Policy and Planning Officer
Financial Reporting Council
8Th Floor
125 London Wall
London
EC2Y 5AS

By email to: plan@frc.org.uk

12 February 2016

Dear Sir/Madam

Draft plan & budget and levy proposals 2016/17

PricewaterhouseCoopers LLP welcomes the opportunity to respond to the FRC's draft plan and budget for 2016/17.

We have summarised our key comments in the paragraphs below. We have also attached an appendix containing more detailed commentary.

Collaboration and influencing activities

- We warmly welcome the FRC's strategy to adopt a more collaborative approach. We have several suggestions for ways in which we might work together collaboratively and would be delighted to discuss these with you. In particular, we believe that to help develop the trust that is essential for an effective collaborative relationship, a "safe space" is needed for innovation in auditing and assurance by the profession. The FRC has successfully created such an environment for corporate reporting in its Financial Reporting Lab; something akin to this would be helpful for developing new audit methodologies and enhanced audit reporting. We also suggest that it will be important to develop a process by which audit practitioners can informally discuss difficult judgements or interpretation with the FRC, particularly as we work through the first few years of implementing the EU Audit Regulation.

- We support the intention of the FRC to continue to work constructively with fellow regulators in various jurisdictions, promoting the importance of regulatory principles and the benefits of a 'comply or explain' framework compared to a more prescriptive approach. It will be important for the FRC to remain influential in the EU and internationally as a globally consistent regulatory environment will promote growth and stability. It will be particularly important for the FRC to take a leadership role in working towards consistent application and interpretation of regulation across the EU.

Engagement with investors

- We strongly support the FRC in its mission to enhance the degree of investor involvement in its work. This group can sometimes appear to be disengaged from the regulatory process and in order to promote effective engagement we suggest that an element of investor engagement may be constructive. Work by the Policy and Reputation Group in recent years suggests that investors can be unfamiliar with some of the basic premises of auditing and reporting. Clarifying areas such as: the FRC's responsibilities as a regulator; the role that auditors play in the market and clarity on their responsibilities; and what is really meant by the term 'audit quality' will be key to success.

- In engaging with investors, it is appropriate that the FRC should consider long-term investor needs. However, it is also important to keep in mind that long-term investors often rely on other parties (e.g. sell-side analysts) to be informed about a company's reporting. Often it is sell-side analysts and short sellers who uncover problems with a company's reporting. Consequently, part of meeting long-term investors' needs involves focusing on the information intermediaries they rely on.

Corporate reporting and transparency

- We agree with the FRC's intentions to help smaller listed and AIM companies with the quality of their reporting. We suggest that the FRC could issue guidance on materiality, helping preparers to understand better how this concept might be applied in practice. This is also an area where investor education could be beneficial. We suggest that the FRC could consider tackling this through a Financial Reporting Lab project.

Sanctions and enforcement

- We note that the FRC intends to consult on aspects of the new arrangements for delegation to, and oversight of, the professional bodies and its sanction and enforcement procedures. Clarity is needed as to how the two disciplinary regimes are intended to operate in the future. It would be helpful to understand in particular the extent to which the FRC envisages recommending any changes to its current sanctions and enforcement procedures.

Accountability, funding and budget

- As part of the proposals for key performance indicators, we support the FRC commissioning survey evidence of stakeholders' perceptions of key aspects of corporate reporting, governance and the FRC's effectiveness as a regulatory authority, although as noted in our detailed comments, there needs to be a broad constituency of stakeholders surveyed in order to ensure that the results are meaningful.

- We note the FRC's stated intention to increase significantly the level of funding from the accountancy profession, in the light of the withdrawal of Government funding, through a rebalancing initiative over a three year period. We suggest that this should be accompanied by additional transparency and clarity around the levies for firms and how these are calculated.

- In developing its budget, we understand that the FRC needs to estimate forecast expenditure. We note that considerable uncertainty surrounds some of the estimates, in particular those in respect of audit disciplinary costs. Actual costs could well be quite different than the estimate in this area, depending, for example, on the level of tribunals that take place. In the event that actual costs are higher than those estimated, there is a risk that the total amount of funding provided by the accountancy profession could exceed a threshold where an observer might consider that the FRC is no longer “free from undue influence” as required under the EU Regulation. In such a situation, the rebalancing initiative would need recalibration.

If you have any questions or wish to discuss any aspect of our response, please contact Gilly Lord, Head of Regulatory Affairs on 020 7804 8123.

Yours faithfully

PricewaterhouseCoopers LLP

Appendix: Detailed comments on the FRC's draft plan and budget 2016/17 consultation

In this appendix, we have grouped our comments to reflect the sections of the FRC's consultation paper.

