



Financial Reporting Council

**The UK's independent regulator for
corporate governance and reporting**

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Financial Reporting Council

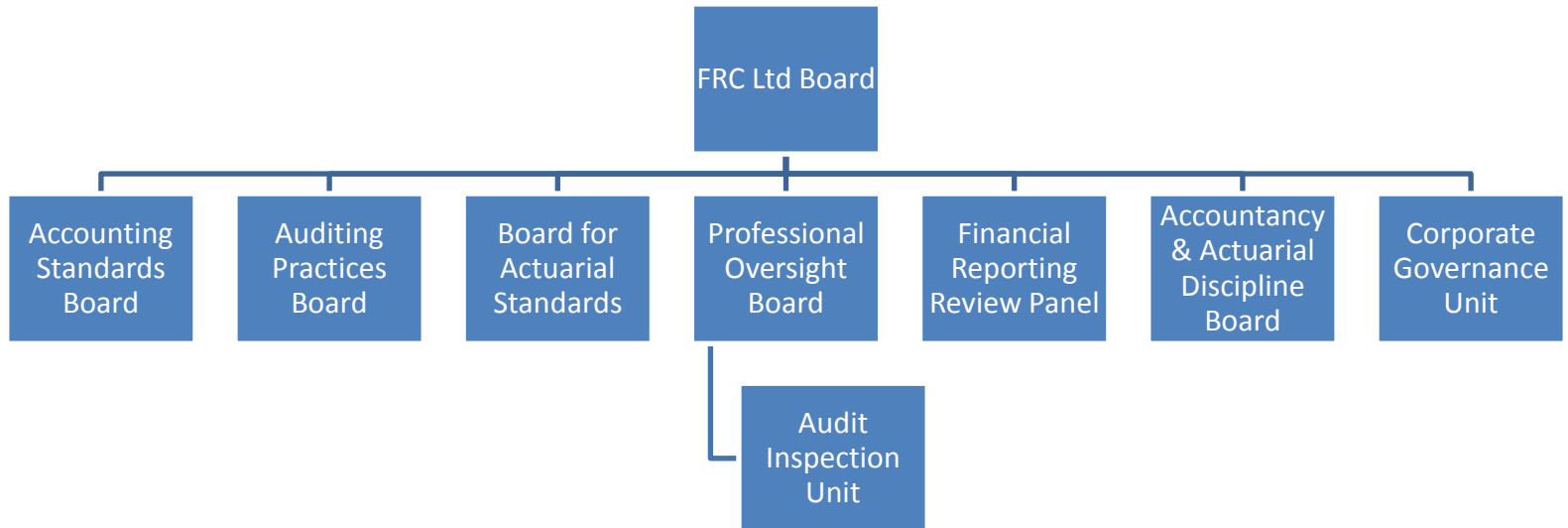
What is the FRC?

- The UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment
- Statutory and non-statutory responsibilities
- Sets accounting, auditing and actuarial standards as well as the corporate governance Code
- Provides independent oversight of the regulation of the auditing, accounting and actuarial professions by their respective professional bodies
- Direct regulatory role in monitoring and discipline of the accounting, auditing and actuarial professions (PIEs only)
- Thought leadership in the UK and internationally
- Funded by a voluntary levy on companies, the audit profession and local authorities

