

Investor ‘Lifting the Lid’ Event

Monday 3rd December 2018



Financial Reporting Council

FRC powers and scope

**What's the difference between the FRC, FCA
and others?**



Financial Reporting Council

Who we are, what we do

- The FRC's mission is to promote transparency and integrity in business.
- The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries.
- As the competent authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.



At a high level

The FRC:

- Is the competent authority for audit in the UK
- Is the standard setter for UKGAAP, Actuarial Standards, UK Audit Standards and the Ethical Standard for Auditors
- Is the setter of the UK Corporate Governance and Stewardship Codes
- Monitors annual reports for compliance with accounting standards
- Has powers to take enforcement action in the case of misconduct by accountants in preparing their annual financial statements and to take enforcement action against auditors for breach of a relevant requirement.



Things that are not in the FRC's powers

Note: This is not a comprehensive list!

- Market abuse (FCA)
- Issues with financial platform providers (FCA)
- Insolvency related issues (Insolvency service)
- Setting international financial reporting standards “IFRS” (IASB)
- Monitor compliance with all listing rules (FCA) – note: CRR monitor compliance with the accounting requirement of the Listing Rules (DTR)
- Any monitoring or powers over non-audit work done by audit firms (including tax, consulting, remuneration advice, insolvency, valuations etc)
- Pre-clear or sign off any audits, financial statements or company annual reports prior to publication
- Any elements of prudential regulation



Accounting & Reporting Things we do:

Policy:

- Set UK GAAP
- Set the UK Strategic report guidance

Conduct Committee (via CRR)

- monitor annual accounts, directors and strategic reports, with power to apply to court for revision
- monitor interim reports and report to FCA
- Challenge 'where there is, or may be, a question' of non-compliance Conduct Committee has statutory power to require documents, information and explanations of companies, officers, employees and auditors
- UK Competent Authority for monitoring financial information under the TD



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Accounting & Reporting **Things we do not do:**

- Pre-clear or sign off annual reports prior to them being published
- Set IFRS
- Review elements of annual reports that are outside of the scope of the conduct committees powers, including: Viability Statements, Governance reports, Sustainability reports, remuneration reports etc.



Audit Things we do:

As competent authority for audit in the UK, the FRC:

- has responsibility for the regular monitoring and mitigation of risks in the audit market. These include the risks of systematic deficiencies within an audit firm network, which could lead to the demise of any audit firm, disruption in the provision of statutory audit services whether in a specific sector or across sectors, and the impact on the overall stability of the financial sector.
- Audit Quality Review (AQR) team monitors the quality of the audit work of statutory auditors and audit firms in the UK that audit Public Interest Entities (PIEs) and certain other entities within the scope retained by the FRC (these are currently large AIM/ Lloyd's Syndicates/Listed Non-EEA).



Audit Things we do:

The policy team develops and maintains auditing and assurance standards and guidance for engagements that are performed in the public interest within the United Kingdom. This includes:

- Standards and guidance for auditors;
- Standards and guidance for reviews of interim financial information performed by the auditor of the entity;
- Standards and guidance for the work of reporting accountants in connection with investment circulars;
- The FRC Ethical standard and guidance for auditors' integrity, objectivity and independence;
- Guidance for the provision of assurance on client assets; and
- Statements that set out its views on particular matters of relevance to audit and other assurance engagements;



Audit **Things we do not do:**

- Pre-clear or sign off audits prior to completion
- Monitor the quality of audits outside of the scope of AQR - monitoring of all other statutory audits is required to be delegated by the FRC to Recognised Supervisory Bodies under a series of Delegation Agreements.
- Appoint auditors on behalf of companies
- Approve the choice of auditor made by companies



Enforcement: Our powers

Accountancy Scheme

- Matters affecting the UK Public Interest
- Misconduct: conduct falling significantly short of the standards reasonably to be expected
- Remains the process for all accountants except Statutory Auditors

The FRC has powers to take enforcement action in the case of misconduct by accountants in preparing their annual financial statements



Enforcement: Our powers

Audit Enforcement Procedure

The FRC will investigate matters relating to the audits of:

- Public Interest Entities (PIEs), being listed entities, credit institutions and insurance undertakings;
- AIM-listed companies with a market capitalisation in excess of €200m;
- Lloyds Syndicates.

Other audit-related investigations have been delegated to the Recognised Supervisory Bodies (RSBs), such as the [Institute of Chartered Accountants for England and Wales](#), but the FRC can reclaim an investigation from an RSB if it chooses to do so.

The FRC has powers take enforcement action against auditors for breach of a relevant standard.



