB.

[104] This Impact Assessment uses the 2021 ONS Annual Survey of Hours and Earnings (ASHE), table 14.5a, data for hourly and yearly gross wage costs for Administrative staff, Accountants, Finance Professionals, Business and research professional, and Directors. We apply a 18.6% UK non-wage labour costs uplift to reflect the total costs to businesses in scope.

[105] We developed our estimate of CEO, CFO and other board members hourly remuneration using the median remuneration of CEO and CFO given in Deloitte's 2021 Director's Remuneration Report for the FTSE 250 market cap band.

[106] https://www.gov.uk/government/consultations/mandatory-climate-related-financial-disclosures-by-publicly-quoted-companies-large-private-companies-and-llps, page 29.

Familiarisation costs	Type of staff	# of Employees required to read guidance	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Reading guidance	CEO	1	2.5	547	£1,366
	CFO	1	2.5	319	£797
	Accountants	1	2.5	39	£99
	Risk Professionals	1	2.5	40	£101
	Business, Research Analyst	1	2.5	43	£108
	Administrative	1	2.5	22	£56
	Audit Committee Chair	1	2.5	363	£907
	Audit committee members	3	2.5	341	£2,555
	Total cost				**£5,989**
Board meeting to discuss requirement and approach	CEO	1	2	547	£1,093
	CFO	1	2	319	£638
	Directors (Board)	5	2	319	£3,188
	Risk Professional (board paper)	1	4	40	£161
	Total cost				**£5,079**
Total familiarisation costs per company:					**£11,068**

131. Identifying areas not covered by existing reports and stress testing for the Resilience Statement: The Resilience Statement builds on existing disclosure requirements on risks and uncertainty by asking companies to report on matters that they consider principal risks to their business model and operations and to provide additional details on likelihood of the risks, their impacts and mitigation actions taken. In addition, companies are also required to develop reverse stress testing. We believe that to comply with these additional requirements companies would need to invest in additional capabilities in year 1 by setting up a team dedicated to producing the Resilience Statement. We would expect the team to be led by the Chief Financial Officer, and include one finance manager, one accountant, one risk manager, one business and research analyst and one member of administrative staff.

132. We expect that the Board would set the overall direction for the project team as well as make decisions on which combinations of risks to use for reverse stress testing.

133. The main tasks that the team would carry out in the first year are described in Table 14 below and include gap analysis to identify required areas that are not covered in their current reports, project management, risk management, and research and approach to data collection for developing stress testing. Table 15 shows the cost associated with these tasks. In quantifying the costs, we have assumed that all companies in scope have a risk register is already in place and kept up to date and reviewed by the Board on a regular basis.

Table 14: Activities and tasks required to develop approach to enhanced disclosure and stress testing

Type of staff	Main stages and sub-stages	Individual tasks involved at this level
Board of Directors	Scope of the project	- Set overall direction for the project.

	Stress testing	- Take decisions on which combinations of risks to use for reverse stress testing.
Audit Committee	Develop models	- Guides the work on stress testing. - Reviews the final Resilience Statement before Board discussion.
Project team	Project management	- Set up a dedicated project team. - Project planning activities e.g. meeting to discuss existing risk assessment, reverse stress testing; identifying stakeholders and the scope of the project; identifying information sources and allocating responsibilities.
	Gap analysis	- Analysis to identify required areas of Resilience Statement that are not covered in current reporting.
	Risk management	- Reviewing existing risk register and company's contingency plans for refinancing and credit facilities. - Identification of additional principal risks to the company's business model or operations for inclusion in Resilience Statement
	Research and data collection	- Research to develop approach to stress testing and developing reporting framework. - Identification of those risks which should form part of the resilience assessment and of reverse stress testing. - Building models for stress testing based on material risks identified.
	Communication	- Developing approach to collecting and processing information/data about material risks for reverse stress testing from across the company e.g. questionnaire - Prepare briefing packs for the Board to consider

Table 15: Expected costs of developing approach to enhanced disclosures and reverse stress testing for the Resilience Statement per parent company (2019 prices)

Approach to enhanced disclosures and stress testing	Type of staff	# of Employees	Hours/Time (% FTE or hours)	Wage (£/year)	Total cost per staff type (£)
Develop approach and models - project team	CFO	1	2%	663,088	£12,752
	Accountant	1	20%	81,985	£16,397
	Risk Manager	1	20%	83,628	£16,726
	Finance Professional	1	20%	83,628	£16,726
	Business, Research Analyst	1	20%	90,129	£18,026
	Administrative staff	1	2%	46,745	£899
	Audit Committee Chair	1	2	363	£725
	Audit committee members	3	2	341	£2,044
Total costs					**£84,294**
	Type of staff	**# of Employees**	**Hours**	**Wage (£/hr)**	**Total cost per staff type (£)**
Board meeting to approve approach	CEO	1	1	547	£ 547
	CFO	1	1	319	£ 319
	Directors (Board)	5	1	319	£ 1,594
Total costs					**£ 2,459**
Total costs per company					**£ 86,753**

134. We expect that the bulk of the costs would be incurred in developing reverse stress testing approaches and models. Our per company cost is around £87,000, or nearly one professional person year. One respondent during our consultation suggested that reverse stress testing models could cost between £50,000 and £150,000 placing our estimate near the middle of the range. Unfortunately, we do not have other data to validate this cost estimate and we will test this assumption in a future post-implementation review. However, under risk and uncertainties below we also show that the impact of changing this cost on the EANDCB is small.

