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EXECUTIVE SUMMARY

Introduction

ICAS welcomes the opportunity to contribute to the FRC Review and to submit its views on the future focus and direction of the FRC, or a successor body.

There is much in the current role and operations of the FRC that works well. In this submission we have looked to build on the core strengths of the FRC, while addressing areas where we feel change would be beneficial.

While ICAS has many members who work in practice and across business and industry sectors, and who will be affected by any change to the accountancy, audit and PIE regulatory regimes, we work primarily in the public interest. It is this public interest that drives our proposals.

We hope this submission will support the goals of the Review and remain available to discuss it further.

Bruce Cartwright
Chief Executive

A New Purpose and Focus

1. In future, the Financial Reporting Council (the FRC), or a successor body, should have a new purpose and be focused on generating and maintaining enhanced public trust in Public Interest Entities (PIE companies).

The global landscape has changed. We are no longer simply concerned with the regulation of auditors, or the members of six professional bodies, but rather with the wider stewardship and financial reporting of those companies that are deemed core to the UK and global economies.

The FRC should therefore be refocused around a new core purpose, which is to provide high quality regulation of PIE companies. The more historical lens of the accountancy and audit profession therefore becomes a subset of the new FRC purpose.

To achieve this aim, ICAS considers that the roles, responsibilities and resources of the FRC should be refocused around four key activities.

These four activities are:

- Corporate Governance
- Financial Reporting
- PIE Audit Regulation
- PIE Director Enforcement

This will allow for the building of a strong framework which engages PIE companies, auditors and investors in a joint enterprise to achieve the highest quality of corporate governance of PIE companies, and it is the key to future success.

2. The enforcement arrangements currently in place for qualified accountants who sit on PIE boards should be extended to all directors who exert influence over the preparation of the financial statements. The current voluntary FRC Accountancy Scheme should be discontinued. Short term transitional arrangements could be put in place for any cases not yet concluded, and future cases which involve members of the Profession (who are not PIE directors) would still be subject to the disciplinary arrangements of the accountancy bodies.
3. All FRC activities which are not deemed necessary for the delivery of its core purpose should be discontinued, including the general oversight of the accountancy and actuarial professions. By general oversight we mean all non-audit regulation. Insolvency and taxation should not be matters for the FRC. Cessation of local audit oversight would require government support.

The FRC would retain an oversight role for statutory company audit, maintaining supervision of four Recognised Supervisory Bodies (ICAS, ICAEW, ACCA and CAI) and five Recognised Qualifying Bodies (ICAS, ICAEW, ACCA, CAI and AIA). The oversight of the profession should also be consistent with the principle of proportionate regulation.

GOVERNANCE AND TRANSPARENCY

4. To support a refreshed FRC, the governance arrangements should be simplified and enhanced as follows:

- A reduced main board composition, with between five and ten executive and non-executive board members, selected from a diverse range of candidates.

- A wider governance framework (which is accountable to the main board), should also be considered and aligned with the key activities of the FRC.

- This wider governance framework should include the establishment of new Advisory Boards to provide relevant and current insight and expertise, whilst allowing executive and board independence to be maintained. A new FRC needs to remain “fresh” in its approach to regulation and have access to the most current and relevant expertise available. These Advisory Boards should be advisory, meaning their views need not be followed, but they would help support the working teams, as well as the FRC board, to ensure that decisions and policies of the FRC are well informed, credible and, above all, respected.

- All key executive decisions which impact on regulatory outcomes should be capable of review, and have possible routes of appeal. The long-term success of any regulator is determined in part by how well its activities and outcomes are respected by those it regulates. Appropriate arrangements should be set up to allow for this.

- Clarity is needed around the wider accountability of the FRC and its Board to government and parliament. Again, the long-term success of a regulator will depend on how it is perceived by the government that approves its purpose and provides its powers. Any future reporting framework should therefore be reviewed in the light of the future roles, responsibilities, powers and legal status accorded to the FRC. We consider that the reporting to BEIS remains appropriate, but could be enhanced in a similar way to the FCA reporting arrangements to the Treasury.

PEOPLE

5. The relationship between powers and people is often very important. Those charged within the new FRC with performing and overseeing the activities relating to PIE governance, financial reporting, audit regulation and director enforcement should be able to demonstrate access to or experience of working at a senior level. They should also possess the necessary expertise to both challenge and inform the regulated community. Consideration therefore needs to be given to how to best resource the FRC for the future.
FUNDING

6. With a more focused role as gatekeeper of the capital markets in the UK, and new powers over directors, the FRC cannot retain its current funding dependency on the accountancy profession (presently 48%).

