

Association of Accounting Technicians response to the Financial Reporting Council (FRC) Draft Plan & Budget and Levy Proposals 2016/17

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1. Introduction

- 1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the Financial Reporting Council (FRC) Draft Plan & Budget and Levy Proposals 2016/17, released on 21 December 2015.
- 1.2. AAT is submitting this response on behalf of our membership and from the wider public benefit of achieving sound and effective corporate reporting, auditing and corporate governance.
- 1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.
- 1.4. AAT has focussed on the operational elements of the proposals and has provided opinion on the practicalities in implementing the measures outlined.
- 1.5. Furthermore, the comments reflect the potential impact that the proposals would have on SMEs and micro-entities, many of which employ AAT members or would be represented by our operationally skilled members in practice.

2. Executive summary

- 2.1. AAT comments in answers to the questions below on the FRC's focus in the document. Overall AAT considers that there is little in the FRC Draft Plan about the smaller, unlisted sector in terms of the FRC's activities, particularly around corporate reporting and auditing.
 - 2.1.1. In relation to smaller company reporting, the FRC is almost silent, but AAT remains very concerned about the impact of the micro-entity regime and the deemed true and fair view. In order to address these concerns AAT recommends that the FRC should consider monitoring the impact of the regime, the extent of its take-up and the reaction of any users of the micro-entity accounts. (3.24, below)
 - 2.1.2. AAT is also concerned as to whether the restrictions to mandatory disclosures for small companies will cause companies to aim for the minimum required or whether they will add more to deal with the requirement to show a true and fair view. Again, AAT recommends that monitoring this should be considered. (3.25, below)
 - 2.1.3. AAT is concerned that there is little in the FRC consultation about the non-PIE audit market, merely a statement on page 17 that the FRC will "Consider the most effective and proportionate way to respond to the challenge of delivering high quality audit of SMEs". This statement is rather broad and AAT questions if it would be better if some indication could be given as to what actions, if any, the FRC is proposing above and beyond their monitoring of Recognised Supervisory Bodies (RSBs). (3.28, below)

- 2.1.4. Given the government's recent confirmation¹ of its decision to raise the audit exemption threshold, AAT has some serious misgivings about the fact that the accounts of some companies of considerable size and impact are now not subject to any form of independent oversight. AAT has previously suggested that the accounting and audit exemption threshold should be delinked as they serve different purposes, but as this has not happened AAT questions what work will be done in order to monitor the impact of the raised threshold, including removing capacity from the audit market to carry out smaller audits. Investors, and perhaps more so creditors of such companies, may be at significant risk. (3.29-3.30)
- 2.2. As noted in our answer to Question 4, the use of 'indicators' by the FRC is in AAT's view a little muddled. In some instances they are used as targets, to indicate what success may look like in terms of judging FRC activities, but this is done too infrequently and often indicators simply state that something will be measured. While AAT accepts that in some cases progress would be very difficult to measure, in others the FRC could be more ambitious in setting stretching targets for itself. AAT considers that the FRC should re-categorise the indicators into targets, that there should be more targets, and other 'indicators' should be sharpened and made as specific as possible.
- 2.3. The FRC should indicate how it is working with legislators and other regulators, both in the UK and the EU, as well as how it gathers views from constituents before giving input to international standard-setters, to ensure that rules and regulations are developed that are appropriate to the UK and that they are joined up to the greatest extent possible. FRC obviously already does work closely with other regulators and the government in some areas, but a stated commitment to a joined up approach in general terms would acknowledge this imperative.

3. AAT response to the consultation on the FRC's Draft Plan & Budget and Levy Proposals 2016/17

- 3.1. The following paragraphs outline AAT's response to the proposals outlined in the consultation on the FRC's Draft Plan & Budget and Levy Proposals 2016/17.

Q1 Do you have any comments on the regulatory approach we are proposing for our new three year strategy?

- 3.2. AAT welcomes the FRC's regulatory approach, particularly where it is committing to minimal or no changes unless absolutely necessary.
- 3.3. The FRC should be aware that its constituents have been and are subject to almost constant, voluminous new and changing regulatory and legal requirements, not just from the FRC but from the government and other regulators, including the RSBs. All change is costly and the capacity of the regulated to deal with the changes, as well as responding to consultations and legislative proposals, is not infinite, particularly at the smaller end of the market. In AAT's view, a deregulatory approach would be to aim to change as little as possible as infrequently as possible.
- 3.4. This includes the FRC simply putting out statements and reports to indicate its own activity. It would be helpful if such were kept to a minimum or compiled and issued in useful packages of information rather than a constant stream of *ad hoc* documents and messages.

