CIMA response

to the

Call for Evidence

as part of the

Independent Review of the

Financial Reporting Council

Chartered Institute of Management Accountants

The Helicon.

One South Place.

London.

EC2M 2RB

Current Mission and role

Question 1: What should the FRC's objective(s) be? Is its present mission statement the right one?

We agree that the FRC's mission 'to promote transparency and integrity in business' is the right mission statement. However, we believe that 'how' it achieves this mission needs to be strengthened in certain areas, particularly in relation to the extension of the FRC's monitoring and enforcement powers, as indicated in our responses to the more detailed questions.

We acknowledge that the FRC has sought to engage effectively in developments in the broader corporate reporting agenda. The recent Guidance on the Strategic Report and the work of the Financial Reporting Lab are good examples here. However, in a post-Brexit world, we believe that the FRC has an opportunity to be a global leader and advocate for leading-edge corporate reporting practice, for example, as defined by the Integrated Reporting Framework. Such multi-capital approaches to reporting would help to address broader areas of public concern around corporate performance and behaviour. We would therefore recommend that the mission statement reflects this stronger corporate reporting role more explicitly.

Question 2: Does the FRC's name remain right?

As a reflection of the shift away from purely financial reporting towards a broader narrative reporting we would argue that the FRC needs renaming to become the *Corporate Governance and Reporting Council*. This would capture the shift in both public expectation and professional practice and would place the regulator at the forefront of the governance and reporting debate.

Question 3: Are the functions and structure of the FRC still relevant and appropriate, or is there a case for any structural change? Should any of the FRC's functions move to other regulators?

The new FRC structure should be developed to respond to the needs of a post Brexit world and should address independence and the need to respond quickly to corporate misdeeds. This could include faster processes and a higher public profile for public interest investigations.

In terms of structural change, consideration could be given to the time taken to address regulatory matters. Should a case continue for many years, it drives uncertainty, cost and often public resentment. It also delays progress in improving corporate governance and reporting. We recommend that in reviewing the future role and structure of the FRC, including the relationship with other regulatory bodies, this should be addressed

We would also support continuing work with other regulators internationally so that cross border learning and intelligence can be coordinated. Specifically, a Europe wide reporting Lab has been floated by Accountancy Europe and we would hope to see the FRC working with this new body.

Question 4: What lessons can be learned from other countries' regulatory systems? Which ones?

In many countries, the mandated reports require focus on multiple capitals as developed by the International Integrated Reporting Council (IIRC) including social, environmental, human, financial, manufacturing and intellectual. Although the FRC guidance on the UK's Strategic Reporting requirements is aligned with the principles underlying Integrated Reporting, we believe it would be more beneficial if Integrated Reporting was explicitly required in the UK based on the Integrated Reporting Framework as published by the IIRC.

There is some evidence that companies in the UK are undertaking such wider reporting on an ad hoc basis. Our view is that this process could be accelerated given the growing acceptance of integrated reporting as demonstrated by its adoption in countries such as South Africa and the Netherlands.

Question 5: How effective has the FRC been in influencing wider debates that affect its ability to deliver its objectives – for example, around audit competition, or its legal powers?

We believe the FRC is doing a good job, however, there is room for improvement. The FRC should focus on the quality and effectiveness of its communication. It must also acknowledge its role in consumer protection and address public perception of systemic imbalance. Specifically, there needs to be a campaign to ensure increased understanding of the role and powers of the FRC as well as significant campaigns of influence to explain why high profile action is not taken against perceived wrong doing.

While decision making should be evidence led, it should also take into account the public interest. Specifically, social media can be an effective way of improving communications and wider public understanding and this should be used as much as possible in this regard. Although this may mean engaging in wider debate, we feel that the benefits would be greater public support in the long term.

Impact and Effectiveness

Question 7: What are the FRC's strengths and weaknesses?

The FRC has developed core strengths in a number of areas. The recently updated UK Corporate Governance Code and thought leadership in reporting through initiatives such as the Financial Reporting Lab contribute to the high standards in Britain. The strategy of the FRC is fit for purpose and it has competent and capable leadership and staff.

The FRC weaknesses are to be found, for the most part, in its current structures. It would be immeasurably strengthened by an expansion of its scope and powers and by being established as an independent statutory body. The FRC would be well served by strengthening its communication function to ensure that its purpose is well understood by a broad range of stakeholders particularly those outside out its immediate circle of influence. This would improve understanding though transparency of operations. Finally, we suggest greater consideration is given to issues of proportionality when the FRC is dealing with individuals. Please see our response to question 9 for more detail.

