# Financial Reporting Council
# Annual Open Meeting
# 21 September 2017

**Opening Address**

**Sir Winfried Bischoff**

**Chairman, Financial Reporting Council**

## I. Welcome

Good afternoon, ladies and gentlemen. It is just about four o'clock. Firstly, I would like to welcome you and thank you all for coming. This is a new venue for us, as you will have noticed; I nearly went to the old one out of force of habit.

## II. Global Developments

Over the past year, we have seen an unprecedented wave of political change in the UK and globally. The Brexit referendum result was obviously a surprise for many of us, and ushered in a new political and economic narrative and, to some degree, a sense of uncertainty about the future. Our work has to involve supporting business for the betterment not only of the United Kingdom economy, but also for the perception of the public, to whom we are beholden. Public confidence in business has been undoubtedly damaged over the last decade, leading to a view that it is not delivering for all. This has highlighted the need for companies to focus on the effectiveness of their governance and of their stewardship practices, as well as to explain and to be transparent about how they are doing so. We have looked deeper into how well our own activities and mission are aligned with the needs of a broad stakeholder audience. In a moment, Stephen Haddrill will explain more about this and outline our preliminary conclusions.

The unexpected political turns that have surprised many and confused some since June have led to the FRC being asked by the government to be in the forefront of its plans to adapt UK corporate governance and to prepare it for Britain's future as the obvious and natural place to do business. Brexit obviously adds urgency to that. The United Kingdom's departure from the EU has further implications for our work. The accountancy and actuary professions in the UK are held in generally high regard around the world. I was just in Singapore and the way in which the Singaporeans look at both our governance and the industry in the UK is quite remarkable. Professionals who qualify in the UK must be able to ply their trade wherever it is needed in pursuit of the UK's international commercial aims. We need to aim that our professionals remain respected and able to work worldwide. Investors tell us that they want the international accounting regime to continue after Brexit so that they can more easily compare company performance and make effective and objective decisions. The UK must make a decision on adopting international financial reporting standards as part of its post-Brexit competition strategy.

## III. Audit Quality

Here at home, progress has been made on improving the quality of audit work. In the years since the FRC became the competent authority for audit in the UK, our inspections of audit have shown further progress towards our target of 90% of FTSE 350 audits requiring no more than limited improvements. We have a number of initiatives in place to support audit firms in that direction of travel. Our enforcement activity has picked up pace, with an increasing number of cases concluded either by an independent tribunal or a settlement with the firms and with individuals. We are conducting an independent review of sanctions to ensure that the level and type of sanction have a real deterrent effect and help the greater focus on quality work by the professionals that we regulate.

## IV. Looking Forward

Our plans for 2018 and 2019 will build on recent developments with the aim of further improvements in governance, reporting, auditing and actuarial work. Personally, I hope that the results of our enforcement activity, in helping to raise standards, will contribute to increased trust and confidence in business. Over the next year, we will keep the needs of investors and all stakeholders at the front of our minds. We will remain focused on our priorities, measuring success by the impact we make, not by our level of activity. We will maximise that impact by working in close collaboration with professional bodies, fellow regulators and others to avoid imposing unnecessary burdens on those that we regulate.

We will continue to work closely with the Department of Business, Energy and Industrial Strategy on corporate governance reforms and other important policy work, including the industrial strategy and diversity initiatives. We will, in conjunction with BEIS, Cabinet Office and the Treasury, resolve any remaining issues in respect of our status as a public body and we will conclude a review of our own governance structure and processes to ensure our decision making is robust and appropriate to our public interest responsibilities. One aspect of this review has been the preparation of a register of interest for all members of our board, committees and councils. That register will be published in October on our new website. Such a register is important for the FRC to retain confidence in how it reaches its decisions, particularly on enforcement matters.

The Executive Counsel's decision, announced earlier this week, to end the investigation into KPMG's audit of HBOS has been questioned by media and politicians, and it has attracted questions about our independence. It is vital that these decisions are taken based on the available evidence rather than on political considerations or public clamour. Our robust policies and procedures on conflicts of interest ensure those decisions are appropriately made by the Executive Counsel. Many of you, but not all commentators, know that the Board of the FRC does not take enforcement decisions. Publishing our policy and our register of interests should further remove doubt about the objectivity of our decisions

## V. Diversity

Finally, I want to say a word about diversity. I am delighted that Stephen Haddrill has been appointed to represent the FRC on the Business Diversity and Improvement Group, which is chaired by the business minister, Margot James MP. At the FRC, we embrace diversity in all manifestations, of thinking, experience and background. Diversity encourages better leadership and contributes to better all-round performance, engagement and innovation by the Board, our committees, our councils and throughout our workforce.

Thank you once again for joining us this afternoon, I now hand over to Stephen Haddrill, our CEO. I hope that you will join my colleagues and I for refreshment at the end of our meeting. Thank you very much.

