



# FINANCIAL REPORTING COUNCIL

STAKEHOLDER RESEARCH

REPORT 2018

## Contents

OBJECTIVES AND METHODOLOGY.....	3
COMRES FOREWORD .....	4
EXECUTIVE SUMMARY .....	5
RECOMMENDATIONS .....	7

## OBJECTIVES & METHODOLOGY

Following on from the stakeholder survey in 2017, the Financial Reporting Council (FRC) commissioned ComRes to deliver a mixed-methodology research project to analyse current stakeholder engagement and perceptions, and how these have shifted in the past year. The research was designed to test levels of familiarity with the role and functions of the FRC, explore favourability of the FRC among priority audiences, and to measure effectiveness of FRC communications. The initial phase of the research comprised a survey (telephone and online) with agreed segments of stakeholders outlined below, followed by qualitative interviews with these audiences, to provide more depth of understanding on stakeholder attitudes.

The stakeholder sample was a mixture of FRC and ComRes contacts; the company directors and non-executive directors (NEDs) sample was supplied by ComRes, supplementing the FRC's existing contact lists. For the 2018 survey, the decision was taken to include retail investors and some 'other' stakeholders in order to ensure a more holistic view of the stakeholder universe in the quantitative survey as well as the qualitative interviews.

The survey was conducted among 313 key stakeholders between 4<sup>th</sup> July and 17<sup>th</sup> August 2018. Interviews were conducted with 47 stakeholders who had opted-in to an interview and took place between 19<sup>th</sup> July and 14<sup>th</sup> September 2018.

Responses were split as follows:

Role	Stakeholder survey	Stakeholder interviews
Institutional investors	34	6
Retail investors	30	5
Company directors	101	10
Non-Executive Directors (NEDs)	33	7
Auditors	42	7
Actuaries	32 (20 insurance Actuaries, 12 pensions Actuaries)	1
Professional bodies	19	7
Others	22	4
<b>Total</b>	<b>313</b>	<b>47</b>

# COMRES FOREWORD



2018 has been a challenging year for the Financial Reporting Council, and the audit sector more broadly. In 2017 ComRes noted that the FRC was well-placed to build on its positive familiarity and favourability among stakeholders. However, with the high-profile collapse of Carillion acting as a lightning rod for criticism, the FRC and the audit sector has seen declining favourability, as well as confidence in its work. In response to the large corporate failures of the past several years, politicians and the public have been increasingly demanding answers, which has been in evidence with the multiple official reviews into the sector, and Sir John Kingman's independent review into the FRC itself.

But the FRC is far from alone in facing increased public scrutiny; other regulators are also feeling the effect of increasing examination of their activities, and the role they play in protecting and enhancing business practices. The general public now have greater expectations of regulators: that they will be more proactive in responding to issues, quicker in resolving them, and ensure that the punishment is tough enough to deter future transgressions. While some of these issues were noted as potential issues in the 2017 report, recent events have tipped them into being critical issues under intense public scrutiny.

That acknowledged, the FRC has stepped up efforts to demonstrate that it is attempting to tackle issues within the areas it governs, from the recently published *Developments in Audit* report to the announced plans to review corporate reporting to ensure it is fit for purpose. Steps such as these will hopefully provide stakeholders with the assurances they need that the FRC is committed to tackling some of the criticisms levelled against itself and the broader industry.

While these issues undoubtedly need to continue to be addressed, it is important that they don't obscure horizon scanning to ensure that the industries the FRC regulates are adequately prepared to face future challenges. For example, what role can and should technology (and artificial intelligence) have in shaping the future of audit and corporate reporting? What role can corporate governance play in helping shape productive and inclusive working practices?

In order to re-build confidence amongst stakeholders and strengthen this relationship, it will be critical that the FRC continues to demonstrate its willingness to listen and engage with its critics and be active in implementing change in the year ahead.

