Think Ahead ACCA

Independent Review of the Financial Reporting Council – Call for evidence

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We offer business-relevant, first-choice qualifications to people around the world who seek a rewarding career in accountancy, finance and management.

ACCA has 208,000 members and 503,000 students in 179 countries, with approximately 75,000 members and over 70,000 students in the UK, and works to help them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 104 offices and centres and more than 7,300 Approved Employers worldwide, who provide high standards of employee learning and development. Through our public interest remit, we promote appropriate regulation of accounting, and conduct relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA is a Recognised Supervisory Bodies (RSB) for audit under Schedule 10 of the Companies Act 2006. The FRC, as the audit competent authority, delegates certain audit regulatory tasks to ACCA as an RSB under a Delegation Agreement. This places an obligation on the ACCA as an RSB to fund the FRC's performance of any tasks that have not been delegated where these relate to the regulation of auditors registered with ACCA. This funding covers the costs of the FRC's audit review activities, audit enforcement activities and standard-setting procedures.

We welcome the Independent Review of the Financial Reporting Council (FRC) and its aim to improve the current regulatory structures and ensure that these are as effective as they need to be in the current circumstances and for the future and to establish the FRC as a beacon for best practice in governance, transparency and independence. It is vital that the UK economy has efficient and effective capital markets and there is confidence in the corporate framework through greater transparency.

Our response comprises a number of key points which we consider to be fundamental to the call for evidence and which we would like to discuss with the review team. We also include responses to the individual questions posed in the call for evidence.

We welcome the opportunity to be involved as the review process progresses to support the development of a regulatory system that is proportionate, effective and credible and which operates to uphold the public interest.

Further information about ACCA's comments on the matters discussed here can be requested from Maggie McGhee (maggie.mcghee@accaglobal.com).

ACCA
+44 (0)20 7059 5000
info@accaglobal.com
www.accaglobal.com
The Adelphi 1/11 John Adam Street London WC2N 6AU United Kingdom

FRC PURPOSE AND FUNCTION

Function and structure

The first objective of the Independent Review is to ensure that the FRC's structures, culture and processes, oversight, accountability and powers are operating optimally. Trust and quality in financial reporting, audit, corporate governance, and investor stewardship are essential. They are critical to the functioning of financial markets, the economy and to public confidence. They are what the FRC is for. It is of the utmost importance that the FRC is seen to be sufficiently independent of those it regulates, and that it is able to effectively challenge failure to meet the standards of behaviour expected with agility and responsiveness. It is also important that the FRC focuses its attention on those entities that pose a systemic risk to the economy.

We believe that the scope and remit of the FRC needs to be more clearly defined. This should focus on the FRC's role as competent authority for audit and in particular, the audit of Public Interest Entities. This approach would be consistent with the written statement by Baroness Neville-Rolfe (Parliamentary Under-Secretary of State for Business, Innovation and Skills and Minister for Intellectual Property) in June 2015[1].

In order to support a more clearly defined scope and remit, structural improvement is necessary. The FRC was last restructured in 2012. The intention of this was to simplify its structure, focus its activities and reinforce its independence. It was felt that its previous structure, which constituted seven bodies, was inefficient and confusing. As a result, many of these bodies were discontinued and their functions subsumed by the FRC itself, with the technical expertise of the former bodies being replaced by a number of councils and committees. At the time, ACCA and many other respondents supported those changes. We responded at the time[2]

> *A more streamlined governance and structure would be welcomed. The division into two sectors – codes and standards, and conduct – would facilitate better understanding of the structure by stakeholders. ACCA has, for some time, maintained the view that the current seven-board structure of the FRC is far from ideal. It is the result of piecemeal changes in the past, and would certainly not be the chosen structure if designing a completely new FRC today.*

However, reluctantly we must now concede that the benefits of this new structure have not been fully realised. The added focus on the Financial Reporting Council Board has led to less clarity over the activities of the FRC in relation to its core responsibilities. There is evidence that the public is confused over where the responsibilities for regulation lie, how decisions are reached and how effective governance is exercised. For example, promoting the FRC brand has meant that some members of the public believe that it is the FRC Board itself that makes decisions over whether to pursue disciplinary cases in matters of the public interest. This is evidenced by media comments. This may in turn fuel misconceptions about the extent to which conflicts of interest exist between the FRC's governance and regulatory activities.

In this section we provide responses to question 1 to question 6.

---

[1] https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2015-07-20/HLWS137/

[2] https://www.accaglobal.com/uk/en/technical-activities/technical-resources-search/2012/january/frc-reform.html

Q1: What should the FRC's objective(s) be? Is its present mission statement the right one?