# Progress in a Year of Change

**Stephen Haddrill**

**CEO, Financial Reporting Council**

## I. Promoting Transparency and Integrity in Business

Thank you Sir Winfried. Thank you, those present, for joining us today. As Sir Winfried mentioned, this last year has certainly been eventful for the UK economically, as well as politically. It has been an eventful year for the FRC too, as we work to ensure Corporate Governance is held in the highest regard in the UK and internationally. We continue to develop our role as the competent authority for audit, as well as assessing the implications of Brexit, which is something I will speak further on at the end of these remarks.

As we navigate these challenges and opportunities, we must also ensure that we as an organisation have the right culture, leadership and strategic direction in place, as well as the necessary skills and resources. During the course of this last year, we have refreshed our mission statement to 'promote transparency and integrity in business': sharper language than we had before. We believe that high levels of transparency and integrity create investor confidence, support sound business decisions and crucially serve the public interest and contribute to prosperity and stability. This new mission aligns with the needs of the broader stakeholder audience whilst the investors' shareholder audience remains very important to us.

Transparency makes a stronger connection with the wish for more relevant information from business and integrity aligns our work on culture, the role of leadership and the pursuit of improved governance both in the corporate sector, as well as in the professions and the audit firms. More than ever, we must take into account broader public expectations; the FRC's new stakeholder panel is helping us to achieve this and has been a very important development for us in the course of this year.

## II. Review of the Corporate Governance Code

We are exploring how companies can better reflect and report on the ways in which they are taking into account their own wider stakeholder needs. This will form part of our consultation on the Corporate Governance Code, which we plan to go public with in November; Paul George will be talking about this in more depth. It is vital that the UK corporate governance framework, corporate reporting system and audit continue to instil confidence in UK capital markets following the UK's exit from the EU. We are working to ensure that investors continue to see the UK as a long-term home for their capital and we are determined that the standards that we promote and uphold will support this end.

UK Governance is well regarded as a whole internationally and within the UK; however, there has been poor behaviour and governance of some UK companies, both private and public, which has come under the spotlight over the last year. The number of high-profile cases of misconduct, combined with concerns over levels of executive remuneration, have eroded public confidence in business and strengthened concerns that business benefits a few disproportionately, sometimes at the expense of the many. The parliamentary and governmental enquiries have explored how we can strengthen the UK's governance regime in order to restore public trust and retain the UK's globally recognised standards for the future. We welcome the government's recent proposals for reform of the governance framework, which we will consider as part of our comprehensive review of the code. We will publish a broad stakeholder consultation on this in the autumn and I hope that you will all wish to contribute.

The Corporate Governance Code is based on a set of principles that embody best practice and help companies and boards focus on long-term success. The detailed priorities of the code are on a comply or explain basis; the principles are on a comply basis: companies need to do a good job of reporting how they have complied and we will be checking to ensure that they have indeed met that expectations. Companies also need to consider the links between diversity and business success. As Sir Winfried mentioned, I am sitting on this ministerial group and it is a great privilege to do so. Whether diversity of gender, ethnicity or background, it is vital that businesses draw experience widely from the society in which they operate. Diversity helps to drive the ongoing success of a company and to avoid groupthink in the boardroom, and more generally; this is an area that we will be exploring as part of our code review. By itself, a code cannot prevent inappropriate behaviour. Only people, in particular leaders within a business, can do that by setting and modelling the high standards that are required, leading by example.

## III. Corporate Culture

Culture in business is a key ingredient in delivering long-term sustainable performance. When there is a healthy culture, the systems, procedures, overall functioning and mutual support of an organisation exist in harmony. This leads to enhanced integrity, confidence, long-term success and ultimately trust. In my view, a poor culture is a significant business risk.

## IV. Oversight Responsibilities of Audit

### 1. Quality of Audit

The quality of audit must be of the highest level to promote confidence on the public reporting of financial performance. This must be driven from the leadership within audit firms themselves and the FRC is increasing its focus on the quality of that leadership, as well as the quality of individual audit engagement. In terms of those individual engagements, the audit quality of FTSE 350 firms is improving, with 81% of companies now requiring no more than limited improvements, but that is not good enough. More progress is needed to reach the target that we have set the profession of raising that to at least 90%. I must stress that that figure is a waypoint not the destination and we will be raising the bar when we get to that figure.

### 2. Enforcement

An important part of our regime is our enforcement work. We have worked hard during the course of this year to speed up the handling of cases and have had some success in that regard. We have overhauled our processes and I am pleased to say that we have also invested significantly in our staff numbers, which have increased from a handful a few years ago, to 30 highly experienced, trained and professional people of today. We have also initiated an independent review of our sanctions, by Sir Christopher Clark, as Sir Winfried mentioned. Fines have increased typically five to tenfold in recent years. Sir Christopher's job is to consider if they are at the right level or need to increase, and whether other types of sanctions should be introduced.

Enforcement is high in terms of our focus and I am very proud of our work there. I would like to pay particular tribute to the work that Gareth Rees has done during the course of his five years there; we are very sorry to lose you, Gareth, but you leave us with our best wishes and great thanks for what you have done. In October, we will be publishing a full report drawn from all of our experience in relation to corporate reporting and audit, particularly concerning the banks and financial services sector. Since the financial crisis, we have worked hard to address the problems that we saw at that time, we will be reporting on the changes that have been made, where we are now and crucially what further improvement is called for.