Meghan Oliver

Associate Director



# EXECUTIVE SUMMARY

Findings in 2018 show significant concern among stakeholders in a number of areas, in sharp contrast to a generally positive opinion in 2017. Lack of transparency has emerged as a key issue which has impacted views towards enforcement and disciplinary activities in particular, as well as attitudes towards audit. Further to this, stakeholders raised questions over the FRC's independence and fears that their enforcement and disciplinary activities are not effective at stopping some of the problems in the audit sector. Those stakeholders who were more familiar with the FRC were often more likely to be understanding of these issues and sympathise with the constraints within which the FRC operates. Contrastingly, those who were more unfamiliar wanted to see greater transparency from the Regulator, plus more stringent enforcement and disciplinary activities being pursued.

Further to this, views towards audit have become much more negative since the last survey, perhaps unsurprising given recent, high-profile corporate collapses. Confidence in and efficacy of audit has deteriorated in the past year, in part driven by views that audit has become a 'box ticking' exercise and isn't able to effectively comment on the overall financial health of a company. These attitudes had a negative 'halo effect' on other areas of the FRC's work and contributed towards less favourable attitudes towards the Regulator overall.

- One of the main drivers of more negative perceptions in response to the 2018 survey is a view that **the FRC lacks transparency as an organisation**, where stakeholders did not feel that they understood the Regulator's ways of working or how decisions were reached. In particular, this applied to the FRC's disciplinary and enforcement activities, where stakeholders wanted more information generally about the process, and for the FRC to publish at the outset of an investigation the actions it plans to undertake and, at the end, the outcomes. Though there was some acknowledgement of the limitations placed on the FRC during this process, stakeholders felt that **greater clarity in this area would help to foster a more positive image of the FRC as an independent and transparent regulator**.
- At the same time, **the proportion of stakeholders who say that the FRC is independent has declined significantly since 2017 from four in five to three in five in 2018**. Concerns around the hiring of ex-auditors and conflicts of interest were present across stakeholder groups and seen to be of real concern. There was limited knowledge of the safeguards that the FRC puts in place regarding the hiring of ex-Big Four auditors, which contributes to views about a lack of independence.
- **Related to this, fewer than half of stakeholders (46%) say that the FRC is effective in its communications with stakeholders compared with 69% in 2017**. Further investigation revealed that stakeholders are content with the *amount* of communications received, with the exception of retail investors who wanted more, however messages were seen to be too technical, difficult to digest and not sufficiently tailored to stakeholders' areas of work. Although stakeholders appreciated the need for confidentiality on individual cases and where imposed by the rules on legal proceedings, stakeholders wanted more transparency on process and outcomes on enforcement activity.
- **Confidence in the FRC's work has declined across all areas and most significantly in audit**. This is perhaps unsurprising given the events of the previous year, but it should be noted that this appears to have had a knock-on effect on stakeholder's perceptions of other areas of the FRC's

work. Having said that, some stakeholders who are more familiar with the FRC thought that some of the issues that had arisen over the past year were outside the Regulator's power and resources to remedy.

- **Whilst 73% of stakeholders were familiar with the FRC's work in audit, less than half (46%) of those thought it was effective, with significant declines in both since the 2017 survey.** There is a sense amongst some stakeholders that these corporate failures show that audit has become a 'box ticking' exercise, and that auditors should be looking more at the big picture of a company's financial health and performance. Some stakeholders also expressed the view that there remains a limited understanding of audit amongst politicians and the wider public, and what an audit can and cannot do. It was felt that more work should be done to increase this knowledge to ensure a greater understanding of what the FRC does and how it can effectively regulate.
- **Views on corporate governance and corporate reporting held up slightly better** and although ratings of both familiarity and effectiveness declined compared to the 2017 survey, a majority of stakeholders who were at all familiar with the FRC's work in these areas, still rated them as effective. High levels of use and usefulness were cited for Annual Reports and Accounts with improvements focused on reducing the length of annual reports and exploring whether some information would be better placed elsewhere (e.g. company websites).
- **Familiarity with, and perceived effectiveness of, each of the areas of FRC's works has declined compared to 2017, with the exception of actuarial work** where familiarity increased but was still very low at 27%. Familiarity among stakeholders is limited with the exception of actuaries themselves. Although engagement with the survey – in particular, the interviews – has declined compared to the 2017 survey, actuaries remain positive about the work that the FRC does in this area. Unsurprisingly, views of the FRC's actuarial work were limited among other stakeholders, with several questioning the inclusion of actuaries in the FRC's remit.
- **Investor stewardship had a lower profile** compared to corporate reporting, governance and audit, and stakeholders were concerned that the FRC's work in this area was less effective. Reasons for this mainly centred around the perception that the FRC has very little power over investors, and because the Stewardship Code is still in its early stages and its enforcement and application are still being fine-tuned.
- **Stakeholders are familiar with the FRC as an organisation, but this familiarity is often limited to the specific areas on which stakeholders engage with the FRC.** In line with the 2017 survey, those who are more familiar with the FRC are more likely to be favourable. However, familiarity and favourability have both seen notable declines since 2017.