¹ <http://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Lords/2016-01-26/HLWS479>.

- 3.5. It is AAT's view that the FRC is generally a proportionate and well-focussed regulator. Out of a recognition of this fact AAT recommends that any proposed changes arising out of the Effectiveness Review² are supported by a cost / benefit analysis.
- 3.6. While the FRC is right to listen closely to stakeholders, complete transparency around, say, audits, would tend to undermine the agency relationship between auditors and shareholders and create problems for confidentiality. Investors will always want more information, but there are limits and there can be unintended consequences in giving some forms of information.
- 3.7. In particular AAT is concerned that not all of the ramifications are clear in respect of the proposal, set out below (page 8, para 2):

"We propose that in future we should pilot naming in advance a small proportion of those reports and audits we intend to review; we should inform companies when their reports have been reviewed and we do not intend to take any further action; and we should make clear our expectation that audit committees should when appropriate report on the outcomes of the FRC's audit quality and corporate reporting reviews."

- 3.8. AAT does not object to the proposal to inform companies (and presumably their auditors) in advance of a review of an annual report, which may nudge companies to do better earlier, nor to the idea of informing them that no further action is proposed where appropriate, but it is not clear from the consultation whether this result of a 'clean' review is to be made public. AAT would have some concerns if it is, because inevitably investors will see the result as some kind of "kitemark" of quality when no such thing was intended; a badge of quality is very different from a clean regulatory check.
- 3.9. AAT would expect the FRC enter into full consultation on this issue if public announcements are proposed.

Q2 Are there areas of our work where we could reduce the regulatory costs we impose without compromising the quality of corporate governance and reporting in the UK?

- 3.10. AAT recognises that the FRC is obliged to carry out the changes that are required to deal with new legislation, not least the recent Audit Regulation and Directive. In this and all instances, the FRC should focus on ensuring that the elements under its auspices are dealt with as efficiently and clearly as possible.
- 3.11. While AAT does not welcome, or encourage, gold-plating, this does not extend to clarificatory-language or changes required in order to correct perverse outcomes in practice. The FRC should not treat such amendments as gold plating, but instead as necessary correctives to ensure efficient implementation.
- 3.12. Once any new requirements are in place, AAT anticipates that the FRC may need to "tweak" things so that the rules are made as effective as possible and to address any operational difficulties that might have come to light. Beyond that the aim should be to allow new requirements to bed down and become familiar to those affected.
- 3.13. While as noted in 3.3 (above) all change is costly, nevertheless amendment might still be necessary. The FRC is likely to receive post-implementation, *ad hoc*, feedback following any change of rules, particularly if there is uncertainty in applying them or the results are not as expected.
- 3.14. Acknowledging this to be the case, the FRC should consider the introduction of formal post-implementation reviews in respect of major areas of change. This will provide the FRC with a rich evidential basis should change be considered necessary and it will also

² As mentioned in the FRC's "Strategy 2016/19" document (October 2015) <https://www.frc.org.uk/Our-Work/Publications/FRC-Board/FRC-s-Strategy-for-2016-19.pdf>.

be helpful in providing invaluable feedback to the UK government or the EU in relation to, for example, the impact of the new audit legislation.

Q3 Do you have any comments on the FRC's proposed projects and activities in 2016/17?

- 3.15. AAT's comments below should be read in the context of the answers given to questions 1 and 2 (above).

Corporate governance.

- 3.16. AAT acknowledges that changes (already subject to consultation) will need to be made to the Code regarding the new Audit Regulation and Directive.
- 3.17. AAT expects the balance of responsibilities between audit committees and auditors to be properly calibrated as audit committees have duties under the Audit Regulation to monitor the statutory audit and carry out certain very specific functions, such as running an audit tender process. As a consequence the onus should not only be placed on auditors to get things right.
- 3.18. While AAT supports the projects on board culture³ and succession planning⁴, AAT remains to be convinced that FRC guidance or regulatory action will produce the desired results in the boardroom. The FRC may need to look to other routes to achieve success, for example helping to initiate better training for directors, perhaps through bodies such as the Institute of Directors or the Confederation of British Industry.

Investor stewardship.

- 3.19. AAT accepts that the FRC should examine actual compliance of signatories with the Stewardship Code, but the FRC should not underestimate the barriers to engagement and the need to wield the carrot as well as the stick in order to see improvements.

Corporate reporting.