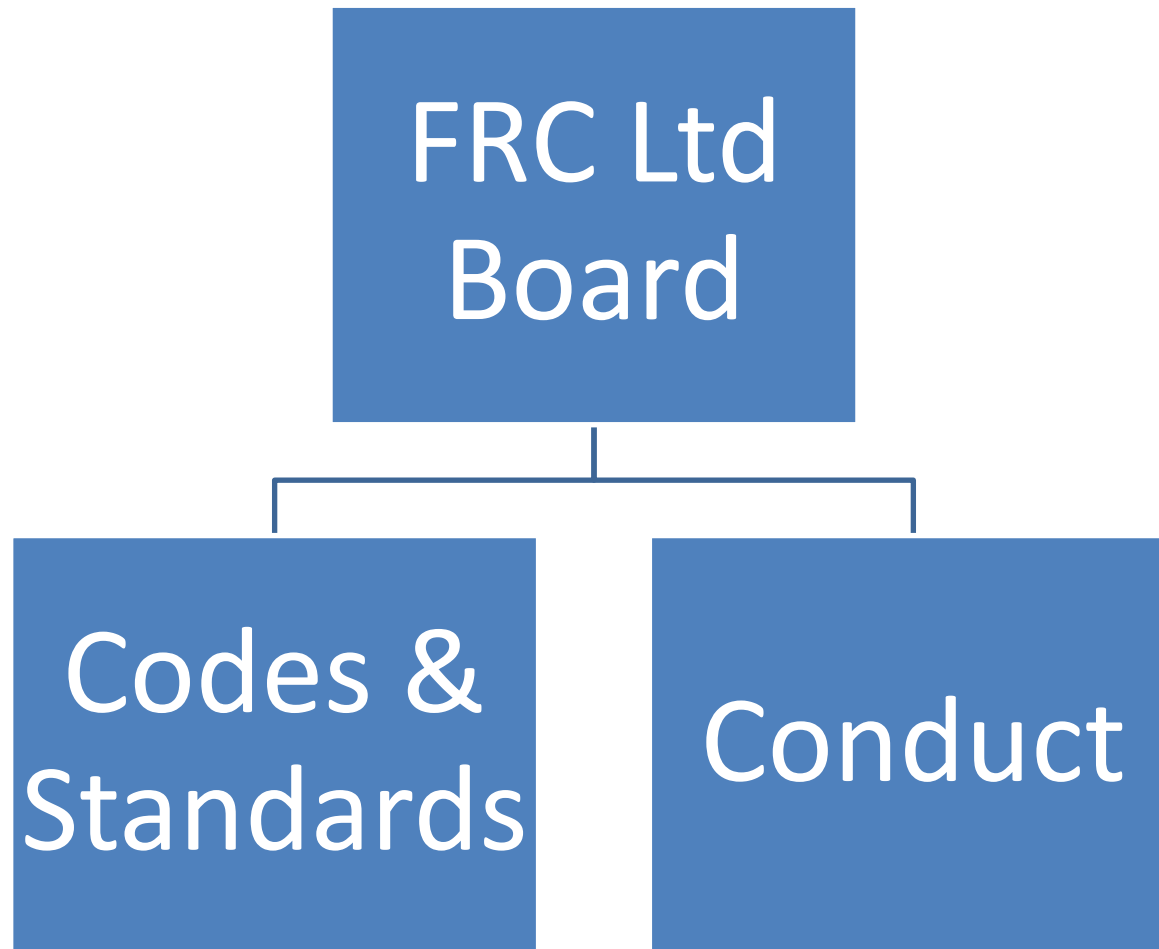
History of the FRC

- Originally set up in the 1980s as a private sector body tasked with promoting high quality financial reporting . It consisted of two bodies, the Accounting Standards Board and the Financial Reporting Review Panel, respectively setting UK accounting standards and reviewing listed companies' compliance with those standards
- Following Enron and WorldCom scandals, the Swift Report recommended that the FRC also take on formal responsibilities for audit and accountancy regulation; this was enacted in 2004
- From 2006 the FRC also took on formal responsibility for actuarial oversight and standard-setting
- Publication of “Reform” consultation in 2011 – aimed at cementing FRC’s independence, increasing our effectiveness and focusing our activities on capital markets

FRC current structure



FRC proposed new structure



Professional Oversight Board

- Most of the FRC's statutory responsibilities under the Companies Act currently rest with the POB
- Oversight of the Recognised Qualifying Bodies and Recognised Supervisory Bodies for audit
- Regular monitoring of the RQBs and RSBs to ensure their continued compliance with the Companies Act
- Annual publication of report to Secretary of State on our activities



Audit Inspection Unit

- Part of the Professional Oversight Board
- Monitors the audits of listed companies and certain other public interest entities
- Around 100 audits inspected annually, selected using a risk model
- Also carries out inspections of firm-wide quality control processes at the ten largest firms

Audit Inspection Unit reporting

- Private reports to firms on outcome of inspections
- Public reports detailing the results of its inspections of individual firms, as well as an annual report with an overview of its activities
- A letter detailing the AIU's findings on each individual audit is sent to the relevant Audit Committee Chairman
- Report to Audit Registration Committee on findings
- Post-reform we hope to have the ability to sanction firms whose audits are of unsatisfactory quality