The FRC's current mission is to "promote transparency and integrity in business". This mission statement was introduced in 2017. The previous mission statement was to "promote high quality corporate governance and reporting to foster investment". We consider that the previous mission statement more accurately reflects the FRC's role and remit. The mission statement (based on our recommendations in this paper) should be defined by reference to the audit of Public Interest Entities (PIEs), financial reporting and corporate governance. In acting to achieve this mission, the focus of activities should be to meet their responsibilities as competent authority for audit and in particular, the audit of Public Interest Entities and it must therefore focus its attention on business that poses a systemic risk to the economy.

Q2: Does the FRC's name remain right?

We consider the remit and corresponding structure and functions of the FRC to be of paramount importance. The name of the organisation should reflect this. Potential changes to the name of the organisation should only be considered once the remit is agreed.

Q3: Are the functions and structure of the FRC still relevant and appropriate, or is there a case for any structural change? Should any of the FRC's functions move to other regulators?

It is critically important that the interaction between the FRC and other regulators within the UK is effective. We believe the answer to refocusing the FRC and enhancing the wider regulatory ecosystem would be met by introducing a board which includes senior representatives encompassing independent representatives and individuals from those engaged in the governance of other UK Regulatory Bodies (including the Financial Conduct Authority, Prudential Regulation Authority, The Pensions Regulator and the Insolvency Service). This oversight board would be supported by underlying boards which address the four key areas of the FRC; namely, audit, accounting, enforcement and corporate governance.

The role of the Oversight Board would be to ensure that there is appropriate and effective coordination between these boards and across the wider regulatory ecosystem, support collective responsibility and ensure that a holistic consideration of emerging issues was possible. This structure would help to ensure that the public interest is being served and is seen as being served.

The structure of the FRC should be independent of the profession, both within the Oversight Board (and other Boards) and on the secretariat. It is however important that within this there are people with sufficient experience of the environment being regulated. These underlying boards would address audit standard-setting, corporate reporting standard-setting, oversight of the audit regulation of PIEs, corporate reporting enforcement, and corporate governance. These should be given the autonomy and prestige necessary to restore public confidence in their respective functions.

In order to ensure appropriate focus on these activities the FRC should divest itself of all other activities.

We propose that responsibility for local public audit and for the regulation of the actuarial profession be transferred to other bodies as these responsibilities distract from the key responsibilities of the FRC which we consider (as outlined above) should be focussed on the on the FRC's role as competent authority for audit and in particular, the audit of Public Interest Entities

Q4: What lessons can be learnt from other countries regulatory systems?

There are a number of audit regulators which are highly regarded and are seen to be effective. These include the US Public Company Oversight Board, the Australian Securities and Investments Commission, the Singapore Accounting and Corporate Regulatory Authority, the Malaysia Audit Overnight Board and the Independent Regulatory Board for Auditors of South Africa.

However, we cannot identify a single audit regulator that has all of the ideal characteristics of a model audit regulator. Furthermore, most international audit regulators have other responsibilities in addition to audit regulation. Some are also responsible for regulating securities markets or operate under the supervision or oversight of securities market regulators. We therefore suggest that the inquiry refers to the audit regulators named above with a degree of caution.

Q5: How effective has the FRC been in influencing its wider debates that affect its ability to deliver its objectives – for example, around audit competition, or its legal powers??

We believe the FRC has been effective in influencing international debates on audit standard-setting (for example, in leading the development of extended auditor reporting) and is seen as world-leading in its guidance on corporate governance. It is also seen globally as an audit regulator to emulate.

The FRC was heavily engaged in the development of the European Union Audit Regulation and Directive of 2014, which was transposed into UK law via the Statutory Auditors and Third Country Auditors Regulation in June 2016. This increased the powers of the FRC's regulatory regime.

However, following the collapse of Carillion the FRC has subsequently publically requested more powers. In the FRC response to the Work and Pensions and BEIS Joint Select Committee report on Carillion3, the Chief Executive Officer highlighted areas where additional powers would support their activities. This indicates that the FRC has been reactive rather than

[3] https://www.frc.org.uk/getattachment/83bd34ec-2f5b-4d62-80d6-11944c702e47/FRC-Response-to-Carillion-Select-Committee-030718.pdf

proactive in influencing the debate and in fully utilising the existing powers that it has.

Q6: Is the current balance between cross-cutting reviews and firm-specific investigations most effective?

We support the use of a variety of approaches by the Competent Authority to enhance audit quality. The FRC, as the Competent Authority, is responsible for the on-going monitoring and mitigation of risks in the wider audit market and therefore firm specific investigations are critical to meeting this objective. The impact of wider thematic reviews and wider research pieces (such as the reviews of extended auditor reporting) has led to improvements in audit quality and auditor reporting. This approach is replicated by other regulators.

IMPACT AND EFFECTIVENESS

This section considers what changes would enable the FRC to be seen as a world class regulator which is able to take effective action to deter and act on breaches and which incentivises compliance.

