G·E·S®

FRC Review Secretariat
Victoria 1, 1st Floor
1 Victoria Street
London
SW1H 0ET

FRCReview@beis.gov.uk

6 August 2018

Dear Sirs,

Independent Review of the Financial Reporting Council

GES is a leading provider of engagement services to institutional investors globally. Representing more than EUR 1.5 trillion of investments worldwide, GES acts as an owner advocate by assessing and engaging with clients' portfolio companies and reporting and providing related recommendations to investors.

GES is dedicated to good stewardship. We take seriously our clients' responsibility to exercise their ownership rights globally, particularly through voting their shares at all the general meetings of companies in their portfolios and/or engaging with companies.

We interact with the Financial Reporting Council (FRC) primarily on behalf of shareholders – users of accounts. We welcome the opportunity to respond to the review. Overall, we do not have major concerns with the structure or work of the FRC. However, we do believe that there is a resource issue at the organisation, which should be addressed. Below are responses to the specific questions asked in the review.

QUESTIONS

Q1. What should the FRC's objective(s) be? Is its present mission statement the right one?

As mentioned in the introduction, we do not have major concerns about the structure of the FRC. Therefore, we believe that its present mission to promote transparency and integrity in business is appropriate.

Q2. Does the FRC's name remain right?

We believe that the FRC's name is established in the UK market and recognisable. Given that we do not have strong concerns about the structure, we believe the name seems appropriate.

Q3. Are the functions and structure of the FRC still relevant and appropriate, or is there a case for any structural change? Should any of the FRC's functions move to other regulators?

As mentioned in the introduction, we do not have major concerns about the structure of the FRC. The key issue with the FRC is the lack of resources provided to it. The FRC is classed as a 'public body', yet all government funding was cut in 2016. Furthermore, levies are non-statutory and voluntary. This has all transpired over a time during which the FRC's role has grown and expectations have increased. Therefore, we believe that any shortcomings are not necessarily a result of its structure, but more a result of growing expectations and a squeeze on resources.

Q4. What lessons can be learned from other countries' regulatory systems? Which ones?

We have no comments in relation to this question.

Q5. How effective has the FRC been in influencing wider debates that affect its ability to deliver its objectives – for example, around audit competition, or its legal powers?

We have no comments in relation to this question.

Q6. Is the current balance between cross-cutting reviews and firm-specific investigations most effective?

The current balance seems effective. We also are supportive of the FRC's Financial Reporting Lab as a way to improve corporate reporting and share best practice.

Q7: What are the FRC's strengths and weaknesses?

We believe that a strength of the FRC is its willingness for consultation and collaboration with market participants. In terms of investors, we believe that the FRC has been stepping up its outreach to investors over the year, which is welcomed.

A key weakness is the lack of resources provided to it in an environment of enhanced responsibilities, which we highlighted in our response to question 3. We also note that, in the past, the FRC was not very transparent about its investigations and/or sanctions. However, we believe that this is changing. In the last 12 months, we have had the impression that there has generally been an increase in transparency and proactive communication from the FRC.

Q8: The recent joint report on Carillion from the Business, Energy and Industrial Strategy and the Work and Pensions Select Committees considered the FRC to be characterised by "feebleness and timidity" and recommended that a change of culture and outlook is needed. Do you agree? If so, please cite relevant evidence which informs your view.

We have no comments in relation to this question.

Q9: Are there changes respondents would like to see to achieve the vision set out in the Review's terms of reference?

We believe that more funding and resources, along with some clarification of the FRC's legal status and responsibilities would help the FRC to achieve the vision set out in the Review's terms of reference.

Q10: Are arrangements for financial reporting, audit and corporate governance the critical elements for effective delivery of FRC's mission, or are elements missing?

We do not believe that there are elements missing.

Q11: How effective is the FRC at driving quality improvements in audit? What further improvements would respondents like to see?

It is unclear how effective the FRC is at driving quality improvements in audit and/or whether the FRC's actions taken when audit quality is poor is a deterrent. Recently, there have a been a number of issues that have arisen that have caused investors to question audit quality. However, it is unclear to us whether this is the result of poor monitoring or a combination of factors, including the ongoing development of accounting standards and/or the general market environment.

