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Dear Sir/Madam

**PwC response to the Financial Reporting Council (FRC) Draft Plan and Budget 2014/15**

We welcome the opportunity to respond to this consultation by the FRC on its draft plan and budget for the forthcoming year. We have considered each of the questions in the consultation document and where we have specific comments these are included in the attached annex. In this covering letter we highlight our views on what we consider to be the more important issues raised by this consultation. These are as follows:

1. **Focus on quality and value of audit** - We remain fully supportive of the FRC's focus on the quality and value of audit. However, in discussing this priority, the FRC asserts that audit is becoming a less significant part of the business of professional firms. We disagree with the premise that the audit part of the professional firms' overall business is diminishing in importance. The firms, professional bodies and the FRC itself are making considerable efforts to examine and improve audit quality; audit has, and will continue to have, a material impact on the culture throughout our entire firm;
2. **Public interest** - Within the audit section of the plan, we note and support the focus on the remit of audit in the public interest. Of course the public interest debate extends beyond pure audit and we would encourage the FRC to work with the ICAEW to develop more guidance on the definition and scope of the public interest; and
3. **Budgetary and levy increases** - We are somewhat surprised at the scale of the proposed budgetary and levy increases, especially given that there remains uncertainty concerning the extent to which in 2014/15 the FRC will implement recommendations arising from the Competition Commission's inquiry and the outcomes from the EU audit reform initiative. The ICAEW communicates directly to firms concerning their registration fee increases, but there is an absence of

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transparency from the FRC as to how the allocation amongst firms is arrived at. We would like to see more transparency by the FRC in this area.

We would be pleased to discuss our views further with you. If you have any questions in the meantime regarding this letter, please contact Gilly Lord (0207 804 8123) or Margaret Cassidy (0207 213 1285).

Yours faithfully

PricewaterhouseCoopers LLP

## **Responses to Consultation Questions**

### **1. Do you agree with the FRC's assessment of the current strengths and weaknesses of corporate governance and reporting in the UK?**

- We agree that quality of governance is generally sound, but note that the FRC has concerns around the internal control and risk management exercised in companies. We presume that this concern is linked to the proposals contained in the draft Sharman/Turnbull guidance issued by the FRC. As we have said in our response to that consultation, we urge the FRC to be clear on whether it regards the new guidance as a substantial change to current practice, and if so, to make this view clearer in all communications. As part of this, the reference in the plan & budget could be clarified and strengthened.
- We agree with the FRC's summary on quality of corporate reporting, and we support further refinement of reporting through moving towards an integrated reporting model, such as that proposed by IIRC. We comment further on this below.
- We note the FRC's concerns about the need for improvement in engagement between investors and companies. We agree and in particular would welcome a broadening of the agenda beyond the dominance of directors' remuneration. We also believe that there is scope for better engagement between investors and audit committees about audit-related matters. We have been encouraging clients to include more insights into the discussions between auditors and audit committees within their annual reports for a number of years, and we welcome the enhancements to audit committee reporting that the 2012 Code has driven and similarly the enhancements to audit reporting that ISA (UK&I) 700 has driven.
- We also note the FRC's concerns about market participants taking a long term view, and we are interested in learning more about the intended thought leadership initiative. More transparency on the FRC's engagement with Europe in this area, e.g., on the Shareholder Rights Directive would be welcomed.

### **2. Do you agree the proposed priorities?**

#### *Corporate Governance*

- In general terms we support the intention of the FRC to "take action" to promote improvement in quality of explanations in relation to the UK Corporate Governance Code ("the Code"). The Code should be enforced by investors rather than the regulator, and we note that the FRC has, in the recent past, incorporated new wording into the Code to encourage better explanations and released a helpful report on discussions between companies and senior investors on the concept of comply or explain. In order to stimulate further improvement in some areas (e.g. succession

planning) and given the comments in the plan about a need for further commitment by investors to engagement with companies (on page 5) we presume that the sort of action envisaged may be for the FRC to work more closely with investors to apply a further degree of “soft enforcement”.

