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To The Department for Business, Energy & Industrial Strategy ("the department"),

1. This letter is Protect's submission of evidence for the department's consultation on "Restoring trust in audit and corporate governance". It seeks to answer the following questions listed in the consultation (as therein numbered):

52.Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

75.Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?

2. The final section of this letter details Protect's view on section 11.7 "Whistleblowing" in the consultation document.

3. Please note that numbers in square brackets are references to the numbered paragraphs in the consultation document.

PROTECT – THE UK WHISTLEBLOWING CHARITY

4. Protect's aim is to protect the public interest by helping workers to speak up to stop harm and wrongdoing. We support whistleblowers by providing free and confidential legal advice. We support employers to implement effective whistleblowing arrangements. We campaign for legal and policy reform to better protect whistleblowers. We want a world where no whistleblower goes unheard or unprotected.

5. Since 1993, Protect has operated its free, legal Advice Line offering specialist whistleblowing advice to over 3,000 workers a year. We provide consultancy and training services for employers to improve their whistleblowing arrangements and in 2020 alone the employers we worked with had between them an estimated 1.3 million employees. These experiences inform our policy work in campaigning for better whistleblowing laws and public policy.

52.Do you agree that ARGA should be given the power to set additional requirements which will apply in relation to FTSE 350 audit committees?

6. Protect welcomes the government's proposal in Chapter 7 to give ARGA powers to set and enforce requirements as to an audit committee's role and to give ARGA regulatory powers where problems exist, such as when a persistent issue with audit quality is identified.

7. In Protect's view, however, these requirements should not be limited to an audit committee's function in appointing and overseeing an external auditor.[1] These

[1] As indicated at [7.1].

requirements should be extended to whistleblowing. Specifically, Protect envisages a role for ARGA to set and enforce minimum standards for an audit committee to follow with regards to whistleblowing.

8. An audit committee can play a key role in being the recipient of concerns from employees and workers of the audited entity. These concerns, which may relate to fraud or financial abuse/misconduct, can provide vital intelligence to the audit committee about wrongdoing for it to investigate and/or inform the external auditor.

9. The issue is that, save for employers in the health and financial services sector, there are no minimum standards that an employer must meet with regards to whistleblowing. The consequence of this is that whistleblower concerns are not properly handled or investigated in a way that protects whistleblowers and results in a meaningful investigation. Protect's whistleblowing bill proposes minimum legal standards for an employer, including establishing internal speak up arrangements, designating a senior manager with responsibility for whistleblowing, training staff, and taking proactive steps to prevent victimisation (please see p 4 here).

10. Our research into Covid-19 and whistleblowing (please see here) found that a worrying 41% of whistleblowers raising concerns of "furlough fraud" to their employer were ignored and in only 1% of cases was the concern resolved.

The following is an anonymised case study from our Covid-19 report:

Timothy works in the finance department of a small company. During his work organising the company accounts he noticed that he and 5 other members of staff (including a director) were placed on furlough leave. All the staff on the scheme were still working for the company.

Timothy raised his concerns with his line manager, the Finance Director. The response was to remove Timothy from the furlough scheme, but the line manager refused to remove anyone else as he felt bodies such as HMRC would not have the resources to prosecute all those companies that breached the rules.

11. In the above case study, whistleblowing standards would have provided Timothy with a route to escalate his concerns (such as to an audit committee), ensured that the employer engaged with the concern with a view to preventing the Finance Director from breaching the scheme, and provide relevant assurances to Timothy, such as confidentiality.

12. Minimum legal duties of the kind we suggest would provide a clear route for the whistleblower to raise concerns and give audit committees the competitive advantage of robust channels that identify risks to business early (of which the committee may otherwise have been unaware) so that any wrongdoing can be addressed. Whistleblowing intelligence assists an audit committee to fulfil its function of "reviewing the effectiveness of the audit" [7.1.3]. Information about such frauds is clearly relevant to an audit committee's work so standards set by ARGA can help to ensure consistent handling and investigation of whistleblowing across all ARGA-regulated entities.