Q12: Where quality does fall short, do the FRC's interventions have sufficient impact and deterrent effect?

Please see our response to question 11.

Q13: What force is there in the concern of some that the FRC may be too close to the "big 4"? Or that the FRC is too concerned with the risk of failure of one of the "big 4"?

We have no comments in relation to this question.

Q14: Are investigations of audit work effective, transparent, satisfactorily concluded and unfettered?

As mentioned in our response to question 7, we believe that the FRC's investigations of audit work have become more transparent in the last 12 months, which is to be welcomed. Further transparency and publication of their enforcement activities and investigations should help to raise the deterrent effect of their activities.

Q15: Could a different regulatory strategy or tactics result in greater avoidance of harm?

We have no comments in relation to this question.

Q16: Could or should the FRC's work promote competition and a well-functioning audit market? Does the FRC's work undermine competition or a well-functioning audit market in any way?

We think that it should be within the FRC's remit to promote competition to the extent that it promotes audit quality and mitigates risks in the audit market. As noted in the review's consultation paper, the FRC is starting a review of the six largest audit firms and we support this action as an attempt to enhance oversight of the audit market.

Q17: Can questions regarding the effectiveness of the FRC be separated from the wider question on whether change is needed to audit arrangements to take account of shifting expectations?

No, we think that one needs to evaluate both together, as they are not mutually exclusive. In our response to question 11, we allude to this.

Q18: Has the FRC been effective in influencing the development of accounting standards internationally as well as accountable and effective in setting UK GAAP?

We have no comments in relation to this question.

Q19: How else could the FRC improve the quality of financial reporting with a view to ensuring investor confidence?

In general, we believe that more timely investigations that are well-resourced and examine both the responsibilities of the issuer and the auditor (where appropriate) will help to improve the quality of financial reporting in the UK. For example, if there is an issue with an accounting judgement, the issuer should not be the only party subject to questions. The auditor should also be involved, given their role in the audit process. Approaching investigations in this manner would help to enhance both corporate reporting and audit quality.

Q20: Are there wider issues of financial and other reporting on which a stronger regulatory role would be desirable to better meet the information needs of investors and other stakeholders?

Given the FRC's role in developing the UK Corporate Governance Code, it does seem incongruous that the organisation does not play a role in monitoring the corporate governance statement, remuneration report and the viability statement. We would support the FRC having greater ability to monitor these aspects and company's disclosure.

Q21: Is the current combination of statutory and voluntary methods of oversight for professional bodies effective, and do they remain fit for the future?

We have no comments in relation to this question.

Q22: In relation to the UK Corporate Governance Code, are there issues relevant to the Review's terms of reference that respondents believe the Review should consider?

No. Overall, we believe the UK Corporate Governance Code (the Code) is fit-for-purpose and believe that the FRC has done a satisfactory job at overseeing the development of the Code.

Q23: How effective has the Stewardship Code been in driving more and higher quality engagement by institutional investors? If not, why? How might quality of engagement be further strengthened?

We believe that the Stewardship Code has had a positive impact at driving more and higher quality engagement by institutional investors, and we have seen investors become much more active in this space since the Stewardship Code was brought in. However, we recognise that more can be done to improve this further.

In our response to the FRC's consultation on the proposed revisions to the UK Corporate Governance Code, we were supportive of the FRC's plans to review the Stewardship Code and the general sentiment for the FRC to make the Stewardship Code more explicit in terms of expectations on investors and enhancing the 'comply or explain' aspect of the Stewardship Code. We noted that the FRC's tiering exercise that was carried out in 2016 seemed to have had a positive impact in terms of enhancing the reporting provided by investors. Unfortunately, the FRC has suggested that it does not have the internal resources to continue this exercise. This serves to highlight our earlier comments that perhaps the FRC does not have the resources to undertake new exercises to improve corporate reporting and audit quality.

Q24: Do respondents view the FRC as reluctant to undertake investigations or enforcement, or able to do so at speed?

We do not view the FRC as reluctant to undertake investigations. This perception may stem from the fact that, until recently, the FRC's investigations and enforcement activities were not very transparent. As we have noted earlier in our response, we believe that this improved recently.

