Ernst & Young LLP
1 More London Place
London
SE1 2AF

Deputy Head of FRC Delivery Unit
Financial Reporting Council
8th Floor
125 London Wall
London
EC2Y 5AS

17 February 2017

Direct line: 020 7951 2082

Email: emcgrath@uk.ey.com

Sent by post & email: plan@frc.org.uk

Dear Sir/Madam

Draft Plan & Budget and Levy Proposals 2017/18 – Consultation

We welcome the opportunity to comment on the Financial Reporting Council's (FRC's) consultation document: *Draft Plan & Budget and Levy Proposal 2017/18.*

We would like to acknowledge the important new role that the Government gave the FRC in June 2016, as the UK Competent Authority for audit, focusing on promoting continuous improvement in audit quality underpinned by effective and timely enforcement. We also recognise the FRC's work in implementing the EU Audit Directive and Regulation.

We would also like to acknowledge the work that the FRC undertook in 2016 to promote the importance of good corporate culture in delivering long-term business and economic success. The FRC report on *Corporate Culture and the Role of Boards: Report of Observations,* published in July 2016, was based on extensive consultation and input from external organisations. The report made it clear that the way companies create and sustain value is directly linked to the debate about the role of business in society. This report also recognised that the reputation of business as a whole has been damaged by the behaviour of a few. We believe that the FRC should continue its work in this important area and we look forward to further detail on how the findings might be used to facilitate change.

EY is also responding to the Department for Business, Energy & Industrial Strategy (BEIS) Green Paper on Corporate Governance Reform. We also look forward to providing feedback to the FRC on its consultation on possible changes to the UK Corporate Governance Code (the Code). We agree it is important for the FRC to consult widely on this topic to ensure the current strengths of the Code and its international reputation are retained.

We have responded to the specific questions included in the Draft Plan & Budget and Levy Proposal 2017/18 consultation below. However, the key element we believe should be included, is a contingency plan which outlines the risk mitigation options and actions the FRC will take on the backdrop of the Brexit process. We note that the overall funding requirement is budgeted to increase by 4%. With finite resources, it would be helpful to better understand how these resources will be deployed and which elements of the proposed FRC work programme might be deprioritised. In response to Q4, we have also offered some specific areas of risk which do not seem to us to be addressed in the proposed work programme, but which we believe could impact the FRC's mission.

As ever, our comments are offered in the spirit of constructive feedback and we welcome the opportunity to discuss further.

EY's response to the FRC's consultations questions 1-6:

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

Broadly speaking, we are supportive of the FRC's proposed priorities for 2017/18 as noted below:

- Promoting high quality corporate governance and effective investor stewardship.
- Enhancing the speed and effectiveness of enforcement.
- Promoting clear and concise corporate reporting.
- Promoting justifiable confidence in auditing.
- Promoting high quality actuarial work.
- Ensuring that the FRC is effective and efficient and has a corporate culture that supports its mission and regulatory role.

We would, however, ask the FRC to consider both its new role as the UK Competent Authority for audit and its proposed priorities against the challenges that are likely to arise during the Brexit negotiations and, from 2019, the potential of pursuing an appropriate de-regulation agenda. We believe that during this time of uncertainty it is important for the FRC to strike the right balance between a combination of high standards and low additional burdens to ensure that the UK market remains attractive to businesses of all size.

Perhaps one area of focus that the FRC may wish to consider prioritising is the investment and use of technology and data analytics to drive efficiencies and deliver effective outcomes. EY believes that the auditing profession itself is at a '*tipping point'* and needs to invest and adapt with pace to ensure it is '*fit for purpose'* to meet market demands in the new digital world.

We further acknowledge the importance of promoting high quality corporate reporting as we believe that communication and transparency go '*hand in glove'* with corporate governance when renewing the social contract with society.

We support the FRC's desire to continue to have a single set of high quality global financial reporting standards for all listed companies. Over the longer-term, we would also encourage the FRC to work with the IAASB on the challengers to the existing framework for accounting and reporting arising from intangible drivers making up a much larger percentage of organisational value.

We also encourage the FRC to continue to engage with all stakeholders to glean feedback, from investors in particular, to ensure the accounting standards and corporate reports are meeting the needs of stakeholders.

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

We are wholly supportive of the FRC using indicators to measure the effectiveness of its work and ensuring that the indicators are *SMART - specific, measurable, assignable, realistic and time-related*. We note that for the 2017/18 Plan the FRC has identified six areas of priority and 21 effectiveness indicators.

We offer the following suggestions for consideration:

- *Striking the right balance* - given the complexity and uncertainty of the market, striking the right balance between what is in scope and what can be achieved by the FRC in 2017/18 is an important consideration.

- *Effectiveness indicators versus activities* - it is important to ensure that the effectiveness indicators are indeed measuring impact and outcomes – and are consistent and comparable year-on-year to really demonstrate that the FRC is making progress and/or 'moving the needle in the market'.

  For example, on page 7 the priority is: 'Promoting high quality corporate governance and effective investor stewardship' and one of the indicators is; 'Survey evidence of the extent to which asset owners are satisfied with the standard of reporting from asset managers.'

  Perhaps the indicator could be: 'Successfully glean feedback from 40% of the UK asset owners on their overall satisfaction of reporting from asset managers. Based on this feedback, identify the top 3 areas that the asset managers need to focus on.'

  On page 7 the priority is: 'Promoting high quality corporate reporting' and one of the indicators is: 'Our assessment of the impact of the Lab's initiatives on corporate reporting'.

  Perhaps the indicators could be: 'To conduct an awareness survey of financial reporting teams a listed companies, successfully gleaning feedback from 30% of those surveyed, to measure their awareness of the Lab and if they have improved disclosures having read Lab reports".