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Corporate Reporting Review

Carol Page



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Regulatory framework

Conduct Committee

Functions and powers

- Authorised to monitor annual accounts, directors and strategic reports, with power to apply to court for revision
- Authorised to monitor interim reports and report to FCA
- Challenge 'where there is, or may be, a question' of non-compliance
Conduct Committee has statutory power to require documents, information and explanations of companies, officers, employees and auditors

Scope

- All UK public and large private companies ie all UK AIM quoteds
- Certain non company corporates with listed securities (eg some building societies)
- Certain overseas issuers (reporting under IFRS or UK GAAP)
- Limited liability partnerships



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2015 Effectiveness review – key improvements

- Investors and preparers supported greater transparency
- FRC decided clearer regulatory stance of continuous improvement
- Increased use of thematic reviews
- Standardise and simplify processes to drive efficiency
- More decision making by the Executive



Selection

- ESMA Guidelines on Enforcement – risk based approach assessing both probability of error and potential impact
- Full reviews
 - FTSE 350** – at least once every 5 years
 - Subject to at least one thematic in-between
 - Priority sectors
 - Financial press
 - Random sampling
 - Outside 350**
 - As above – but no rotation
- CRR welcomes well informed complaints and referrals



Thematic reviews

- Means of driving continuous improvement
 - Some companies pre – informed before relevant year end
 - Report publicly, identifying better disclosures
- Choice of topic
 - Area where room for improvement (CRR evidence based)
 - Area that resonates with investors
 - Area of broader public interest
 - Trailed with firms in advance
- 2018
 - Smaller Listed Company reporting
 - IFRS 15
 - IFRS 9



Thematic reviews

2019

- IFRS 15 – Revenue
- IFRS 9 – Financial Instruments
- Areas of focus : impairment of non-financial assets, BREXIT disclosures, effect of new leasing standard on 2019 interim reports



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Letters to companies

- Companies will be informed accounts have been reviewed
 - Substantive letter of enquiry – where there is, or may be a question; where accounting may comply but not well explained/supported by narrative
 - ‘No substantive issues’ letter – with caveats
 - Some ‘No substantive issues’ letters have more minor issues to bring to the Board’s attention for future consideration
 - All letters reviewed by CRR Director or Technical Director



Common areas of questioning

- Judgements and estimates
- APMs
- Strategic report
- Tax
- Revenue
- Business combinations
- Impairment
- Employee benefits



Increased transparency

- Use of published Briefings
- Publication of company list of reviews
 - Post publication of next accounts
 - Company name
 - Accounts under review
 - Scope



FRC Enforcement Division

Claudia Mortimore
(Interim Deputy Executive Counsel)

David Johnson
(Senior Lawyer)

3 December 2018



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Recap: Enforcement remit

- Audit Enforcement Procedure, Accountancy Scheme, and Actuarial Scheme
- AEP – Breaches of “Relevant Requirements” in PIE audit work and other “retained matters” (large AIM)
- Accountancy / Actuarial Schemes – “Misconduct” by “Members” of relevant member bodies.
- *“the FRC has no business in intervening in the day-to-day management of companies to prevent them failing” (Report of the Carillion Joint Inquiry)*



2018 Review

- *PwC / BHS* – fines for firm and partner, 15 year audit ban for partner and non-financial penalties
- *Assetco plc* management - significant exclusions for former management (16 years, 14 years, 12 years)
- Significant ethics cases concluded (*GT/Nichols*, *KPMG/Ted Baker*)
- *KPMG/Quindell* – fines for firm and partner
- *KPMG/ESML* and *Baker Tilly/Tanfield* Tribunal hearings (reports due soon)
- Formal complaints delivered in *Deloitte/Autonomy*, *KPMG/BNY Mellon* and *KPMG/Silentnight*
- Revised sanctions guidance, following Sir Christopher Clarke's review



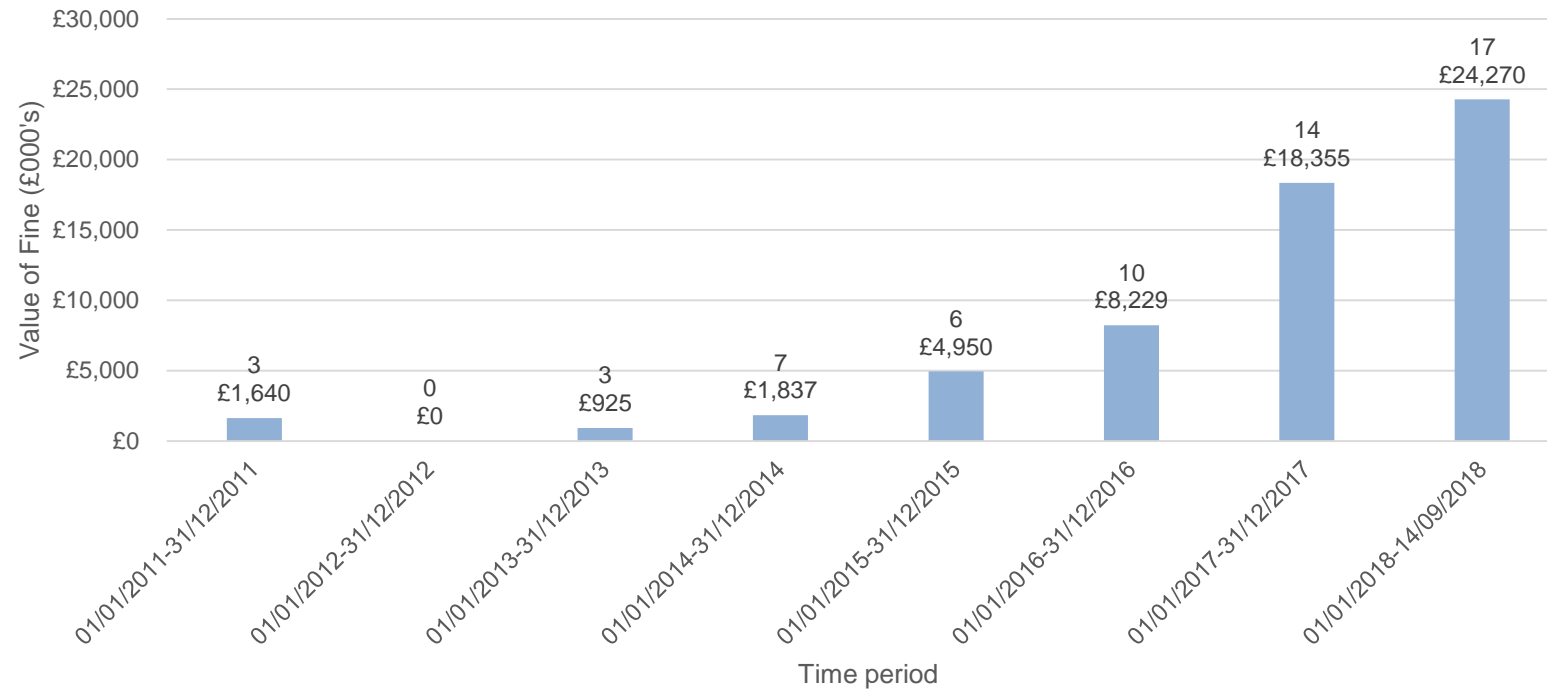
2018 Review (continued)