- 3.20. AAT acknowledges the very positive work the FRC has undertaken across the corporate reporting arena recently, not least the deregulatory impact of new UK GAAP⁵ as it comes into effect.
- 3.21. The Financial Reporting Lab⁶ is a good example of an innovative approach to engagement between companies and investors, allowing best practice and new ideas to develop in a safe environment, as well as getting important messages out to constituents. AAT agrees with, and supports, the direction of further work to be undertaken by the Financial Reporting Lab.
- 3.22. The output of the work of the Corporate Reporting Review⁷ has also changed for the better to align with the 'Clear and Concise' theme, while at the same time improving reporting as a whole. AAT supports the FRC's work in raising smaller quoted companies reporting standard.
- 3.23. The Capital Markets Union (CMU)⁸ agenda appears somewhat opaque at present and it is not clear how and in what way corporate reporting will be asked to change as a result.

³ <https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/Culture-Project.aspx>.

⁴ <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/Discussion-Paper-UK-Board-Succession-Planning.pdf>.

⁵ <https://www.frc.org.uk/Our-Work/Codes-Standards/Accounting-and-Reporting-Policy/New-UK-GAAP.aspx>.

⁶ <https://www.frc.org.uk/Our-Work/Codes-Standards/Financial-Reporting-Lab.aspx>.

⁷ <https://www.frc.org.uk/Our-Work/Publications/Corporate-Reporting-Review/Corporate-Reporting-Review-Annual-Report-2015.pdf>.

⁸ http://ec.europa.eu/finance/capital-markets-union/index_en.htm.

However, to date AAT has not seen any evidence that moving away from full IFRS for any listed companies would be appropriate.

- 3.24. Although the FRC document says almost nothing about it, AAT remains very concerned about the impact of the micro-entity regime and the deemed true and fair view. The FRC should consider monitoring the impact of the regime, the extent of its take-up and the reaction of any users of the micro-entity accounts.
- 3.25. AAT is concerned that the restrictions on mandatory disclosures for small companies will cause companies to aim for the minimum required or whether they will add more to deal with the requirement to show a true and fair view. It would be prudent for some post-implementation monitoring to be considered.

Audit and assurance.

- 3.26. Establishing the FRC's new responsibilities as the Competent Authority will obviously take up a good deal of time and effort in the next few years. As noted at 3.10 (above) AAT would urge the FRC to introduce the relevant requirements as clearly and effectively as possible given the complexity in some areas, with good cooperation with government and other regulators such as the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA).
- 3.27. There are some gaps in the overall legislative and regulatory response at the moment, not least in relation to sanctions over auditors and also companies and their directors. AAT encourages the FRC to work with Department for Business, Innovation and Skills (BIS) and other regulators to deliver some clarity and certainty around the consequences and penalties for breaching a very wide range of requirements, including indicating how serious a breach of the independence rules would need to be to cause a statutory auditor to be deemed not independent, and whether breaches will cause sanctions for both auditors and, where appropriate, the directors (and particularly audit committee members) of the audited company.
- 3.28. There is little in the FRC consultation in respect of the non-PIE audit market, other than a statement that the FRC will "Consider the most effective and proportionate way to respond to the challenge of delivering high quality audit of SMEs" (page 17, condoc). AAT is concerned that this is rather a broad and unclear statement and considers that it would be better if some indication could be given as to what actions, if any, the FRC is proposing above and beyond their monitoring of RSBs.
- 3.29. Given the government's recent confirmation of its decision to raise the audit exemption threshold, AAT has some serious misgivings about the fact that the accounts of some companies of considerable size and impact are now not subject to any independent oversight.
- 3.30. AAT has previously suggested⁹ that the accounting and audit exemption threshold should be delinked, but as this has not happened AAT is concerned about what work will be done to monitor the impact of the raised threshold, including removing capacity from the audit market to carry out smaller audits. Investors, and perhaps more so creditors of such companies, may be at significant risk.

Professional discipline.

- 3.31. AAT notes the proposals and commends the speeding up of cases. See the answer given to Question 5 at 3.44 and 3.45 below for AAT's comments on the budget.

⁹ [AAT response to Auditor regulation: effects of the EU and wider reforms](#)

Q4 Are the proposed indicators helpful in assessing progress towards the FRC's objectives; and are there other indicators that should also be taken into account?

- 3.32. AAT's comments under this section should be read in the context of the answers given to questions 1, 2 and 3 above.
- 3.33. The use of 'indicators' by the FRC is in AAT's view a little muddled. In some instances they are used as targets, to indicate what success may look like in terms of judging FRC activities, but this is done too infrequently and often indicators simply state that something will be measured. While AAT accepts that in some cases progress would be very difficult to measure, in others the FRC could be more ambitious in setting stretching targets for itself. Other indicators are self-referencing and do not really add anything. For example, "our views on the development and impact of international standards" says nothing about judging whether the FRC has produced high-quality input to the development of those standards. AAT considers that the FRC should re-categorise the indicators into targets, that there should be more targets, and other 'indicators' should be sharpened and made as specific as possible.

