

October 2016

Consultation paper: Revised Operating Procedures for reviewing corporate reporting

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Part 1: Introduction

Through legislation, the Conduct Committee (“Committee”) is authorised and appointed by the Secretary of State to review the published reports and accounts of companies to monitor and enforce relevant accounting and reporting requirements.

The Committee may apply to the court for a declaration that the annual accounts, strategic or directors’ report of a company do not comply with the requirements of the Companies Act 2006 and for an order requiring the directors to prepare a revised report or set of financial statements.

Pursuant to the Companies (Audit, Investigations and Community Enterprise) Act 2004 (the “2004 Act”) the Committee may also inform the Financial Conduct Authority (“FCA”) of conclusions it reaches in respect of periodic accounts and reports that are produced by issuers of transferable securities and are required to comply with any accounting requirements imposed by FCA rules.

To support the effective exercise of its functions, the Committee is assisted in its corporate reporting review activity by the Corporate Reporting Review Committee, (“CRR Committee”), which comprises the Chair and Deputy Chairs of the Financial Reporting Review Panel (“FRRP”), and FRC staff. The review process is undertaken in accordance with the Committee’s operating procedures for reviewing corporate reporting (“Operating Procedures”).

Earlier this year, changes were made to the FRC’s governance and executive structures which resulted in minor amendments to the Operating Procedures; these were published and took effect on 1 April 2016. It was indicated at the time that a further review of the Operating Procedures would take place over the coming months and would, in all likelihood, result in more extensive changes being proposed which would be the subject of public consultation.

This consultation paper explains the rationale behind the more extensive changes that have been made to the Operating Procedures since April. It invites feedback from interested parties to the questions set out in Section 2 of the consultation document on or before 4 January 2017.

How to respond

Responses should be sent by e-mail to consultation@frc.org.uk, or in writing to:

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It is the FRC’s policy to publish on its website all responses to formal consultations unless the respondent explicitly requests otherwise. A standard confidentiality statement in an e-mail message will not be regarded as a request for non-disclosure. The FRC does not edit personal information (such as telephone numbers or e-mail addresses) from submissions; therefore only information that you wish to be published should be submitted.

Rationale for the changes to the Operating Procedures

The objectives of the Operating Procedures are to:

- demonstrate that the Committee has satisfactory procedures in place for the purpose of carrying out its statutory functions; and
- provide transparency about the review process to those companies whose accounts and reports may be reviewed, and to complainants, investors, and the public generally.

The drivers of the revisions to the Operating Procedures are:

- the need to reflect the implementation of FRC Board approved recommendations following an independent review of the FRC's Audit Quality Review ("AQR") and Corporate Reporting Review ("CRR") functions to assess their efficiency and effectiveness ("Effectiveness Review").
- a demand for transparency in respect of the review process and greater clarity in the content of the Operating Procedures.

In light of the above, we considered that this was a good opportunity to reflect on the content of the Operating Procedures more generally.

Changes to the review process following the Effectiveness Review

In 2015, the FRC commissioned an independent review of its AQR and CRR functions to assess their efficiency and effectiveness.

The review, which included stakeholder surveys, concluded that the FRC's monitoring activities are seen as a force for good, having driven substantial improvements in the quality of reporting and auditing in the UK. The FRC is also viewed as a benchmark for its international peers.

The Effectiveness Review highlighted a number of areas in which the efficiency and effectiveness of CRR operations during the review process could be improved. Recommended changes were considered by the FRC Board and the Committee for implementation.

Some proposals did not require any change to the Operating Procedures because they were already permitted by the current provisions or because they related to the supporting operations of the FRC as a whole, or wider FRC strategy. Changes to the Operating Procedures are, however, required to implement new ways of working to address two key themes arising from the Effectiveness Review.

Stakeholders asked for more transparency about CRR reviews and their outcomes

Historically, only a small percentage of CRR cases have been made public. These are cases where companies have made significant changes to their accounts necessitating that the outcomes should be publicised. Publicity has been achieved either through press announcements by the FRC, or, in other cases, by the companies themselves who were asked

to refer to CRR intervention in their accounts in which the necessary correction or clarification was reported.

No information has been made public where reviews have:

- been closed without writing to the companies concerned;
- identified only relatively minor points; or
- involved significant discussions with companies but concluded that no significant changes were required.

The Effectiveness Review highlighted that stakeholders, investors in particular, would like more information about our reviews of specific cases; which reports had been reviewed, and what the findings were.

The FRC Board debated whether these details should be published in respect of all the reports and accounts subject of review. It concluded, however, that individual companies' Audit Committees would be best placed to explain the nature of any FRC regulatory review or intervention including the nature and extent of interaction with the CRR team and that this should be included in their Audit Committee reports. The Audit Committee guidance on the Corporate Governance Code has been amended to include this disclosure for years beginning on or after June 2016.

The Board also concluded that the FRC should publish the names of its closed cases. Such publication will only take place once each company has had the opportunity of reporting on the review in their next set of published accounts post resolution of the case.

We have started writing to companies advising them when we have completed a review of their report and accounts but have not identified any substantive matters, so that they are able to comment on the review before the FRC identifies them.