- The key indicator of effectiveness suggesting that measurement of compliance is a measure of success would appear to be in conflict with the nature of ‘comply or explain’, since a good explanation may be more appropriate than compliance in some cases, and would equally be an indicator of success. Also, we suggest that if this KPI is retained, you remove the reference to audit retendering, since the FRC has announced that this provision will be removed, and therefore checking compliance with it will be inappropriate.
- We support the FRC’s intention to assess the number of Stewardship Code signatories having an independent opinion on their engagement and voting processes, and who make those opinions available to clients.
- In relation to the economic and market context area of the updated work plan 2013 – 2016, on strengthening the FRC’s understanding of investor rights (p28), we question whether the work on considering the relevance of proportionate investor rights is likely to conclude by mid-2014.
- Also in the updated work plan for 2013-2016, in relation to corporate governance and stewardship, we suggest that activities around encouraging better transparency on engagement with companies by fund managers and asset owners, and also influencing legislation such as the Shareholder Rights Directive coming out of EU Company Law Action Plan are both likely to extend into 2015/16.

#### *Corporate Reporting*

- The plan appears incomplete without some further comment, aside from the references to IFRS 3 and the conceptual framework, on the FRC’s influencing activity in relation to the IASB. For example, the work of the FRC as one of the National Standard Setters advising the IASB through the Accounting Standards Advisory Forum would seem to merit mention.
- The FRC also contributes to the many bulletins and papers produced by EFRAG on topics such as business model, prudence, reliability, etc. which is important work that we believe should be covered in the plan, in particular given the FRC’s objective of improving its international influence mentioned at the open meeting on 29 January.
- From a UK perspective, the strategic report guidance does not feature in the summary of activities and plans and there is little reference to the integrated reporting framework and plans for the FRC’s work with the IIRC. We believe these to be critical areas for the future of reporting and we consider that they should be mentioned in the plan alongside the references to the planned work on clarity of narrative reporting and cutting clutter.
- We support the plans for the Financial Reporting Lab to contribute to thinking on reporting of taxation and/or dividend capacity in groups. We would be pleased to share our recent work on



reporting total tax contribution if this would be of assistance in this area.

- We note the press release issued in December 2013 urging improved reporting of exceptional and additional non-GAAP items. It would be helpful to know whether there are plans for any work to be done in this area.
- The recent and forthcoming thematic reviews are a key feature of the FRC's paper. We note within the corporate reporting priorities section that the FRC also intends to carry out an assessment of the take-up and quality of UK GAAP. It is good practice to review impact on users of the FRC's various standards and guidance and we therefore suggest that a natural area for a future assessment might be narrative reporting, particularly since the proposals under the draft Sharman/Turnbull guidance should have a significant impact on boards both from behavioural and disclosure perspectives: we believe that the enhanced risk reporting, including the reporting of risks to solvency and liquidity, should enable users to better understand the risks in the context of companies' business models and help link the front and back halves of the annual report. We would be happy to talk to the FRC about how potentially we could help with impact assessment of guidance on corporate reporting.

#### *Audit*

- We are surprised that the priorities in this area do not include the activities that will be required to implement the requirements of the new EU Audit Directive. It has clearly been referenced in the priorities for oversight, monitoring and enforcement, but there is also work to be done to address changes in the audit evolution area.
- We understand the focus on audit of banks and building societies, and welcome work that will lead to an improvement in audit quality in this area. As part of this, we urge the FRC to engage at an early stage with the PRA in order for both parties to better understand their respective scope and objectives.
- We are pleased to see the planned forward focus on quality and value of audit and the skills and competencies of auditors in the future, as this is clearly a most important project. The need to properly define the concept of audit in the public interest and communicate clear thinking on this area is particularly critical. We recommend that the FRC engages with the ICAEW, whose Audit Futures initiative is relevant in this area. We think that the plan should indicate whether the FRC proposes to publish any guidance on the public interest aspect of auditors' and other accountants' work.
- An area of focus that has taxed the profession for a number of years is the attempt to define audit quality. The FRC's 2008 "Audit Quality Framework" paper was a helpful addition to the debate. We note also the recent publication of the IAASB's framework document. We trust that the FRC will seek to make further progress, in particular in thinking about audit quality indicators, liaising with both the PCAOB and CAQ in the USA as they gradually make progress with their thinking

around this area.

- We note the comment: “Early matters for consideration are the impact on the delivery of audit by firms for which the audit business is becoming a progressively less significant part.” We disagree with the premise that the audit part of the professional firms’ overall business is diminishing in importance and believe this is not the right message for the regulator to disseminate, especially with the efforts that the FRC, the firms and the professional bodies are making to consider and improve audit quality.
- Whilst there is reference to the FRC’s contribution to IAASB, IFIAR and EAIG, there will also be a need to contribute to the EU’s new body, the CEAOB. Clearly there may be scope for overlap and duplication with the existing work done with EAIG and the plan ought to address how this will be managed, and how the FRC plans to work effectively with the new and old bodies, so as to avoid the risk of unnecessarily increasing or duplicating the regulatory burden on firms.