- C.£42.5m of fines (pre-discounts) since 2017
- Cases opened in 2015 / 2016 now concluding
- Starting to see effects of 2014 reforms leading to quicker conclusions, e.g. PwC/BHS: 2 years from opening to sanction
- Opened several new investigations into (amongst others) audits of: *Carillion, Conviviality, SIG* and *Patisserie Valerie*.
- More cases opened in 2018 than in 2017
- Used new powers to force production of documents (*Sports Direct* in the High Court)



Financial Penalties since 2011

Number of cases and aggregate starting point of fines
- before settlement discount
- all subjects



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What changes might be in store?

- Kingman:
 - structure, governance, and resourcing of FRC
 - wider powers and enforcement remit?
- CMA: Reform of audit market
- Future of audit market and select committee review



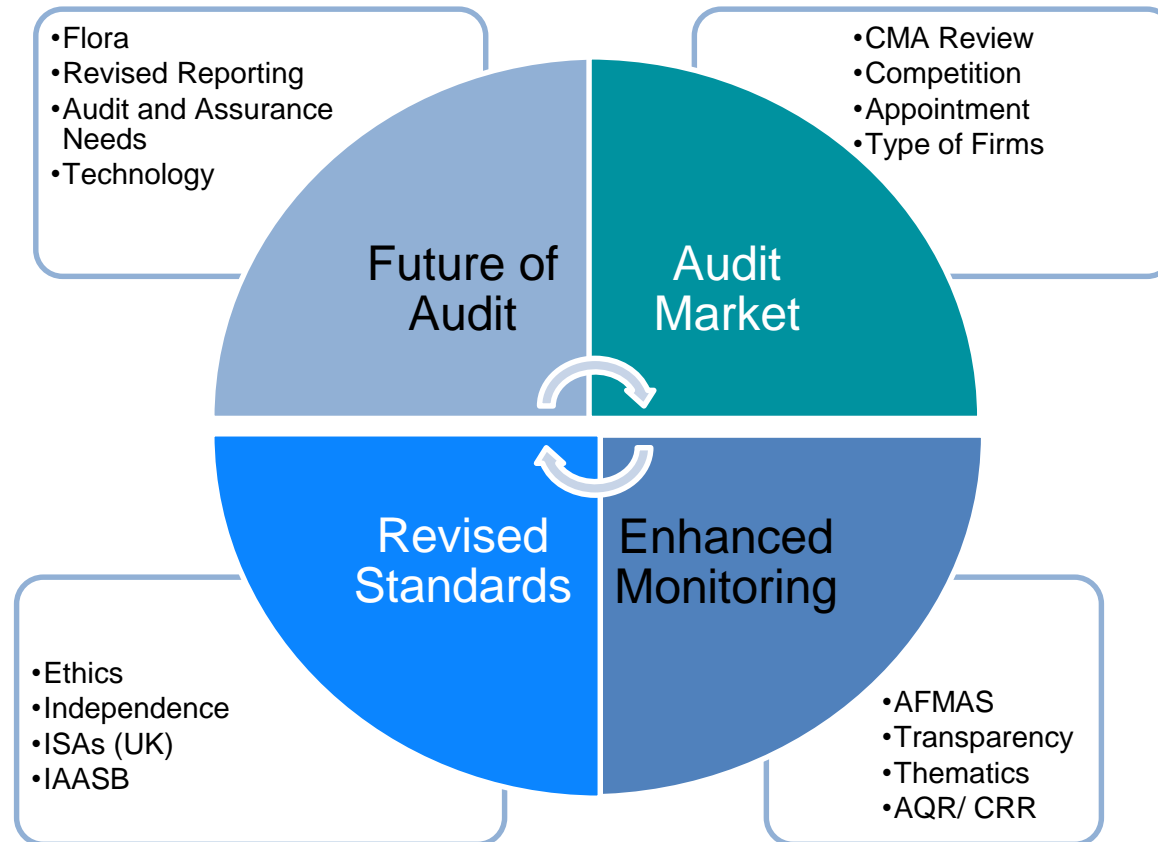
Developments in Audit

James Ferris

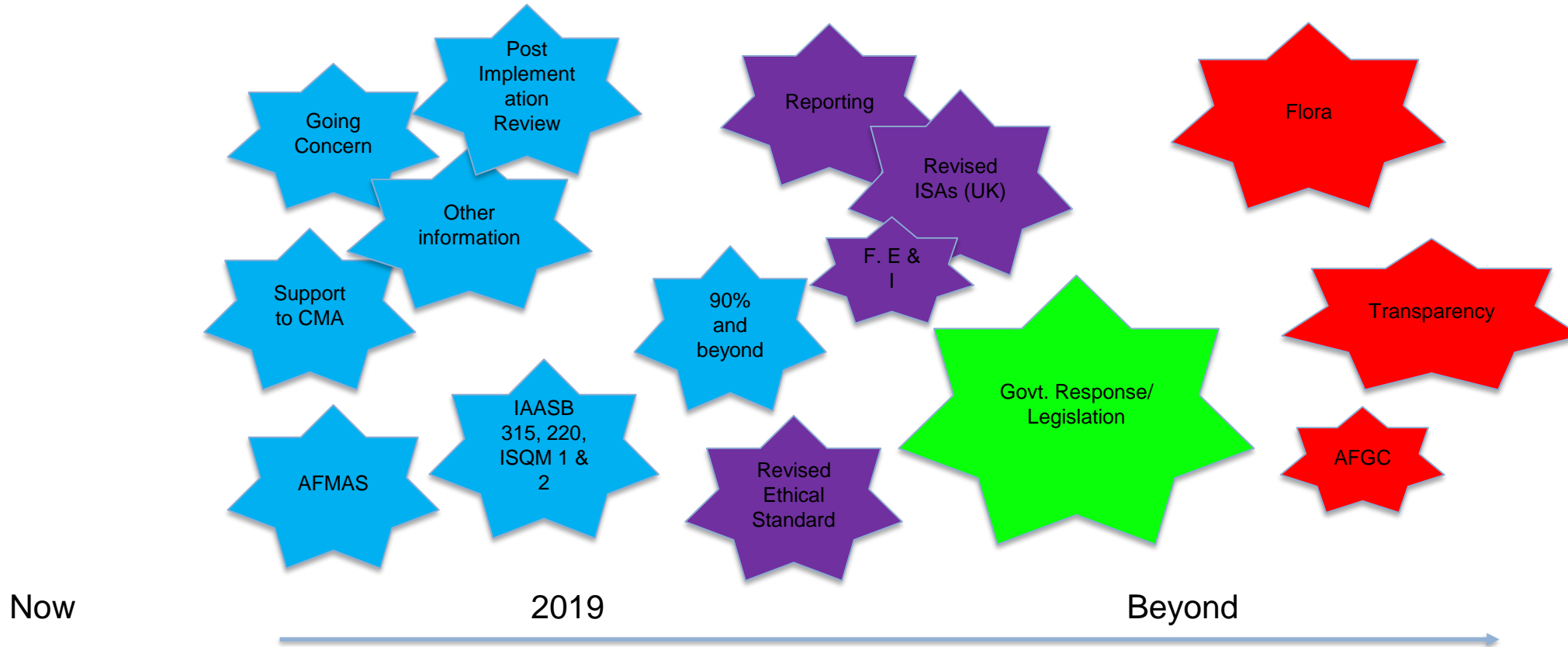


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Lots going on.....



What and When?



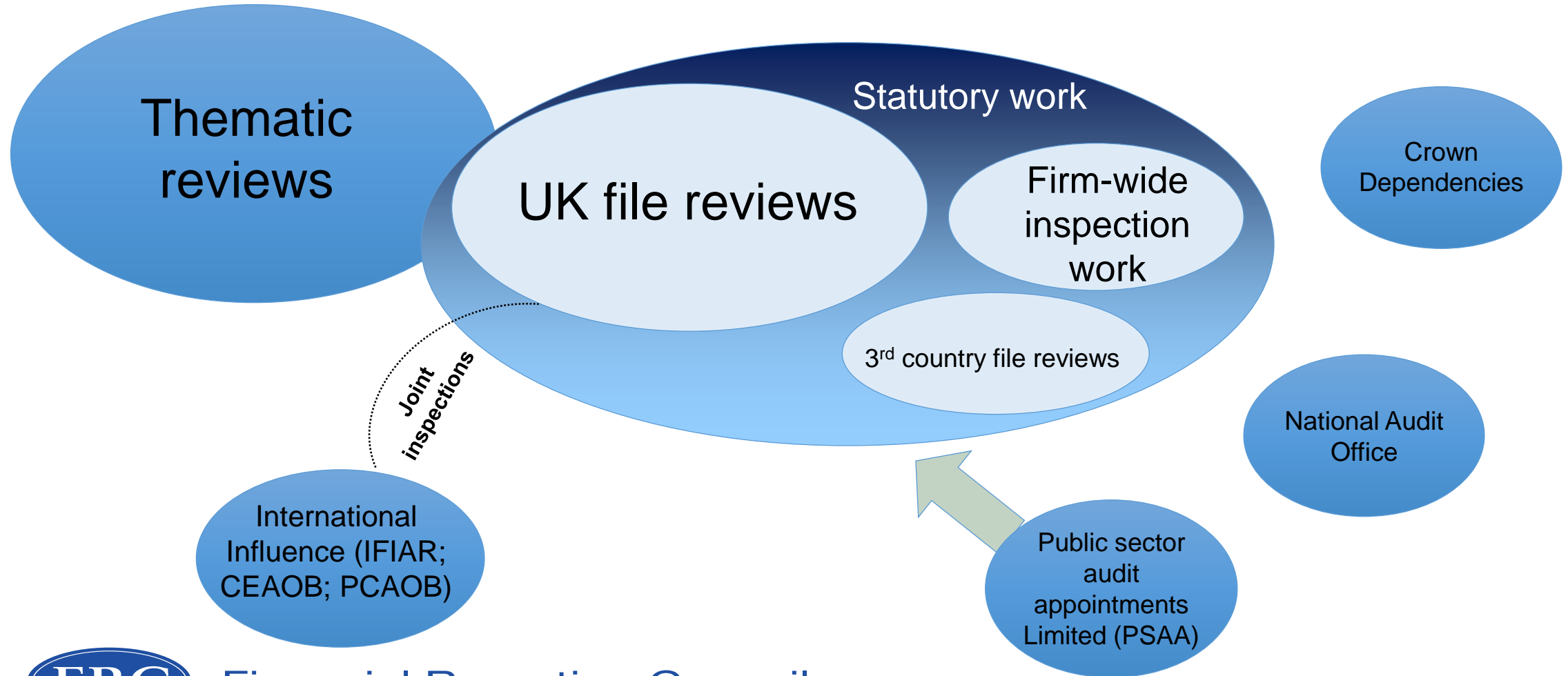
Addressing the Fundamentals of the Audit

