

6 August 2018

By electronic transmission to:  
FRCReview@BEIS.gov.uk

Dear Mr. Kingman,

**CFA UK response to the Call for Evidence for the Independent Review of the Financial reporting Council**

The CFA Society of the UK (CFA UK) is pleased to take this opportunity to respond to the call for evidence for the BEIS' Independent Review of the FRC.

CFA UK exists to serve nearly 12,000 leading members of the UK investment profession. Our mission is to build a better investment profession and to do this through the promotion of the highest standards of ethics, education and professional excellence to serve society's best interests. CFA UK is the UK affiliate of the CFA Institute which is the world's largest global association for investment professionals. The CFA Institute has more than 160,000 members in 159 countries and over 155,000 members hold the Chartered Financial Analyst (CFA) designation, which is the CFA Institute's flagship professional examination programme.

The investment profession relies on financial reporting. There can be no ambiguity on this point - investment professionals must be able to trust the financial reports that inform their investment decisions. It follows that the governance and regulation of the financial reporting industry has to be robust and that the auditing profession acts with integrity at all times. Efficient and effective capital markets simply cannot function without it.

A quick scan of the UK financial press over recent years reveals a growing list of corporate collapses or irregularities and many have accounting issues associated with them. This is far from unique, however: – Terry Smith's "*Accounting for Growth*" documents a similar list from the recession of the late 1980s. Such situations are generally born out of economic austerity and recession; the accounting issues that turn up as a result, however, are the product first and foremost of a weak corporate culture at the companies concerned. Unfortunately, auditors have to be prepared to challenge management in these situations and in turn be held account to do this by their own regulator.

The FRC, as the regulator for the auditors, has the primary responsibility to ensure the competency and the integrity of the auditing profession in the UK. In this capacity, the FRC assumes a vitally important role for our membership.

The fiasco around Carillion has been the lightning rod for this Independent Review and it is clear from the joint report of the BEIS and Work & Pensions Select Committees that the FRC themselves accept (with the benefit of hindsight) that there was a need for more proactivity and system-driven enquiry on their part. Press reports list other accounting irregularities and it is possible (though to our eyes not yet proven) that this is all symptomatic of the FRC requiring either (i) major reform or (ii) greater resources, stronger powers and sanctions to help develop a better culture within, and dialogue between, corporates and their auditors.

The answers to these questions need to come out of the Independent Review process and from within the professions familiar with the detail and directly affected and involved. As such, CFA UK does not have a grand solution since the full extent or nature of the problem is unclear to us. Nor does CFA UK feel qualified to answer the full suite of 45 questions in the call for evidence document. However, CFA UK welcomes the opportunity to record the following opinions and observations which address some of the question-set:

1. **Corporate Governance Code:** CFA UK has responded to ten consultations and calls for evidence relating to the corporate governance code since 2010 – please see Appendix 1. Taken as a whole, CFA UK believes that the advances in corporate reporting that have taken place over this period as a result of these consultations have been of significant benefit to the investment profession. In particular, the disciplined application of the “comply or explain” principle to the Guidance over this period has facilitated the development not only of better corporate governance but also of company annual reports far better suited to investment purposes;
2. **Corporate Reporting:** Given the growth in importance of non-financial reporting in company annual reports and the requirement for auditors to ensure the consistency of the front section with the financial statements and any capital markets investment circulars, it may be more accurate to describe the FRC’s activities as “Corporate Reporting” rather than “Financial Reporting”;
3. **Stewardship Code:** The FRC has overseen the successful introduction of the Stewardship Code over the last few years. Most recently the FRC consulted on the Stewardship Code’s “future strategic direction” which suggests that the future development of the Stewardship Code may have reached a critical juncture. Depending on the feedback of the last consultation and the decisions that flow from it, and particularly if significantly greater detail is to be demanded of signatories, it may be appropriate to move the Stewardship Code function from the FRC to another regulator more exclusively involved in financial services. In terms of CFA UK’s response on the Stewardship Code earlier this year, a link is provided in Appendix 1. Our two main proposals were that (i) ESG issues should be integrated into an investment manager’s investment procedures and not carved out as a separate check-list or principle; and (ii) that signatories statements should be supported by evidence (incorporated by link or independent verification);
4. **Regulator:** The FRC is first-and-foremost a regulator – i.e. a rule-maker and enforcer. In the Call for Evidence document the FRC describes itself as “the regulator of accountants, auditors and actuaries”. The word “Council” suggests something softer – with an emphasis on being a centre of expertise, advice and debate. During its 30 year history the FRC’s reach, authority and importance to corporate UK has increased significantly. Against this backdrop, if the FRC’s title were to change, the inclusion of the words “Regulator” or “Regulatory Authority”, rather than “Council”, would give proper prominence to this primary aspect of its role. This name change would reflect the desire of CFA UK’s membership for a strong accounting regulator that was feared and respected;
5. **Interim Reviews:** We would particularly encourage the BEIS to review and, in conjunction with the FRC, to potentially refine, triggers for event-driven investigations by the FRC of audited annual reports and/or other documents. This review should include a cost-benefit analysis of the increased resultant burden on