Ongoing Costs to Businesses

135. Following the first year, we expect the cost of these activities to fall and that the main tasks will from the second year onwards will relate to data collection, updating analysis and reports, internal reviews, disclosure and publishing as described below. We expect the ongoing costs to businesses to fall into five categories:

- The time taken to collate and analyse necessary information regarding material risks.
- The time taken to identify relevant sets of risks, assess interdependencies, assess likelihoods of the combinations occurring and identify which sets of risks to use for reverse stressing; undertake stress testing and write up of findings.
- The time taken to draft/update the Resilience Statement.
- The time taken for internal review and quality assurance of stress testing and other reporting over short, medium, and long-term sections of the Resilience Statement.
- The time taken for director-level discussion of reporting, reading of documentation and sign-off process for the Resilience Statement.

136. Some of the costs, particularly related to reporting and sign off, are likely to be non-additional. For example, all companies are required to disclose their principal risks and uncertainties and make a Going Concern statement. And companies with a premium listing are required to produce a Viability Statement. So, it is likely that discussion of the Resilience Statement would replace other discussions, particularly those related to the viability statement. Therefore, for the 160 premium listed parents that currently prepare a viability statement we assume that there are no additional costs related to securing Board sign off for the resilience statement.

Table 16: On-going activities and tasks required to develop approach to enhanced disclosure and reverse stress testing

Main stages and sub-stages	Individual tasks involved at this level
Collating, processing and analysing information	- Reviewing information provided from across the whole group on material risks, including from subsidiaries. - Communicating with subsidiaries/other parts of the group as appropriate to refine/clarify information collected
Undertaking analysis for stress testing	- Identify relevant sets of risks, assess interdependencies, assess likelihoods of the combinations occurring. - Identify which sets of risks to use for reverse stress testing. - Update models for stress testing - Review and cleanse data to use in models. - Undertake stress testing and draft findings from analysis
Drafting of Resilience Statement	- Preparing layout and design of Resilience Statement report - Drafting narrative for each section of the Resilience Statement - Draft narrative to explain any significant judgement exercised by management to determine that there are no material uncertainties to the company being a going concern. - Draft narrative to explain any significant change since last published Resilience Statement
Internal review and quality assurance	- Review of results and assessment for stress testing - Review of data/modelling used for other parts of the report - Review of Resilience Statement report
Board discussion and sign off	- Review and sign-off of narrative to be included in Resilience Statement - Internal clearances and publishing of report - Publication of Resilience Statement

137. In total we expect ongoing costs to comply with the new requirements for the Resilience Statement of around £50,000 per company for stress testing; and around £5,000 each for drafting the statement itself and subsequent Board approval. We assume that there will be at least one Board meeting and one Audit Committee meeting (one hour discussion, one hour preparation time for each) where the Resilience reporting is discussed.

Table 17: Expected ongoing costs to comply with reverse stress testing requirements per parent (2019 prices).

Ongoing costs to parents	Type of staff	# of Employees required	Time (Hours)/FTE (%)	Wage (£/hr or £/yr)	Total cost per staff type (£)
Annual data gathering; collating, processing and analysing information	Accountants	1	5%	£ 81,985	£ 4,099
	Finance Professional	1	5%	£ 83,628	£ 4,181
	Risk Manager Professional	1	5%	£ 83,628	£ 4,181
	Business, Research Analyst	1	10%	£ 90,129	£ 9,013
	Administrative	1	2%	£ 46,745	£ 935
	Total cost				**£ 22,410**
Undertaking analysis for stress testing	Accountants	1	5%	£ 81,985	£4,099
	Finance Professional	1	5%	£ 83,628	£4,181
	Risk Manager Professional	1	5%	£ 83,628	£4,181
	Business, Research Analyst	1	10%	£ 90,129	£9,013
	Administrative	1	2%	£ 46,745	£935
	Total cost				**£22,410**
Internal review and quality assurance	CFO	1	5	319	£1,594
	Accountant	1	10	39	£394
	Finance Professional	1	10	40	£402
	Risk Manager Professional	1	10	40	£402
	Business, Research Analyst	1	10	43	£433
	Audit Committee Chair	1	2	363	£725
	Audit committee members	3	2	341	£2,044
	Total cost				**£5,995**
Total ongoing costs per company					**£50,815**

Table 18: *Expected ongoing cost relating to drafting the Resilience Statement, including long-term sections of the Resilience statement (2019 prices).*

Ongoing costs to parents	Type of staff	# of Employees required	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Drafting of Resilience Statement, including additional text on longer term risks	Audit Committee Chair	1	2	363	£725
	Audit Committee members	3	2	341	£2,044
	CFO	1	2	319	£638
	Accountants	1	5	39	£197
	Risk Manager Professional	1	20	40	£804
	Business, Research Analyst	1	20	43	£867
	Administrative	1	2	22	£45
	Total cost				**£5,320**

Table 19: *Expected ongoing costs to comply with new Resilience Statement requirements relating to Board discussion and sign off (2019 prices).*

Ongoing costs to parents	Type of staff	# of Employees required	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Board sign off	CFO	1	2	319	£638
	Directors (Board)	5	2	319	£3,188
	CEO	1	2	547	£1,093
	Total cost				**£4,919**

138. We expect UK subsidiaries to also incur costs. These relate to additional information that needs to be submitted to the Group. This could include information relating to risks that are not managed centrally, or additional data that is required for stress-testing. We estimate that there are, on average, 25 first tier UK subsidiaries per group. Table 20 sets out the cost to individual subsidiaries.

Table 20: Expected ongoing costs to comply with new Resilience Statement requirements per subsidiary (2019 prices).