Question 8: The recent joint report on Carillion from the Business, Energy and Industrial Strategy and the Work and Pensions Select Committees considered the FRC to be characterised by "feebleness and timidity" and recommended that a change of culture and outlook is needed. Do you agree? If so, please cite relevant evidence which informs your view.

We have seen no evidence of 'feebleness and timidity' by the FRC in fulfilling its mandate

In our view, the principle problem the FRC faces in accomplishing its regulatory remit is that it is charged with supervising only a relatively narrow segment of what are generally multi-faceted problems. The precipitating factor for this review was a corporate failure that likely involved (with varying degrees of culpability) external auditors, banks, investors, consultants and legal advisors; internal managers, lawyers and accountants and boards consisting of executives and non-executives. The FRC's ability to regulate these parties – or even to obtain evidence from them – is constrained by the limits of the Accountancy Scheme and the Audit Enforcement Procedures. It is clear that many of the FRC's stakeholders are alive to the fairness (or otherwise) of its inability to pursue disciplinary proceedings against those who are not professional accountants. However, there is a more fundamental question of the overall regulation of corporate misconduct.

Just as integrated reporting requires a holistic view of a company's health, the kind of effective regulation that will maintain the confidence of the public and markets requires a joined up approach that can deploy all the necessary tools (clear powers to compel evidence and interview witnesses; and powers to discipline and/or disqualify directors; as well as powers to seek or recommend criminal prosecution) against all potential malefactors (whether professional accountants or not, firms or individuals). This seems (as we state elsewhere) to require a broad review of the entire regulatory structure and that primary legislation places the FRC (or whichever successor body may supplant it) on a firm statutory footing.

CIMA has been highly supportive of the FRC and of the Accountancy Scheme since its inception. However, it is clear that it has struggled ever since its first case (*Mayflower*) to decide who it should be investigating and on what grounds. This is in part as a result of the fact it is limited to investigating professional accountants and accountancy firms, rather than having the power to look at the entire management team in cases of corporate failure. More recently, we are aware of some concerns that the FRC enforcement team has chosen to investigate some areas of work by professional accountants (eg insolvency) in which it lacks any relevant experience (and which arguably are regulated by others).

The FRC has also taken a relatively restricted view of what constitutes the public interest, as demonstrated by the relatively small selection of cases it has chosen to investigate which have resulted in effective disciplinary action. Its enforcement arm must seek to work closely with those responsible for standard setting, in order to ensure that relevant feedback is supplied to professionals and positive corporate and professional behaviors are encouraged.

Question 9: Are there changes respondents would like to see to achieve the vision set out in the Review's terms of reference?

- **Alignment of powers with Financial Conduct Authority Powers**
  A key issues for the FRC is lack of public trust in business and the need for greater accountability of company directors. This stems from its lack of powers to protect the public against egregious corporate behavior at senior level. To remedy this situation we recommend the granting of new powers to the FRC akin to those of the Financial Conduct Authority (FCA).

- **Ensuring equality of directorial accountability**
  Increasing fairness and transparency should be at the heart of a structural reform. At present professional accountants who serve as directors face greater jeopardy than other board members. This is because, in general, non-regulated directors are not subject to any professional conduct regime. A creates a consequent potential risk that companies may decide to appoint non-accountants to senior finance positions as the perceived regulatory risks to the organization are less. This is clearly contrary to the public interest. The fact that the FRC and other accountancy regulators can only take action against professional accountants creates the damaging impression that miscreants can go unpunished.

- **Extension of Corporate Reporting Remit**
  It is critical that the review consider a cover wider corporate reporting remit for the FRC. The agenda has moved substantially since the FRC was reconstituted in 2012 and a wider remit would strengthen transparency and accountability. Specifically the International Integrated Reporting Council (IIRC) has developed a framework that takes into account wider value creation measures and the EC Directive 2014/95/EU on non-financial reporting now mandates reporting on environmental and social issues.

  While the FRC has engaged in the developing corporate reporting debate, for example, through the *Guidance on the Strategic Report* and the work of the Financial Reporting Lab, we believe it should have a stronger role so that it can be a global leader and strong advocate of leading-edge corporate reporting practice. This will be particularly important in a post-Brexit world to position the UK at the forefront of corporate reporting.
  We also believe the remit of the FRC in relation to monitoring and enforcement should be extended explicitly to all value adding activity. This would improve public perception of big business and build confidence that the public are protected from corporate excess.