## V. Budget versus Actual

As a result of efficiency savings last year and case costs being lower than planned, the FRC spent less than expected. We are now reviewing the impact of becoming a public body on costs in the future, including our need, given a change in status, for reserves. I will be saying more about that when we publish our strategy plan and budget towards the end of the year.

## VI. Brexit

### 1. Comparability

We are working with government regulators, companies, the firms and a broad range of stakeholders in order to respond effectively to the implications of leaving the European Union and to make sure that we are fully prepared for our departure.

Investors value comparability of information. To this end we are exploring options for the UK's future accounting framework. Comparability will be retaining IFRS that are currently adopted through the EU. At the same time, we must understand the way in which the UK's interests are impacted by new standards under the IFRS; we must use that understanding in exerting influence on the development and adoption of those standards in future. We believe that it is right to adopt the standards and we believe in the principle of comparability, but we also believe that we should make sure that we understand the UK impact and if, subject to some strict criteria, there are points that need to be adopted differently in the UK, we should not be afraid of exploring those.

### 2. Equivalence

We must get the right answers on equivalence. After leaving the EU, depending on the withdrawal negotiations and any agreement on our future relationship with the EU, UK audit firms may be deemed third-country audit firms. This will have a number of implications for our regulatory landscape.

It may be necessary for the system of regulatory oversight and quality assurance in the UK, currently operated by the FRC, to be recognised as equivalent by the EU so that UK firms' audit reports are accepted by securities regulators throughout the EU post-Brexit. The UK may also have to deem the EU equivalent. Now, equivalence necessarily places some constraints on the flexibility that we will have to depart from current arrangements. At the same time, we must get understanding, both here and in Brussels, that equivalence does not have to mean all stays the same. We should aim to secure equivalence of outcomes, in terms of the protection of public interest, and in our case the protection of the investor, and not be held in a straitjacket determined by equivalence of process. It is particularly important that the UK maintain a third-country auditor regime post-Brexit to provide investors with assurance about audit work done on overseas companies listed in the UK. Whether or not the UK uses EU assessments of equivalence, or makes its own judgments based on our own regulatory assessments, an effective regime will be needed to underpin investor confidence during any transition period and after we leave the EU.

### 3. Professional Qualifications

In a similar vein, the success of both accounting and audit, and our actuarial work, depends on the UK having the skilled and experienced people needed to ensure the UK's reputation for quality. As such, recognition of professional qualifications and a system enabling auditors to work across national borders and other professions will be a vital post-Brexit requirement. We know that the government, as part of the withdrawal negotiations, has begun to look at professional qualifications and we are pleased that they intend that the Audit Directive be within the scope of any agreement reached. Whether the EU agrees is another matter and we are preparing for every outcome.

### 4. Economic Relationships

As a regulator, the FRC has strong bilateral relationships with regulators, governments and supervisory bodies in the USA and around the world, not just in the EU. These jurisdictions recognise the importance of robust corporate reporting and governance frameworks to the development of transparency and integrity in the capital markets. We will continue to work in partnership with them to share experience and expertise to raise quality and business confidence globally. As I have said before, our regulatory regime is recognised as the gold standard in many parts of the world for both protecting and underpinning investor confidence and encouraging trade;

we must continue to uphold that. The UK's decision to leave the EU will not affect our determination to continue strengthening and enhancing these relationships, and may in fact bolster our position in relation to some of them.

### VII. Moving Forward

The UK's economic relationship with the EU and with other nations must go hand in hand with a vision of what kind of economy and society we wish to build for the future. Sometimes accounting standards, audit standards, actuarial standards feel a bit technical and remote from that issue but there is indeed a connection, because they do underpin integrity and integrity leads to trust. If we are to build a confident, inclusive and open economy, we will need to maintain our status as a global centre for capital by continuing to promote high standards of regulation, to maintain the status of the UK's highly respected professional services and to do more to reach out beyond Europe, whilst maintaining key relationships within. Thank you very much.

## Corporate Governance Agenda

**Paul George**

**Executive Director for Corporate Governance and Reporting, FRC**

### I. Preamble

Good afternoon. Sir Winfried and Stephen, in their opening remarks, have already provided some background to the context in which the FRC announced in February this year that we were going to undertake a comprehensive review of the code. They have also provided some background into the work that we are doing and what I intend to do is to go into that in further detail.

You will all be familiar with some of the key issues and the four bullet-points that we have put up on the slide here are some of the key issues that we have fed back into government, into the BEIS Select Committee that was looking at the whole area of governance, but also our response to the government's green paper. It is not surprising therefore that we now find ourselves with the challenge of implementing those ideas into our revised code. Many of the ideas that we have submitted to government featured in their response to the green paper published recently and we are now moving ahead to finalise our consultation on the code.