Regulatory approach

- We note the FRC's intentions to invest in the skills of its people, in particular improving their knowledge of the sectors and businesses whose reports and audits are reviewed. As well as developing existing teams, there should also be recruitment of high calibre people with the skills and knowledge to fulfil the expectations created by the EU audit reform agenda. Areas to be covered will not only include technical and communication skills, but also leadership and project management skills to enable the FRC to demonstrate clearly how the regulator is performing effectively as the single competent authority in audit regulation.

- We fully support the FRC's plans for more transparency and collaboration; these are bold moves and we appreciate the work and effort that this will entail for people working at the FRC. In particular, we support: naming in advance of reports and audits to be reviewed, informing companies where no significant problems were identified, and encouraging transparency in reporting by audit committees on the outcomes of reviews. It is important to keep stakeholders informed when things are satisfactory as well as when there are problems. The promotion of good practices by the FRC will do much to encourage a culture of continuous improvement in the market. We look forward to commenting on the detail of the changes to operating procedures that these moves will entail, which we assume will be subject to consultation.

- We note and agree with the FRC's statement that "We need to take tough action to hold people to account where we determine that this is necessary in the public interest". The FRC should continue to pursue accountants in companies, in particular those in financial reporting functions, who have either failed to bring matters to the attention of the auditors in breach of their obligations, or have deliberately concealed or misrepresented relevant information. It is important that accountants in companies recognise their professional responsibilities and play their part in contributing to good corporate reporting, including the effectiveness of the audit process.

- We support the aim to complete investigations under disciplinary schemes after no more than two years on average, taking as a starting point the date on which the FRC's Conduct Committee passes the 'formal complaint' to the Executive Counsel for investigation. The term 'formal complaint' usually refers to the document prepared by the Executive Counsel detailing the allegations that a member/member firm of a professional body has committed Misconduct. We assume that the FRC means the point at which its Conduct Committee considers that there is a case to answer (under paragraph 5(1) of the Accountancy Scheme). Whilst we would encourage the FRC to set this as an indicator for professional discipline, we consider that the regulator should try to conclude its **formal investigations** sooner, wherever possible, especially where there does not appear to be a clear case for Misconduct. We would also support longer periods for **preliminary enquiry** prior to deciding whether it is appropriate to proceed to a formal investigation. This would have the merit of being able to dispense with some matters without the need for a formal investigation.

- We draw your attention to a typographical error in the second bullet in the list on page 16 under "During 2016/17 we will", where the second sentence is duplicated.

Corporate governance

- We note the priority to promote corporate cultures that support the long-term success of companies and the further details in Section Three about the culture coalition and the ambitious plans for this project. We understand that the FRC's work in this area will lead to guidance that seeks to encourage companies to adopt an appropriate culture. We suggest that the FRC could benefit from liaison with the financial services regulators in order to learn from their experience and share knowledge.

- Whilst a focus on dissemination of good practice is laudable, it will also be important for companies to understand that simple adoption of good practice will not automatically create a "good culture". The focus must be on alignment of intended, expressed and actual culture. The plan for the output of the work by the culture coalition is focussed on ownership by the Board and behaviours by board members. However, in all likelihood it is middle management rather than board members who will be responsible for driving cultural change in the organisation and achieving the alignment mentioned above. This is an area of focus for the FCA and other regulators, and we suggest it should also be on the FRC's agenda.

- We believe that the indicators on p11 of the document would benefit from reworking in some areas, as explained in the paragraphs below.

- We do not agree with the first element of the indicator dealing with the % of FTSE 350 companies meeting "all but one or two" provisions. The comply or explain approach is not about complying with as many provisions as possible, but applying the main principles of the Code first and foremost, and then complying with those provisions that are suitable for the best outcomes for the company and adapting other provisions accordingly. The second element of the proposed indicator, an assessment of quality of explanations, is much more appropriate. The first element also takes no account of the weighting of the provision in terms of a company being perceived as having good governance; for example, depending on circumstances, C.2.3 concerning the board's monitoring of risk management and internal controls might be given a stronger weighting than B.3.2 concerning the chairman reviewing and agreeing the training and development of individual board directors. The weightings of course will depend on the individual circumstances of both the company and the board.

- We would suggest that instead of the first indicator, focussing on % of FTSE350 companies that depart from Code provisions on a long-term basis (possibly stratifying those with and those without good explanations) would give a more useful picture. Alternatively, or additionally, an indicator might be % of newly listed companies that depart from the Code in more than (say) three respects and the duration of time taken to rectify this, assuming it is appropriate to do so. These indicators would be relevant to issues noted in the recently published 2015 '*Developments in corporate governance and stewardship*' report and be more meaningful in terms of the likely results.

