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17<sup>th</sup> February 2017.

Dear Sir / Madam

**Draft Plan & Budget and Levy Proposals 2017/18**

We welcome the opportunity to comment on the Financial Reporting Council's (FRC) Draft Plan & Budget and Levy Proposals for 2017/18 (the draft Plan). The FRC's willingness to consult on the draft Plan (and the related stakeholder engagement through open meetings, etc) is to be commended, and we look forward to understanding feedback received from this consultation and how the FRC has adapted its final plan in the light of that feedback.

**Do you have any comments on our proposed priorities and work programme for 2017/18?**

Generally we support the priorities articulated by the FRC in the draft Plan. For completeness, the FRC might include in its list of proposed initiatives the planned review of the UK Corporate Governance Code (the Code) announced on 16<sup>th</sup> February (which does not currently appear as a planned initiative on page 5 of the draft Plan).

We do not comment further in this response on aspects of the draft Plan that we support. Further, our comments below are not intended to suggest that we disagree with the FRC's approach, but rather are intended to encourage the FRC to consider whether it could or should aim to achieve more given its authoritative position in the UK.

*In terms of corporate governance and stewardship, the FRC might consider whether, in advance of (but without "second guessing") the outcome of the open BEIS consultation on its Green Paper on Corporate Governance Reform, the FRC could encourage better or more consistent practice without making a formal change to the Code itself.*

As an example, the BEIS consultation highlights the extent to which companies give adequate regard to the interests of other stakeholders in the performance of their

fiduciary duties (as required by s172 of the Companies Act 2006). We believe that greater transparency (through disclosure) as to stakeholder groups regarded by the Board as significant (in the specific circumstances of the company and its business model) and how the Board had discharged its obligation to have regard to the interest of those stakeholders would require, at least in some cases, additional focus by the Board and enable greater understanding by stakeholders (even if any individual stakeholder might still consider that inadequate regard had been given to their interests). The FRC could stimulate better practice simply by formally and publicly encouraging such disclosure without having to change the Code itself.

*The FRC might seek to identify barriers to company – investor dialogue in particular areas.*

We frequently hear Audit Committee chairs observe that they are never contacted by investors and investors observe that companies do not engage on certain corporate reporting, accounting or audit related issues. This is notwithstanding, we believe, a willingness on both sides to engage if this increases transparency and trust. The FRC might address how this relatively straightforward engagement could be encouraged to the extent it is not happening effectively at present.

*Whilst we believe UK corporate reporting to be “leading edge” in many respects, the basic form of the annual report – front end narrative and financial statements – is largely unchanged over many years. Given the current focus on directors’ responsibilities and the questions being asked as to the level of public trust in corporate Britain, now may be the time to consider this more holistically. Whilst the form of corporate reporting is largely defined in company law the current focus on directors’ responsibilities and stakeholder needs provides the ideal opportunity to consider whether the UK regime could be further improved.*

In our view there are two central questions, namely in relation to the role of the annual report in the corporate reporting matrix and the adequacy of the information that it provides to relevant stakeholders.

Annual reports are generally aimed at investors, but of course much of the information provided therein is also of value to other stakeholders. Whilst the content of the annual report has evolved over time through initiatives such as integrated reporting and the introduction of the strategic report in the UK, investors still obtain much information from other sources – such as preliminary announcements, investor presentations, etc. This begs the question as to whether channels other than the annual report are the most appropriate for conveying important information, particularly when information provided through other channels may be less accessible and / or visible to investors (and other stakeholders) other than large institutions. Further, information presented via these channels is generally not subject to assurance, notwithstanding it may be important to investors.



Questions therefore arise as to:

- Whether investors (and, potentially, other stakeholders) receive the information that they need;
- Whether the form and timeliness of receipt of this information is appropriate;
- Whether assurance needs to extend beyond the financial statements if information outside the financial statements is important to decision making.

In the absence of the FRC leading on an initiative to consider the adequacy of the current corporate reporting model, it is hard to see that any other body with sufficient convening power would be in a position to do so.

*We note that the priorities for 2017/18 do not include specific reference to reporting by smaller listed companies and question whether, assuming that the FRC does not consider that desirable improvements have taken place, this should be an area of continuing focus.*

In 2015, the FRC issued discussion paper on improving the quality of reporting by smaller listed and AIM quoted companies and provided an update on its work in this area in June 2016. Assuming that this area remains of interest to the FRC, it would be helpful to understand how it intends to take forward this aspect of its work in 2017/18.

*In relation to the quality of audit, we welcome the FRC's statement (in its recent 'Developments in Audit' update) that it would seek to understand the differences between Audit Committee Chairs' (ACCs) views on quality, the views of investors and the views of the FRC itself.*

Whilst we believe the quality of audit is generally good, we recognise that there is always room for improvement and that exceptions arising from inconsistent quality do not help build confidence in the value of audit. Factors that ACCs (and audit committees generally) consider as a demonstration of the robustness of challenge from the audit and other aspects of "quality" may not be visible directly to investors, and anything that can be done to increase transparency in this area is to be welcomed.

