



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

By email to: [plan@frc.org.uk](mailto:plan@frc.org.uk)

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Dear Sir/Madam

***Draft plan & budget and levy proposals 2017/18***

PricewaterhouseCoopers LLP welcomes the opportunity to respond to the FRC's draft plan and budget for 2017/18.

We continue to be supportive of the FRC and its activities, recognising that we have several shared objectives, one of which is to promote justifiable confidence in the quality of audit. We are committed to working collaboratively with the FRC, and with other capital markets stakeholders, in order to achieve these objectives.

We have summarised our key comments on the 2017/18 plan and budget in the paragraphs below. A more detailed commentary is attached in the appendix to this letter.

**A narrative which inspires trust in the capital markets**

- The FRC is an important voice in setting the tone for trust in the capital markets, in particular in the areas of corporate governance, corporate reporting and audit. We recognise that the FRC has an enforcement remit, and that exercise of enforcement responsibilities will necessarily be accompanied by a critical narrative. We believe that this critical narrative could be better balanced with discussion of good practice, particularly given the FRC's stated aspiration to be a collaborative regulator focussed on improvement.

**The FRC's culture**

- The draft plan highlights the importance of good corporate culture in delivering long-term business and economic success. We are pleased that the FRC has indicated that it will focus on its own culture and effectiveness. We have already observed the work done to instil a culture of collaboration (the TAG group set up to discuss implementation and interpretation of the new Ethical and Auditing Standards is a good example).
- However, we believe there is more to do in making this culture consistent across the organisation. For example, in our some of our dealings with the AQRT, and in some of the AQRT's public narrative, a more collaborative tone could be taken.

*PricewaterhouseCoopers LLP, 1 Embankment Place, London WC2N 6RH  
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7822 4652, [www.pwc.co.uk](http://www.pwc.co.uk)*



### **Collaborating with all relevant stakeholders**

- FRC's stated mission is to promote high quality corporate governance and reporting to foster investment. In order to support the mission it is important for all groups involved in the capital markets ecosystem (investors, companies, those charged with governance, auditors and regulators) to collaborate actively on an improvement agenda. In all of the FRC's initiatives, we would encourage active engagement with all stakeholders, not just those with the 'loudest voices'. In some instances, more work is needed to even out the level of engagement from all stakeholder groups. We recognise that this could mean a diminished role for the larger audit firms, and we believe this would be appropriate if more complete stakeholder views are obtained. The restructuring of the FRC Financial Reporting Lab Steering Group is an example of where this is already taking place.
- In many FRC initiatives, we observe that only a small section of the investment community is engaged and often there is only limited involvement from company executives. Given the emphasis on investment in the FRC's mission, we encourage it to engage fully with those who make investment decisions as well as corporate governance investor representatives. The participation of executives from the preparer community is essential to ensure that practical consequences of proposals are fully considered.

### **Corporate governance in the UK**

- We understand and support the high priority accorded to corporate governance initiatives in this plan and budget. We agree with the FRC's view that there are core aspects of the current framework, such as the unitary board and the 'comply or explain' principle, which should be retained.
- An aspect of the framework which could be strengthened is the consideration by company boards of the interests of all significant stakeholders (as set out in s.172 of the Companies Act 2006). We support the FRC's focus on improving the understanding and reporting of this area.

### **Maintaining international influence**

- Recent political events on both sides of the Atlantic pose significant challenges for the FRC in its international activities. We encourage the FRC to continue to play an active role with other regulators and to remain influential on the international stage. This should include participation in EU debates, even after Brexit has taken place.
- We believe that a globally consistent regulatory approach is the best answer for business. The new US administration has suggested that a deregulatory agenda may be pursued; the FRC may be able to play a critical role in bridging the differing philosophies of US and European regulators as we move forward.

### **Enhancing the speed and effectiveness of enforcement work**

- We agree with the emphasis on speed and effectiveness of the FRC's enforcement activities. We think further granularity is required on how the FRC will in practice ensure that enforcement investigations proceed efficiently and how the FRC will operate processes to ensure that those subject to enforcement procedures are enabled to engage in early disposal discussions so that there is a real likelihood in practice that enforcement cases can be resolved at an earlier stage. Protracted investigations lasting several years are not conducive to the fulfilment of the FRC's



objectives and the bridge needs to be made between the published processes and procedures and the time frame of actual investigations and final outcomes.