# RECOMMENDATIONS

## Transparency & independence

- The FRC should be more transparent about itself as an organisation, specifically around its ways of working and processes for enforcement of standards. Information which is released should be both concise and clear, so as not to give the impression that key points are obfuscated by the volume of information released. While stakeholders understood the need for confidentiality, there was frustration that there was a lack of clarity or communications about the enforcement process.
- Concern over the FRC's independence from the audit profession is much stronger among stakeholders in 2018 than in 2017. Stakeholders feel that the FRC is too close to the audit profession, with limited understanding of the safeguards that the Regulator has in place to avoid conflicts of interest with ex-Big Four auditors. More information needs to be made readily available about what steps are taken to ensure impartiality among its ex-Big Four employees as well as the process for enforcement of standards.

## Enforcement

- Stakeholders feel that fines are not necessarily an effective means to preventing illegal behaviour, with companies absorbing any costs and auditors not changing their behaviour as a result. They would like to see alternative enforcement activities explored, and more efforts to prevent bad behaviour, as opposed to monetary fines to punish audit firms. Comparisons were drawn to the equivalent US regulator who was seen as a body to be feared. Stakeholders were keen for the FRC, and the enforcement actions it takes, to be more feared among those it regulates.
- Furthermore, specifying what actions the FRC can and cannot do in relation to its enforcement activities could help manage stakeholder expectations of the outcomes of any proceedings.