#### *Actuarial*

- We believe that the implementation of TASs has been a success story; they are principles based and therefore flexible for streamlined application in practice; it would be a retrograde step to change this approach. There is an allusion to a substantive review of the standards framework and TASs in 2014, which we believe would not be the best use of resources. Rather, a focus on quality assurance of work would be useful, with full account being taken of feedback from the IFoA’s 2013 exposure of a draft on a proposed Quality Assurance Scheme.

#### *Oversight, monitoring and enforcement*

- We support the concept of the thematic reviews, but we believe that there is scope for enhancing the insights gained through inspections and the articulation of the findings and recommendations.
- We note that the FRC is currently considering the implementation of the Competition Commission recommendations which will impact this area of its operations. We hope that the additional resources being recruited and applied in this area will provide an opportunity to shorten the lead time between the inspections and the production of reports. This is relevant to another of the Competition Commission’s recommendations, concerning the publication of inspection report grades in the Audit Committee reports of companies whose audits have been the subject of an AQRT inspection. Reviews by the AQRT involve a considerable delay between the financial statement year end date of the audit and the date when the findings are publically reported. If this does not change, grades reported in Audit Committee reports would relate to audits carried out up to two years previously, and therefore would be at best out of date, and at worst would have the potential to mislead as to the current level of audit quality of a particular firm. We made this point to the Competition Commission in our response (dated March 2013) to their Remedies Notice.

- We agree that the FRC needs to have a focus on the implementation of the Local Audit and Accountability Act 2014. However, in terms of recruitment of additional staff to meet the new requirements, we question whether there is a need for a marked uplift in numbers, given that the work to be undertaken may not be increased significantly and certainly the scope of work required will need full consideration. We will be interested to know more about the rationale for allocation of costs to firms in relation to these inspections.
- In relation to the updated work plan 2013 – 2016, on oversight, monitoring and enforcement we suggest including an item relating to the new regime for co-ordination under CEAOB.

### **3. Do you have any comments on our proposed effectiveness indicators?**

- The introduction of performance effectiveness indicators is an interesting and welcome development. We support this direction of travel, but to be meaningful these indicators need to be measurable and set clear targets. We look forward to the FRC's future reporting against the measures proposed.

### **4. Are there any areas where you consider the FRC should reduce its activities?**

- As we mention above when commenting on priorities in the actuarial work of the FRC, there is a reference to a substantive review of the standards framework and TASS in 2014, which we believe would not be the best use of resources.

### **5 & 6. Do you have any comments on our proposed budget or on our proposed preparers levy rates for 2014/15?**

- As we comment in our covering letter, we are surprised at the level of increase in the budget and the funding requirements in particular for the accountancy professional bodies this year. We understand and support some of the drivers, but would appreciate more clarity on others. We question whether the increases to these, and the preparers levy, are justified and correctly timed, in particular due to the high level of uncertainty that exists, as detailed in our next point.
- We understand that clearing the backlog of disciplinary cases will have an impact on budget, but we are less clear about how the impacts of the Competition Commission investigation into the large company audit market and the European audit reform initiative have been factored into the budget at this early stage, since there is uncertainty around implementation dates of both sets of forthcoming recommendations/reforms, and indeed the actions that will ultimately be undertaken by the FRC, since much of it remains open to consultation. In some cases, the FRC is challenging the Competition Commission about whether their recommendations are necessarily the best course of action to follow for market participants.



- We challenge the FRC to consider whether it is appropriate that relocation costs are expected to be funded from levies. We question whether the FRC considered using its general reserves, since these are meant to be available “to enable the FRC to meet its obligations should there be unexpected reductions in funding received or to meet unexpected but necessary increases in core operating costs” rather than increasing contributions from both preparers and accountancy bodies.
- In respect of the fees for the accountancy bodies, the FRC explains that audit quality concerns are more prevalent in the mid-tier, and clearly there are large increases in the budget for audit quality inspections. We question whether these costs are to be applied across firms in the same proportions as usual.

**7. Do you have any comments on our proposal further to align the FRC levy arrangements with the FCA listing fees?**

- This would seem reasonable.