Ongoing costs to subsidiaries	Type of staff	# of Employees	Time (Hours)	Wage (£/hr)	Total cost per staff type (£)
Information provision	Director (subsidiary)	1.00	2.00	319	638
	Accountant	1.00	10.00	39	394
	Administrative	1.00	5.00	22	112
Total cost per subsidiary					**£1,144**

Total monetised costs

139. Our total monetised costs capture one-off costs incurred in the first year of implementation and ongoing compliance costs for businesses. The FRC lab research cited earlier suggests that a significant number of companies, especially AIM or listed, may already be engaged in stress testing – even if they do not currently disclose the results. Our assumptions have been informed by the following findings of the FRC lab report[107]:

- Around a third of companies had carried out reverse stress testing in helping them to assess going concern.
- In the case of the viability statement, only 5 out of 27 (18%), made use of reverse stress tests to inform their assessment of viability.
- Stress-testing, i.e., not reverse stress-testing, was far more common with 21 out of 27 companies using it for the viability statement and 26 out of 27 companies using it for a going concern statement.
- The findings on stress testing more generally suggest that the capacity to do some form of reverse stress testing might be more prevalent.

Therefore:

- Our best scenario is one where 30% of companies already reverse stress test. And,
- A high-cost scenario where only 15% of companies already reverse stress test. And,
- A low-cost scenario where 50% of companies already reverse stress test.

140. Table 21 below sets out the additionality assumptions used to estimate total costs in the best case.

Table 21: Additionality assumptions used to estimate total costs in best case.

[107] https://www.frc.org.uk/getattachment/2b213ba8-b950-49e4-838d-d919cbcbd6e6/Going-Concern-and-Viability-Review.pdf

Stage	Type of cost	Additionality assumption	Number of additional companies incurring additional cost		Total
			Listed	*Not listed*	
Familiarisation	One off	Additional for all companies	180	570	750
Approach to enhanced disclosures and stress testing	One off	Either 15%,30% or 50% of companies already stress test and for these the costs is non-additional	126	399	525
Stress testing	Annual	Either 15%,30% or 50% of companies already stress test and for these the costs is non-additional	126	399	525
Drafting of resilience statement, including long term risks	Annual	Additional for all companies	180	570	750
Board discussion of resilience statement	Annual	Subsumes viability statement discussion required for premium listed companies	20	570	590

141. In the best case, we estimate a total PVC of approximately £365 million over the 10-year appraisal period, with an EANDCB of £42 million (range: £32 million to £50 million).

Risks and uncertainties

142. A key uncertainty within our analysis is the extent to which the costs estimated are likely to be additional. For example, some UK parent companies are already doing reverse stress testing on a voluntary basis. This includes companies which are within the scope of the Resilience Statement such as BP and Marks Spencer. Further, some banks and financial institutions within the scope of the new Resilience Statement are already required to do stress testing on an annual basis[108]. The Bank of England reports that eight banks and building societies are required to run an annual stress test[109] and some insurance companies are also subject to stress testing by the PRA. To address this, we have used a range for our estimates.

143. Another uncertainty relates to the cost of developing stress testing models, which we estimated to be a one off cost of £87,000 but one consultation respondent suggested could be between £50,000 and £150,000:

- If the cost of developing stress testing models is £50,000 then the EANDCB falls to £40.5 million, a reduction of £2 million.
- If the cost of developing stress testing models is £150,000 then the EANDCB increases to £45.5 million, an increase of £3 million.
- Overall, then varying the cost of developing stress testing models, within the range suggested by one stakeholder, does not affect the EANDCB by a great deal.

Differences with Consultation Impact Assessment

108 Please see Section 3: https://www.bankofengland.co.uk/stress-testing/2021/key-elements-of-the-2021-stress-test

144. The Consultation IA estimated that the costs of mandating enhanced disclosures that build on the current Going Concern and Viability Statements would lead to an EANDCB of £0.9m (2016 prices) or £0.95m (2019 prices). However, these cost estimates only included familiarisation costs and did not include costs related to stress testing because of evidence gaps.

a. The Consultation IA assumed familiarisation costs of £5,000 per entity. Following feedback our estimate of familiarisation costs is substantially larger at £11,000. This is largely due to the use of more realistic labour cost estimates. Whilst the hours estimated per report are less, they are more heavily weighted to senior and professional staff. We also set aside time for the Board to discuss the implications of the familiarisation and plan next steps.

b. The Consultation IA also assumed that the Resilience Statement would apply to 1,945 existing PIEs, whereas our estimates are based on 750 companies in scope.

145. We have refined the cost estimates presented in the consultation IA and included additional costs for internal auditing and quality assurance. We have also included additional costs for each subsidiary to reflect the cost of familiarisation with the Resilience Statement requirements well as the cost of collecting information and passing this to their UK parent company who is expected to publish the Resilience Statement for the entire group.

Appendix: Resilience reporting inputs into BIT calculator

One off costs

Familiarisation costs				
	Reporting year	Number	Unit costs	Total
Listed on LSE	2025	180	£11,068	£1,992,268
Not listed	2026	570	£11,068	£6,308,847
				£8,301,115

Approach to enhanced disclosures and stress testing							
	Reporting year	Number	Unit costs	Total	15%	30%	50%
Listed on LSE	2025	180	£86,753	£15,615,597	£13.3	£10.9	£7.8
Not listed	2026	570	£86,753	£49,449,390	£42.0	£34.6	£24.7
				£65,064,987			

Recurrent costs (£m)

Note: central case given only.

