David Andrews
Financial Reporting Council
5th Floor Aldwych House
71-91 Aldwych, London
WC2B 4HN

23rd January 2012.

Dear David,

The Financial Reporting and Analysis Committee (FRAC) of The Chartered Financial Analyst Society of the UK (CFA UK) welcomes the opportunity to respond to this consultation exercise.

CFA UK represents more than 9,000 investment professionals working across the financial sector. For advocacy purposes in the field of financial reporting, these members are represented by the Financial Reporting and Analysis Committee.

About CFA UK and CFA Institute

The CFA Society of the UK (CFA UK) represents the interests of more than 9,000 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members. Most CFA UK members have earned the Chartered Financial Analyst® (CFA®) designation, or are candidates registered in CFA Institute's CFA Program. Both members and candidates attest to adhere to CFA Institute's Code of Ethics and Standards of Professional Conduct.

CFA Institute is the global association for investment professionals. It administers the CFA and CIPM curriculum and exam programs worldwide; publishes research; conducts professional development programs; and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute has more than 100,000 members in 140 countries, of which more than 90,000 hold the Chartered Financial Analyst (CFA) designation.

Proposals to Reform the Financial Reporting Council A joint DBIS and FRC consultation

Introduction

Our reaction can be split into two. On monitoring and enforcement, or Conduct, we are in broad agreement with the analysis – insufficient independence and inadequate powers – and with the proposed reforms.

On Codes/Standards, we are concerned about a potential undermining of the UK's expertise and reputation in the fields of accounting, auditing and actuarial standards, and the potential dilution of the UK's influence on international standards-setting.

On structure, while agreeing that there is scope for rationalising the present arrangement, we have several questions about the composition, roles and powers of the new layers being proposed – the two board committees and the advisory councils – and how they interact with the board and the executive.

We do welcome the emphasis placed on an investment focus for the FRC's activities, and we hope that whatever reforms are made will cement its independence in pursuing this.

Since we have a number of doubts and questions about the proposals, we would welcome an opportunity to meet the FRC/BIS to discuss our concerns. We would also welcome any public meetings or round-table events to debate the issues.

Consultation questions

1. Do you have any comments on the case for FRC reform as set out in this document?

Taking each heading in turn, our responses are:

The scope of its regulatory activities is not clearly defined

While the FRC comprises seven bodies, the over-arching purpose is not difficult to understand. High quality financial reporting is essential to the fair and efficient working of capital markets. To achieve this, corporate governance must be sound, financial statements have to be audited and other financial information (such as actuarial calculations) must also be comprehensive and reliable. In addition, company directors and professionals involved in producing and verifying financial information need to be held to account. The primary audience should be the providers of capital, so we welcome the "investment focus".

The FRC's structure is over-complex

Yes. This has arisen through a historic bundling together of bodies without an overall review of structure. There are overlaps and synergies between the units, which argues for both some rationalisation and better co-ordination. It is also the case that the UK is now more a taker of regulation than a maker of it, but this makes the role of influencing international rule-making all the more important.

This exercise is, therefore, welcome and there is some logic in the split between Codes/Standards and Conduct. We are concerned, however, that the proposals threaten the status of the bodies engaged in accounting and auditing standards. We would not want the UK to lose any of its international influence in these fields, or indeed on corporate governance. We know less about actuarial standards-setting, but again the question is whether an advisory council has the same clout as a board with decision-making powers.

Other questions we have include:

- Who would represent the UK on EFRAG and committees of national standards-setters?

- Who would propose that the UK's standards-setting team might partner the IASB or the IAASB in projects to develop future standards? Would an "advisory council" attract the same calibre of person as a board?

<u>The FRC is insufficiently independent from the accountancy professional bodies</u>

The FRAC agrees with this proposition and thinks it is important to address it. We are broadly in agreement with the analysis and proposed reforms.

<u>The FRC does not have a proportionate range of sanctions and procedures</u>

The FRAC agrees with this proposition and thinks it is important to address it. We are broadly in agreement with the analysis and proposed reforms.

2. Do you agree that the proposals for reform will bring benefits and increase the effectiveness of the FRC?

On the Conduct side, yes. We see benefits in strengthening the inspection and enforcement side of the FRC. It is not perceived to be as tough as the SEC, for instance, and its activities and sanctions are limited in scope and in severity. It should be independent of the professions, have the resources to intensify its monitoring of corporate reporting and audit quality, and greater powers both to publicise failings and to impose fines and other sanctions.

