

10 January 2012

David Andrews
Financial Reporting Council
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Dear Mr Andrews

BIS/FRC Consultation on the Future Role of the FRC

I am pleased to enclose CIPFA's response to the consultation.

We believe that the consultation document is right to identify a number of problems with the Financial Reporting Council's role, and with its structure which is over-complex, and difficult to understand. We do however have a number of concerns about the implications of some of the proposals, and these are set out in the response.

Our main concern is that the consultation fails to address the key strategic issue of public sector standards setting and audit regulation, despite its proposed new role in respect of local public audit. CIPFA urges the FRC to consider whether these important areas can be addressed in a focused and holistic way within its proposed new structure, or whether in order to achieve the increased private sector focus that it seeks, other regulatory models should be explored.

Yours sincerely



Steve Freer
Chief Executive



INVESTOR IN PEOPLE

CIPFA's response to:

Proposals to Reform the Financial Reporting Council

A joint BIS and FRC consultation

10 January 2012

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

The case for FRC reform

1 Do you have any comments on the case for FRC reform as set out in this document?

CIPFA supports in principle the need to clarify the scope of the FRC's role, and to re-examine its internal structure with a view to making it less complex. However, we do not believe that the arguments set out in the independence section have been properly followed through. Regulation of the profession is a responsibility that is shared between the FRC and the professional Institutes. It is therefore essential that disciplinary schemes, for example, should be the subject of agreement amongst the responsible bodies; if issues raised through consultation are not properly resolved this could create major procedural inefficiencies that are in no-one's interest, least of all that of the public.

2 Do you agree that the proposals for reform will bring benefits and increase the effectiveness of the FRC?

It is difficult to comment on this question given the general absence of detail in the proposals. We have commented under Q4 below about the lack of clarity concerning the future of public sector regulation.

3 Do you have any comments on the consultation stage impact assessment?

We were pleased to note that the overall costs of the FRC, and hence the financial burden on both the profession and the audited organisations, are expected to reduce as a result of the proposals. However, we question whether the proposals are in fact significantly deregulatory, as the proposed increase in the range of powers – as summarised in sections 1.16 to 1.18 of the consultation document – seems likely to us to lead to more instances of intervention.

An investment focus for the FRC's activities

4 Should the primary focus for regular FRC activity in relation to codes and standards for corporate governance, accounting and auditing, and for monitoring the quality of corporate reporting and auditing, be publicly traded companies and large private companies?

This part of the consultation document leaves the major strategic issue of the FRC's responsibilities in respect of the public sector unaddressed. While, the paper refers to the development of proposals in respect of oversight of the audit of local public bodies, it does not explain how this extension of its role in the public sector would be reconciled with a stronger focus on the governance and information provided by publicly traded companies and the largest private companies. There is also no mention of how the FRC's other existing public sector responsibilities would be handled within such a private sector focused organisation.

CIPFA urges the FRC to consider the important strategic issue of whether public sector standards and audit regulation can be addressed in a focused and holistic way within its proposed new structure, or whether in order to achieve the focus that it seeks, other regulatory models should be explored.

5 Is the definition of large private company for this purpose – an annual turnover of £500m or more – appropriate?

We have no specific views on the appropriateness of this threshold, but we believe that any definition should balance considerations of efficiency with those of public interest.

6 Should the scope of the FRC’s accountancy disciplinary arrangements be narrowed to cover the quality of work and conduct of accountants in relation to the preparation and audit of annual reports and other reports for the capital markets, leaving other cases of potential misconduct to the professional bodies?

Narrowing the scope of the FRC’s disciplinary responsibilities could be possible, as other review mechanisms exist in the context of the public sector, such as public interest reports, and review by the Public Accounts Committee.

7 Are there other areas of activity from which the FRC could appropriately withdraw?

As indicated by our answers to previous questions, CIPFA has significant concerns about the lack of focus in the consultation on the public sector. A significant role is proposed for the FRC in the future arrangements to ensure the quality of local public audit following the planned abolition of the Audit Commission. We believe that this makes clarification of the FRC’s views on its future role and approach in relation to the public sector essential, and in particular how this fits with the expressed intention to focus on the capital markets and large private companies.