30%													
Annual costs													
Ongoing costs				1	2	3	4	5	6	7	8	9	10
	Reporting year	Number	Annual cost										
Listed on LSE	2025	180	£50,815	£6.40	£6.40	£6.40	£6.40	£6.40	£6.40	£6.40	£6.40	£6.40	£6.40
Not listed	2026	570	£50,815		£20.28	£20.28	£20.28	£20.28	£20.28	£20.28	£20.28	£20.28	£20.28
Annual costs													
Board sign off				1	2	3	4	5	6	7	8	9	10
	Reporting year	Number	Annual cost										
Listed on LSE	2025	20	£4,919	£0.10	£0.10	£0.10	£0.10	£0.10	£0.10	£0.10	£0.10	£0.10	£0.10
Not listed	2026	570	£4,919		£2.80	£2.80	£2.80	£2.80	£2.80	£2.80	£2.80	£2.80	£2.80
Annual costs													
Drafting statement				1	2	3	4	5	6	7	8	9	10
	Reporting year	Number	Annual cost										
Listed on LSE	2025	180	£5,320	£0.96	£0.96	£0.96	£0.96	£0.96	£0.96	£0.96	£0.96	£0.96	£0.96
Not listed	2026	570	£5,320		£3.03	£3.03	£3.03	£3.03	£3.03	£3.03	£3.03	£3.03	£3.03
30%													
Annual costs													
Subsidiary costs				1	2	3	4	5	6	7	8	9	10
	Reporting year	Number	Annual cost										
ted on LSE	2025	4500	£1,144	£3.60	£3.60	£3.60	£3.60	£3.60	£3.60	£3.60	£3.60	£3.60	£3.60
Not listed	2026	14250	£1,144		£11.41	£11.41	£11.41	£11.41	£11.41	£11.41	£11.41	£11.41	£11.41
Grand total				£11.06	£48.59	£48.59	£48.59	£48.59	£48.59	£48.59	£48.59	£48.59	£48.59

Summary of costs – central estimates

Measure	EANDCB (£m)	NPSV (£m)
Audit and Assurance Policy	5.1	43.8
Capital Maintenance and distribution policy	2.9	24.7
Reporting on measures to report and detect fraud	2.8	24.5
Resilience Statement	42.4	364.8
TOTAL	**53.2**	**457.9**

Notes: 2019 prices, NPV base year 2020, assumes costs begin in 2025

Benefits

146. Our approach to justifying the costs of this measure is twofold. Firstly, we set the evidence that reporting can change corporate behaviour; secondly, we set out break even analysis which sets out the size of the benefits required to justify the costs.

Evidence that corporate reporting can change behaviour

147. The academic evidence suggests that:

- Higher quality financial information is associated with improved management behaviour.
- Non-financial reporting can change corporate behaviour.
- High quality reporting can influence a firm's cost of capital and make investment less sensitive to cashflow.
- Poor company reporting by one firm may adversely influence the decisions of other firms.

Taking each in turn.

Financial information and management quality

148. **Poor quality reporting may allow managers to empire build or engage in risk averse behaviour which is not in the interests of shareholders**. Hope and Thomas (2008)[110] found that the passage of SFAS 131 in the US, which eliminated the need for geographic earnings disclosures, caused a decline in transparency about foreign operations possibly enabling greater scope for empire building. It found that, after the adoption of SFAS 131, firms that stopped disclosing geographic earnings experienced higher sales growth, but lower profits and firm values. Further, the results are concentrated in foreign investments, where the new regime most significantly impacts shareholders' ability to monitor the manager's investment decisions (Hope and Thomas 2008)[111]. Likewise, the analysis of Biddle (2009) below, is consistent with managers of cash rich firms engaging in empire building.

149. McNichols and Stubben (2008) find that firms experiencing SEC investigations, class action litigation, and restatements exhibit significant evidence of over-investment in fixed assets during the misreporting period. One interpretation of this result is that managers find it easier to engage in empire building when poorer reporting quality makes it more difficult for shareholders to monitor managerial actions. However, the authors' preferred explanation for this relationship is that firm managers who have the decision rights on investments believe the firm's own misreported growth trend and (over-) invest accordingly.

150. **Improvements in financial information are associated with higher management quality**. The US Centre for Audit Quality Pulse Poll: CFO Perspectives on the Sarbanes-Oxley Act[112] performed in 2017 surveyed 105 CFO's of publicly traded companies in the US and found that:

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110 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=997864

111 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=997864

112 CAQ Pulse Poll:CFO Perspectives on the Sarbanes-Oxley Act 0417_PulsePoll_CFO.indd (thecaq.org)

- 79% of CFOs who took part felt that the overall quality of information in audited financial statements had improved since the enactment of SOx.
- 85% believed the external audit of their company's ICOFR (internal controls over financial reporting) resulted in improvements in the company.
- 79% agreed that the benefits of SOx outweighed, or were at least equivalent to, the expense.

151. A similar, larger survey, carried out in 2008 found substantially fewer companies thought that the reforms brought net benefits. Alexander et al[113] analyse a survey of corporate insiders on the impact of SOX section 404 compliance. The survey was administered by the US SEC[114] between 2008 and 2009, and specifically asked whether the benefits of SOX compliance outweighed the cost of compliance. 19% of respondents to the survey perceived a net benefit from compliance in the most recently completed financial year (at the time of the survey) and 25% in the current year. **Taken together, these results suggest that management improvements from SOx took time to occur.**

152**. Firms with low reporting quality, and poor access to external finance, can invest in higher levels of disclosure to gain investment provided disclosures are credible** (Balakrishnan et al. 2014)[115]. But if firms voluntarily increase reporting quality and disclosure, disclosures may not be credible. Kausar et al. (2016)[116] exploit a UK regulatory change which exempted some private firms from a mandatory audit requirement. They find that firms continuing to provide audited financials even after the regulatory exemption can raise more capital and increase investment relative to control firms, and that this effect is concentrated among financially constrained firms. This may explain a finding in the audit literature where there is no evidence of a Big 4 premium for large firms, but there is one for smaller firms: if smaller firms want the signal associated with a Big 4 auditor (Ferguson et al 2013)[117].