Q25: How could the FRC better ensure it is able to take swift, effective and appropriate enforcement action? What practical or legal changes would be needed to achieve this?

We believe that the speed of investigations should be addressed and agree that some enforcements seem to have been taken too late to make a discernible impact. Again, we would posit that a lack of resources may be responsible for the ability to undertake investigations in a timely manner. We are not aware of the legal challenges associated with this and so have not provided any comments on that aspect.

Q26: Have the arrangements put in place following the 2005 Morris Review stood the test of time, or is there a need for change? Should actuarial regulation be a focus for the Review's work?

We have no comments in relation to this question.

Q27: Is there more the FRC could or should do to help reduce the risk of major corporate failure?

We have no comments in relation to this question.

Q28: Is the FRC quick and effective enough to act on warning signs arising from its work on accounts and financial reporting, or on evidence of concerns over poor corporate governance?

Please see our response to question 25.

Q29: Is there a case for a more "prudential approach"? If so, how could this operate in practice, and to which category of company might such an approach apply?

We have no comments in relation to this question.

Q30: Introduction of the viability statement was an important development, but could it be made more effective?

On page 9 of this review, it notes that the FRC does not have the power to monitor viability statements. This seems like something that should be addressed in order to ensure that the statements are effective.

Q31: Are there gaps in the FRC's powers? Would its effectiveness be improved with further (or different) powers?

Please see our response to question 20.

Q32: Are the FRC's powers coherent in relation to those of other regulators?

We have no comments in relation to this question.

Q33: Taking account of Sir Christopher Clarke's review of sanctions, and subsequent changes, does the sanctions regime now have the right deterrent effect? Does the FRC make best use of the sanctions at its disposal?

We have no comments in relation to this question.

Q34: Should the Government legislate to put the FRC on a more conventional consolidated statutory footing?

We have no comments in relation to this question.

Q35: What is the optimal structure for the relationship between the FRC and the Government, best balancing proper accountability with enabling the FRC's effectiveness?

We have no comments in relation to this question.

Q36: In terms of the FRC's broader accountability, is there a case for further transparency in its actions or functions?

Yes. Please see our response to question 7.

Q37: How effective is the current leadership and Board of the FRC? Please cite relevant evidence which informs your view.

We have no comments in relation to this question.

Q38: Is the Board's composition appropriate? Is it the right size? Does it have appropriate membership?

We have no comments in relation to this question.

Q39: Is the balance of decision-making between the Board, its Committees and the Executive described in paragraphs 34-36 above right, given relevant legal constraints?

We have no comments in relation to this question.

Q40: Is the Board's structure appropriate, including given the FRC's roles on standard setting, assessment and enforcement? Does the Board's accountability appropriately reflect its role and functions? Are its decisions appropriately transparent, bearing in mind the need to balance public interest and confidentiality?

We have no comments in relation to this question.

Q41: How should the Executive's effectiveness be assessed and ensured?

We have no comments in relation to this question.

Q42: Who should fund the FRC, and how? What are the impacts of current funding arrangements, including of having a partially voluntary funded regime?

Please see our response to question 3. The current funding model does not seem sustainable, especially if the organisation will continue to undertake new responsibilities and act as a competent authority.

Q43: What skills are needed for the FRC to be most effective? Does the FRC have the people, skills and resources it needs, of the quality it needs?

We believe that the FRC should seek to recruit a diverse group of individuals that have relevant experience in corporate reporting and audit. It should not limit itself to recruiting people solely with experience of working in an audit firm. People with a background in investment, financial/ESG analysis and/or management experience would complement those coming from a pure audit background and perhaps provide a different viewpoint.

Q44: Are there conflicts of interest in the FRC's structure, processes, or culture? Are there deficiencies in the FRC's approach to managing conflicts of interests?

We have no comments in relation to this question.

Q45: Are there any other issues relevant to the terms of reference that respondents would like to raise?

We have no further comments.

If you have any further queries about our responses, please do not hesitate to contact us.

Yours sincerely,

Kate Jalbert
Head of Corporate Governance
GES International AB