13. In our Covid-19 report, we made six recommendations which included introducing legal standards on employers, introducing a penalty regime where an organisation

can be fined for breaching said standards, and requiring regulators to drive up whistleblowing standards in regulated entities. The latter two recommendations are particularly relevant and align with the intention of the government's proposals to, amongst other things, create auditing systems that encourage transparency and safeguard the interests of shareholders and others. Protect agrees with the government's proposal that any standards set by ARGA must be monitored and enforced in order to be meaningful. Where an audit committee is found to be in breach of the whistleblowing standards, ARGA could use some of the powers already proposed at paragraphs [7.1.17] and [7.1.18]. This includes, for example, requesting information and/or reports from the audit committee and taking action against company directors and/or the audit committee.

75.Do you agree that ARGA should have regard to these regulatory principles when carrying out its policy-making functions? Are there any other regulatory principles which should be included?

14. In order for ARGA to fully carry out its policy-making functions and have regard to the regulatory principles, it should be a prescribed person for the purposes of whistleblowing law. A prescribed person under UK whistleblowing law is an independent body which usually has an authoritative relationship with the organisation, industry or individual worker, such as a regulator or professional body. Prescribed persons include the Financial Reporting Council (FRC), the Financial Conduct Authority (FCA), and HMRC.

15. There are four reasons why ARGA should be a prescribed person. Firstly, ARGA is intended to replace the FRC and it is already prescribed. It is only logical and natural that the FRC's successor should also be a prescribed person. This will ensure continuity and certainty for whistleblowers, as well as the sector generally. If ARGA was not prescribed, the government would be actively creating a lacuna in the regulatory landscape that does not currently exist. This would be unjustifiable and run against the intention espoused in Chapter 10 to create a regulator that not only replaces but strengthens upon the FRC.

16. Secondly, whistleblowers more easily acquire protection under whistleblowing law where they disclose public interest concerns to a prescribed person.[2] This is significant because we know from our Advice Line that there are many reasons why a whistleblower may choose to disclose concerns to a regulator, such as protection from reprisal, distrusting the employer or being dissatisfied with the employer's response. As such, by being prescribed, whistleblowers are more likely to come forward with concerns knowing that they are more likely to have legal rights against victimisation. This encourages public interest concerns to be raised to, and addressed by, the regulator.

17. Thirdly, being prescribed is advantageous to ARGA. It means that it is more likely to receive information from whistleblowers about audit-related concerns so will have a more complete understanding of issues within the sectors and industries that it regulates. This can help ARGA to spot trends and use its regulatory powers to address such issues, achieving its proposed quality and competition objectives at [10.1.12].

[2] Under s 43F of the Employment Rights Act 1996, the whistleblower would need to show that the information they disclose is "substantially true" and satisfy the requirements in s 43B. If ARGA was not prescribed a whistleblower would instead have to satisfy the much stricter legal tests in s 43G ERA.

18. Fourthly, ARGA being prescribed is beneficial for the government. Since 2017, prescribed persons must produce an annual report giving the number of disclosures received and the general types of concerns. These reports can provide useful evidence for the government to assess the effectiveness of ARGA as a new regulator, as well as the whistleblowing framework more generally.

Protect's view on Chapter 11.7 "Whistleblowing"

19. In Chapter 11.7 "Whistleblowing", the government expresses the view that: (a) it disagrees that statutory auditors for PIEs be added to the list of prescribed persons and (b) it disagrees that whistleblower protection under the Public Interest Disclosure Act 1998 (PIDA) be extended to anyone with a direct economic relationship to the audited entity, such as suppliers, customers, and/or other creditors.

20. In relation to (a), Protect disagrees with the government and adopts the reasoning of the Brydon Review on this point, namely that it is a hindrance that a whistleblower's protection for disclosing directly to an auditor should be contingent on the procedures authorised by an individual employer's whistleblowing policy.[3] In addition, the four benefits of being prescribed as described above apply equally to statutory auditors. There is already precedent for external auditors to be prescribed as the external auditors of all local authorities in England are listed on the prescribed persons list. The government can follow this model and, by so doing, ensure there is a complete system for whistleblowing on audit-related concerns.

21. The government gives three reasons justifying its reluctance to make statutory auditors prescribed. Firstly, it says that there are risks of "abuse of process". The government should recognise that the reality of the situation is that a whistleblower can and will approach an external auditor with whistleblowing concerns whether that auditor is prescribed or not. The real issue, therefore, is the risks that arise by keeping external auditors off of the prescribed persons list. In our view, because a whistleblower's legal rights are less certain when disclosing to a non-prescribed person, they are more at risk. This can lead to a culture where whistleblowers are reluctant to speak up so concerns are not raised and addressed. This would defeat the purpose of trying to strengthen audit and corporate governance. Furthermore, it could lead to a rise in anonymous disclosures. It is much harder for a recipient of concerns to investigate anonymous disclosures as they cannot go back to the whistleblower to ask for further information. This can lead to an investigation being terminated early and, again, concerns will go unresolved.