Remuneration has been quite a significant issue, and I will talk through some of our proposals in that area, which run in parallel with some of the government's initiatives around register of adverse votes and also some additional reporting requirements. Concerning the wider stakeholder issue, Stephen has explained how the FRC has embraced that over the last 12 months. A key part of responding to the government's agenda has been to focus on the Section 172 responsibilities of directors to have regard both to the longer term and the environment, and to the wider group of stakeholders; I will explain a little bit more about what we are doing in that regard. I will not talk too much about large private companies but we are and will be working alongside many interested organisations to develop a governance framework for large private companies which seeks to address concerns in that sector. The final bullet-point is around FRC powers. In order for our governance framework to be effective we made some suggestions around additional powers, to help us help the stewards enforce the Corporate Governance Code. Stephen has already mentioned that we will be doing more work in that area in terms of our monitoring activity, even though we will be doing that without the additional powers we sought.

## II. Code Revision

### 1. Structure

When we announced our proposals to do a comprehensive review of the code we did that, in part, in recognition that we were going to be asked to take forward, or at least consider, a number of the government's initiatives. The code has been a great success, but has evolved over the 25 years since Cadbury first developed it. Often that evolution has been due to specific events and each time we have looked at the code, we have added more content, significantly around areas of risk management and controls. However, because it has been altered incrementally, the code was beginning to creak and did not necessarily fit together as we would have wished. We therefore decided to take the opportunity to give a thorough revision to the code.

The first aspect of that change is to shorten and sharpen it; this was particularly important because there are some things we need to bring into the code, over and above what is there now, but we did not want to add to the burden of length. Stephen has already mentioned the reporting obligations, the obligation through the listing rules of directors to explain how they have applied the principles of the code, but we felt that there has been too much focus on the reporting on a comply or explain basis against the 55 provisions that are currently in the code. What we fear that this has done is to lead many people to approach those provisions as a tick-box exercise, as opposed to stepping back and thinking hard about what they need to do to apply the principle. One of the things we want to do, as part of this exercise, is to refocus reporting of how boards have applied them.

The second thing that we have done is to rationalise the code somewhat. The code is currently structured as a number of principles, a further set of supporting principles and 55 provisions. We are removing entirely the concept of supporting principles. Some of those principles are being reformatted into principles in their own right; some of them are being built into the provisions; some of them are being moved into the 'Guide to Board Effectiveness'. We are well on our way in terms of drafting a code for consultation. We are not there yet; there is a lot of work and outreach to be done before we get there. However, as part of this exercise, we aim to reduce the number of provisions by about a third, whilst also incorporating the additional matters that I will come to in a moment and keeping the number of provisions roughly the same that we have today.

### 2. Content

The first thing we have done is to emphasise the importance of the board for the long-term success of the company. As the code has evolved over a number of years, focusing on addressing a number of issues, there has probably been too much focus on risk identification and risk management and less focus on the long-term success of the company. That does not mean that the FRC does not believe that risk identification and management is important, it means that we want to just get a little bit of rebalancing of those responsibilities, and particularly around the long-term success and the growth agenda.

We seek also to reemphasise the directors' responsibilities around wider stakeholders. Part of that is being done through the consultation that we issued a few weeks ago around 'Guidance to the Strategic Report', so some of our effort on broadening those responsibility you will find there. It will be mutually supported by what we are doing in respect of the code itself. Many of you will be familiar with the government's suggestion that boards should take particular steps to ensure the employee's voice is properly heard, be it through having an employee on the board, having a non-executive director with specific responsibilities or through an advisory panel. We aim to consult on a provision of that nature as a mechanism for supporting the wider principle of engagement.

### 3. Language

We also wish to strengthen the language of the code around culture, following on from the cultural report we issued a year or so ago, to enhance the responsibilities of the board around succession planning and diversity. In respect of remuneration, we are looking to broaden the responsibilities of remuneration committees for overseeing the pay and conditions of employees more broadly, rather than just focusing on the most senior executive in the organisation. We also want to emphasise the principle of discretion and emphasise that society expects remuneration committees to exercise discretion if the pay outcomes are inconsistent with what they believe appropriate reward for the performance of the executives should be. We will also bring in there some of the governments other proposals around reporting in respect of remuneration. I mentioned earlier the government's acceptance of the Investor Association maintaining a register where there are significant votes against shareholder resolutions. We plan to consult on a mechanism for what is expected of boards by way of an escalation process should there be a significant vote against, making sure that there are real actions being taken.

### III. Stewardship Code

Alongside our work on updating the code, we are very conscious that we need to toughen and strengthen the role and responsibilities of the stewards. Our code is only effective if the stewards discharge their responsibilities effectively and hold boards to account. When we publish our consultation on a fully marked-up, revised Corporate Governance Code, we will be starting the process of a formal external consultation on the Stewardship Code; it will not be a marked-up version of the Stewardship code itself but we will be asking some important questions. One such question that we want to get feedback on through that process is the concept of better aligning the objectives and responsibilities of directors within Section 172 of the Companies Act with those of the stewards. For example we can use the Stewardship Code to introduce the concept of a Section 172 obligation on investors. Once we get feedback from these open questions and a number of roundtables that we have organised or are in the process of organising, we expect to do a formal consultation in 2018. Part of the reason for staggering these consultations is to ensure that what we propose for the Stewardship Code dovetails nicely with the changes that will be agreed on following the consultation to the Corporate Governance Code.