153. **Businesses using more conservative accounting practices are likely to be more resilient**. Balakrishnan et al. (2016)[118] investigate the influence of financial reporting on investment in a period with substantially reduced capital supply, the 2007-2008 financial crisis. They find that firms with more conservative accounting practices prior to the crisis experienced a lower decline in investments during the crisis. Further, the effect is stronger among firms more dependent on external financing.

Non-financial reporting and corporate behaviour

154. There is evidence that **some non-financial disclosures change corporate behaviour**. Dyreng et al. (2016)[119] find that forcing firms to disclose the location of their subsidiaries disincentivises firms from locating subsidiaries in tax havens. Christensen et al. (2017)[120] show

113 Alexander et al (2013): https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=4660&context=lkcsb_research

114 SEC Study of the Sabanes-Oxley Act of 2002 Section 404

115 https://onlinelibrary.wiley.com/doi/abs/10.1111/jofi.12180

116 https://econpapers.repec.org/article/eeejaecon/v_3a62_3ay_3a2016_3ai_3a1_3ap_3a157-181.htm

117https://www.researchgate.net/publication/259550229_What_If_There_Were_Three_Audit_Pricing_within_the_Big_4_and_the_PricewaterhouseCoopers'_Premium_in_the_Australian_Audit_Market

118 https://onlinelibrary.wiley.com/doi/abs/10.1111/jbfa.12206

119 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2474346

120 https://www.sciencedirect.com/science/article/abs/pii/S0165410117300538

that requiring mine owners to disclose information about their mine-safety performance in their 10-K filings incentivizes mine owners to increase investments in mine-safety.

155. Rauter (2017)[121] finds that a law requiring European firms engaged in extraction activities (e.g., of oil, gas, and minerals) to provide detailed disclosures on monetary payments to foreign host governments led to an increase in such payments. This implies that the disclosure law impeded extraction companies' attempts to exploit the host nation by bribing government officials in charge of approving the projects to secure lower extractive payments. Interestingly, the paper also documents a decline in the extraction companies' investments in the host countries, possibly an unintended consequence of the now-reduced profitability of extraction projects.

156. **But not all non-financial reporting disclosures are value relevant**. Moneva and Cuellar (2009)[122] evidence that financial environmental disclosures (investments, costs and contingencies) are value-relevant, but non-financial ones are not. Furthermore, their evidence confirms that environmental information provided on a compulsory basis has recently become more value relevant. Ioannou and Serafeim (2017)[123] document a similar positive link for mandatory CSR disclosures. Yet, Plumlee et al. (2015)[124] shows that even firm's voluntary environmental disclosures are value relevant. Specifically, higher quality of such disclosures is associated with higher firm value through two channels: lower cost of equity capital and higher expected future cash flows. However, the results of Cho et al. (2015)[125] challenge the claim that CSR disclosures are positively valued by shareholders. Finally, Qiu et al. (2016)[126] find that value effects of CSR disclosures vary by the type of the disclosure: while environmental disclosures (more often studied in the literature) do not appear to be valued, firms that make higher social disclosures have higher market values, with the link being driven by higher expected growth rates in the cash flows of such companies, rather than by cost-of-capital effects.

High quality reporting can influence a firm's cost of capital and investment.

157. Research shows the cost of equity depends on institutional features in countries, which includes disclosure regulations.

158. Some empirical studies confirm a negative link between the quality of corporate reporting/disclosures and firms' cost of capital. For instance, Shroff et al. (2013)[127] document that following the regulatory reform relaxing US firms' restrictions on disclosures in the periods preceding security offerings, firms provide significantly more of such pre-offering disclosures, which are in turn associated with decreased costs of raising equity capital. Francis et al. (2005)[128] tests the prediction that firms more reliant on external financing are more likely to undertake higher levels of disclosure and that a higher level of disclosure should, in turn, lead to a lower cost of external capital. Using an international sample of companies from 34 countries, they document **beneficial effects of voluntary disclosures on cost of both equity and debt capital**. El Ghoul

121 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049941

122 https://www.researchgate.net/publication/225371218_The_Value_Relevance_of_Financial_and_Non-Financial_Environmental_Reporting

123 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1799589

124https://www.researchgate.net/publication/228278961_Voluntary_Environmental_Disclosure_Quality_and_Firm_Value_Further_Evidence

125 https://www.emerald.com/insight/content/doi/10.1108/AAAJ-12-2013-1549/full/html

126 https://www.sciencedirect.com/science/article/abs/pii/S0890838914000705

127 https://onlinelibrary.wiley.com/doi/abs/10.1111/1475-679X.12022

128https://www.researchgate.net/publication/228306345_Disclosure_Incentives_and_Effects_on_Cost_of_Capitol_Around_the_World

et al. (2011)[129] and Plumlee et al. (2015)[130] find a negative relationship between the quality of a firm's **voluntary** environmental and social disclosures and cost of equity capital, but Clarkson et al. (2013)[131] and Qiu et al. (2016)[132] find no such effect for environmental disclosures but do find one for social disclosures, and Richardson and Welker (2001)[133] find the relationship to be positive.

159. The cost of equity is negatively associated with extensive disclosure requirements. But this effect tends to be smaller in globally integrated capital markets (Hail and Leuz 2006)[134]. For example, research on the impact of SOx suggests that unaudited disclosures under S302 reduce market values and increase costs of equity whereas S404 disclosures elicit no market response, probably because accelerated filers subject to S404 operate in a more information rich environment (Beneish et al 2007)[135]. Other research also suggests that the new information in S404 disclosures is significantly less than S302 disclosures (Gupta et al 2017)[136].