In answering this section, we reviewed the Regulators' Code, issued in 2014 by the Better Regulation Delivery Office of the then Department for Business Innovation & Skills. This sets out six criteria which regulators should follow when performing their duties:

- Regulators should carry out their activities in a way that supports those they regulate to comply and grow
- Regulators should provide simple and straightforward ways to engage with those they regulate and hear their views
- Regulators should base their regulatory activities on risk
- Regulators should share information about compliance and risk
- Regulators should ensure clear information, guidance and advice is available to help those they regulate meet their responsibilities to comply
- Regulators should ensure that their approach to their regulatory activities is transparent

The first of these criteria is important: it establishes that regulatory activity cannot focus solely on compliance. In the case of the FRC, we understand 'growth' to mean activities to enhance audit quality and thereby encourage market entrants by facilitating confidence in the market.

In this section we provide responses to question 7 to question 25.

Q7: What are the FRC's strengths and weaknesses

The FRC works effectively with the International Standard setters and in supporting the development of robust global standards. The wellbeing of the interconnected global economy is predicated on the basis of robust, comprehensive, high quality and transparent financial reporting, auditing and ethical standards.

Monitoring results prior to 2018 had indicated improvements in overall quality however the most recent monitoring results demonstrate a fall in overall quality within the Big 4 accountancy firms and improvements in the mid-tier firms inspected.[4]

At the same time public confidence in audit is decreasing and large corporate failures have led to a lack of confidence in the regulator by Parliament and by the wider public. The FRC must therefore focus its attention on business that poses a systemic risk to the economy.

The responses to the individual questions provide an assessment of the strengths and weaknesses of the FRC under its current structure.

Q8: The recent joint report on Carillion from the Business, Energy and Industrial Strategy and the Work and Pensions Select Committees considered the FRC to be characterised by "feebleness and timidity" and recommended that a change of culture and outlook is needed. Do you agree? If so, please cite relevant evidence which informs your view?

The aims of this review will necessitate changes within the FRC and the successful implementation of these changes will require cultural change. The board and senior leadership have governance responsibilities and are best placed to drive corporate culture.

The Select Committee considered the wider effectiveness of the FRC and areas that fell outside of its remit. We agree with the select committee's assessment that 'the FRC has no business intervening in the day-to-day management of companies' and we can conceive of no mechanism by which this could reasonably change. The activities covered by the FRC's regulation – auditing, financial reporting, corporate governance and enforcement – all aim to encourage better corporate behaviour, which should in turn make corporate failure less likely. But it is no guarantee. So the prevention of corporate failure should not be the sole metric by which the FRC's performance is judged.

Q9: Are there changes respondents would like to see to achieve the vision set out in the Review's terms of reference?

There have been calls for the FRC's powers to be extended in order to ensure the effective oversight of non-accountant Directors who exert influence over financial statements. We would strongly support the regulation of all directors of Public Interest Entities. It does not however follow that such responsibility should rest with the FRC and it may be more appropriate for this responsibility to rest with the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). This would support transparency and in dependence and ensure that the regulation of audit and auditors was separate from the regulation of corporates and directors.

[4] https://www.frc.org.uk/news/june-2018/big-four-audit-quality-review-results-decline

The audit committee is a central tenet of effective corporate oversight and they play a vital role in capital markets' investor protection. We believe that the audit committee's role and the accountability mechanisms supporting the effective operation of their functions should be further considered. This should go beyond the provision of guidance and support a constructive engagement and enhanced accountability. Currently, both the FCA and PRA undertake some elements of this function. This should be reviewed and enhanced. The resulting responsibilities do not however need to sit with the FRC and there are logical arguments for the separation of the regulation of audit and auditors from the regulation of corporates and directors.

The FRC has a specific role under the Public Interest Disclosure Act 1998 (as does the PRA) as a body to which people can report concerns in relation to matters within the scope of the FRC's regulatory duties. This very important role is communicated via a single page on the FRC website. We propose that the FRC should see what may be learned from other regulators, such as the PRA, on how to promote this vital function more widely to potential whistle-blowers.

Q10: Are arrangements for financial reporting, audit and corporate governance the critical elements for effective delivery of FRC's mission, or are elements missing?

Arrangements for financial reporting, audit and corporate governance are critical elements for the effective delivery of FRC's mission. As outlined in question 9, the specific role of the FRC under the Public Interest Disclosure Act 1998 is also a vital element.

Audit Regulation

Audit has a vital role in underpinning confidence and trust in the capital markets. However, the regulator and the wider profession must also do more to improve the understanding of the purpose and value of audit.

Q11: How effective is the FRC at driving quality improvements in audit? What further improvements would respondents like to see?

This is a vital part of the FRC's mission, as it means firms are incentivised to think about innovations that may increase audit quality, rather than solely focusing on avoiding censure. Despite being a requirement of the Regulators' Code, the FRC's activities in this area do not seem to have achieved appropriate recognition from Parliament and the public, and we would welcome actions being taken by the FRC to support greater publication and awareness of its activities. This could include greater use of the annual Quality Report to highlight areas of identified improvement and best practice.