### IV. Next Steps

We aim to consult on the code itself towards the end of November. We will move onto the Stewardship Code later next year. As part of our consultation on the code itself, we will also consult on an updated 'Guidance on Board Effectiveness', which we had always suggested that we were going to update in light of our report on corporate culture. That is all I wanted to say in respect to the work we are currently doing on corporate governance. I am sure there will be some questions on that and we can pick them up as part of a general Q&A session which Stephen is going to chair.

## <u>Questions and Answers</u>

**Stephen Haddrill**

Thank you, Paul. We have managed to get a bit ahead of our time, so that is good; it means there is more time for questions, which is always the best bit. As it says up there, if you could just indicate what your name and organisation. I will just introduce my colleague, Melanie McLaren, who is Executive Director of the Audit Division.

**Mohammed Amin, UK Shareholders Association**

What is the FRC's current thinking on the three plausible alternatives for listed company reporting post-Brexit, which is either international financial reporting standards as issued by the IASB full stop, international financial standards as issued by the IASB as endorsed by the EU, sometimes with modifications, or IFRS as modified by the UK?

**Stephen Haddrill**

That is a good question. I think the first thing to recognise is that what happens will largely be determined by the arrangement that goes with the EU. If there were a transition period of any length, one would expect in that time that the standards that we adopt to come into force in the UK would be the EU adopted standards. That period is quite significant because currently there is really only one major standard coming forward for adoption, which is the insurance standard, IFRS 17. We do not know what the process will be. What we do know is that we need – as I was saying in my speech more generally but specifically in this area – to get the best possible understanding of the impact of that standard in the UK, both in terms of the impact on cost, on the industry and the benefits to investors looking at the insurance sector. It is very important that this be got right because we have not really had an effective standard in this area for many years. Companies are effectively reporting under a number of different models and we think that has disadvantages in terms of the impact on the capital markets and so on, so we want to see that corrected. That is the focus at the moment: getting the understanding, influencing the EU whilst we remain in it, and once we have left, whenever that may be, if that standard is still there, making sure that we have a good basis for a UK decision.

**Edward Mott, Oxford Capital Partners, LLP.**

Are we allowed to say something nice? I do think you all need huge congratulations on the quality of your messaging and reaching out to people. I circulate your emails to lots of people, and I do not know who does it all, but it is really nice the way you send all little messages out and spread them around; it radiates. Secondly, I followed up on one of your messages and read your annual report and review, and again, I think you need huge congratulations on the level of quality and tone about that. For anybody here who has not looked at it, it is a model to look at, so congratulations to the whole team. My question, if I may, is one on diversity. We live in a very politically correct society. I work with a number of quite small companies, companies that are not FTSE 350 and so on, and we all recognise that we want to embrace talent wherever it is, but society is saying 'You have got to be politically correct; you have to have lots of diversity…' and this, that and the other. I would like your comment on how we ensure that meritocracy remains and how we get the best talent, whoever they may be.

**Stephen Haddrill**

Thank you, firstly, for your opening remarks. It is much appreciated; we have put a lot of work into our annual report this year. Meritocracy remains important to me, but the question is as follows: what selection process do you go through in order to make sure that you have the best people and the best balance at the same time? I think that we have to ask ourselves some serious questions about what the right way of doing that is, to make sure that the unconscious bias and so on is stripped out of the system so that we do actually get the best people. A lot of thinking is going into that. There is also the issue that you only end up choosing from those people that actually apply. How does the company project itself in such a way that people from diverse backgrounds, excellent people, can see themselves in that business? Certainly, this is an issue for the professions: how do the professions make sure that people from the ethnic minority communities really do feel that this is somewhere that they want to be? Once you have some role models, you can start to move on that, but I think that projection of the business to a wide range of communities in a way that will resonate is most important. Thank you.

**Mira Makar, SME Alliance Ltd**

I am a contractor to the European Space Agency in Darmstadt. To date, I have operated through UK public companies, originally on the USM, then two main market companies. Despite that, the economic centre of our activity is Darmstadt and, consequently, we are looking at three generations of integrated families and, with a third generation coming out of university and getting married, their UK grandparents are sort of like the foreigners. In other words, it is absolutely integrated socially, culturally and economically, but with the economic centre firmly in Darmstadt, Germany. With Brexit, it does raise the fundamental question: personally, my functional currency, which is the phrase that is used in private wealth planning, is the euro. There are going to be lots of people in a similar situation, where you are going to have to start considering protecting yourself from economic risk, and considering UK branch operations and, in fact, if you are going to continue to be quoted, being quoted somewhere else. Those people have a need that needs to be addressed. My question is as follows: will the FRC, when it is very busy considering best practice and guidance, consider Brits who have to report in what is ultimately in a different regime?

**Stephen Haddrill**

That is certainly amongst the things that we need to understand. What are the costs of extra reporting going to be? Is there any risk that European regulation in future – the creation of a separate reporting mechanism, a reduction in passporting and all those sorts of things – will lead to business turning around and saying, 'Well, it is easier to establish ourselves in the EU'? I mean, we are very aware of that risk. We will do what we can in tandem with the FCA, other regulators and indeed the government to make sure that risk is minimised.