Question 10: Are arrangements for financial reporting, audit and corporate governance the critical elements for effective delivery of FRC's mission, or are elements missing?

We would concur that these are the three critical elements. However we would like to see the FRC remit with regards to statutory corporate reporting extended to cover reporting on all value-adding corporate activity.

Accounting and financial reporting

Question 18: Has the FRC been effective in influencing the development of accounting standards internationally as well as accountable and effective in setting UK GAAP?

Yes, we would support the work of the FRC in this area.

Question 19: How else could the FRC improve the quality of financial reporting with a view to ensuring investor confidence?

We support the Financial Reporting Lab as a mechanism for improving corporate reporting amongst leading organizations. The Lab has successfully brought together investors and preparers in a way that is being emulated internationally.

Question 20: Are there wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders?

Current legislation and regulation provides investors and other stakeholders with the powers to hold boards and directors to account. Any changes to the regulatory or institutional framework should therefore build on these successful fundamentals rather than seeking a comprehensive overhaul. Nevertheless, improvements can always be made to the systemic environment, and if done well, can provide the scope for increased long-term business success. The aim should be to make the UK an even more attractive place for businesses to be located.

Question 21: Is the current combination of statutory and voluntary methods of oversight for professional bodies effective, and do they remain fit for the future?

Yes, we support the current model.

Corporate Governance and Stewardship Codes

Question 22: In relation to the UK Corporate Governance Code, are there issues relevant to the Review's terms of reference that respondents believe the Review should consider?

We urge the FRC to adopt an evergreen approach. This means all policies and protocols are kept under constant review so that proportionate and relevant regulation is delivered in a consistent, timely and cost effective manner.

We recommend that the review considers a revised public interest test to cover broader intervention. This should include, for example, private companies where public detriment can be demonstrated.

Question 23: How effective has the Stewardship Code been in driving more and higher quality engagement by institutional investors? If not, why? How might quality of engagement be further strengthened?

We are supportive of the Stewardship Code which fosters a sense of ownership from investors and helps to address the principle of wider stakeholder relationships within business.

London remains one of the world's leading capital markets and those elements over which the FRC has a role - the Governance and Stewardship Codes and the accounting profession - contribute to this success.

It is of vital importance that the strong reputation is maintained post Brexit.

Speed and effectiveness of investigations; enforcement and compliance

Question 24: Do respondents view the FRC as reluctant to undertake investigations or enforcement, or able to do so at speed?

Please refer to our response to question 8. Whilst we do not recognise “timidity and feebleness” in the FRC’s approach to its enforcement role, our perception is that the FRC has taken a relatively restricted view of the public interest and/or has been constrained by the somewhat incoherent regulatory framework for large corporates. So for instance, the only investigation of auditors falling out of the financial collapse of 2008 (concerning the auditors of Lehmans Brothers International (Europe) did not result in any action; we ask rhetorically, what happened to the rest?

Question 25: How could the FRC better ensure it is able to take swift, effective and appropriate enforcement action? What practical or legal changes would be needed to achieve this?

We would also emphasize the need for the FRC to work more closely and consistently with the Financial Conduct Authority (FCA) and the Insolvency Service. It is critical that the accounting profession maintains a discipline of approach maintained through standards and enforcement action. There is a perception that the strengthening of FCA powers following the financial crisis of 2008-09 has led to imbalance whereby the FCA has significantly greater powers of enforcement than the FRC. As a minimum we would encourage greater consistency of regulation and greater cooperation between regulators so as to address public perception in these areas. We would also suggest that the fining regime for large organisations who fall short in terms of Strategic Report legislation should be reviewed and penalties increased where necessary. In part this would address public perception that enforcement action does not match the impact of the offences.

The lessons, particularly from the financial sector are that regulation needs to be coordinated and consistent. This both lessens the burden for business and gives confidence to the wider public. Given the overall effectiveness of the FCA in performing its duties we believe that the FRC should be given comparable powers. Additionally, the organisations, together with the Insolvency Service should work together effectively to avoid any systemic gaps in enforcement.

FRC and corporate failure

Question 27: Is there more the FRC could or should do to help reduce the risk of major corporate failure?

We would suggest that the review considers a revised public interest test within the FRC’s new mandate. Traditionally the FRC has championed the investor view, however, many large investors are able to protect themselves from loss through spreading risks whereas the wider public who may end up unemployed and lose pension income through corporate failure are not so well protected.