As mentioned above, we are at best confused about the proposals for codes and standards and at worst concerned that UK expertise and influence will be downgraded. It should be noted that we are less concerned than BIS about the state of narrative reporting. [Please see the FRAC chair's letter of 25 November 2011 in response the consultation on "The Future of Narrative Reporting".]

3. **Do you have any comments on the consultation stage impact assessment? [See http://www.bis.gov.uk/Consultations]**

Has a case been made on the codes and standards side that there are serious failings that need to be addressed, as opposed to some complexity and possible inefficiency in the structure?

4. Should the primary focus for regular FRC activity in relation to codes and standards for corporate governance, accounting and auditing, and for monitoring the quality of corporate reporting and auditing, be publicly traded companies and large private companies?

Yes, we welcome the phrase "investment focus". CFA UK members mainly deal with the financial reporting of companies that use the capital markets to issue shares, bonds and other securities.

5. **Is the definition of large private company for this purpose – an annual turnover of £500m or more – appropriate?**

No. A number of smaller companies by turnover make use of the capital markets. Also turnover is not a good measure of the size or capital market significance of financial institutions. The EU has a public interest definition and the ASB has done work on this in its proposals for reforming UK GAAP.

6. Should the scope of the FRC's accountancy disciplinary arrangements be narrowed to cover the quality of work and conduct of accountants in relation to the preparation and audit of annual reports and other reports for the capital markets, leaving other cases of potential misconduct to the professional bodies?

CFA UK is clearly most concerned with the financial reporting of companies that use the capital markets. This does suggest that areas of individual misconduct that do not materially affect the veracity of these reports can be left to the professional bodies. However, self-policing has its drawbacks – so the FRC should maintain adequate oversight to ensure that cases that have significance for the workings of, or trust in, public markets are referred to it.

7. Are there areas of activity from which the FRC could appropriately withdraw?

The answers to questions 4-6 suggest where the FRC should focus its resources, and so can minimise what it does elsewhere. We also agree with sections 4 and 5 on supervision, disciplinary arrangements and proportionate regulation. This should help focus the FRC's work on areas that concern users of capital markets, and it may allow some devolution of the AADB's work to the professional bodies.

8. Do you agree that streamlining the FRC's governance and structure will bring the benefits described?

Please see answers to questions 1 and 2. We are most comfortable with the proposals to reinforce the FRC's independence from those it regulates and to improve the effectiveness of its monitoring and enforcement activities. We also see the merit in reviewing the current complex structure. We are, however, concerned that the proposals might reduce effectiveness in the Codes/Standards field.

9. Do you have any comments on the proposed reformed FRC governance and structure?

We have a number of questions on this, such as: will the FRC board and the Codes and Standards Committee have sufficient expertise, time and focus to influence international regulators effectively, notably the IASB, IAASB and the European Commission? Are the advisory councils shadows of the existing boards and panels? If yes, this risks undermining the UK's influence without achieving additional efficiency from rationalisation. Will advisory councils that are less visible to the public be more likely to be captured by the accountancy profession?

We would welcome further clarification of the composition, roles and powers of the FRC board, the two new committees, the advisory councils and the executive.

10. Do you agree the FRC should be given powers to determine and require a Recognised Supervisory Body to impose proportionate sanctions, subject to appropriate safeguards, on an audit firm and/or individual auditor in respect of poor quality work?

Yes

11. If not, what are your concerns and how do you believe this issue should be addressed?

12. Do you agree the FRC should have the ability to make its own rules for the independent disciplinary arrangements without being required to obtain the agreement of the accountancy professional bodies?

Yes

13. If not, how would you propose the FRC demonstrates its independence in this regard?

14. Should the FRC be able to take more proportionate, nuanced action against a Recognised Supervisory or Qualifying Body and therefore be given a wider range of enforcement powers against the recognised bodies? In particular, should the FRC be able to:

- Issue an enforcement order, requiring the body to take specified actions by a specified date, without the need for a court order?
- Impose conditions on continued recognition as an RSB or RQB?
- Impose fines on an RSB or RQB and if so, at what level?

Yes

15. Should the Companies Act and the AADB Accountancy Scheme be amended to allow for the conclusion of cases without public hearings where appropriate and where agreed by the parties?

Yes

16. Do you agree that the FRC should develop a mechanism to enable it to undertake supervisory inquiries into matters of concern, either of individual market events or wider market interest, initially building on its current powers to secure information?

Yes

We look forward to discussing the issues raised in this response.

Yours sincerely,

Jane Fuller
Chair, Financial Reporting and Analysis Committee
CFA Society of the UK

Will Goodhart,
Chief Executive
CFA Society of the UK