**Neville Wells, Bridgewell Corporate Communication**

Could we have an indication of timetable of the corporate reporting events coming up? We have a change to the UK Corporate Governance Code, which came in in June this year for reporting. We have the non-financial coming in at the end of the year, on which the guidance is going to appear imminently before that, so we have a bit of a time pressure there for clients. Then we have several other things that are coming along with the government's developments. Is the strategic report guidance going to change again after the end of this year? Could you give an indication of what the timetable is over the next two years?

**Paul George**

My honest answer is that I do not know. The timetable so far is that we have issued the consultation, we have asked for responses on the strategic report guidance by mid-October, we are going to have to deal with what responses come out of that and then finalise the report. It is slightly unfortunate for the timing for those that have a December year-end, but I think that the legal requirements for companies were set out pretty clearly in the consultation documents. Therefore, I think that piece of it companies will have readily available to them by this reporting cycle. The expected content that we have added to that guidance we see very much as best practice encouraged content: companies can seek to take what we have put in the guidance and work with it. What actually ends up in the final guidance that we issue is clearly going to be dependent on the responses to the consultation and the level of responses that we get.

When the government gave its response to the green paper, it suggested that they were considering bringing in some secondary legislation to make Section 172 work more effectively. We have anticipated part of that, not least because we had fed some of those suggestions into government, but we do not quite know what that legislation is going to look like. I think their plans were to lay that early in the new year, but I suspect that there will be some decisions that have to be taken depending on the extent to which there is going to be political support to what they want to do. It may be that no secondary legislation is proposed, in which case it will be a case of us finalising the strategic report guidance on the back of the consultation. It may be that we are faced with a clearer picture of whether the government is going to change the legislation, in which case we will need to update the guidance to reflect that. However, we hope that any revisions to do what the government might do through secondary legislation are pretty well foreshadowed through our encouraged content.

**Neville Wells**

Just to get that clear, they are saying they are going to do something in March for implementation in June next year.

**Paul George**

Yes.

**Neville Wells**

That is their legislation. In addition, we have the FRC's fundamental review of the Corporate Governance Code which started in November this year, for implementation when?

**Paul George**

Normally when we update the code, we expect the application of it to be in the next financial reporting cycle. During 2018, I am sure many companies will think about the direction of travel and will be starting to report against, or early adopt against, the revised code. In terms of the period in which we will issue the final code, depending on the responses from the consultation, we would hope to do that by the middle of next year, maybe early autumn.

**Stephen Haddrill**

Paul, when you mentioned the next reporting cycle, are you saying December 2018 year-end? Is that when it will come into effect?

**Paul George**

I think the following year will be when it becomes a reporting requirement. Next year, early adoption will be welcome.

**Henry Irving, ICAEW**

I just have a question about audit quality. Stephen, you mentioned that the waypoint was the goal to have less than 10% of the FTSE 350 audits having less than minor improvements. Then you said that, once that had been achieved, you would be looking to raise the bar. My question is as such: where is the end game for this? What is the next step as far as raising the bar is concerned? Is the bar going to be raised for more companies? I would just like a few of your thoughts on what the next steps are and what the end game is, because at the end of the day it is going to be very hard for anyone doing anything to be absolutely perfect.

**Stephen Haddrill**

On the other hand, auditors have a statutory role, a public interest role. We are discussing the FTSE 350, major companies in this country, the biggest firms, and they do have the resources to get it right. We have high expectations and I think that 10% falling below the bar is not good enough. I am going to turn to Melanie to say a little more about where the bar might go.

**Melanie McLaren**

I think we have a number of thoughts in that regard and it is a very good question, Henry. As Stephen said, we need to continue to focus on those companies that most affect the public interest and the capital market, so that is the FTSE 350. We can see that the big four, who are the companies that audit predominantly in that part of the market, are making significant investment in promoting audit quality improvements. They are using technology, they are looking at their audit quality culture and we can see good progress. However, there are some sectors that there have been issues with in recent history, thinking particularly about the financial crisis, so perhaps we might look at the question of needing a more specific target in financial institution audit as opposed to other types of audit.

As you will have seen in our 'Developments in Audit' report in June, we also highlighted that whilst we are seeing improvements in the FTSE 350, we are not yet seeing improvements in audit quality outside of the FTSE 350. If that target has effected improvement in the FTSE 350, perhaps we should be broadening that target and looking more broadly, including potentially in the non-public interest entity, outside of the non-public interest entity definition. For those of you less *au fait*, the FRC inspects directly, legally, public interest entity audits, but the professional bodies look outside. For example, large private companies are reviewed by professional bodies in those terms, the most significant of which is the ICAEW. I think that we feel that we have a responsibility to raise levels of quality right across the market; a rising tide floats all of the boats, we would hope, so let us look at the targets in that light.

**Deborah Gilshan, Standard Life Investments**

I was interested in the idea around the equivalent for stewards, for shareholders, on the Section 172 and directors' duties. I appreciate this might still be quite embryonic in your thinking, but I wondered if you could just explain a little bit more about what you are currently thinking. For example, would it be different for asset owners and asset managers? Obviously I think that the success of the Stewardship Code has been because a lot of asset owners have signed up to it as well, so I just wondered if you could just give us a little more flesh on the bones on what you are thinking there.