the FRC to ensure proper resourcing. Learning from the Carillion episode, potential triggers might include (i) findings in previous investigations of a company's annual reports, (ii) press speculation about potential liquidity issues, (iii) press speculation of aggressive accounting, (iv) a significant share price decline and/or (v) a material short interest in a company's stock and possibly (vi) the unexpected departure of the Finance Director. Any of these may warrant the start of fresh investigations outside of the annual review cycle. It would be important in our view to codify a robust process that ensures resources are prioritised to cases where they are most needed. Furthermore, CFA UK would note that a company's financial state may deteriorate significantly many months after the publication of a (potentially flawless) annual report, with a consequently heightened risk of corporate failure or collapse prior to the publication of the next annual report. We believe that in these situations, it may be worth considering resources other than annual reports that the FRC and/or other regulators or stakeholders could rely on as part of an investigation.

- 6. Viability Statements:** CFA UK responded to the earlier FRC consultation in 2014, addressing questions 6, 8 & 9 and calling into question the practical value of the viability statement for investors. Since then we have remained sceptical as to its practical value to investors and events at Carillion have only confirmed this scepticism. The Carillion episode does, however, demonstrate another perhaps intended consequence of the viability statement which is to intensify company directors' accountability - and that is no bad thing.

We are grateful for the opportunity to provide our opinions on the FRC - an organisation of great importance to our own profession and to which we entrust the regulatory oversight of a product and service on which we unequivocally rely.

Should the Independent Review reach the conclusion that major reform of the FRC were required and wish to consult stakeholders further on their views of different specific proposals, CFA UK would look to respond and provide its opinion where and as appropriate.

Yours sincerely,



Will Goodhart,  
Chief Executive  
CFA Society of the UK



Andrew Burton  
Professionalism Adviser  
CFA Society of the UK

## **Appendix 1: Previous CFA UK consultation responses to the FRC on corporate governance**

- Response to FRC's consultation on the UK Corporate Governance Code and the Future Direction of the Stewardship Code (Feb 2018):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-letter-to-catherine-horton-28-feb-2018--final.pdf?la=en>
- Response to Green Paper on UK Governance Reform (Nov 2016):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/responses/cfa-uk-response-to-corporate-governance-reform-green-paper-nov-2016.pdf?la=en>
- Response to FRC's consultation on proposed revisions to the UK Corporate Governance Code (May 2014):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2014/6-june/ukcorporategovernancecode.pdf?la=en>
- Response to FRC's consultation on revisions to the UK Corporate Governance Code (July 2012):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2012/7-july/codeforcorporategovernance.pdf?la=en>
- Response to FRC's consultation on revisions to the Stewardship Code (June 2012):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2012/7-july/stewardshipcode.pdf?la=en>
- Response to the Kay Report Interim Review (April 2012):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2012/4-april/kayreviewinterimreport.pdf?la=en>
- Response to the FRC's consultation on proposals to reform the FRC (January 2012):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2012/1-january/reformtothefinancialreportingcouncil.pdf?la=en>
- Response to the Kay Review of UK equity markets (December 2011):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2012/11-november/kayreviewrecommendations.pdf?la=en>
- Response to FRC's consultation on revisions to the UK Corporate Governance Code (March 2010):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2010/3-march/reviseducorporategovernancecode.pdf?la=en>
- Response to FSA's consultation paper (10/03) on effective corporate governance (May 2010):  
<https://www.cfauk.org/-/media/files/pdf/pdf/5-professionalism/2-advocacy/letters/2010/4-april/effectivecorporategovernance.pdf?la=en>