#### **Promoting high quality actuarial work**

- We support the emphasis on promoting high quality actuarial work. In the context of the size of UK PLC's pensions deficit, there is a rising systemic importance to the role of the actuary in helping to ensure that the deficit is appropriately valued and funded.

#### **Proposed budget 2017/18**

- We note the budgeted costs for 2017/18 as set out in the document. Our understanding of the proposals would be greatly enhanced if the document also included the actual spend for 2016/17 (or at least the latest forecast). This would allow areas of increasing cost to be identified and provide additional context for the 2017/18 budget proposals. We have requested the inclusion of this information in previous years and continue to believe it would significantly improve transparency.
- The funding requirement is budgeted to increase by 4% from £34.6m to £36m which is to be paid for in part by an increase of 2.5% in the levies on the professional bodies. We would also encourage the FRC to work with the professional bodies to increase the clarity with which these levies are then allocated to firms.

We would welcome the opportunity to discuss these points with you. If that would be of assistance, or if you have any other questions, please contact Gilly Lord, Head of Regulatory Affairs on 020 7804 8123.

Yours faithfully

PricewaterhouseCoopers LLP



## **Appendix: Detailed comments on the FRC's draft plan and budget 2017/18 consultation**

In this appendix, we have grouped our comments to reflect the sections of the FRC's consultation paper.

### **Promoting high quality corporate governance and effective investor stewardship**

- It is appropriate, in the light of current government initiatives on Corporate Governance, that this area is given such prominence in the draft plan and budget. The FRC will be central to any changes that may follow from the BEIS consultation on Corporate Governance Reform.
- Page 5. There may be a need for guidance on what good reporting on corporate culture looks like – this could be a project for the FRC's Financial Reporting lab.
- Page 6. Although we support the use of indicators, the list of these related to corporate governance seems a fragmented list and does not constitute a “balanced scorecard”. Given the emphasis in the Developments in Corporate Governance and Stewardship publication issued since the draft plan, we suggest there should be indicators on Code compliance and quality of comply or explain explanations.
- Page 6. The indicators refer to ‘surveys’ in three instances - one on corporate culture and two on Stewardship. We suggest that rather than relying on the Investment Association and the accounting profession, etc. the FRC's position would be strengthened if it commissioned its own surveys where appropriate.
- Page 6. The final indicator ‘relevant evidence of greater focus on the importance of company culture from surveys’ is the only indicator relevant to culture, which is a key element of the FRC's approach. We suggest the following indicators could also be included: % of FTSE350 companies with behaviour measurement frameworks in place; % of FTSE350 companies with a dedicated culture/conduct/ethics committee; number of internal audit functions auditing culture; number of organisations that have undertaken an exercise to refresh/assess their values.
- Page 6. In relation to examining the quality of reporting against the Stewardship Code, it would be helpful for the FRC to explain the implications of delisting signatories that fall in tier 3. The FRC will need to guard against a loss of transparency whereby stakeholders might no longer be aware of those investment entities that fall in tier 3.
- Page 6. On stewardship, we suggest that a constructive next step would be for FRC to set and publish criteria for procedures and reporting that could be used as the basis for objective assessment and assurance. Some examples of reporting were included in the Developments in Corporate Governance and Stewardship paper published in January, and more such examples of best practice, both in reporting and in terms of actual activity, would be helpful.
- Page 7. We agree with the indicator ‘survey evidence of the extent and effectiveness of companies’ engagement with investors’. Anecdotally, we hear many audit committee chairs say they have never been contacted by investors with questions or comments on reporting. It would be helpful to measure this with survey evidence and then to engage with audit committee chairs and investors as to the root causes.



### **Enhancing the speed and effectiveness of the enforcement role**

- Page 7. The FRC includes as one of its priorities "enhancing the speed and effectiveness of our enforcement role". It is stated that FRC will complete two reviews (of their enforcement procedures and resources and of the effectiveness of sanctions). We would find it helpful to have clarity over the objective of these reviews, in particular because the enforcement team is being expanded and the budget includes a £0.5M increase in core costs for enforcement.
- Page 7. We observe that the FRC has not proposed any indicators for this section. We believe the FRC should establish indicators against which its progress can be measured. Lengthy investigations lasting several years are not conducive to the fulfilment of the FRC's objectives nor to fairness to the parties under investigation. The FRC should aim to conclude investigations to the point of Decision Notice within 2 years.
- We suggest the FRC could also establish a transparent process by which parties wishing to engage in early disposal discussions can understand the outline of the FRC's case and the proposed penalty at an earlier point than is envisaged in the Sanctions Policy Guidance of June 2016. This will be an enabler of the objective to enhance the speed and effectiveness of the FRC's enforcement role.

