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August 28, 2015

Stephen Haddrill
Chief Executive
Financial Reporting Council
125 London Wall, 8th Floor
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Reference: Financial Reporting Council Consultation: *Audit Firm Governance Code*

Dear Mr. Haddrill;

CFA Institute,[1] in consultation with its Corporate Disclosure Policy Council ("CDPC"),[2] appreciates the opportunity to comment on the Financial Reporting Council (FRC) Consultation: *Audit Firm Governance Code: A Review of its Implementation and Operation* (Consultation).

CFA Institute is comprised of more than 130,000 investment professional members, including portfolio managers, investment analysts, and advisors, worldwide. CFA Institute seeks to promote fair and transparent global capital markets and to advocate for investor protections. An integral part of our efforts toward meeting those goals is ensuring that corporate financial reporting and disclosures provided to investors and other end users is of high quality.

General Comments

CFA Institute supports the Financial Reporting Council's (FRC) efforts to promote high quality corporate governance and auditing standards for audits of financial statements. We have a history of supporting efforts to enhance the quality, relevance and value of the independent audits and in that regard we particularly agree with FRC's statement in its Annual Report for 2014/15 (Annual Report) that:

> *Audit exists to provide investors with confidence in the trustworthiness of the company's financial statements and it is essential to that goal that the auditor is also worthy of trust.*

We believe that the Consultation is a significant step taken by the FRC to consider for implementation to the Audit Firm Governance Code (Code) which will further strengthen audit quality. We are encouraged by the positive trend noted in the Annual Report showing that the FRC's annual audit quality inspections found that 67% of audits inspected in 2014/15 were

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1 With offices in Charlottesville, New York, London, Brussels, Hong Kong, Mumbai, Beijing, CFA Institute is a global, not-for-profit professional association of more than 133,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 150 countries, of whom nearly 123,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 144 member societies in 69 countries and territories.

2 The objective of the CDPC is to foster the integrity of financial markets through its efforts to address issues affecting the quality of financial reporting and disclosure worldwide. The CDPC is comprised of investment professionals with extensive expertise and experience in the global capital markets, some of whom are also CFA Institute member volunteers. In this capacity, the CDPC provides the practitioners' perspective in the promotion of high-quality financial reporting and disclosures that meet the needs of investors.

assessed as either good or requiring only limited improvements compared with 60% in 2013/14. While this indicator still shows room for improvement we see it as a positive outcome. We hope that additional changes will further strengthen the effective functioning of the Code and contribute to additional positive outcomes to audit quality.

We offer our response to the Consultation in the sections which follow.

Purpose
CFA Institute believes that the Code's principal purpose is still valid in that it should exist primarily for the benefit of shareholders in listed companies. To strengthen this key objective, the Code indicates that audit firm leadership should appoint Independent Non-Executives (INEs) to provide an external voice in the firms to enhance its commitment to the public interest in the firm's governance and decision-making. Protection of the public interest, which should naturally extend to investors and other stakeholders, is essential for INE's to carryout their responsibilities as members of an audit firm's governing board. Investors do indeed want the Code and INE's (in fact all firm governing members) to focus on audit quality, and to reinforce the importance of independence and professional skepticism.

Question 1. Do you agree that the Code's purpose should be re-defined in this way?

We agree with the FRC's conclusion that the Code should be clearly restated to state that the public interest rests in:

- *Firstly, and of greatest importance audit quality.*
- *Secondly, the firm's reputation more broadly; this involves oversight of the firm's non-audit business.*
- *Finally, prevention of firm failure.*

Safeguarding Audit Quality
A high-quality audit of the financial statements is an integral element to the effective functioning of the global capital markets. To that end, an audit firm's governance plays a critical role to ensure that there is an appropriate balance in how a firm conducts its responsibilities for leadership, ethics, engagement performance and human resources. At the foundation for delivering a high-quality audit, is the firm's integrity, skepticism and independence from clients. At risk to these three key components is the ever wider reach of a firm's revenue sources into consultancy over the last several years. Investors generally are concerned that the rise in the consultancy arm of audit firms poses a threat to audit quality and auditor independence.

Question 2. Should there be separate governance arrangements for audit? What might such arrangements look like?

No. We believe that given the interrelationship between the audit and consultancy arms of an accountancy firm that INEs should focus on the firm as a whole. This arrangement would encourage firm culture that is holistic in its approach to governance, such that risks that might occur outside of the audit practice would be more easily identified and come to the INEs attention.

Question 3. Should the Code include more detail and impose more requirements on tone at the top and professionalism more generally?