Further work is required to ensure that business – and, vitally, the general public –understand what audit is and what it is not. One promising approach is to think about the psychology of audit. ACCA has undertaken research in this area (Banishing bias: audit, objectivity and the value of professional scepticism)[5]. This research recommended changes to the standard-setting, regulatory and audit processes to improve and encourage audit quality and tackle cognitive bias, allowing for a more holistic approach that encourages market participants to think actively about cognitive bias – underlying behavioural drivers that could influence decision making – and take steps to minimise its impact on audit quality.

Q12: Where quality does fall short, do the FRC's interventions have sufficient impact and deterrent effect?

The existing powers of the FRC have impact and act as a deterrent. The regulatory regime must be transparent, consistent, accountable and proportionate. It is important that regulatory regime encourages innovation and supports continual improvement in the audit process but does not deter suitable entrants (both at a firm and individual level) from entering the market.

Q13: What force is there in the concern of some that the FRC may be too close to the "big 4"? Or that the FRC is too concerned with the risk of failure of one of the "big 4"?

There is a perception that the FRC is not entirely independent from the auditing profession and is too closely aligned to the major firms. This view appears to be based not on the funding that the professional accountancy bodies provide to the FRC but on the number of personnel recruited from the major firms, some of whom hold senior positions within the FRC. We recognise, however, that to be effective, the FRC has to employ staff who are as knowledgeable and as experienced as those that the FRC regulates. There is therefore no realistic alternative to recruiting staff from the major firms.

However, we believe that the FRC could do more to safeguard against this potential threat to its independence. For example, careful consideration should be given to the application of the principle of separation of powers. This might suggest that senior FRC staff, who may have been recruited from the major firms, should not have seats on the FRC committees that set standards or consider conduct.

It is positive to note that very few of the FRC board members have worked in major audit firms and those that have left those firms three or more years ago, as required by the EU Statutory Audit Directive. We believe that the FRC should do more in defining appropriate safeguards to protect its independence from the major firms and in publicising the existence and operation of those safe-guards.

We were very pleased to note the publication of the Register of Interests in 2017 covering both FRC Board members and members of the FRC Committees. We were similarly pleased to note that the FRC Bible has a section on conflicts of interest. However, it does not cover how potential

[5] https://www.accaglobal.com/content/dam/ACCA_Global/Technical/audit/pi-banishing-bias-prof-scepticism.pdf

conflicts of interest arising from previous employment and long association are to be safeguarded. Simply disclosing potential conflicts is not sufficient: the FRC must specify how it deals with them. An example of disclosing the existence of potential conflicts of interest without disclosing how they have been dealt with is the close family relationship of the Chief Executive disclosed in the Register of Interests.

Q14: Are investigations of audit work effective, transparent, satisfactorily concluded and unfettered?

As outlined above, we consider that the FRC could do more to enhance the transparency of its work. In part, giving greater autonomy to the individual regulatory functions would help provide greater clarity of purpose. It is important that the FRC is given the time to undertake a thorough review and that it is defended from external interference while conducting its investigations.

Q15: Could a different regulatory strategy or tactics result in greater avoidance of harm?

Please see comments to other questions in this section.

Q16: Could or should the FRC's work promote competition and a well-functioning audit market? Does the FRC's work undermine competition or a well-functioning audit market in any way?

Yes. The FRC should seek to promote a well-functioning audit market which provides and promotes choice for the large and listed companies.

Q17: Can questions regarding the effectiveness of the FRC be separated from the wider question on whether change is needed to audit arrangements to take account of shifting expectations?

An assessment of the effectiveness of the FRC as a regulator can only be considered based on the current audit environment and in accordance with existing auditing standards (International Standards of Auditing (UK)).

A wider assessment of audit arrangement and the changing expectations on auditors is timely. In ACCA's further research on audit[6] we have identified the key tensions in the audit process and a guide to the features that a quality audit should possess, recognising that these features can be interrelated and sometimes act in tension. Balancing these tensions requires extensive consultation with stakeholders, drawing on their viewpoint of the role of the audit, and the value of the process to company, stakeholder and society.

[6] https://www.accaglobal.com/gb/en/professional-insights/global-profession/Tenets-of-quality-audit.html

Accounting and financial reporting

Q18: Has the FRC been effective in influencing the development of accounting standards internationally as well as accountable and effective in setting UK GAAP?

Yes. The FRC works effectively with the International Accounting Standards Board and has worked effectively in setting UK GAAP. It is important that responsibility for both the endorsement of International Standards and the setting of UK GAAP sits with the same body in order to support consistency, clarity and efficiency. UK GAAP is substantially consistent with the principles of global standards, subject to the constraints of the needs of different users and the cost/benefits of preparation by entities other than listed companies.