### **Promoting high quality corporate reporting**

- Page 8/9. There is a general presumption in the paper that the Financial Reporting Lab is entirely successful. We remain extremely supportive of the Lab, and would encourage the FRC to consider commissioning an independent effectiveness review of the Financial Reporting Lab. It would be useful to know whether a wide range of investors are satisfied with the Lab outputs and to explore whether companies have improved their reporting as a result.
- Page 8. There appears to be a slight disconnect between the 'draft plan & budget' and the FRC's consultation on its 'Corporate Reporting research activities' which were published in the same month. We would encourage a clearer alignment between the two.
- Page 9. We support the use of indicators in this area, but note that it may not be easy to measure some of the more subjective ones listed within the corporate governance and corporate reporting sections. For example the % of listed companies providing a clear, broad and longer term view of risk management, internal control and viability in line with the 2014 Corporate Governance Code, or the quality of reporting by (a) large public companies and (b) smaller listed and AIM quoted companies. We agree with gathering independent evidence through surveying views: the FRC could actively survey different groups of users within the market to obtain views from a variety of perspectives.

### **Promoting justifiable confidence in auditing**

- Page 10. We support the FRC's strategy of promoting continuous improvement in audit quality, through engagement with a range of stakeholders. In particular we support the use of an 'audit lab' to provide a safe space where innovation in market developments can be undertaken. We are pleased to note that the FRC intends to pilot an audit lab project in 2017/18 and would welcome further detail on what is proposed. For example, is it for the development of new audit methodologies and enhanced audit reporting (which is something we called for in our response to the FRC's draft plan and budget for 2016/17)? A project on the use of technology, enablers and disenablers, in the audit process would be a good (though challenging) first project.



- Page 10. We believe that the areas proposed for thematic reviews are valuable and would suggest also examining auditor responsibilities in relation to alternative performance indicators (APMs).
- Page 10. In regard to implementation of the local audit regime we very much support increased dialogue between the FRC and the Department of Communities and Local Government (DCLG). We would welcome greater transparency of the cost associated with overseeing the new regime. Since the first audits that fall for inspection by the FRC are for the year ended 31 March 2018, we would expect the costs of inspection to fall principally into the next budget period (ie for 2018/19). We presume the activity of "introducing monitoring" in 2017/18 relates to planning and agreeing with DCLG what monitoring and inspection work will be done.
- Page 11. In relation to overseeing the RQBs' compliance with the Companies Act in respect of the recognition of professional qualifications, and influencing the work of the IAASB, it will be important to have a focus on whether the audit qualifications and standards remain relevant given rapidly changing technology.
- Page 11. Some of the suggested indicators relate to activities rather than measurable outputs (eg 'pilot an audit lab report on audit'). Some of the other indicators may result in subjective views being expressed, for example surveying audit committee chairs' views on audit quality. Audit committee chairs' views might be balanced also by obtaining views from a wide range of investors.
- Page 11. In relation to achieving the benchmark of at least 90% of FTSE 350 audits requiring no more than limited improvements, an important way of achieving this will be explicit identification and sharing of good practice.

#### **Promoting high quality actuarial work**

- Pages 12-13. The issuing of the new Technical Actuarial Standards (TASs) has been a considerable achievement and the emphasis in the next year should be on their implementation by the industry.
- Page 13. The indicators in this area are very broad. One of them simply indicates "feedback on the new TASs..." – it is unclear from whom the feedback will be sought: we suggest both actuaries in practice and in industry so that a balanced view is obtained.

#### **FRC's efficiency, effectiveness and corporate culture**

- Page 13. We welcome the fact that the FRC recognises that it needs to be efficient and effective in the way it operates and that this requires a strong focus on its own organisational culture. No indicators are included for this section. We suggest that there is an opportunity to make the FRC's annual review clear and concise in the way that activities during the year are communicated. A more streamlined and integrated picture of activities could be compiled that uses the priorities presented in the consultation paper as the framework of the report.