FRC and choice in the audit market

- The FRC has been concerned about the extent of market concentration, and the risk of a major firm failing, for some years
- FRC and BIS commissioned Oxera to carry out a study in 2006
- Following on from this the FRC set up the Market Participants Group (MPG)
- This was an attempt to reduce both concentration and the risk of a firm leaving the market by means of voluntary action by market participants

FRC and choice in the audit market (cont)

- The MPG produced a list of 15 recommendations, 14 of which have now been implemented
- FRC has monitored progress and published a number of progress reports
- It is clear that the recommendations may have helped audit quality but have done nothing to reduce market concentration; indeed there is evidence that the market is becoming more concentrated
- FRC has exhausted its audit regulator's toolbox; the issue needs looking at by competition authorities

FRC current work on audit market

- Focus on contingency planning; working with firms to develop “living wills”
- Review of recent audit proposals and meetings with audit committee chairs indicate increased propensity for large companies to put audits out to tender, partially for governance reasons, partially to obtain a cut in fees
- Review of recent auditor changes points towards increasing concentration; very few companies switching from Big Four to non-Big Four, but several moving in the opposite direction

Specific issues CC may wish to consider

- Possibility of an unequivocal statement that under no circumstances would it permit the market to be dominated by three or fewer audit firms
- Hyper-concentration in particular industries (eg banking, insurance, utilities)
- Propensity for small FTSE companies to use Big Four auditors; contrast with similarly-sized AIM companies
- Big Four expanding into AIM markets
- International issues:
 - Regulation of central entities at heart of global networks
 - Trend for Big Four networks to acquire smaller rival firms in developing markets
- Interaction with European Commission proposals

Appendix A – AIU gradings

The AIU rates individual audits as:

- Good with limited improvements required; or
- Acceptable but with improvements required; or
- Significant¹ improvements required.

A variety of factors are considered when arriving at the conclusion, including:

- Sufficiency of audit evidence
- Quality of audit evidence
- Appropriateness or otherwise of audit judgements
- Evidencing of thought processes underlying audit judgements
- The existence and extent of concerns in other areas

¹ Factors to be taken into account in assessing significance include the materiality of the area or matter concerned, the extent of any concerns regarding the sufficiency or quality of audit evidence (e.g. whether they relate to specific elements of the audit evidence only or are more pervasive to the overall sufficiency or quality of audit evidence in the areas concerned), whether appropriate professional scepticism appears to have been exercised in forming audit judgments and the extent of any non-compliance with standards or the firm's methodology identified.

Appendix B – MPG recommendations

1. The FRC should promote wider understanding of the possible effects on audit choice of changes to audit firm ownership rules, subject to there being sufficient safeguards to protect auditor independence and audit quality.
2. Audit firms should disclose the financial results of their work on statutory audits and directly related services on a comparable basis.
3. In developing and implementing policy in auditor liability arrangements, regulators and legislators should seek to promote audit choice, subject to the overriding need to protect audit quality.
4. Regulatory organisations should encourage participation on standard setting bodies and committees by appropriate individuals from different sizes of audit firms.
5. The FRC should continue in its efforts to promote understanding of audit quality and should promote greater transparency by the firms and the FRC of the capabilities of individual audit firms.
6. The auditing profession should establish mechanisms to improve access by the incoming auditor to information relevant to the audit held by the outgoing auditor.
7. The FRC should provide independent Guidance to Audit Committees and other market participants on considerations relevant to use of firms from more than one audit network.
8. The FRC should amend the section of the FRC Guidance to Audit Committees dealing with communications with shareholders to include a requirement for the provision of information relevant to the auditor re-selection process.
9. When explaining auditor selection decision, Boards should disclose any contractual obligations to appoint certain types of auditing firms.
10. Investor groups, corporate representatives, firms and the FRC should promote good practices for shareholder engagement on auditor appointment and re-appointments.

11. Authorities with responsibility for ethical standards for auditors should consider whether any rules could have a disproportionately adverse impact on auditor choice when compared to the benefits to auditor objectivity and independence.
12. The FRC should review the Independence section of the FRC Guidance on Audit Committees to ensure that it is consistent with the relevant ethical standards for auditors.
13. Regulators should develop protocols for a more consistent response to audit firm issues based on their seriousness.
14. Every firm that audits public interest entities should comply with the provisions of a Combined Code-style corporate governance guide or give a considered explanation.
15. Major public interest entities (PIEs) should consider the need to include the risk of the withdrawal of their auditor from the market in their risk evaluation and planning.