Q19: How else could the FRC improve the quality of financial reporting with a view to ensuring investor confidence?

Corporate reporting should provide a holistic picture of the performance of a business, beyond just showing investors its financial performance. In order to provide this, investors need more information on the business and the business model; management's view of the business outlook and prospects; strategy and intentions and performance, measured against both financial targets and the non-financial operational objectives that are used to manage the business and are often more leading indicators than the lagging financial ones.

In addition, there are other stakeholders who are interested in the corporate track record, whether that concerns the entity's contribution to society more generally or to important societal objectives, such as limiting the effects of climate change or environmental degradation. Longer-term financial performance is influenced by these considerations.

The International Integrated Reporting Framework is one mechanism of providing such information.

The FRC should ensure that this wider holistic view of corporate performance is considered across all of its interventions.

Q20: Are there wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders?

Please see response to question 19.

Q21: Is the current combination of statutory and voluntary methods of oversight for professional bodies effective, and do they remain fit for the future?

The current statutory arrangements for the oversight of the professional bodies reflect the changes effected in 2016 from the EU Statutory Audit Directive and Regulation 2014. At present the arrangements appear to work reasonably well.

We have, however, recommended that the FRC should focus on matters of public interest and therefore the regulatory tasks delegated to the professional bodies in respect of non-PIE audits should be subject to a degree of oversight consistent with the low level of risk to the public. We also believe that this is an appropriate time to review the voluntary arrangement between the professional bodies and the FRC. This includes the Accountancy Scheme as well as oversight of the non-audit regulatory activities of the professional bodies.

Corporate Governance and Stewardship Codes

Q22: In relation to the UK Corporate Governance Code, are there issues relevant to the Review's terms of reference that respondents believe the Review should consider?

Corporate governance is a means to support companies (including non-company organisations) to achieve their long-term success. It supports economic efficiency, sustainable growth and financial stability. A legislative mandate helps to level the minimum standard in governance practice. However, where companies understand and embrace the purpose of corporate governance, they can and should go beyond what law and rules require them to do.

Government and regulators needs to show stronger support for voluntary measures which improve corporate governance. The enforcement of superficial targets is not a substitute for a principles-based approach to corporate culture which tackles issues at the root cause.

Q23: How effective has the Stewardship Code been in driving more and higher quality engagement by institutional investors? If not, why? How might quality of engagement be further strengthened?

We support the FRC's work to improve the effectiveness of the Stewardship Code (2010) in order to enhance the quality of engagement between investors and companies. We consider regular company/shareholder engagement to be vital to a strong accountability structure in the listed company sector. Shareholders that are engaged regularly in a company and its performance are more likely to exercise powers on pay or any other matters.

The Government should consider proposals to increase the effectiveness of the Stewardship Code to ensure investors comply. These include, but are not limited to:

- Encouraging all institutional investors to publish a statement on their website on the extent to which they have complied with the Code;

- To notify the FRC when they have done so and whenever the statement is updated; and

- To name in the statement an individual who can be contacted for further information and by those interested in collective engagement.

In respect of institutional investors and large asset managers, the existing voluntary regime appears to be effective. Many asset managers have voluntarily signed up to the Stewardship Code. The FRC's recent initiative to rank signatories based on the quality of published reports should further encourage positive behaviour.

Q24: Do respondents view the FRC as reluctant to undertake investigations or enforcement, or able to do so at speed?

The speed and agility of the FRC does not meet market needs and does not allow for a timely consideration of the issues, root cause analysis or wider market impact. It is important that enforcement activities are adequately resourced and can address the increasingly complex issues which are presented and reduce challenge of bias or lack of robustness.

It is important that the differing roles of regulators in investigations are fully co-ordinated. This would enhance the effectiveness and speed of investigations. This would require the Review Team to consider the combined roles of all regulators and how these can be used to greatest effect.

Q25: How could the FRC better ensure it is able to take swift, effective and appropriate enforcement action? What practical or legal changes would be needed to achieve this?

As outlined above, there have been calls for the FRC's powers to be extended in order to ensure the effective oversight of non-accountant Directors who exert influence over financial statements. We would strongly support the regulation of all directors of Public Interest Entities. It does not however follow that such responsibility should rest with the FRC and it may be more appropriate for this responsibility to rest with the Financial Conduct Authority and Prudential Regulation Authority. This would support transparency and independence and ensure that the regulation of audit and auditors was separate from the regulation of corporates and directors.

Actuarial oversight

Q26: Have the arrangements put in place following the 2005 Morris Review stood the test of time, or is there a need for change? Should actuarial regulation be a focus for the Review's work?

As outlined above, we propose that responsibility for the regulation of the actuarial profession be transferred to other bodies as these responsibilities distract from the key responsibilities of the FRC which should be focussed on the on the FRC's role as competent authority for audit and in particular, the audit of Public Interest Entities.