## Communications & engagement

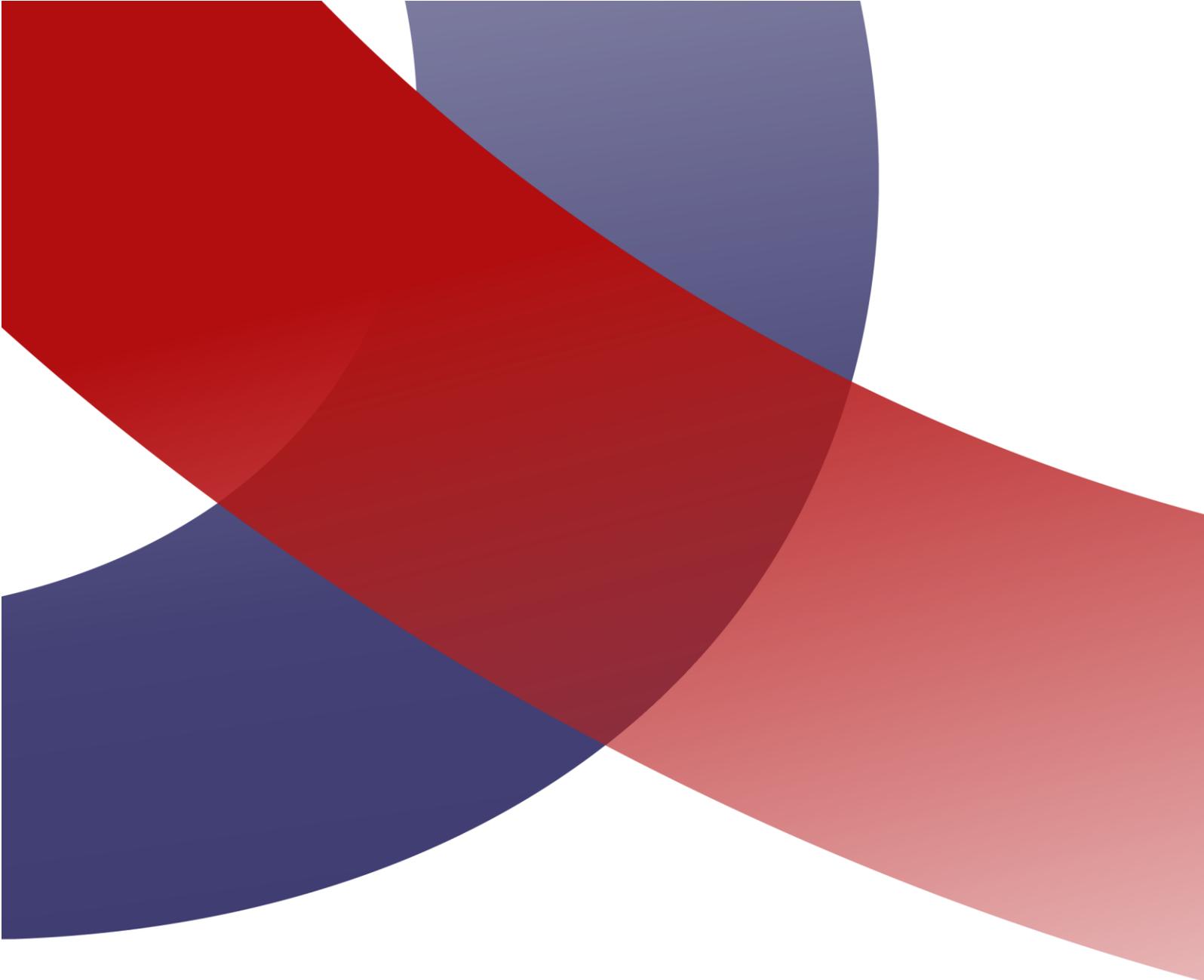
- Following a year of public criticism, stakeholders would like more tailored communications and engagement from the FRC with themselves, as well as the general public. There is a sense that increasing useful, relevant communication will in turn increase transparency, and give stakeholders and the public a better understanding of what audit is, what role the FRC plays as a regulator, and what disciplinary and enforcement powers the FRC has.
- Given the breadth of the FRC's remit, trying to engage all stakeholders in all areas would be time and resource expensive. Instead, communications around areas targeted to specific groups will help stakeholders to get a better understanding of the relevant work being done. Broader communications and events which stakeholders can opt-in to and explore at their convenience could help stakeholders to get a better understanding of the other work that the FRC does.
- Stakeholders want to see a clear spokesperson from the FRC, someone who is the face of the Regulator and can talk to the media with clarity and efficacy. Having a defined spokesperson would also allow the FRC to proactively respond more visibly to issues in the public sphere.

## The FRC's work

- There is a perception amongst stakeholders that audit has become a box-ticking exercise and too narrow in focus, often missing the bigger picture. Stakeholders want to see the FRC think

more critically about the potential to reform this in favour of an approach which looks to apply both the spirit of the law, as well as the letter.

- In terms of improving the usefulness of corporate reporting, ideas centred on shortening annual reports and accounts in order to improve their relevance and make it easier for stakeholders to find the information they need. Stakeholders were divided as to whether it was useful to include non-financial information like environmental, social and community matters, culture, values and stakeholder management in the Annual Report and Accounts and two in five thought they would be better communicated elsewhere – a minority, but the highest proportion of any of those matters tested. Whilst retail and institutional investors found broader information useful in understanding and assessing the importance of companies and auditors, company directors had a greater tendency to question whether this information was best-placed in annual reports and thought that the FRC needed to demonstrate the value that this information provides.



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