160. Leuz and Wysocki (2016)[137] review early studies on the topic to argue that the empirical evidence on the negative link between corporate disclosures and the cost of capital is somewhat mixed, holding only for a) some firms or b) some types of disclosures, or c) in only some institutional contexts. For instance, Li (2015)[138] documents that firms domiciled in countries with **more conservative** financial reporting systems have lower cost of equity and debt capital. Daske (2006)[139] shows that adoption of internationally recognised financial reporting standards (IAS/IFRS or US GAAP) by German companies has not reduced the cost of capital for adopting firms as expected and has led to its increase.

161. Research shows that financial information increases information flows between firms and shareholders and can make investment less sensitive to cash flow:[140]

- The **higher quality of financial information, the less sensitive investment is to cash flow suggesting easier access to external capital**. This effect is stronger for countries where companies are more reliant on equity, as opposed to debt, finance (Biddle and Hilary 2006)[141]. Another study also finds a similar relationship for private firms i.e. lower investment sensitivity to cash flow as a result of higher quality financial information (Chen et al 2011)[142].

- Higher quality financial information **increases investment amongst financially constrained firms but reduces investment in cash rich firms** – perhaps because these cash rich firms over-invest (Biddle et al 2009)[143].

129 https://econpapers.repec.org/article/eeejbfina/v_3a35_3ay_3a2011_3ai_3a9_3ap_3a2388-2406.htm

130https://www.researchgate.net/publication/228278961_Voluntary_Environmental_Disclosure_Quality_and_Firm_Value_Further_Evidence

131https://www.researchgate.net/publication/228317884_The_Relevance_of_Environmental_Disclosures_For_Investors_and_Other_Stakeholder_Groups_Are_Such_Disclosures_Incrementally_Informative

132https://www.researchgate.net/publication/280265909_Environmental_and_social_disclosures_Link_with_corporate_financial_performance

133 https://www.sciencedirect.com/science/article/abs/pii/S0361368201000253

134https://www.researchgate.net/publication/336738217_Public_Information_and_Efficient_Capital_Investments_Implications_for_the_Cost_of_Capital_and_Firm_Values

135 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=896192

136 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3045882

137 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2733831

138 https://onlinelibrary.wiley.com/doi/abs/10.1111/jbfa.12121

139 https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1468-5957.2006.00611.x

140 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3429337

141 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=910806

142 https://meridian.allenpress.com/accounting-review/article-abstract/86/4/1255/68869/Financial-Reporting-Quality-and-Investment

143 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1146536

162. Generally, these studies, although they seek to control for other factors, cannot control for all factors which may be driving the investment results. For example, companies with the best managers may make the best financial disclosures and be the most investable. If so, it would not follow that a poorly run business would see more stable investment because of better financial disclosures.

163. To address this, several studies look at changes within firms' overtime. These support the premise that higher quality financial information leads to more efficient, though not always more, investment:

- For instance, Cheng et al. (2013)[144] use the remediation of internal control weaknesses to measure variation in financial reporting quality overtime. They show that (i) firms substantially under- and/or over-invest prior to the disclosure of internal control weaknesses, but (ii) these investment distortions are reduced following the remediation of internal control deficiencies.

- Dou et al. (2018)[145] exploit the adoption of SFAS 123R as an exogenous mandatory change in the information available to shareholders about employee stock options (ESOs). They report that financially constrained firms with the most unreliable estimates of ESO costs before the new rule experienced an increase in investment after the introduction of the new regime.

- Naranjo et al. (2019) use the adoption of IFRS as another change to the information provided to shareholders and find that firms increase financing and investment after the new regime.

While these studies are still susceptible to omitted variables (e.g., changes in growth opportunities), they mitigate concerns that their results are driven by unobservable factors such as managerial ability that are unlikely to change over short timescales.

Poor company reporting by one firm may influence the decisions of other firms.

164. **Financial disclosures by one firm potentially influences the decisions of other firms** e.g., customers, suppliers. High quality financial disclosures provide benefits to other firms; poor quality financial disclosures impose costs. Announcements of previously overstated earnings by one firm lead the restating firm's peers to reduce their investment (Durnev and Mangen 2009)[146]. Fraudulently overstated earnings of an (industry-leader) peer firm causes managers of other economically related firms to believe that future industry prospects are rosier than they truly are, which leads these firms to over-invest (Beatty et al. 2013)[147]. Another study shows that financial misstatements by one firm causes peer firms to over-invest significantly in R&D, Capex and Advertising by between 7% and 16% during the misstatement period (Li 2016).[148]

144 https://www.sciencedirect.com/science/article/abs/pii/S0165410113000165

145 https://pubsonline.informs.org/doi/abs/10.1287/mnsc.2018.3045

146 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1091475

147 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2197429

148 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2172074

165. Firms manage their earnings opportunistically to influence suppliers and customers to make larger relationship-specific investments (Raman and Shahrur 2008)[149]. Specifically, transactions between customers and suppliers often require specialized investments that have lower value outside the relationship (Williamson, 1979). The value of relationship-specific investments depends in part on the firm's expectation about the prospects of the customer/supplier because (i) the size of future transactions is likely correlated with the customer's/supplier's prospects and (ii) the period over which relationship-specific investments generate value depends on the customer's/supplier's survival. Thus, firms seeking relationship-specific investments from their customer/supplier have incentives to manage earnings to increase their customer's/supplier's willingness to make such investments. Raman and Shahrur (2008) provide evidence consistent with the above hypothesis by showing that customers and suppliers invest more in R&D (their proxy for relationship-specific investments) when firms report higher discretionary accruals.