FRC AND CORPORATE FAILURE

The FRC is responsible for the regulation of statutory audit and for the Corporate Governance Code and the Stewardship Code.

In relation to the FRC's powers, we would recommend that the FRC has a few powers that it exercises really well rather than a broad set of powers that it uses vaguely. While the FRC has consistently called for more powers, we do not believe the case for them has been fully made and we suggest that progress is made in fixing the structural issues first rather than trying to change both structure and powers at the same time.

We believe the decision as to whether to investigate should be based on regulatory need. As such, we think there is merit in exploring whether the current approach, under which the FRC investigates some cases itself and instructs the relevant professional body to investigate others, should be reformed. For example, given the public interest in ensuring effective enforcement, it would be appropriate for HM Treasury to fund all public interest investigations, with HM Treasury subsequently receiving all fines and penalties for surrender to the Consolidated Fund. This would help support public confidence that it is the public interest, rather than possible recoveries that is the main driver in deciding whether to investigate.

This new model of funding would provide transparency and seek to mitigate concerns regarding the independence of its enforcement activities.

It is important that enforcement activities are adequately resourced and can address the increasingly complex issues which are presented and reduce challenge of bias or lack of robustness.

This section considers question 27 to question 33.

Q27: Is there more the FRC could or should do to help reduce the risk of major corporate failure?

The issues surrounding corporate failures are multi-faceted and we should guard against looking at single issues as proposed solutions may have unintended consequences.

We consider that relations between the FRC and various other regulators need to be strengthened. One organisation may lead on certain aspects but there needs to be a collective responsibility and an end-to-end view. The review outcome should encourage more information-sharing between regulators.

Q28: Is the FRC quick and effective enough to act on warning signs arising from its work on accounts and financial reporting or on evidence of concerns over poor corporate governance?

The engagement of the FRC on accounts and financial reporting is by its nature retrospective. However, we consider that the FRC should ensure that it discharges its existing responsibilities role under the Public Interest Disclosure Act 1998 as effectively as possible. We suggest that in the first instance the FRC should see what may be learned from other regulators, such as the PRA, on how to promote this vital function more widely to potential whistle-blowers.

Q29: Is there a case for a more "prudential approach"? If so, how could this operate in practice, and to which category of company might such an approach apply?

This approach would align to that adopted by other regulators. However, in assessing this it would be important to consider the costs, practicalities and inherent limitations in this approach. We consider that the remit of the FRC should focus on Public Interest Entities.

Q30: Introduction of the viability statement was an important development, but could it be made more effective?

We consider the introduction of the Viability Statement to be a positive development however the successful implementation is dependent upon the underlying process and the completeness of disclosures. The Financial Reporting Lab of the FRC issued a report in November 2017 'Risk and viability reporting[7]'. We would endorse the recommendations in this report.

Q31: Are there gaps in the FRC's powers? Would its effectiveness be improved with further (or different) powers?

As outlined above in response to question 25, we would strongly support the regulation of all directors of Public Interest Entities. It does not however follow that such responsibility should rest with the FRC and it may be more appropriate for this responsibility to rest with the Financial Conduct Authority and Prudential Regulation Authority.

Q32: Are the FRC's powers coherent in relation to those of other regulators?

Please see the response to question 27 and the need for the interaction between the FRC and various other regulators to be strengthened.

Q33: Taking account of Sir Christopher Clarke's review of sanctions, and subsequent changes, does the sanctions regime now have the right deterrent effect? Does the FRC make best use of the sanctions at its disposal?

The updated sanctions guidance issued following Sir Christopher Clarke's review has only just taken effect and therefore it is too early to gauge their application. However, we consider the range of potential sanctions to be appropriate and support acting as a deterrent effect.

[7] https://www.frc.org.uk/getattachment/76e21dee-2be2-415f-b326-932e8a3fc1e6/Risk-and-Viability-Reporting.pdf

Sanctions are by definition a reactive approach to addressing failings. We would strongly support a wider review on the purpose of audit. Auditors are called on to simultaneously follow rules and judgement - which do not always align. Standard-setters also reflect this in the way they prioritise them when drafting new standards. Balancing the tensions requires extensive consultation with stakeholders, drawing on their viewpoint of the role of the audit, and the value of the process to company, stakeholder and society.

THE FRC'S LEGAL STATUS AND ITS RELATIONSHIP WITH GOVERNMENT

The review is seeking input to the FRC's legal status and its relationship with government. The nature of regulators (and the requirement for operational independence) is not in conflict with its designation as a public body. Our response in this section consider how best to balance operational independence and appropriate levels of oversight and accountability.

This section considers question 34 to question 36.

Q34: Should the Government legislate to put the FRC on a more conventional consolidated statutory footing?

Yes. Given the uncertainty in the past over whether the FRC is a public body, it would seem appropriate to ensure that it is now established on a more conventional consolidated statutory footing. This could also enhance transparency and provide more stringent, structured and established mechanisms of accountability.