IAASB

International Auditing
and Assurance
Standards Board®



Audit Quality Review



Transparency

- Inspection of the audits of UK Public Interest Entities – 160+ per year
- Public reports on largest audit firms
- Final individual inspection reports to firms and Audit Committee Chairs
- Four grade system used – 1, 2A, 2B & 3
- FRC target for audit firms - by 2019 to conclude that 90% of FTSE 350 audits are 1 or 2A

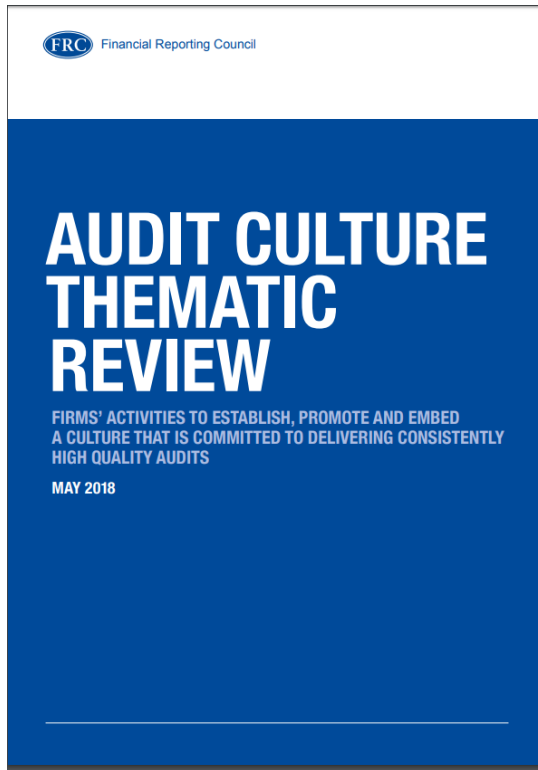


Most recent overall results

- 73% of FTSE 350 audits 1 or 2A in 2017/18
(previous three years: 81%; 77%; 70%)
- 71% of non-FTSE 350 audits 1 or 2A
(previous three years: 72%; 74%; 63%)
- Variable performance across the Big Six
- Common areas where audits fall short



Thematic reviews & firm-wide work



Recent	Current	Future
<ul style="list-style-type: none">• Materiality	<ul style="list-style-type: none">• Front half of the Annual Report	<ul style="list-style-type: none">• Audit Quality Indicators
<ul style="list-style-type: none">• Audit culture	<ul style="list-style-type: none">• Transparency Reports	<ul style="list-style-type: none">• Use of Technology

- Importance of investor perspective
- Firm-wide arrangements

Fit for the future

The 2018 UK Corporate Governance Code

Catherine Horton



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Drivers of change

- Changing governance landscape
- Declining public trust in business
- Government and Parliamentary interest
- Legislation - stakeholders, remuneration and large private companies
- 25 years old in 2017



Revision of the UK Corporate Governance Code

Structure

- Principles and Provisions
- Use of Board Effectiveness Guidance

Language

- Shorter and clearer

Content

- Overall purpose, stakeholders and workforce (culture); chair – tenure and independence; board diversity composition and succession; remuneration committee



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Key Issue: Stakeholder Engagement

Principles A & D and Provision 5

- The 2018 Code references the board's responsibility for considering the needs and views of a wider range of stakeholders
- This approach follows our observations from the Culture Report that companies benefit when considering all wider stakeholders



Key Issue: Significant Votes Against

Provision 4

- Companies should engage in the event of a significant votes against the board recommendation for a resolution
- Significant = 20% or more
- Companies should:
 - (i) immediately explain what actions they intend to take to consult with shareholders;
 - (ii) no later than 6 months after the vote, publish an update; and
 - (iii) publish a final account in the next annual report.



Aiming High!