*Whilst not an easy question, we believe the FRC has a key role to play in enhancing understanding of the nature of an audit and considering whether the current statutory audit meets the needs of investors.*

The current model for audit is tried and tested, and any change would need to be made only after very careful consideration. However, it remains the case that the question of whether audit "did the job people thought it should do" in the financial crisis remains largely unanswered whilst at the same time there remains a perception, at least in some quarters, that "audit failed".

The latter sentiment suggest that there continues to be an expectation gap as to the role of the audit as it is currently undertaken under ISAs, for example its role in detecting fraud, potential company failure (although the latter has been mitigated with the introduction of the viability statement), poor controls and / or poor governance. The FRC has a role to play in helping increase awareness as to what an audit is and what it is not, since perpetuation of that expectation gap will not help to instil public confidence in audit.

Beyond this, however, consideration of whether the audit should and could be developed to provide broader assurance at an acceptable cost is a subject which would require much broader engagement, and the FRC is the logical authority to convene a more extensive debate on this.

**Do you have any comments on our proposed effectiveness indicators?**

Generally we believe the indicators to be appropriate. However, the FRC might consider:

- Whether a focus on “the quality of reporting by audit committees on corporate reporting and audit quality matters and on FRC regulatory interventions” places undue emphasis on this aspect of reporting rather than on the overall quality of reporting by the Board (particularly since the intention in relation to the quality of reporting in relation to risk management and control appears to be limited only to the proportion of companies providing a clear and longer term perspective).
- Related to both the preceding point and to our comment on corporate governance above, whether the FRC might monitor the extent and quality of Board reporting on stakeholders regarded as significant and how the Board has discharged its obligation to have regard to their interests.

Finally, we would suggest that the FRC should not restrict itself to focussing solely on the indicators identified in the draft Plan when reporting on progress for 2017/18, if others also appear appropriate.

**Are there any areas where the FRC could reduce its proposed activities without reducing the overall impact of FRC regulation?**

No, the areas appear appropriate.

**Are there any significant risks to the quality of corporate governance and reporting in the UK which are not addressed in the proposed work programme?**

We do not believe that radical change is necessary in any of the areas subject to the FRC's jurisdiction at this time.



This is particularly the case in the light of current uncertainty for business; actions that will inevitably arise from the BEIS consultation on corporate governance and the FRC's own planned review of the Code; and, in the case of audit, the significant changes following on from the recently implemented EU Audit Directive and Audit Regulation (including the revised Ethical Standard). Rather, as envisaged originally in the FRC's Strategy for 2016/19, we would support embedding recent change / completing work in hand and reviewing progress in, say, two to three years' time, rather than making further changes at this time.

**Do you have any comments on our proposed budget?**

It is pleasing to see that the FRC's current expectation is that it will achieve efficiency savings of £0.5m against its budget for 2016/17 (1.5%) and is targeting a similar absolute saving (£0.5m) against its budget for 2017/18. We note, however, that even assuming this saving is achieved in 2017/18, the increase against 2016/17 current forecast will represent 5.5% (or 6.4% excluding case costs) in a low inflationary environment.

We recognise the increasing obligations and demands on the FRC by virtue of it being sole competent authority for audit in the UK and as a result of increasing public expectations and the resultant cost pressures this creates and believe that it is important that the FRC is funded sufficiently well to enable it to discharge its mandate.

However, the level of detail provided by the FRC does not really enable any understanding of whether this budgeted increase is appropriate taking into account both increased demands and the challenge of seeking to operate efficiently. To that end it would be helpful in future to understand in more detail both the impact of incremental workloads and the initiatives being taken to achieve efficiencies.

In addition, it would be helpful to have a longer term projection of how the FRC envisages its cost base might change and the additional opportunities for efficiency rather than focussing solely on the coming year only.

In so far as the level of reserves is concerned, the FRC is clear on its target – six months operating costs, but less clear on why six months – rather than (for example) three or nine months – is the appropriate period. Given the increasing level of reserves, it would be helpful for the FRC to clarify this.



**Do you have any comments on our proposed levy rates?**

Our only observation in relation to the proposed levy rates follows from the point above regarding a longer term perspective on cost increases. In a similar vein, it would be helpful for all those funding the FRC to understand the extent to which the FRC considers the basis of allocation between funding sources might differ from the overall projected increase over a similar period.

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Please do not hesitate to contact David Matthews (contact details above) should you have any questions relating to the content of this letter. We would be happy to elaborate on its content if that would be helpful and look forward to supporting the FRC in its work during the year ahead.

Yours faithfully

*KPMG LLP*  