We agree that in carrying out its functions, it is important that the FRC acts with appropriate independence, as appears to be the position currently.

In our submission to this call for evidence we have recommended that the FRC be divested of some of its non-core responsibilities to enable it to focus on statutory audit and corporate governance. We believe that this streamlining of its responsibilities should enable it to better define its relationship with government.

We are concerned, however, that the FRC's status as a public body should not result in it being hindered in discharging its responsibilities: it needs the operational freedom to discharge its responsibilities effectively, including being able to recruit, remunerate and retain specialist staff. To be effective, the FRC has to employ staff who are as knowledgeable and as experienced as those that the FRC regulates.

Q35: What is the optimal structure for the relationship between the FRC and the Government, best balancing proper accountability with enabling the FRC's effectiveness?

As outlined to question 34, the independence of the FRC is –and will remain - of critical importance.

The nature of the FRC's proposed remit means that it should continue to operate at arm's length from government. It currently (and in the future) would meet all three tests to support this assertion[8]. Namely, that is

- It performs a technical function
- Its activities require political impartiality
- It needs to act independently to establish facts.

In order to reflect this requirement, we would consider the use of Non-Departmental Public Body status as the most appropriate vehicle to provide statutory oversight and accountability whilst not impinging on operational independence. The current status as a company limited by guarantee is not in conflict with this.

Q36: In terms of the FRC's broader accountability, is there a case for further transparency in its actions or functions?

The FRC's designation as a public body should require the FRC to be subject to the same high level of financial discipline as that of other government entities as outlined in the HM Treasury publication 'Managing Public Money'[9] which offers guidance on how to handle public funds.. This should include the adoption of the 7 Nolan Principles of Public Life[10]. These relate to selflessness, integrity, objectivity, accountability, openness, honesty and leadership.

The designation of the FRC as a public body may result in the appointment of the Comptroller and Auditor General (C&AG) as the statutory auditor. This would include the provision of an audit opinion on the regularity of expenditure. This designation would also provide the opportunity for C&AG to undertake value for money reviews on the economy, efficiency and effectiveness of the FRC in discharging its statutory responsibilities. This would provide transparency and enhance accountability.

GOVERNANCE AND LEADERSHIP

As noted above, we do not believe the 2012 simplification of the FRC's structure has achieved the desired benefits and it has led to a lack of focus over the specialist regulatory functions. As a result, we support a re-designed and simplified structure which ensures cross-collaboration between the different regulators in operation within the UK. We consider that this will improve transparency with stakeholders and wider society.

This section considers question 37 to question 41.

Q37: How effective is the current leadership and Board of the FRC? Please cite relevant evidence which informs your view.

[8] https://www.gov.uk/guidance/public-bodies-reform
[9] https://www.gov.uk/government/publications/managing-public-money
[10] https://www.gov.uk/government/publications/the-7-principles-of-public-life

We believe the FRC leadership has been effective in supporting the development of standard setting and in establishing the FRC as world-leading by international comparators.

However, in the FRC response to the Work and Pensions and BEIS Joint Select Committee report on Carillion11, the Chief Executive Officer highlighted areas where additional powers would support their activities. This indicates that the FRC leadership has been reactive rather than proactive in influencing the debate.

This is also true of the piecemeal growth of the FRC in recent years. Additional responsibilities have been accepted by the leadership and Board without a proper assessment of whether the FRC had sufficient capacity and capability to undertake the additional responsibilities or whether there was a more suitable place outside of the FRC.

As noted, earlier in the response the current leadership and Board are not operating effectively to support cross regulator collaboration and co-operation.

The proposed structure outlined in the first part of this response would support a more stream lined approach to the activities.

Q38: Is the Board's composition appropriate? Is it the right size? Does it have appropriate membership?

It is important that the overall composition of the Board provides a breadth of experience has a wide range of skills and capabilities and adheres to the highest standards of governance.

Although the FRC chairman and deputy chairman are appointed by the Secretary of State, the FRC Board has the authority to appoint its own members through the Nominations Committee. However, the Nominations Committee is appointed by the Board and comprises the FRC Chair and Deputy Chair and the Chairs of the Conduct Committee, the Codes & Standards Committee, the Audit Committee and the Remuneration Committee.

While we appreciate that The Nominations Committee will make decisions on board appointments with the assistance of an independent assessor we believe that it is inappropriate and contrary to good governance for any board of directors to determine appointments to that board.

Q39: Is the balance of decision-making between the Board, its Committees and the Executive described in paragraphs 34-36 above right, given relevant legal constraints?