- The third indicator, being the "headline figure" for female directorships in FTSE 350 companies, focuses purely on gender diversity. Clearly gender and ethnicity metrics have the potential to be easily tracked, measured and reported, plus they provide a proxy for valuing difference more generally. Ideally, a measure that considers a range of diverse people, reflecting the profile of a company's customers for example and bringing a wider range of viewpoints, would be more appropriate than one focussed purely on gender. However, in the interests of simplicity, gender and ethnicity targets are a good starting point. So to add to the indicator that is suggested, the FRC could also consider: an increase in ethnic minority representation on FTSE 350 boards; a decrease in gender pay disparity; and evidence of more diverse recruitment. For the indicator that is suggested, it might be helpful to distinguish between executive and non-executive roles.

- The fourth indicator reads: "the quality of reporting by audit committees on corporate reporting and audit quality matters and on FRC regulatory interventions". In our view, this will be difficult to measure and therefore could be impractical, since it fails to take account of the discretion and flexibility afforded to audit committees in determining the content of their reporting, particularly in respect of audit quality. The FRC's draft Guidance on Audit Committees, exposed for comment recently, rightly encourages the use of judgement in determining the significance of findings from an FRC audit quality review and how any findings should be communicated to shareholders. In addition, in making its disclosures, the audit committee is encouraged to exercise judgement as to whether information may be prejudicial to the interests of the company. These are two examples of the discretion afforded to audit committees. This would make comparability for the purposes of an indicator difficult. In addition, the reference to "FRC regulatory interventions" is unclear. For example, does the term refer to disciplinary cases which the FRC currently has under investigation (i.e. public) or those which the FRC has under consideration, but have not yet been referred to the FRC's Executive Counsel (i.e. not public). It may be that "interventions" is not actually a reference to disciplinary investigations: we would welcome clarification on this.

- The final indicator is the only one on culture which is one of the FRC's major projects, and is, in our view, too vague. The FRC has asked whether there may be other indicators in this area and suggests the effectiveness of boards in "determining" company culture. Following our earlier comments, we would question whether determination is the right measure, rather than implementation of the desired culture. We suggest: % of FTSE350 companies with behaviour measurement frameworks in place; % of FTSE350 companies with a dedicated culture/conduct/ethics committee; number of internal audit functions auditing culture; number of organisations that have undertaken an exercise to refresh/assess their values.

Investor stewardship

- We note the FRC's intention to seek that proxy advisors be more accountable for the "quality of their advice". We think it would be more precise to seek for proxy advisors to be more accountable for ensuring that their advice is well considered and is of sufficient quality to be useful to shareholders and appropriate for the circumstances.

- The intention of the FRC to look at all participants in the investment chain is appropriate and we question whether Sovereign Wealth Funds should also be challenged by the FRC on their stewardship activities.

- As previously stated (in our covering letter) we strongly support the focus on promotion of wider investor engagement. We note the recent announcement by FRC on its intention to scrutinise adherence to the Stewardship Code, and to allocate signatories into two tiers, depending on the FRC's judgement about their level of engagement with companies. We have some concerns about this, because there may be investors who engage privately, for example through the Investor Forum, and it would be wrong to assess such investors as having a poor record on engagement, simply because their engagement was not visible to the market.

- We believe the final proposed indicator contains a typographical mistake ("the views on" can be deleted). More fundamentally, we believe that this indicator is too subjective, since a company may find a specific encounter with an investor to be uncomfortable, if they are being criticised, and therefore may not respond positively to a survey about the extent and effectiveness of engagement with the investor, even if the investor was right to be critical.

- Further, on this indicator, it should not be limited to companies' views; it should be clear that for companies it will include views of both executive and non-executive directors, plus any other relevant department – such as investor relations – and it could also extend to surveying the views of auditors, who will certainly have a perspective on the effectiveness of engagement with investors.

- We suggest adding an indicator about whether and how a company has engaged with smaller asset management firms.

Corporate Reporting

- We support the aim to encourage all involved in financial reporting to focus on clear presentation of information that is material and relevant. We believe that there could be a role for the FRC in promoting a better understanding of the meaning of "material" and the need to report material items only in financial statements.

- We also note with interest the final phrase in this aim, which is: "including in relation to the longer-term viability of the company". Clearly the introduction of the viability statement plus the important associated information in relation to principal risks will be of interest to users of financial statements this year and is rightly therefore a priority area for the FRC. We would welcome clarity on whether the FRC is intending to undertake a targeted review of this area, a collection of best practice disclosure, or if the FRC will take a different approach.