Corporate governance.

- 3.34. Some indicators are capable of multiple interpretations, for example if there is a specific reason in a particular year that many companies do not believe it is appropriate for them to comply with a requirement of the Code.
- 3.35. In addition, there is an absence of quantification, where either a range or a specific target would be helpful. For example, the headline figure for female directorships in the FTSE350 might go up, but how far up does it need to go for the FRC to believe that there has been real progress?
- 3.36. AAT is unsure in respect of the efficacy of surveys of market commentators in assessing changes or improvements in corporate culture; such things are extremely difficult to pin down in any meaningful fashion.

Investor stewardship.

- 3.37. AAT would expect to see hard data on the FRC's findings in relation to compliance with the Stewardship Code and, where relevant, naming of both good and bad signatories.

Corporate reporting.

- 3.38. As noted in paras 3.24 and 3.25 above, there is almost nothing in the consultation about unlisted company reporting, and no indicators are given in relation to an important area.
- 3.39. Furthermore, AAT considers that it would be helpful for the FRC's future work on the new accounting regime to consider feedback on the new UK GAAP regime as it comes into operation so the FRC can ensure it is fit for purpose for users of the relevant financial statements. AAT would be particularly interested to see some work undertaken in respect of the impact of the micro-entity regime, under which statutory accounts are likely to disclose little information as public documents.
- 3.40. AAT would encourage FRC to consider and implement a post-implementation review, perhaps in conjunction with BIS.

Audit and assurance.

- 3.41. The indicators have some quantitative aspects, which is welcome. That said, there is nothing in respect of monitoring the impact of changes to the non-PIE audit sector.
- 3.42. In addition, there is no mention of competition, particularly in the listed sector, where the Audit Regulation was designed to increase competition and (it was hoped) allow some

non-Big 4 firms to move into market for the largest audits. It would seem sensible to consider this as an indicator as it still seems very much an issue in the minds of investors and the market generally.

Professional discipline.

- 3.43. AAT considers it to be a significant shortcoming that indicators are not given for this area, particularly around targets for timely completion of cases.

Q5 Do you have any comments on our proposed budget for 2016/17?

- 3.44. AAT commends the FRC's commitment to be a cost-effective regulator. Nevertheless, given the FRC's new responsibilities as the Competent Authority for audit, AAT views the budget proposed as rather modest. There is a risk that relying on a reduction in accountancy disciplinary case costs may be misplaced if unexpected cases arise of any complexity.
- 3.45. AAT agrees with the FRC that the focus should be on getting and retaining high quality staff and, given the competitive market for such staff, AAT would not want to see FRC's resources falling short.

Q6 Do you have any comments on our proposed funding requirement for 2016/17?

- 3.46. The FRC is proposing to rebalance its funding requirement so that all the costs of its audit role as Competent Authority fall on the audit profession only. AAT queries the logic of this when the whole market, including companies and investors, benefits from high quality audit. It is also the case that some aspects of the new requirements arising from the Audit Regulation and Directive fall on companies and the FRC needs to ensure that the implementation and oversight of such requirements are not subsidised by the audit profession.

7 Do you agree with our proposed levy rates for 2016/17?

- 3.47. AAT has no further comment beyond our answer to question 6.

4. Conclusion

- 4.1. In summary, and as detailed in the responses to the questions detailed above, AAT applauds the progress the FRC has made in many areas of its work, particularly around corporate reporting.
- 4.2. AAT recognises the challenges facing the FRC and advises caution in underplaying the need for resources to meet those challenges.
- 4.3. AAT is concerned that the unlisted sector is not neglected in the FRC's work, and is willing to give further help and input if required.
- 4.4. Indeed, AAT suggests that the FRC should utilise partnership opportunities with other bodies, including the accountancy institutes, to leverage resources in the best possible way.
- 4.5. AAT shares some of the FRC's uneasiness with legislative changes in corporate reporting and audit at the smaller end of the market and we suggest the FRC should monitor carefully the impact of the new requirements to ensure the public is properly protected.

5. About AAT

- 5.1. AAT is a professional accountancy body with over 49,700 full and fellow members¹⁰ and 85,500 student and affiliate members worldwide. Of the full and fellow members, there are over 4,200 members in practice who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.
- 5.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

6. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact AAT at:

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¹⁰ Figures correct as at 31 Dec 2015