Yes. The culture of an organization is a key influencer to what its people think is important and also what will be considered by management to be important. We believe that any effort to strengthen the Code to enhance the effect of the tone at the top of the firm should be pursued. By doing so, the Code will foster a culture whereby everyone feels ownership and responsibility for doing the right thing. Setting the tone for the culture begins at the top of the firm and incorporates elements of concrete policies, positive reward systems and leading by example. These expectations should be reinforced throughout the organization and pushed out to all levels within the firm.

International Context

Question 4. Do agree that the concept of the Code should be spread elsewhere in the world? How might this be achieved?

Yes. We believe that the Code should be promoted and spread to other areas in the world. Investors rely on quality audits that are often the product of a network of firms located in regions across the globe. Firms should have a common frame of reference regarding governance and daily practices related to audit quality and ethics.

We understand that spreading the Code to other jurisdictions throughout the globe will be difficult to accomplish. We suggest that the FRC discuss the possibility with securities regulators and other public interest bodies to identify possible avenues for adoption.

Role of Independent Non-executive Directors (INE)

Question 5. How might the independence of INEs be protected and demonstrated?

We believe that generally to be considered independent an INE must not have a material business or other relationship with the following individuals or groups:

- The firm (including any related non-audit consultancy relationships), including former employees and partners and their family members;
- Individuals, groups, or other entities that can exert significant influence on the firm's management;
- Executive managers, including family members; and
- Firm advisors and their families.

We also believe that the nominating committee responsible for the appointment of INEs should comprise at least one existing INE.

Question 6. Should firms follow a standard process in appointing INEs, including all such positions being publicly advertised? What engagement, if any, should investors in audited entities have into an audit firm's appointment of INEs?

Yes. We believe that a standard process is necessary to ensure reasonable consistency across all firms and that public advertisement of the positions is important. Public advertisement of the process will provide needed transparency. In addition we believe that investors should be engaged in the process. To that end, we recommend that the FRC suggest that two or more INEs be appointed who have investor backgrounds.

Furthermore, we believe that firms should include the names and bios of the INEs to be posted prominently on the firm's website.

Question 7. Should the FRC or any other regulator have a role in the appointment of INEs: perhaps a right of veto?

Yes. We believe that the FRC should have an oversight role into the appointment of INEs. This oversight/approval will ensure that the standards established for firms to appoint INEs will be subject to a rigorous review of the approval process and provide a sense of accountability to an independent party.

Question 8. Which of these, if any, should be incorporated into the Code? Are there any other aspects of the Corporate Governance Code which should also be considered?

We believe all of the following elements of the Corporate Governance Code as stated in the Consultation should be incorporated into the Code:

- The inclusion in the firms' transparency reports of a viability statement providing an assessment of long term solvency and liquidity;
- Term limits on INEs' appointment;
- Transparency around the remuneration of INEs;
- A minimum number of INEs per firm;
- A requirement for at least one INE to have recent and relevant financial experience;
- An independent Chairman;
- Greater consideration of diversity; and
- A formal role for INEs on remuneration, nomination, risk and/or audit committees.

We also refer you to CFA Institute publication ***The Corporate Governance of Listed Companies: A Manual for Investors*** as a resource for other best practices to consider including in the Code.

Accountability

Question 9. To who should the boards, INEs and public interest committees be accountable? How should this accountability be discharged, including to the FRC?

We believe that the boards, INEs and public interest committees should be held accountable to the general investing public. This may best be demonstrated through expanded reporting from the firms specifically detailing their responsibilities. The best means of ensuring this accountability is to consider assigning oversight to the FRC since as the regulator they are best suited to independently assess compliance with the Code.

Question 10. Should the Code include specific provisions on the firms' Boards and Public Interest bodies engaging with and disclosing certain matters to regulators?

Yes. We believe that to strengthen accountability INEs should be required to engage directly with the FRC and should have a duty to report any matters of governance concern.

Question 11. Is greater transparency sufficient? What else can be done?

There appears to be a wide variation in content provided in the Transparency Reports among firms. We believe that more could be done to strengthen the content of the report and comparability across firms. However, we do caution against an overly prescriptive requirement since doing so may turn what should be meaningful and transparent reporting into a compliance exercise.

Other Issues

Question 12. Should the Code be applied to a wider group of firms?

Yes. We believe that the code should apply to all firms regardless of size.

Closing Comment

Thank you for the opportunity to express our views on this important proposal. If the FRC has questions or seek furthers elaboration of our views, please contact Matthew M. Waldron by phone at +1.212.705.1733, or by e-mail at matthew.waldron@cfainstitute.org.

Sincerely,

/s/ Sandra J. Peters
Global Head Financial Reporting Policy
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/s/ Ashwinpaul Sondhi
Chair Corporate Disclosure Policy
Council