166. Collectively, the inference from the above studies is that firms rely on the financial statements of their peers, which leads them to make better (worse) investment decisions when the reported information is accurate (inaccurate).

Break-even analysis

167. Responses to the previous consultation noted that the consultation IA did not provide monetised benefits for the proposed reforms. There were three reasons for this:

- Monetising the benefits of any audit reforms is challenging; as one study noted: *benefits assessments in interventions such as ours are "at least an order of magnitude more difficult than the task of estimating direct costs and are possibly beyond the present capacity of researchers to achieve with much precision*".[150]

- In part this is because we are dealing with uncertainty, not risk. In the case of uncertainty, either the outcomes and/or their probabilities of occurrences are unknown to the decision-maker[151]. We may believe that it is likely that in the absence of improved reporting another Carillion may occur, but we are unable to say what is the likelihood that it would occur nor what the impact of that would be.

- Under the better regulation rules only **direct** costs and benefits of a measure are included in the Equivalent Annualised Net Direct Cost to Business (EANDCB)[152]. To be classified as "direct" an impact must directly arise from the implementation of a measure. However, many of the benefits we anticipate arising from the reforms would not be classified as direct as they depend on numerous steps after the implementation of the regulatory measure.

168. The Carillion experience shows that the costs of insolvency can be substantial. As argued earlier, the purpose of the reforms is not to prevent companies from failing, as companies will fail often for good reasons such as not producing a product that consumers wish to buy at the price

149 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1089921
150 Coates, J. and Srinivasan, S. (2014), SOX after Ten Years: a Multi-disciplinary Review. Accounting Horizons, 28 (3): 627–671. https://doi.org/10.2308/acch-50759.
151 See, F Knight (1921) Risk, Uncertainty and Profit. https://www.econlib.org/library/Knight/knRUP.html?chapter_num=3#book-reader
152 See: https://www.gov.uk/government/publications/rpc-case-histories-direct-and-indirect-impacts-march-2019

being offered. The reforms aim to ensure that investors and other stakeholders have the information so that their business terms more accurately reflect the risks involved in dealing with different companies. In doing so, the measures should reduce the costs of insolvency: when companies fail, they do so with less investor or creditor capital tied up in them.

169. To assess the potential benefits of this approach we compare:

- The Equivalent Annual Net Direct Cost to Business (EANDCB) for the reform package is £53 million.
- The net liabilities of Carillion were nearly £4 billion. If these reforms reduced the cost of one Carillion like insolvency by 14% then that implies a benefit of £550m from any future similar collapse.

170. This suggests that if these reforms reduced economic losses by around 14% for at least one major corporate failure on a par with Carillion, every 10 years, then the reforms would break even. It is important to note that there have been at least three major UK corporate failures every decade since the 1990s. For example, Polly Peck (1990), Bank of Credit and Commerce International (1991), Barings Bank (1995), Equitable Life (2000), MG Rover Group (2005), Northern Rock (2008, RBS (2008), Carillion (2018), BHS (2018) and Patisserie Valerie (2019).

Impact on medium, small and micro businesses

171. The measure does not apply to companies with less than 750 employees and turnover of less than £750 million. It therefore does not pose direct costs on medium, small and micro businesses. However, these businesses can be at risk if a large corporate customer fails. By aiming to reduce losses from large corporate failures these measures will reduce losses incurred by small and micro suppliers of large corporates. This would be an indirect benefit. Medium, small and micro businesses are therefore likely to be net beneficiaries of these measures.

Wider impacts

Statutory equality duty

172. These measures apply to legal entities. We therefore do not expect any impact on the Convention rights of any person or class of persons arising from the measures assessed in this IA. Our view is that there would be no impact on race, disability, gender or any other protected characteristic from any of the measures in this IA.

Competition and Innovation Test

173. These measures apply to all PIEs that meet the 750 test which operate across all sectors and applies both to listed and unlisted entities. Thus, we do not consider that there will be any competition impacts. Impacts on innovation could be marginal and mixed at best: it is theoretically possible that the reporting requirements distract boards from discussions of a major innovation;

but discussions around resilience could equally prompt boards to discuss innovations to ensure the company's future sustainability.

Justice Impact Test

174. These measures do not create new offences.

Family Test

175. These measures are not expected to have any impact on family well-being.

Human Rights

176. These measures are not expected to have any impact on human rights.

Environmental Impact Test

177. These measures are not expected to have any environmental impacts.

Rural proofing

178. This measure is not expected to have any impact on rural communities.

A summary of the potential trade implications of measure

179. This measure will only apply to UK companies that meet the 750 test, therefore:

- Foreign companies based in other legal jurisdictions are not affected.
- Any foreign resident, that has an eligible UK company, is subject to the same requirements as UK residents that have an eligible UK company.
- If a foreign resident, that has an eligible UK company, wishes to avoid these requirements then they could reconfigure their operation as a branch of an overseas company, although the costs would be significant, and they would no longer benefit from limited liability.

This measure is not expected to have any impact on trade flows, either between partners, or in aggregate.

Monitoring and Evaluation

180. The regulator will be responsible for monitoring compliance with the reporting requirements and for making judgements on the quality of disclosures. The measure will be evaluated via a post-implementation review. The review will take place five years after the regulations come into force. It will seek to validate the cost assumptions used in this IA as well as provide early

evidence on the indirect effects of the regulation. The judgement on whether the regulations should continue will depend on performance against the success factors (see below).

181. One potential interaction with the review is the Government's on-going review of non-financial reporting[153] which may lead to future changes in reporting obligations or reporting thresholds.

Logic model

182. The intervention logic is as follows:

- Inputs: Government introduces reporting requirements which seek to ensure that investors and other stakeholders have improved information on the resilience of large corporates.