A successfully embedded Code should encourage:

- improved governance practices and culture
- better quality information for investors and others
- support long-term sustainable business success
- improved public trust in business

This will be accompanied by enhanced
monitoring from 2020



Work in Progress

- 2018 CG Code – embedding and monitoring
- UK Stewardship Code – we will publish a consultation on a fully revised Code on 30 Jan.
- ‘Wates’ Principles – final publication and launch event on 12 Dec.



Any Questions?

For further information, please contact:

David Styles, Director Corporate Governance
d.styles@frc.org.uk

Catherine Horton, Corporate Governance Policy Advisor
c.Horton@frc.org.uk



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The Financial Reporting Lab

**Helping companies and investors improve
corporate reporting**

**Phil Fitz-Gerald
Lab Director**

Financial Reporting Lab



- Market led, not regulatory
- Provides a safe environment to encourage innovation and experimentation
- Reports express views of market participants
- Reports include practical examples
- Since inception in 2011, over 76 companies and 85 investment organisations have been involved in projects
- 18 project reports published (many with animations, slide packs, quick reads)



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Project reports

Strategic Report

- > Business Model reporting
- > Risk and Viability Reporting
- > Disclosure of dividends - policy and practice
- > Towards Clear and Concise
- > Performance metrics

Remuneration Report

- > Single Figure for Remuneration
- > Reporting of Pay and Performance

Governance Reporting

- > Reporting of Audit Committees
- > WM Morrisons Supermarkets PLC

Technology

- > Digital Present
- > Digital Future Framework
- > XBRL
- > Blockchain

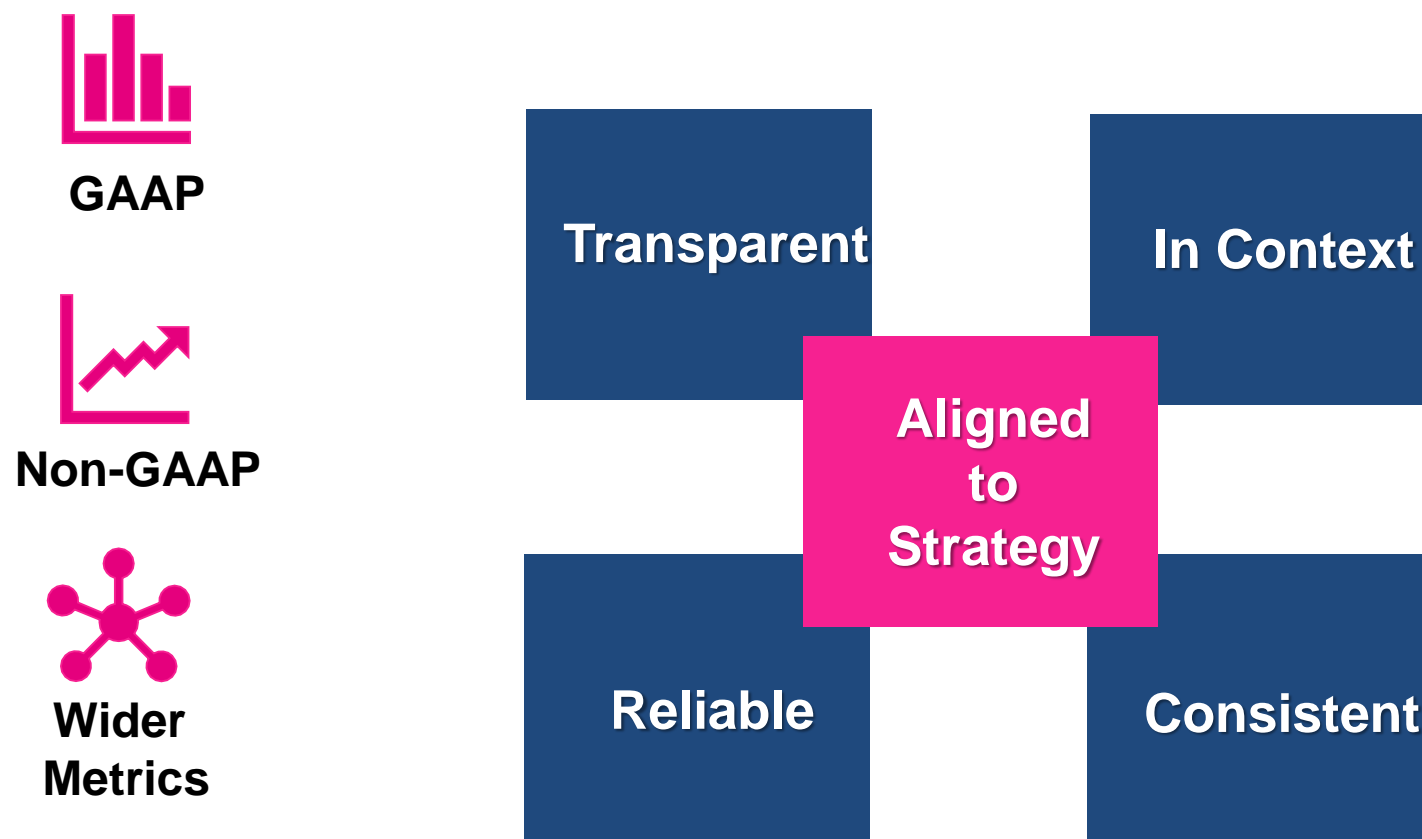
Financial Statements

- > Net Debt reconciliations
- > Operating and investing cash flows
- > Debt terms and maturity
- > Accounting policies and integration of related financial information
- > William Hill: Accounting policy
- > HSBC: Presentation of Market risk reporting