A future funding model should reflect the new purpose, and focus on wider community of PIE companies, investors and auditors, with consideration being given to the following:

- Preparers and Investors – the current voluntary levy (based on market capitalisation) should be reviewed to deliver a mandated levy arrangement, with a broader funding model that captures PIE companies and investors.

- Accountancy Bodies – the bodies that are subject to oversight for statutory audit regulation should continue to fund the costs of such oversight (which should not be disproportionate), and remain committed to making a contribution towards the costs of financial reporting activities.

- Auditors – the audit firms that are subject to PIE audit regulation by the FRC should contribute to the costs of financial reporting and audit regulation, through their audit registration fees and AQR inspection fees (or a new single combined fee). Further consideration could be given to the direct payment of PIE audit registration fees and AQR inspection fees to the FRC, rather than via the Recognised Professional Bodies.

7. We understand that the FRC may presently rely on the Financial Conduct Authority (FCA) for the billing of the Preparers Levy, and therefore current debt recovery sits with the FCA and not the FRC. Funding powers should be aligned with the organisation, and this current arrangement appears to be an anomaly which should be addressed for the future.

DEVELOPMENTAL REGULATION – A PROACTIVE REGULATOR

8. In its Corporate Reporting Review work, the FRC seeks to ensure that the provision of financial information by public and large private companies complies with the relevant reporting requirements. This work is an area where the FRC could become a successful developmental regulator and/or respond promptly and proactively to emerging issues.

9. The evolution of corporate reporting and financial accounting standards over the past years has put greater focus on management (i.e. PIE director) judgements and audit partner assessment of those judgments. Many of these judgments are forward-looking, and of significant importance to those in the capital markets who are users of corporate reports and the associated audit opinions.

10. In the current AQR process there is an increasing focus on audit file documentation, at a time when demand for management and auditor judgement is increasing. If the AQR is to add real value, there needs to be a shift away from an assessment of audit quality (as evidenced by the audit files), to a more balanced assessment of documentation and judgements; possibly extending to whether the audit opinion is sound. In the event of corporate failure, this is the question that everyone asks. It might as well be the starting point for the regulator’s response.
11. Thematic reviews are a strong development source for PIE companies and auditors. Sharing good practice between audit firms is a positive way to improve audit quality. Absent a benchmark for what high quality audit looks like, PIE companies and audit firms do not always know what the FRC expects of them. A developmental regulator should be able to clearly articulate where the bar is.

NEW INITIATIVES

12. There is substantial evidence that the capital markets signalled issues with the strategy and operation of some high profile corporate entities which failed, well in advance of their actual collapse and any historic intervention by the FRC.

13. The establishment of a new Capital Markets Intelligence unit within the FRC would create an early warning approach, allow for earlier intervention, and improve the prospects of avoiding ultimate corporate failure. With an intelligence gathering and monitoring role, it would offer the FRC more flexibility and support; similar to intelligence gathering activities undertaken by the Listing Authority.

14. Consideration should be given to the current whistleblowing arrangements for PIE officers and employees, with changes being made where appropriate to ensure that adequate protections are in place to encourage concerns to be voiced at the appropriate time. People could make a strong contribution to the future management of systemic risks.

ICAS considers that the combination of the oversight supervision by a Capital Markets Intelligence Unit, the powers of the Corporate Reporting Review (formerly the FRRP), and the prospect of better internal whistleblowing arrangements for PIE companies should help the FRC to proactively challenge companies and flag issues of concern, and possibly avert avoidable business failures.

ROLE OF THE PROFESSIONS

Through their ethical behaviour, members of the Professions are a force for good in the organisations in which they work. They can also influence those around them, and thereby help shape the culture and values of their organisation. The cumulative effect of their influence can help reinforce the importance of ethics at the core of business practices, and of a more responsible and holistic approach to business. ICAS will continue to promote high ethical standards through our publications in relation to the Power of One. Working alongside the training firms, we remain committed to ensuring the CA training continues to promote the relevant knowledge, skills, values and attitudes that will help shape board culture in the future.
IN SHORT - THE KEY PRIORITIES

The FRC, or a successor body, should be:

- The gatekeeper to the capital markets in the UK. It should be focused on maintaining public trust in business and the audit profession. Its roles, responsibilities and resources should therefore be focused around PIE companies and their key stakeholders, including investors and auditors. All other activities that do not support this core objective should be discontinued.

- Able to take enforcement action against all directors of PIE companies, and not just professionally qualified accountants. Members of a unitary board should be treated equally.

- Adequately resourced, with funding arrangements that promote a reduced dependency on the accountancy profession. A broader funding model, which includes PIE companies, investors, auditors and professional bodies, should provide the FRC with access to increased funding, allow it to attract and recruit the right skills, and ensure that it is financially independent from the accountancy bodies and those it regulates.