- *90% quality challenge* - we support the FRC's aim that at least 90% of the FTSE350 audits will require no more than limited improvements, but would note that this indicator is assessed by the FRC's own monitoring programme.

We would also encourage the FRC to consider the power of 'celebrating success' and or 'best-in-class' case studies to affect market change.

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

We believe that the FRC's should focus its activities on the following top three priorities;

1. Promoting justifiable confidence in Audit

2. Promoting clear and concise Corporate Reporting

3. Enhancing the speed and effectiveness of enforcement

We are supportive of the FRC's desire to consult on the Code, but, as we discuss further in response to Q4, we have reservations regarding the timing of any changes being mindful of the need to minimise regulatory change during the Brexit process.

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 believe there could may be potential risks facing the FRC which are not addressed in the proposed work programme. These seem to us to include:

- *Role of the regulator during and post-Brexit* – we note that one of the proposed priorities is to '*play an active role with other regulators in helping address the challenges and opportunities of Brexit and remaining influential internationally'.* It is unclear to us whether the resources needed for Brexit-related activities during 2017/18 can be determined with any degree of certainty. As the FRC has limited resources, unplanned, but nevertheless urgent, Brexit-related activities could impact negatively on other the FRC's functions and priorities. More generally, and when appropriate, we would be interested in understanding, in more detail, what specific Brexit-related risks the FRC has identified, how resources will be allocated to respond to these unforeseen requirements and which of the priorities outlines in the Plan might not be scaled back. We acknowledge the importance of the FRC engaging with policy makers and other regulators to help prepare the UK for leaving the EU, but equally recognise that this could be create a burden on a finite set of resources.

- *Changing too quickly* - business and the business environment is changing rapidly, driven not only by technology, but also by globalisation and public opinion. The FRC was also given the new role as UK Competent Authority for audit in 2016 and, as noted above, will be taking on an active role in relation to Brexit. Whilst recognising that some changes are outside the FRC's power to control, we believe it is time for the FRC to pause, consolidate and then reflect whether the time is right to make further changes to corporate governance and reporting. We support the FRC's intention to consult on the Code, however, it is important than any changes are well considered for the longer time and, given a backdrop of uncertain times, implemented at an appropriate time.

- *Relevancy challenge* – we are aware that there has been feedback from some investors which challenges the relevancy of the corporate report specifically noting the increase of intangible value drivers. If we believe that most industries show intangible value as typically representing more than 50% of true value of the average company – then we would also believe that the traditional methods of reporting may now no longer be enough for many companies if they are effectively to communicate their strategic intent and value to key stakeholders. This challenge on whether current accounting and reporting should recognise intangibles is not new, it has been raging for more than 20 years.

  We acknowledge that the FRC pledges to continue to work with international standard setters but to ensure that the profession and the regulators remain relevant, and to continue to provide the much needed confidence to the UK market, we would like to see the FRC proactively developing a suggested roadmap, inclusive of a timeline extending beyond 2017/18, which outlines the changes that they believe are needed, supported by the outcomes of thematic reviews and evidence gleaned by stakeholder surveys (as noted on page 9 of the Plan).

- *Talent Pool and Effectiveness of the Audit Committee* – we acknowledge the importance of the new responsibilities given to Audit Committee but the new requirements on composition and responsibilities come with risks to the talent pool when recruiting for board positions and maintaining high quality corporate governance. For example, it could prove challenging for companies to recruit individuals with the right skills and experience to meet the composition requirement - which may already be providing recruitment challenges – thereby creating a regulatory ‘unintended consequence’. We wondered if the FRC has considered this as a risk when delivering high quality corporate governance.

Broadly speaking, we would welcome the opportunity to learn more about how the FRC is proposing to combat these risks.

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

We have no specific comments on the proposed budget provided but would like to make the following observations:

- ► We acknowledge that it is in the interests of all market participants to ensure that the FRC is properly funded to carry out its statutory responsibilities and other regulatory objectives to a high standard.
- ► We would like to thank the FRC for offering additional information in the proposed budget for 2017/18, compared to prior years, on the types of expenditures and the functional activities to which they relate.
- ► Overall, it is noted the FRC funding requirement is budgeted to increase by 4%, from £34.6m to £36.0m which includes an additional £0.7m to general reserves, compared to £1.1m in 2016/17, and an unchanged budget of £5m for audit and accountancy case costs which are directly reimbursed by the professional bodies.
- ► We further note that you propose to raise the 4% increase in funding principally through a 2.5% increase in levies on the professional bodies and an overall 5% increase in the levies on preparers – ranging from 2.5-9.5% depending on the market capitalisation of the company.
- ► We welcome learning more about whether the FRC plans, in future years, to allocate investment into RegTech innovations that involve the use of technology and or data analytics to help drive efficiencies in your audit inspections.

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

We have no specific comments on the proposed levy rates but would like to make the following observations:

- ► We note from both the Plan that £17.6m will come from the following three levies:

  1. A preparer’s levy that applies to the preparers of the accounts;
  2. An insurance levy that applies to life and general insurance companies; and
  3. A pension levy that applies to pension schemes with 1,000 or more members.

- ► We also note that the accountancy profession’s funding is paid by the Consultative Committee of Accountancy Bodies (CCAB), whose members are ACCA, CAI, CIPFA, ICAEW and ICAS.
- ► Finally, we are content to continue to pay our contribution to the FRC’s funding through the ICAEW.

EY
Building a better working world

Thank you again for consulting on the Draft Plan & Budget and Levy Proposals 2017/18 and we hope you have found our comments helpful. We look forward to reading the results.

Yours faithfully

Eamonn McGrath

Eamonn McGrath
Partner, UK Head of Regulatory & Public Policy