Current & recent projects

- Performance metrics
- Implementation study:
Business model reporting, risk and viability
reporting – Where are we now?
- Digital Reporting
- Climate & Workforce Reporting

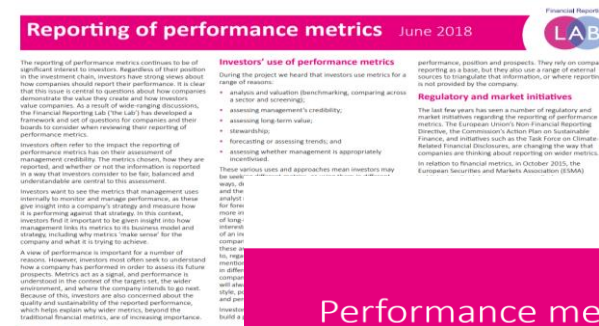
Performance metrics



Participants in the project

Aberdeen Standard Investments
 Allianz Global Investors GmbH
 Barclays
 The Church Commissioners for England
 Colorado PERA
 Fidelity International
 Fuller Analysis
 HSBC Global Asset Management
 Independent Franchise Partners LLP
 Institutional Shareholder Services
 Invesco Asset Management Limited
 Kames Capital
 Legal and General
 Martin Currie Investment Management
 Moody's Investors Service Limited
 Old Mutual Global Investors
 RBC Global Asset Management

Schroder Investment Management Shore
 Capital
 State Street Global Advisors
 S&P Global Ratings
 The Investment Association
 Toscafund Asset Management Limited
 WHEB
 Three representatives from the UK
 Shareholders' Association



Performance metrics –
Principles and practice

November 2018

Business model reporting; Risk and viability reporting

Business models

- Purpose more clearly articulated and more “at a glance” articulation of business models
- Less development of disclosure of key revenue, profit drivers, investment plans and cashflows

Risk

- Many of the Lab’s recommendations have been adopted for risk reporting, including greater linkage, movements in risk, prioritisation of risk
- Less development of disclosure on mitigating actions, such as clearly articulating actions that are already in place and actions that will be taken should a risk crystallise

Viability

- Two-stage process for viability statements developing with greater disclosure of an assessment of prospects, and increasing disclosure of detail on scenario analyses



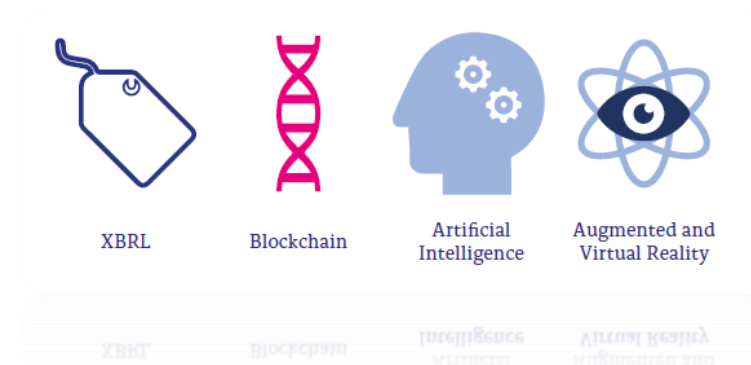
Digital Future



In 2016, the Lab launched the **Digital Future** project, an initiative to investigate the impact of technology on corporate reporting communications to the investment community.

As part of this project we have already:

- Released a framework of characteristics that are important for a system of digital reporting.
- Released a deep dive report on how XBRL fits into corporate reporting.
- Explored the possibilities of Blockchain in the corporate reporting process.

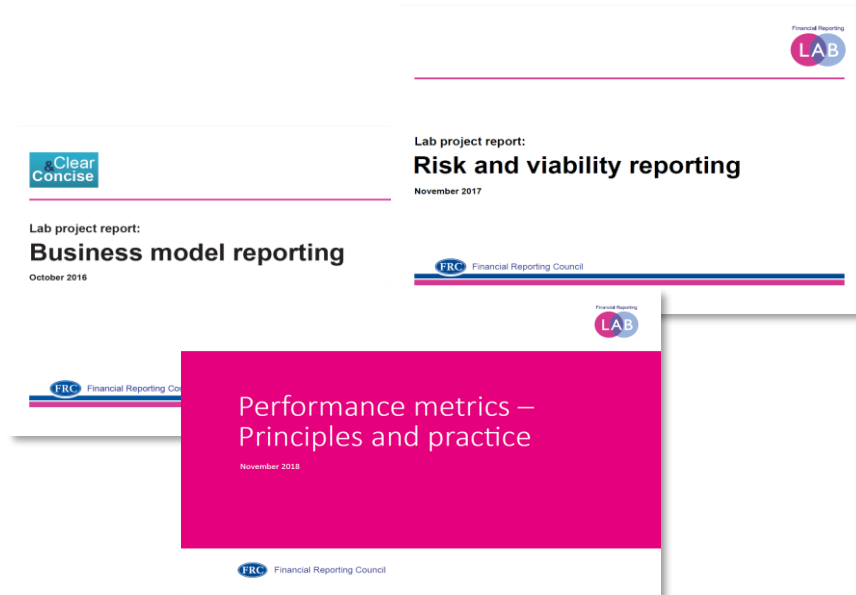


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Climate and workforce reporting



