Grant Thornton

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17 February 2017

Dear Sir

Draft Plan and Budget and Levy Proposals 2017/18

Grant Thornton UK LLP (Grant Thornton) welcomes the opportunity to comment on the Financial Reporting Council's (FRC) 'Draft Plan and Budget and Levy Proposals 2017/18'.

At Grant Thornton, we believe that the health and prosperity of the UK is dependent on the creation of a vibrant economy. For such an economy to work efficiently there has to be trust: trust between governments, communities and business and between businesses and their stakeholders.

Shared responsibility

Given the economic and political uncertainties that we currently face following the decision for the UK to leave the EU there is a shared responsibility to demonstrate the UK as a sound business environment and to continue to drive high standards of corporate reporting and governance. Building trust is an important factor in this that can increase productivity, support innovation, reduce costs, and strengthen customer loyalty. That shared responsibility belongs to government, regulators, individual directors and boards as a whole, accountants, auditors and other stakeholders.

We believe that improved corporate reporting can be achieved through publications such as the FRC's Annual Review of Corporate Reporting, the outcome of projects undertaken by the FRC Financial Reporting Lab and FRC thematic reviews. These publications often contain examples of good practice and highlight innovation, which can then be shared within the profession and used to improve the quality of financial reporting more widely. We also support the FRC's plan to pilot an audit lab project which would provide further opportunity to highlight areas of best practice and innovations within the audit profession.

In terms of governance, the UK already promotes good governance practice in business through the UK Corporate Governance Code that establishes a set of principles distilled from past experience. The guidance provides a flexible framework and its strength lies in emphasis being placed on encouraging engagement and buy-in rather than rigid, perfunctory or legal compliance. Whilst some fine-tuning may be required as practice evolves, we do not believe that significant changes to the Code are necessary as the FRC suggests. The challenge is to get more companies to embrace the principles enshrined in the code, and adopt best practice. This could be achieved through regulatory oversight and peer pressure for the application of best practice.

Role of the FRC

The FRC has a unique role in building a vibrant economy and ensuring that stakeholders can trust in and place reliance on the integrity of companies (and public sector organisations) in which they have an interest, whether that be as an investor, employee or supplier, for example. We support FRC's role as an 'improvement regulator' and consider that it is therefore appropriate that the focus of its work, communications and budget should be in areas that contribute to this goal, thereby improving trust in the UK.

In the interests of building trust and confidence in the UK markets, we believe that it is crucial that the way in which the FRC communicates its findings, and the language that it uses, is balanced. Often the current focus is on poor practices rather than highlighting the positive achievements of business, and the directors and professionals associated with them. Or the headlines used, which set the tone for press coverage, similarly focus only on the areas to improve without recognising the strong starting position. Whilst it is necessary that poor practices are brought to the attention of stakeholders and the wider public, it is equally important that current strengths and good practices are recognised and publicised.

The FRC also has an important role in building a sustainable auditing profession, ensuring that the profession can attract and retain future generations of talent. This is influenced by the way in which the profession is portrayed in the public domain and the same principles apply regarding the need for balance in reporting.

The enforcement powers of the FRC are necessary to ensure that trust and integrity in business is upheld, and that investors and other stakeholders can have confidence in UK markets and the businesses that underlie them. However, we would urge the FRC to ensure that actions taken are fair and proportionate and carried out on a timely basis, and that the resources available to the FRC (financial and other) are allocated to those activities where there is greatest public interest. Further, the impact that a lengthy investigation can have on the individuals concerned must not be underestimated and should be taken into account in developing the future plans.

Other consultations

We have also responded to the BEIS Corporate Governance Reform Green Paper. This document asks for views on a range of reforms to strengthen large businesses through better corporate governance so as to earn and keep the confidence of their customers, employees and the wider public. There is therefore some overlap between the FRC consultation and the issues raised in the BEIS consultation in relation to the need to promote high quality corporate governance to foster investment and enhance stakeholder confidence.

If you have any questions on our response, or wish us to amplify our comments, please contact me, Sue Almond (tel: 020 7728 2201).

Yours faithfully

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Response to individual questions

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

Promoting high quality corporate governance

We are fortunate in Grant Thornton to have a dedicated team specialising in governance research and analysis – The Grant Thornton Governance Institute. We conduct an annual review of governance among all FTSE 350 companies, by assessing the annual reports of these companies using our in-house methodology. We assess the quality of reporting and the compliance of FTSE 350 with the provisions of the UK Corporate Governance Code. We are pleased to be able to work closely with the FRC in respect of this research, which the FRC use to assist in their annual monitoring of the Code compliance.

We note that the Department for Business, Energy and Industrial Strategy (BEIS) have recently consulted on Corporate Governance Reform. We have responded separately to that consultation and look forward to contributing to the FRC's work in this area.

We support the drive to promote high quality corporate governance practices and as evidenced by our research, the majority of companies take the Code seriously. 90% (all but 31 companies) of the FTSE 350 comply with all but one or two of the provisions of the Code.

We note that the FRC consultation paper refers to the need to make 'potentially significant changes' to the UK Corporate Governance Code. However, we would urge caution in making changes that could further increase the governance burden unnecessarily. We believe that the issue is not a lack of guidance or clarity over what best practice governance is: rather the challenge is getting more companies to embrace the principles enshrined in the Code, and draw on the best practice. The Code will inevitably continue to evolve through continued experience – as it has done in recent years – we should however be wary of introducing more compliance, while at the same time encouraging companies to use the Code as the guiding principle. The need is for greater encouragement through transparency assisted by regulatory oversight, and peer pressure for the application of best practice guidance.