- Activities: companies generate information on matters relating to their resilience and other factors that will influence their resilience e.g. audit policies, capital maintenance.

- Outputs: companies report information to users. Users engage with companies to understand and test the information provided.

- Outcomes: the information presented by reporting companies and enable investors to better price risk. It may also affect corporate behaviour and change perceived risk profiles associated with companies that need to report.

- Impacts: Reduced economic losses to creditors and investors from insolvencies as investment in reporting companies, including the quantum and cost, more closely reflects the corporate risk profile.

183. The early stages of the intervention logic can be tested using qualitative research and analysis of existing data sets. Outcomes can be tested using surveys of users to test whether, and what, value do users place on the information provided by the disclosures. The greatest challenge for the evaluation will relate to impacts as changes in the economic environment will create noise. Especially, as the measures aim to reduce economic losses from insolvencies and not prevent insolvencies from occurring in the first place. However, if the evaluation provides good evidence that the information is valued and acted upon then that would give reasonable assurance that impacts are being achieved.

Success indicators

184. A non-exhaustive list of possible success indicators includes:

Logic model step	**Indicators**
Inputs	Companies' views on intelligibility of reporting requirements, guidance and support provided by regulator

[153] https://www.gov.uk/government/consultations/smarter-regulation-non-financial-reporting-review-call-for-evidence

Outputs	Number of companies producing information and proportion that are compliant. Companies' views on the costs of reporting.
Outcomes	Users' views on the usefulness of information, its impact on corporate behaviour and on the pricing of risk, the terms, and conditions of doing business and the impact it has on users' decisions.
Impacts	Impact on risk pricing. Reduced economic losses from insolvencies as investment flows better reflect risk.

Approach to evaluation

185. As a high impact measure we will take the following approach to evaluating the measure, via a post-implementation review, covering:

- Evidence from the regulator on compliance with the new reporting requirements and the quality and effectiveness of reporting.
- Research on the views of preparers and users of corporate reporting on the burdens and value of the new reporting requirements, including indirect effects, any unintended consequences or interactions with other related measures.
- A search of literature that might inform judgements about the effectiveness of the new reporting requirements. Further, whether the additional reporting influenced corporate behaviour.
- Estimates of users' valuation of measures and how they used the information to make investment and other decisions. This will inform judgements about impacts.
- Re-estimation of cost estimates and number of entities affected based on actual experience of reporting requirements. This will involve qualitative and quantitative research, involving companies required to report under the reporting requirements, including the development and application of stress testing processes.
- And based on the above, a judgement of whether the regulations have met their objectives and a recommendation of whether the regulations should be renewed, revised, removed or replaced.

Annex A: Parent companies not meeting 750 test and filing unconsolidated accounts

1. This annex considers how many parents might be eligible to report under the regulations where the parent files unconsolidated accounts and where no individual member of the group meets the 750 test, but that if the activities of all members were aggregated the group would meet the 750 test.

2. To identify these parents:

- Firstly, using FAME, we estimated the number of Domestic Ultimate Owners (UK parents) that did not meet the 750 test and whose parents were not individuals, Charities or Government. There were 9,508 of these.

- Analysis of the accounts type indicates that:

  - 1,930 DUOs filed consolidated accounts indicating that they could not have passed the 750 test, even if the entire group were aggregated.

  - 6,851 DUOs filed unconsolidated accounts, so it is possible in these cases that when aggregated, *including the activities of foreign subsidiaries,* the entire group exceeded the 750 test.

  - 727 DUOs had an unknown accounts type, so it is also possible in these cases that when aggregated, *including the activities of foreign subsidiaries,* the entire group exceeded the 750 test.

- So, in theory, up to 7,578 companies could be in scope of the regulations based on aggregating their subsidiaries.

- This is too many companies to review the entire ownership chain of each. To get a sense of how many additional companies might be in scope, we did the following:

  - Firstly, we identified how many of these DUOs who filed unconsolidated or unknown accounts passed at least one criterion of the 750 test. These are defined as “near misses” and there were 103 of them.

  - Cross-plotting the total turnover and employment of tier one subsidiaries belonging to near misses shows that two subsidiaries are large enough to bring their parents - Peugeot Motor Company Plc and Hitachi Rail Ltd - into scope.

  - However, group structures can be complex with multiple layers of subsidiaries. As there is no requirement to consolidate accounts of subsidiaries at different levels, and UK parents can claim a S401a exemption from consolidation if it has a foreign parent[154], it is possible that no company in the group ever consolidates. To test whether any of the 103 near misses would qualify in aggregate we manually examine all the subsidiaries up to level 10 for each company.

[154] Provided the overseas parents meets the standards of accounts required under Companies Act.

- The data is particularly incomplete, for example size data on foreign subsidiaries is often missing. Further, visual examination may double count if there are intermediate layers of consolidation. Nevertheless, our results suggest that:
    - The activities of 15 sets of subsidiaries, i.e. the subsidiaries of Peugeot, Hitachi and 13 other DUOs, look likely to qualify their DUO to report against the requirements in the SI.
    - There are another 28 cases where because of missing subsidiary data it is not clear whether the DUO would have to report.
    - There are therefore 60 cases where it looks likely that the DUO would not need to comply with the SI's reporting requirements based on the activities of their subsidiaries.

3. Unfortunately, it was not possible to carry out this exercise for all DUOs that file unconsolidated accounts, or where the accounts type is unknown. And based on the above results, the large data gaps would make the utility of the exercise highly questionable. <u>But what this exercise shows is that for the "near misses", where the greatest chance of a false negative is likely, there are relatively few parents filing unconsolidated accounts who would qualify based on the combined activities of their global subsidiaries</u>.