22. Second, the government says that there are "risks around disclosure of commercially confidential information to the audit firm". In Protect's view, audit firms are very familiar with handling commercially confidential information which is, in fact, an ordinary and natural component of their duties. Furthermore, elsewhere in the consultation document, the government accepts that it is possible to put in place "appropriate safeguards … to deal with confidential information which the regulator [ARGA] obtains using these powers" [7.1.17] and "appropriate safeguards" would be needed for the regulator to view information covered by legal professional privilege [9.4.6]. It is disappointing that the government has not even considered the idea that appropriate safeguards could also be put in place to deal with auditors – in addition

[3] Please see paragraph 22.5 of the Brydon Review here.

to ARGA - receiving commercially confidential information directly from whistleblowers which, if considered, could allay the government's concern.

23. Third, the government says that "whistleblowing direct to auditors would instead be used as a vehicle for raising issues that were not within the scope of audit, putting an unnecessary burden on auditors". That objection can be answered by communicating clearly to whistleblowers what the role of the external auditor is and the types of concerns it will investigate. The external auditor can also triage disclosures at an early stage so that it directs whistleblowers with unrelated concerns to other, more appropriate regulators. Alternatively, the external auditor could make a referral of the concern to the appropriate regulator. Whistleblowers can seek advice before raising concerns so that they can be sure that they raise the right concern to the right regulator.

24. The government proposes instead at [11.7.3] that the FRC could consult on changes to requirements for auditors to communicate with a company's governance personnel on matters which the auditor should be made aware. The flaw with this solution is that it fails to address the possibility that governance personnel may either be complicit in wrongdoing or wish to conceal wrongdoing from an auditor. This is why whistleblowing intelligence is important as it provides information about public interest concerns from workers who are the eyes and ears of an organisation.

25. In relation to (b), Protect supports the idea that the scope of UK whistleblowing law should be extended. Our campaign – Let's Fix UK Whistleblowing Law – identifies the groups currently excluded who should have whistleblower protection.[4] In our view, it is perhaps too broad to expand the law to anyone with "a direct economic relationship with the entities being audited" as proposed by the Brydon Review. For example, customers and other creditors are either unlikely to suffer any form of victimisation or have other rights in law. Instead, we suggest that the law be extended in the present context to anyone with "a direct ***working*** relationship with the entities being audited". This would cover, for example, suppliers, partners and business associates of the audited entity and partners of the audited entity (if it operates a partnership structure).

26. Suppliers, partners and employer business associates are currently excluded from PIDA but can be vulnerable to detrimental treatment and/or loss of contract if they blow the whistle. This is particularly the case if the supplier is a sole trader or a small business reliant on a few key contracts with dominant larger companies. Yet these individuals may be aware of patterns and behaviours in a particular employer's procurement and tendering processes (possibly more so than the employer's own employees) that demonstrate procurement fraud or price fixing by the employer.

27. A 2020 study by PwC found procurement fraud accounted for 19% of frauds globally.[5] The lack of rights for suppliers, partners and business associates of the employer impacts on the public interest by limiting the ability for wrongdoing to be raised. The FCA currently requires financial service firms to have in place effective whistleblowing reporting channels to deal with reports from any 'person' (which covers suppliers, business associates and partners of an employer). This is a demonstrable model that can be replicated in the present context.

[4] Please see our campaign webpages for full details here.
[5] "Fighting fraud: A never-ending battle. PwC's Global Economic Crime and Fraud Survey" (2020) PwC

28. With respect to partners of the audited entity, in *Clyde & Co LLP v Bates van Winkelhof* [2014] UKSC 32 (Protect intervening), the UK Supreme Court established that members of limited liability partnerships can be "workers" (as defined in employment law) for the purpose of whistleblowing protection. The case left unresolved, however, whether partners in general partnerships can also be workers. As partners (of an audited entity) are in a strong position to become aware of wrongdoing and be victimised if they raise concerns, the law should be extended to offer them protection.

29. Protect acknowledges the government's commitment to conducting a review of the whistleblowing framework at [11.7.4] and requests the government provide a time scale for that review.

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