- We continue to be strongly supportive of the Financial Reporting Lab and we note that there is a general presumption in the paper that the Lab is entirely successful. We would encourage the FRC to consider commissioning an effectiveness review of the Financial Reporting Lab. It would be interesting to know whether investors are satisfied with what it does and to explore whether companies have improved their reporting as a result of the Lab's recommendations and pronouncements. In our view, whilst supporting the Lab, we find that some of its output can be conservative.

- We note the intention to undertake a targeted review of tax disclosures and look forward to reading the FRC's summary of best practice in what is an extremely important and topical area.

- As noted in our cover letter, we support the proposal to issue an annual reminder to AIM and smaller listed companies to foster improved quality in corporate reporting and we believe this should include guidance on the application of materiality.

- We read with interest about the planned annual assessment of the quality of UK corporate reporting and note the comment that it will be broader in scope than the current annual reporting on the outcome of the FRC's corporate reporting reviews. We would welcome clarity on how the scope will be broadened – will it be through collation of a broader set of data, an increase in the number of companies assessed, or a different approach? We are supportive of the initiative assuming it leverages current activity. However, if the broadening necessitates additional work or analysis, then we question the benefit. A number of market commentators, including PwC, already provide insights on corporate reporting. With budget constraints in a year of significant uplifts to funding requirements, we question the allocation of resources to achieve what the private sector may have already covered.

- On indicators, whilst we support the use of benchmarks, we are not convinced of the ease with which it will be possible to measure some of the more subjective metrics listed within the corporate governance and corporate reporting sections of the report. For example the % of listed companies providing a clear, broad and longer term view of risk management, internal control and viability in line with the 2014 Corporate Governance Code, or the quality of reporting by (a) large public companies and (b) smaller listed and AIM quoted companies. We agree with gathering independent evidence through surveying views: the FRC should actively survey different groups of users within the market to obtain views from a variety of perspectives.

Audit and Assurance

- The FRC suggests that it will direct its audit quality review activities in line with its new regulatory approach, i.e. focussing strongly on identifying and promoting good practice and supporting innovation by the profession. We support this and as noted in our cover letter, believe that innovation in audit methodology would benefit from the same sort of "safe space" afforded to corporate reporting experimentation within the Financial Reporting Lab.

- We believe that the areas proposed for thematic reviews are sensible. We would suggest that under the new collaborative approach, cross-firm discussion groups following the Chatham House rule, facilitated by the FRC, on audit developments and regulatory responses would be a robust way of identifying thematic areas in the future.

- We note the intention to implement the ARD with a clear delineation of responsibility between the FRC and the professional bodies, and to consult on aspects of the new arrangements, including delegation to and oversight of the audit professional bodies and sanction and enforcement procedures. We believe that the FRC should maximise the amount of delegation to the ICAEW in order to ensure effective working in line with the collaborative and improvement approach to regulation.

- We believe that investors will be particularly interested in the FRC's assessment of whether firms are competing in the market based on quality and innovation, and in feedback on whether the changes in reporting by the FRC on audit inspection findings and the practice aids that have been published, have assisted audit committees in assessing audit quality.

- We support the idea of an annual assessment of the quality of audit in the UK. We would be interested to learn more about how the FRC intends to assess the quality and usefulness of audit from an investor perspective. In developing the process of assessment, it will be important to consider all players in the investment chain, and also not to place undue emphasis on those situations where investors are vocal about perceived audit problems, contrasted with those situations where investors are silent because they have found the audit useful and effective.

- In the area of monitoring and reporting of audit quality, we believe there is scope for more focus on firm-wide controls. The AQR focuses about 80% of its work on doing detailed substantive tests, and only 20% on these firm-wide controls.

- On indicators in this area, we think feedback from the audit firms should be included.

Actuarial work

- The indicators in this area are very broad. One of them simply indicates “feedback on the new TASs” which is vague – it is unclear from whom the feedback will be sought: we suggest both actuaries in practice and in industry so that a balanced view is obtained.

- In considering whether independent oversight of the actuarial profession remains necessary and appropriate, it would be helpful if the FRC could clearly set out its rights of enforcement over the profession.

Professional discipline

- We observe that the FRC has not proposed any indicators for this section. We believe it would be helpful to establish some indicators in order for the FRC to be able to track its progress in this important area. One suggested indicator is: "to close or conclude disciplinary investigations for public interest cases involving accountants and actuaries after no more than two years on average (the starting point being the date on which the FRC's Conduct Committee passes the formal complaint to the Executive Counsel for investigation)". This reflects our comment above (see ‘Regulatory Approach’). There is no doubt that long-running investigations have a negative impact on all concerned.