Building on the current s172 Companies Act 2006 requirements for directors to promote the success of the company over the long term for the benefit of shareholders, having regard to a range of other key stakeholders and interests, this test could be based on the work of the King IV Committee review of Corporate Governance in South Africa and specifically the concepts as stipulated in its recent report[1] on page 23. These include integrated thinking, the organisation contributing to societal benefit, corporate citizenship and stakeholder value. The development of a wider public interest remit would ensure that maximum accountability and public acceptance of its mission is fostered within the regulator. Decisive action from the regulator could then be benchmarked against this test and used to publically justify enforcement action.

Across the world and specifically in the UK trust in business and assurance continues to be low. The decline in public trust, which is once again highlighted through the Edelman 2018 global trust survey[2], is something that needs to be tackled. The trust gap is particularly important given that an increasingly high percentage of company value now resides in intangible assets.

Question 30: Introduction of the viability statement was an important development, but could it be made more effective?

We welcome the emphasis in the recently issued *Guidance on Board Effectiveness* on the need for a robust and transparent process underpinning the production of the viability statement. We believe that this additional guidance, complemented by the guidance on risk reporting in the *Guidance on the Strategic Report* are important steps to improving the effectiveness of the viability statement. Improved reporting on the process, including the assumptions, the stress and scenario analyses undertaken and mitigating activities will also help investors and other stakeholders to understand the implications of subsequent changes in trading conditions in between annual viability statements.

We would recommend that, as part of their regular risk assessments, companies should keep the assumptions underlying the viability statement under review, and issue updates on any material changes in assumptions and analysis. The FRC should also have the authority to monitor and enforce improvements of poor viability statements.

Powers and sanctions

Question 31: Are there gaps in the FRC's powers? Would its effectiveness be improved with further (or different) powers?

As CIMA highlighted in our response to the UK Government Green Paper on corporate governance issued on 29 August 2016[3] we feel strongly that there is considerable disconnect between enforcement and sanctions of professional accountants vis-à-vis other directors. This regulatory gap leads to the perception and reality that company directors can be treated differently for the same offence and can in some cases avoid sanction.

Given the success of the FCA in performing its duties we believe that the FRC should be given comparable powers. Additionally, the organisations, together with the Insolvency Service should work together effectively to avoid any systemic gaps in enforcement.

[1] https://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/king_iv/King_IV_Report/IoDSA_King_IV_Report_-_WebVe.pdf

[2] http://www.edelman.com/executive-summary/

[3] https://www.cimaglobal.com/About-us/CIMA-view/

The FRC’s legal status and its relationship with Government

Question 34: Should the Government legislate to put the FRC on a more conventional consolidated statutory footing?

Yes. We recommend the granting of new powers and statutory status to the FRC akin to those of the Financial Conduct Authority (FCA). The Financial Services and Market Authority Act, 2000, gives the FCA a remit based on consumer protection, integrity and competition with wide ranging powers of enforcement to support this.

In our view the FRC would benefit from a similar, clear statutory underpinning. This would address concerns that the current model does not satisfactorily defend the public interest; that it is too close to those it regulates; and that it does not sufficiently separate its powers of standard setting and enforcement.

Question 35: What is the optimal structure for the relationship between the FRC and the Government, best balancing proper accountability with enabling the FRC’s effectiveness?

An independent body created by statute.

Governance and leadership

We have not addressed specific questions in this section but would state that we are broadly satisfied with current arrangements and structures.

Funding, resources and staffing

Question 42: Who should fund the FRC, and how? What are the impacts of current funding arrangements, including of having a partially voluntary funded regime?

We recommend a review of the funding model of the FRC to ensure that the costs are proportionately borne by those who are subject to regime in the first instance and from the wider sector who benefit from the consequent access to the public markets.

Question 43: What skills are needed for the FRC to be most effective? Does the FRC have the people, skills and resources it needs, of the quality it needs?

The FRC should consider investing in and strengthening its communication function to ensure it is properly resourced. A stronger push on communication using all available channels will allow the FRC to ensure that there is a good understanding of its role and purpose and powers. It will also ensure that all stakeholders, particularly the public, understand the role it plays in promoting and upholding the public interest.

Question 44: Are there conflicts of interest in the FRC’s structure, processes, or culture? Are there deficiencies in the FRC’s approach to managing conflicts of interests?

We believe that it is critical for a regulator to be independent from those it regulates and that boundaries are clear and well understood. The risks of losing this need to be understood.