**Sir Winfried Bischoff**

Chief executives or chairmen of companies look at Section 172; all directors adhere to Section 172 and the various parts of Section 172. It is not just for shareholders; it is much broader than that: suppliers, customers, staff and so on. There is a view by them that, if they have to be held to account on that basis, which supports long-term thinking overall, and the shareholders have a completely different way of judging boards and management, this is not a good way of working together with stakeholders and shareholders. We have tested this on a number of institutions and I expected a number of institutions to say, 'No, this would be too difficult.' You will be pleased to know that, as well as smaller institutions, some large institutions think this actually makes a great deal of sense. There is quite a lot of discussion on this very point, for example, in the US, in BlackRock and so on. The aim is to get the shareholders and the management to think along the same lines rather than perhaps the shareholders thinking of what they want companies to do, and the law and people like us wanting them to do something else. That is really the thinking underneath all of that. We have tested on companies, but it is really on both sides and I think that this parallelism is going to be important.

**Paul George**

Perhaps on a slightly different note to Sir Winfried's response, there is the question of whether the Stewardship Code continues to be the most effective mechanism of enforcing corporate governance. The current Stewardship Code seeks to cover fund managers, asset owners and advisors all through one code, though each do have a slightly different role to play. This is a point that we will be doing some informal discussion and consultation on prior to providing any updates: whether all roles are best served by one document or if they are better served by separate documents will need to be decided.

**Sir Winfried Bischoff**

Thirdly, obviously, we look at asset owners and managers, but we also think that proxy advisors should be looking or being aware of some of these things, as they become ever more powerful. It is a broad question; we are going to be looking at it, we are going to go out for consultation, but it is something where the time has come for there to be more of a concerted way of thinking about these things.

**Julia Penny, SWAT UK Ltd.**

Just going back to the issue of audit quality, Melanie mentioned briefly that we have many developments in things like technology, which might help with audit quality. How are the FRC envisaging that they ensure that we have standards, from an ISA point of view or whatever we use in the future, that work with some of the new technologies that are coming in?

**Stephen Haddrill**

Yes, that is a very good question and one on which we have been doing quite a lot of work. Melanie, would you like to expand?

**Melanie McLaren**

We have been doing work in that regard. We issued a thematic report earlier in the year that suggested that currently the use of things like data analytics and artificial intelligence are not that widespread in the UK, but the UK is at the forefront of their usage and the pace of adoption is quickening. We have been working with the firms who are developing their technologies and some of the firms are now beginning to use data analytics in, for example, revenue testing in quite a widespread way, and this is being done within the context of the existing standards. This tells us that the standards are not presenting an obstacle, yet although the standards recognise that computer technology exists, perhaps they do not do enough to encourage the use of more data analytic, big data and artificial intelligence techniques. We have been contributing to work that the international board, the IAASB, is doing; it has a taskforce that is looking at these issues and one of our team members is contributing to that, so that we can make sure that the standards promote and harness the opportunity for improved audit quality that technology provides.

**Mira Makar**

This is partly an observation; I think I am partway to answering my own question. We have been very good about talking about corporates, but in reality, many of the principles that Paul George has been discussing in his governance work are as applicable to branch operations as they are to corporates. In terms of the consultations and the work, where you are talking about stewardship and standards, it is going to be quite important to state that whatever it is that is coming out, being consulted on and being adopted applies to whatever structure it is that you are operating under. In other words, applying everything to a company, when people are transacting in branches and in networks, is rather narrow. A standard value, a stewardship principle and an audit trail stand irrespective of the structure to which it belongs.

**Stephen Haddrill**

I understand.

**Andrew Hobbs, EY**

Stephen, when you talked about Brexit, I think I have it right that there was a great set of issues. In terms of the FRC's international work, you have a great record of promoting consistency and high quality standards across the world; clearly, Brexit throws a bit of a spanner in the works for that. How are you calibrating your international work as a result?

**Stephen Haddrill**

As members of the European Union, we have obviously been heavily engaged in that. We play a leading role within Europe and the question is as follows: how do we extend, and do we need to extend, our broader international focus after we leave? We have always had a global approach. For example, Melanie sits on the board of the international audit regulatory body. We also have a board member on the International Audit and Assurance Standards Board, as Melanie mentioned. We have been very committed to ensuring that our people are making a mark in those international centres, whether it is about standard setting or regulation and supervision. I am also keen that we play a role in relation to thought leadership, which is about the work we do to put out discussion papers and to try things in the UK first. We were not the first country ever to do audit retendering, but I think we made quite an impact in thinking in doing that. We introduced the extended auditor report and so on. We will continue to do this as part of an international network, if not as part of a European network. However, I do stress that Britain will be outside the European Union, but we cannot be outside the European economy. Companies will continue to cross the boundary, cross the channel; audit work will need to be done across that border, just as it is done today across the Atlantic. We will be seeking a close relationship and dialogue, even if it is not a formal and political one, with the regulatory bodies in the European Union that we have such a close relationship with today.