Apply the findings and principles from the Lab's recent projects on strategic report elements to two topics:



Climate & Workforce Reporting

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Find out more about the Lab and our work:



www.frc.org.uk/lab



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Audit & Assurance Lab pilot project

- Promote best practice on audit related issues in a safe and collaborative environment, engaging with audit stakeholders, including audit committees chairs (ACCs), companies, investors and auditors
- Pilot project - explore how investors' confidence in audit is enhanced by, and supported through:
 - The external reporting* by audit committees (AC) in the annual report ([Phase 1](#) – issued 18 December 2017)
 - Auditors' reports to audit committees (Phase 2 – during 2019)

*Audit Committee Report (ACR)



Audit committee reporting - outcome

- Phase 1 focused on good practice elements of existing AC reporting, and encourages audit committees to consider adopting them
 - Good participation across audit committees, investors, audit firms
 - Feedback has been positive so far, from audit committees, audit firms and investors
- Phase 2 will look at (private) reporting from auditors to audit committees

Audit committee reporting - findings

- Investors look to the ACR to give them confidence
- Very limited engagement between investors and ACCs. Some investors willing to engage
- ACR provides valuable insight, more can be done. Less boilerplate.
 - Appointment and tendering
 - Independence and objectivity, effectiveness
 - Reporting on significant issues
 - Internal control, risk management systems and internal audit

Future of Corporate Reporting

Deepa Raval



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Objective

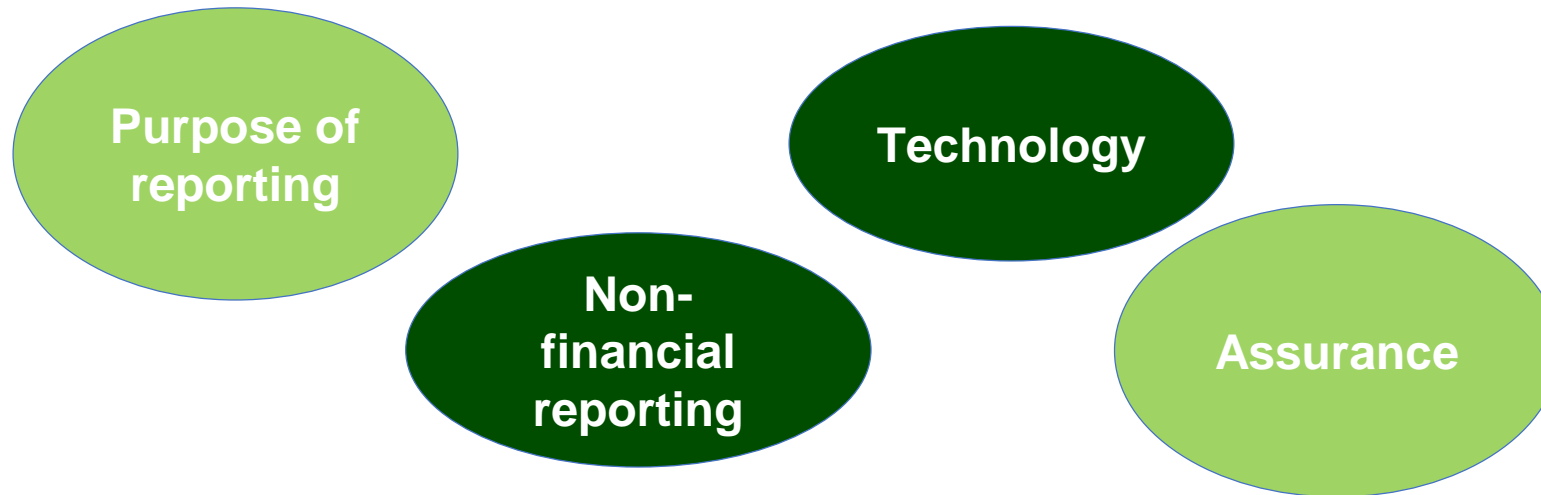
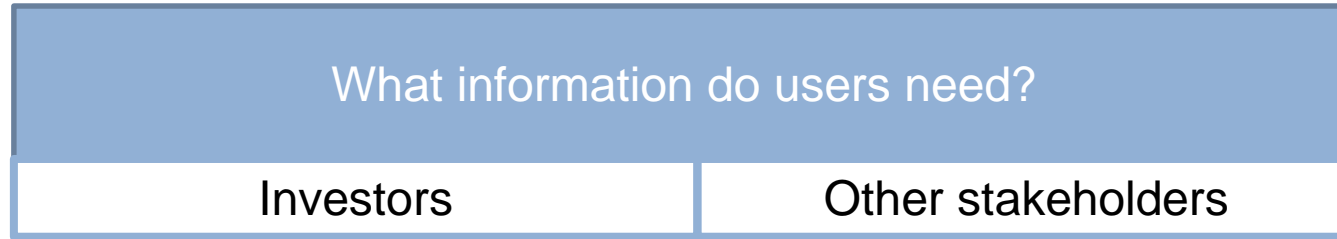


To identify opportunities to improve corporate reporting and make specific recommendations for changes to regulation and practice.



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Project components



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Next steps