As outlined earlier in the response, we do not consider the last restructure of the FRC in 2012 realised the benefits proposed. The added focus on the Financial Reporting Council Board has led to less clarity over the activities of the FRC in relation to its core responsibilities. There is evidence that the public is confused over where the responsibilities for regulation lie, how decisions are

[11] https://www.frc.org.uk/getattachment/83bd34ec-2f5b-4d62-80d6-11944c702e47/FRC-Response-to-Carillion-Select-Committee-030718.pdf

reached and how effective governance is exercised. For example, promoting the FRC brand has meant that some members of the public believe that it is the FRC Board itself that makes decisions over whether to pursue disciplinary cases in matters of the public interest. This is evidenced by media comments. This may in turn fuel misconceptions about the extent to which conflicts of interest exist between the FRC's governance and regulatory activities.

Q40: Is the Board's structure appropriate, including given the FRC's roles on standard setting, assessment and enforcement? Does the Board's accountability appropriately reflect its role and functions? Are its decisions appropriately transparent, bearing in mind the need to balance public interest and confidentiality?

As outlined in our response to question 3, we consider that the board should include senior representatives encompassing independent appointees and individuals from those engaged in the governance of other UK Regulatory Bodies (including the Financial Conduct Authority, Prudential Regulation Authority, the Pensions Regulator and the Insolvency Service). This oversight board would be supported by underlying functions which address the four key areas of the FRC; namely, audit, accounting, enforcement and corporate governance. These would address audit standard-setting, corporate reporting standard-setting, oversight of the audit regulation of PIEs, corporate reporting enforcement, and corporate governance.

The role of the Oversight Board would be to ensure that there is appropriate and effective coordination between these boards and across the wider regulatory ecosystem, support collective responsibility and ensure that a holistic consideration of emerging issues was possible. This structure would help to ensure that the public interest is being served and is seen as being served

Q41: How should the Executive's effectiveness be assessed and ensured?

The performance assessment of the Executive is for the Board to determine. However, this should draw on best practice and seek to draw on a combination of both quantitative and qualitative measures.

FUNDING, RESOURCES AND STAFFING

The review is seeking to determine whether the FRC has sufficient resource, skills, experience and capacity to deliver against its current (and future) responsibilities. As outlined above, we believe that the objectives of the review will be achieved by agreeing a clearly defined remit which focuses on the FRC's role as competent authority for audit and in particular, the audit of Public Interest Entities. In order to deliver this remit it should be provided with the necessary funding and resources to undertake these defined activities.

This section considers question 42 to question 44.

Q42: Who should fund the FRC, and how? What are the impacts of current funding arrangements, including of having a partially voluntary funded regime?

Until recently, the FRC was funded by a mix of sources, including accountancy firms, companies and government. Government funding was reduced and ultimately eliminated. Given the importance of the FRC's regulation to the public interest, we believe the complete withdrawal of government funding has had unfortunate consequences: it has led to the public perception that the FRC is dominated by those that it seeks to regulate. Restoring the government's share of funding would both provide independent resources to support the FRC's vital regulatory functions and also serve to counter the impression that the subjects of the FRC's regulation are influential over its funding and governance. In particular, as noted above we propose that the investigation process in relation to public interest entities should be funded wholly by government, with fines and penalties being remitted to HM Treasury and subsequently to the Consolidated Fund.

Q43: What skills are needed for the FRC to be most effective? Does the FRC have the people, skills and resources it needs, of the quality it needs?

In order to exercise its supervisory role effectively, it needs specialised staff with recent, senior experience of audit and wider skills encompassing new technologies, communication skills, attention to detail and empathy. Some suitable candidates may be dissuaded by the public scepticism and hostility over staff with recent experience in audit firms transferring to the regulator.

Q44: Are there conflicts of interest in the FRC's structure, processes, or culture? Are there deficiencies in the FRC's approach to managing conflicts of interests?

We were very pleased to note the publication of the Register of Interests in 2017 covering both FRC Board members and members of the FRC Committees. We were similarly pleased to note that the FRC Bible has a section on conflicts of interest. However, it does not cover how potential conflicts of interest arising from previous employment and long association are to be safeguarded. Simply disclosing potential conflicts is not sufficient: the FRC must specify how it deals with them. An example of disclosing the existence of potential conflicts of interest without disclosing how they have been dealt with is the close family relationship of the Chief Executive disclosed in the Register of Interests.

OTHER MATTERS

Q45: Are there any other issues relevant to the terms of reference that respondents would like to raise?

The challenges and opportunities posed by technological advancements (including but not limited to data analytics, robotics and Artificial Intelligence) cannot yet be fully ascertained and we should not seek to standardise nascent practices while the full benefits may not yet have been realised. This review should therefore recognise the possibilities of technology whilst simultaneously maintaining the quality of the existing reporting, auditing and regulatory environment.

There are no further matters that we wish to raise.

We welcome the opportunity to be involved as the review process progresses to support the development of a regulatory system that is proportionate, effective and credible and which operates to uphold the public interest.

Further information about ACCA's comments on the matters discussed here can be requested from Maggie McGhee, Director, Professional Insights (maggie.mcghee@accaglobal.com).