**Leor Franks, FTI Consulting**

Building on the questions about audit quality, are there any plans to enhance further the rules around auditor independence and provision of non-audit services to audit clients and public interest entity (PIE) audit clients?

**Stephen Haddrill**

I will ask Melanie to come in in a second because we have changed the ethical standard for audit last year and we did that on the back of the change of the European regulations. We will keep that new standard under review, as we do with all of our standards. I am being very careful what I say here in case you project yourself over the balcony as a result. I think it is very important that we do address that issue you mentioned. We came broadly in line with the EU. There was a serious debate going on in the FRC before the EU legislation came in about whether we should actually go further. At the time, last year, we felt European institutions, including the European Parliament, had debated these things in the public interest and reached a certain conclusion, and we thought that we should be broadly in line with that. I think that if we review the standard in a couple of years' time, outside the EU, we should think about whether we do need to go further. Melanie, am I going too far in saying that?

**Melanie McLaren**

No, I think you have summed it up beautifully.

**Ian McDonald Wood, FutureValue**

Stephen, I have heard it uncharitably commented that consultation is a process of good governance for the FRC, something that does not always lead to substantive change in drafts and guidance in terms of the different consultations that you put out. I am sure that is not true, although there are occasions where I have looked at things and wondered whether, from original drafts and comments on which people have been consulted, there has been sufficient change. What is the process? How can you overcome and perhaps ensure that that is not a perception that persists?

**Stephen Haddrill**

Firstly, you have given me the opportunity to correct the perception, in case there are people in the room that feel this. Through roundtables or webinars, the latter of which we certainly want to do more of, we spend a lot of time talking to people about an emerging issue, a problem that might exist in need for change, before we actually issue the consultation paper. I hope that we have heard quite a lot of the concerns, options and so on, before the consultation paper comes out and that might partly explain why, subsequently, there is not so much change. I think we have a good record of taking what is given to us very seriously; we do not always agree with the majority opinion, even. I remember one of the first consultations I was associated with at the FRC was when we were proposing the annual re-election of directors. Even in the investor community, opinion was very much divided on that, but we thought that we really needed to do that, we explained it and we went along with it. You are right that we do not always follow the consultation, but if we do not follow the consultation, it will always be after very serious and substantive thought.

Does anyone want to add anything?

**Paul George**

If there is a particular example that you have a concern with, then I would be happy to hear it afterwards. We always try to explain in a feedback statement how we have come to our conclusions, but if there is specific thing that you feel we have not listened to properly then I am sure there will be an opportunity for us to listen to it in the future.

**Stephen Haddrill**

If there is one thing that I think we find a bit difficult, and I think it is an area we need to improve and are investing in, it is the cost/benefit side of some of the proposals. Quantification of costs is generally possible; the quantification of the benefits is sometimes a bit thin and that is something I would like to enhance.

**Anthony Carey, Mazars LLP**

It is just to ask a question on the audit market. We were discussing the FTSE 350. Under the regulations, companies are expected to make sure that all firms eligible to tender are given a chance to do so. As the competence authority, to what extent are you monitoring how tenders are working and who is being invited to tender? Perhaps more broadly, how are you monitoring concentration in the audit market and what are your views on the current degree of concentration in the large listed audit market?

**Stephen Haddrill**

We have monitored this, and Melanie will expand on this, because we have published on this subject. My view is that there is too much concentration. If one of the major firms were, for whatever reason, to leave the market, we would have a market that would actually be dysfunctional in relation to the regulations around rotation and so on. I cannot say that we are satisfied with the level of concentration that we have currently, and that is why we keep a close eye on market effectiveness and so on. As to finding solutions, the Competition Commission a few years ago did a major enquiry, and we have brought about some changes as a result of that but as of yet there has been no larger changes, and I have to say I do not think there is an enormous amount of sign that things will change. Whether technology will make an impact is an interesting question, but I would certainly like to see more competition. Melanie, would you like to expand?

**Melanie McLaren**

Building on that, we do have very many more audit committees becoming aware of their responsibilities in terms of retendering and rotating, and looking at how they can broaden the options that are available to them. It is very early days: this is a new regime that has only just come into place. We are going to have to keep monitoring that, engaging with auditing committees about some of the opportunities and concerns that they have about handling these tenders. We need to demonstrate how these committees need to approach audit rotation and retendering on an elongated timeline, to build an understanding as to who the likely providers might be and to ensure that they are looking at the independence of potential providers in advance of the point at which they want to tender. We will be playing our part in that. We have already issued notes for audit committees about how to do audit tenders; we will continue to update that; we will survey audit committees and audit tenders and try to raise the level of awareness whilst continuing to monitor some of the risks and issues that concentration brings. As Stephen has highlighted, we will be focusing on the leadership and governance of those firms that are systemically important to confidence in the UK capital markets and ensuring that audit quality standards are maintained and improved, which refers back to the earlier question and Henry's comment about targets.

**Stephen Haddrill**

Thank you. Thank you very much for some good questions and for joining us today.