Overall, our research and experience leads us to conclude that there are a number of areas of practice and requirements within the code which, if strengthened, would contribute to the overall strengthening of governance practices, and improve UK board effectiveness.

In our view, one area of focus should be on the diversity of boards and their advisors. While positive work has been done in relation to gender diversity in recent years, there is little evidence of wider diversity in terms of experience or background, which can have an impact on the perception of the role of the board and the trust and integrity that stakeholders place in it. Lack of diversity of advisors also raises the question as to whether such restricted pools of external influence over the performance and selection of the UK's largest companies' boards results in insufficient external challenge to the way in which the board operates.

Enhancing the speed and effectiveness of the FRC's enforcement role

We support the proposed improvements to the FRC's enforcement role.

We understand that the enforcement role of the FRC is essential in ensuring that there is confidence in the profession. However, there needs to be a balance between taking a robust approach to enforcement and for the outcome of the enforcement process to be achieved as expeditiously as possible for the benefit of all concerned. The impact on individuals who are subject to an FRC investigation cannot be underestimated and this is made worse when the time taken for an investigation to be concluded spans many years. It is important for the FRC to recognise this and ensure that the individuals are treated in a respectful manner.

The enforcement regime also needs to be fair and proportionate in the way in which action is taken and that the correct individuals are held accountable when 'things go wrong'. There can sometimes be a perception that certain individuals who are not members of professional bodies are 'untouchable' by the enforcement process which can then lead to a loss of confidence in the system by stakeholders. The FRC should look to work with government to improve equality in action against all responsible for failure to demonstrate a fair and robust process to addressing deficiencies in the UK.

Promoting high quality corporate reporting

We support the drive to promote high quality corporate reporting.

We have found the recent thematic reviews issued by the FRC on Alternative Performance Measures and Tax Disclosures to be a valuable way of reminding preparers of the relevant financial reporting requirements and highlighting examples of best practice. It also gives the profession something to 'point to' when encouraging best practice amongst clients. We therefore look forward to the publication of the thematic studies proposed for 2017/18.

We also welcome the FRC's annual review of corporate reporting. Again this review provides a useful summary of the FRC's assessment of corporate reporting in the UK and is another example of the way in which the quality of financial reporting can be enhanced. However, we would welcome more transparency over which companies were reviewed and whose financial statements form the basis of the findings of the report. This would include those companies where there were no findings of note. We believe that greater transparency in this way would lead to increased confidence in corporate reporting in the UK.

In the same way in which the work of the FRC Financial Reporting Lab has been useful in bringing insight and understanding to a number of key areas of disclosure in the annual report and accounts, we would support an 'audit lab' which could provide similar insight and understanding into audit practices.

Finally, we are aware that the decision by the UK to leave the European Union may have significant implications for the corporate reporting framework in the UK. This could include the UK assessing the adoption of international financial reporting standards itself in the future. The EU currently undertakes this for EEA members which results in consistency of application across european markets. In our view, it is important to retain that consistency. Investors want company accounts to be comparable. In future the FRC should therefore be mindful of 'UK adopted IFRS' that differs from that adopted in the EU, unless there is a strong case for this. The FRC should also continue to ensure that it influences the development and endorsement of IFRS.

Ensuring the efficiency and effectiveness of the FRC

There is currently much scrutiny in relation to companies and their corporate culture and values, brought into the spotlight due to recent examples of poor corporate behaviour by some well-known organisations. It is therefore appropriate that if the FRC is to promote and enforce high standards within the corporate environment that it too embeds a culture that is commensurate with its mission and regulatory role. That culture should be reflected within and at all levels of the organisation as well as the way in which the FRC deals with all external stakeholders and individuals subject to monitoring or investigation.

2) Do you have any comments on our proposed effectiveness indicators?

In general we agree that the indicators proposed are relevant in the context of the priority area that they are intended to assess. However, we have the following observations:

In respect of corporate governance, we would look for improvements in how boards engage with shareholders and debtholders. Our Corporate Governance Review found that overall, disclosure on how the board engages with shareholders and debtholders is low, and has been decreasing for the last four years. More detail in annual reports about the steps taken to understand the views of major shareholders (and other stakeholders) would help to achieve this.

We would also reiterate the need to ensure diversity on boards.

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

We do not believe that there are any areas where activities proposed could be reduced.

4) 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 are not aware of any.

5) Do you have any comments on our proposed budget?

We have no significant observations on the proposed budget. Clearly, the most significant area of expense relates to staff costs, which is unavoidable given the nature of the activities that are carried out by the FRC. However, the key consideration is that the financial resources available to the FRC are allocated in the most effective way and that appropriate focus and resource is given to those areas that have the greatest public interest.

6) Do you have any comments on our proposed levy rates?

We note the proposed levies to be charged to different types of entity which range from £535 for a UK Aim company to £42k for a premium listed company. The levy for preparers is therefore considerably lower than that incurred by individual audit firms or the audit profession. We would therefore encourage the FRC to keep its sources of funding and the balance of funding between the profession and preparers under review. As noted in the recent EU Audit Reform debates, ideally the competent authority should be financially independent from the profession that it regulates and oversees, although in the short term we appreciate that it would be difficult to achieve this.