We will publish a list of closed cases on a regular basis, commencing in 2017 and firstly in respect of December 2015 reporters. We will monitor the disclosures made in the Audit Committee reports of the relevant companies to assess the extent to which references to FRC intervention are fair and balanced.

The FRC Board will review the policy of Audit Committees reporting on the detail of our interventions once there is a body of evidence demonstrating how effective the process has been in communicating information about closed reviews to investors and others with an interest in the quality of corporate reporting in the UK.

The efficiency of CRR procedures could be enhanced without compromising the quality of decision-making

Historically most decisions to open and close reviews during the early stage of the review were taken by the non-executive FRRP Chair and Deputy Chairs.

We identified an opportunity to streamline this aspect of the review process by transferring primary decision-making responsibility to the FRC staff involved in CRR activities. Staff will, however, be required to consult the CRR Committee in respect of complex issues or otherwise difficult cases. In addition, safeguards are being put in place so that the standard of the

internal quality review process is maintained. This includes recruiting additional senior CRR staff and enhancing the internal reporting structure.

The CRR Committee retains responsibility for establishing Review Groups and it remains the case that only the Committee can determine whether to utilise its statutory powers during or at the end of the review process.

We hope that the process changes will improve the time taken to resolve more straight forward cases, particularly where there are few substantive points for companies to address or the issues involved are clear.

In respect of reviews carried out for the purposes of the 2004 Act, we subsequently identified that, given the nature of the decision to be made by the Committee, it is likely that there are cases when it would be a more efficient and effective use of time and resource to allow the CRR Committee to determine that a matter be drawn to the Committee's attention without the need for a Review Group assessing the matter first. The option to appoint a Review Group is retained to allow for flexibility.

Transparency in respect of the review process and clarity in the content of the Operating Procedures

As stated above, an objective of the Operating Procedures is to provide transparency about the way in which the Committee and others involved in the review process carry out their work, thereby enabling companies to know and better understand the review process and set expectations.

To achieve this objective, the Operating Procedures must present the review process clearly. During the review, we identified opportunities for improving the transparency, and clarity, of the Operating Procedures and which are now reflected in the text. For example, greater clarity has been provided in respect of the process followed in respect of reviews carried out for the purposes of the 2004 Act; and the text explaining information sharing provisions has also been expanded. We also agreed that other sources of information in respect of the review process, such as the FAQs on the FRC's website, should be signposted or incorporated into the Operating Procedures themselves.

Section 2: A summary of the main changes to the Operating Procedures

The proposed revised Operating Procedures are not presented in track change format as the extent of the proposed changes would render the document unreadable. Summarised below are the main areas of change.

Change in structure

- A contents page has been added for ease of reference;
- How reports are selected for review and information regarding complaints and complainants is set out together in Part 1 of the Operating Procedures;
- All matters in respect of the review process are now contained in one dedicated part, Part 2;
- Public reporting is set out in one dedicated part, Part 4;
- General provisions are contained in the final part, Part 6, reflecting the structure of other FRC procedures.

Changes to reflect the increased role of FRC staff during the early stage of the review process

- As described in Section 1 above, decision-making in respect of the early stage of the review process will be more executive led. This is reflected in paragraphs 18 to 21 of the revised Operating Procedures.

More detailed description of the review process in respect of reviews conducted for the purposes of the 2004 Act

- In the current version, the Operating Procedures have a standalone section dealing with these reviews, Part 3. The description of the process is said to be the same as the review process in respect of reviews carried out for the purposes of the 2006 Act as applicable; see paragraph 53 of the current Operating Procedures. Greater clarity is now provided in respect of this process in Part 2 of the revised Operating Procedures.
- Paragraph 23 of the revised Operating Procedures explains that not all reports and accounts reviewed for the purposes of the 2004 Act will need to be considered by a Review Group before the matter is drawn to the Committee's attention.

Streamlining of the review process at the Review Group stage

- Paragraph 33 of the revised Operating Procedures reduces to one stage the current two stage review process of the Review Group as set out in paragraphs 34 and 35 of the current Operating Procedures.

Disclosure of information

- Changes had already been made in relation to disclosure of information in the current Operating Procedures to reflect recent changes in the FRC's structure. Additional text has been added to elaborate on the circumstances where information obtained voluntarily will be shared outside the FRC and to explicitly acknowledge that no disclosure will be made in contravention of the Data Protection Act 1998; see paragraphs 52 to 60 of the revised Operating Procedures.

Identification of reports and accounts reviewed

- Paragraph 62 of the revised Operating Procedures sets out the new practice of publishing lists of companies whose Reports have been the subject of a review and where the cases have been closed.

Public reporting by companies – Audit Committee reporting

- Paragraphs 71 and 72 reiterate the FRC's Guidance on Audit Committees in respect of reporting and explain the requirements of such disclosures.

Question 1: Do you consider that the changes to the Operating Procedures are clear and understandable?

Question 2: Do you consider that the changes to the Operating Procedures will promote more efficient and effective processes?

Question 3: Do you consider that the revised Operating Procedures are fair and transparent?

Question 4: Do you have any other comments about the revised Operating Procedures?



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