A streamlined structure

8 Do you agree that streamlining the FRC’s governance and structure will bring the benefits described?

CIPFA supports the principle of streamlining the current arrangements. However, the FRC regulates a wide range of activities, and we are concerned that the proposals will not ensure that sufficient relevant expertise is brought to bear directly on each of the issues that will have to be considered by the Board and by the proposed Board Committees. In particular we are concerned about the following aspects of the proposals:

There is no clarity about how these Board committees will be made up or what the skill requirements for Board members will be in order to ensure an adequate level of knowledge across the Board as a whole on all key issues:

There is insufficient explanation of how independent expert advice will be brought to bear as part of a clearly identified standard setting process. We do not believe that the proposed ‘advisory councils’ will allow this to be achieved. If this issue is not resolved, there is a danger of losing relevant expertise in respect of many aspects of the wide range of matters that are regulated by the FRC.

The proposed Board Committees will neither be at the top level of the structure, nor involved in determining specific cases, so it is not clear why lay majorities are proposed.

9 Do you have any comments on the proposed reformed FRC governance and structure?

In addition to the comments in our response to question 8, as indicated previously, CIPFA is concerned by the absence of any public sector strategy, despite the FRC’s proposed new role as the regulator for local public audit.

Independent supervisory and disciplinary arrangements

- 10 Do you agree the FRC should be given powers to determine and require a recognised supervisory body to impose proportionate sanctions, subject to appropriate safeguards, on an audit firm and/or individual auditor in respect of poor quality work?**

We do not believe this to be justified, see Q11 below.

- 11 If not, what are your concerns and how do you believe this issue should be addressed?**

We assume that the 'poor quality work' referred to in the consultation paper would be identified through FRC inspection, as currently takes place through the work of the AIU. CIPFA believes that the appropriate response would be to address the matter through a disciplinary process, either operated by the relevant professional Institute, or through a separate arm of the FRC. We feel particularly strongly that sanctions should not be imposed on either a firm or an individual without the right of appeal.

We are also concerned that the proposals in respect of disciplinary activity do little to move forward from the present arrangements, where the rationale for referral to, or call in by, the AADB, is not clear, and where decisions whether to call in tend to take considerable time. It is here that streamlining proposals would be very welcome.

- 12 Do you agree the FRC should have the ability to make its own rules for the independent disciplinary arrangements without being required to obtain the agreement of the professional bodies?**

No – please refer to our answer to Q1.

- 13 If not, how would you propose the FRC demonstrates its independence in this regard?**

Every effort should be made to find solutions that recognise that stringent responsibilities rest both with the accountancy bodies and with the FRC. Imposition of rules by one party is not a sensible solution as it may not be aware of the full picture. If a solution cannot be agreed then independent arbitration should be used. Protection of public interest is a shared responsibility, and any comments about independence must take this into account.

With the exception of one very specific issue ('preliminary enquiries') experience indicates that it is possible to reach agreement on scheme changes.

Proportionate regulation

- 14 Should the FRC be able to take more proportionate, nuanced action against a Recognised Supervisory or Qualifying Body and therefore be given a wider range of enforcement powers against the recognised bodies? In particular, should the FRC be able to:**

- Issue an enforcement order, requiring the body to take specified actions by a specified date, without the need for a court order?
- Impose conditions on continued recognition as an RSB or RQB?
- Impose fines on an RSB or RQB and if so, at what level?

We accept of course the principle that a body that fails to meet appropriate standards should be required to rectify the situation with the ultimate possibility of losing RSB or ROB status. However, we do not believe that the FRC should have an unfettered right to take enforcement action. We believe such powers should only be given to the FRC if there were a right of appeal or arbitration.

We are not convinced of the appropriateness of a system of fines in this respect.

15 Should the Companies Act and the AADB Schemes be amended to allow for of the conclusion of cases without public hearings where appropriate and where agreed by the parties?

No – the cases are by definition of public interest, and their determination should be fully open to the public.

16 Do you agree that the FRC should develop a mechanism to enable it to undertake supervisory inquiries into matters of concern, either of individual market events or wider market interest, initially building on its current powers to secure information?

We have no objection to this proposal in the context of the FRC's capital market role.