

Response

## **LAPFF Response to the Kingman Review of the Financial Reporting Council (FRC)**

**The Local Authority Pension Fund Forum** was set up in 1991 and is a voluntary association of 77 local authority pension funds and four LGPS pools, based in the UK with combined assets of approximately £230 billion. It exists to promote the investment interests of the funds, and to maximise their influence as shareholders to promote high standards of corporate governance and corporate responsibility amongst the companies in which they invest. The Forum welcomed the announcement by the Secretary of State in March 2018 and welcomes the Kingman Review.

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Parliamentary Questions and Answers

Correspondence obtained under Freedom of Information Act request on BEIS

## 1. Summary – the existing FRC is beyond repair

The FRC – the existing body - can't be reworked. With the existing FRC structure we see **at least three incompatible functions being run by the same body**. These are

- standards (accounting, auditing and actuarial)
- enforcement (annual accounts of public companies, auditors and members of professional bodies of accountancy, actuarial discipline)
- the 'comply or explain' Governance Code

The incompatibility of these three functions would be there as a problem even without the problem of regulatory capture. Essentially, the 2004/5 FRC reforms have not worked and that needs to be recognised when coming up with solutions.

The pre-2004 "Dearing" FRC (1988), had achieved a good reputation in standard setting, urgent issues and monitoring corporate accounts. However, the 2004 reforms (the "Nicholson/Wyman/Haddrill"<sup>1</sup> reforms) created a structure that has been embedded with conflicts and prone to regulatory capture.

Sir Bryan Nicholson had been former Chair of the CBI; Peter Wyman was Head of Public Affairs at PwC, and Stephen Haddrill then went on to be the CEO of the FRC, having been the key Department of Trade and Industry official in charge of creating the FRC as a 'market led' body' in its current form.

There had also been a serious flaw in the policy making process. The FRC was classified by the Office of National Statistics (ONS) as **a public body from 1990** and that was also confirmed to apply to the new structure from 2004<sup>2</sup>. Despite that, the FRC failed to apply the requirements of public body status; with no evidence of ministerial knowledge or approval that there was a mismatch between its mode of operation as a market body whilst in law being a public body.<sup>3</sup>

Added to that, the introduction of International Financial Reporting Standards (IFRS) in 2005 has also been a significant part of the problem, given the way that the FRC has extended these standards beyond the EU legal minimum which was for the group accounts of listed companies.

The FRC extended IFRS to the accounts of companies as legal entities, and achieved a dislocation between the standards and the law. The result has been that this accounting model avoids capital maintenance and solvency, which are critical to the public interest. It is remarkable to say this but the FRC's actions in this were conscious and deliberate (see later and also Parliamentary Answer referenced below)<sup>4</sup>. It is skirting around that crucial public interest function which increases the risk that Carillion-type situations will reoccur.

The position that FRC finds itself in with the law has critics beyond the investment community. The former Senior Partner of Herbert Smith, Mr Edward Walker-Arnott published a paper in 2017 in

<sup>1</sup> "Three Wise Men" Accountancy Age 28 May 2009 [www.accountancyage.com/aa/analysis/1753016/overview-haddrills-choice](http://www.accountancyage.com/aa/analysis/1753016/overview-haddrills-choice)

<sup>2</sup> Source Freedom of Information Act (FOIA) request

<sup>3</sup> Source: PQ HL5904 HL4991

<sup>4</sup> PQ HL5280

which he stated “...the FRC orthodoxy does not accord with the law and that it is based on opinions of Counsel which are flawed<sup>5</sup>.”

*“This revolution has occurred without the explicit authority of statute or case law. It has occurred while the primary responsibility of directors for annual accounts has remained unchanged. It rests entirely on an interpretation of the requirement that accounts give a true and fair view advanced in a series of opinions of counsel obtained by the ASC and the FRC between 1983 and 2013. In particular the expression of the FRC orthodoxy in its June 2014 statement “True and Fair” is explicitly based on opinions written for the FRC in 2008 and 2013. It is the argument of the next section that all the opinions in the series are flawed.”*

Indeed, not only is the standards model disconnected from the law, but the FRC’s model of enforcement, which is a voluntary arrangement with the accounting institutes, is almost bound to result in a ‘cost of doing business’ approach to penalties and regulation.

The conflicts then abound further given that the fines under that system had been passed back to the institutes involved which totalled in excess of £10m for the period 2012-2016<sup>6</sup>, whilst the risk of losing cases was with the FRC, as in the Mayflower case of 2007 where the costs awarded to PwC were £1m. The press at the time stated this:-

*An unnamed FRC spokesman said “We can say there is now an unlevel playing field that pits us, with an £11m budget, against large accounting firms with hundreds of millions in revenues and insurance to boot”<sup>7</sup>.*

Finally, the FRC exhibits an ‘outreach’ approach and has a public relations and website profile that does not sit well with its quasi-judicial responsibilities of being a public body. It gravitates proactively towards leadership on softer issues such as ‘culture’, rather than standards and enforcement where it appears reactive, usually when challenged by Parliamentary inquiries where its ineffectiveness is raised<sup>8</sup>.

## **2. Outcomes - the outcomes must involve Parliament**

This LAPFF response provides solutions, both in avoiding the mistakes made by the FRC (see section 3) and recommendations for new structures (see section 4).

The central matter is upholding the public interest. The outcome must involve Parliament. We were pleased that the statement by the Secretary of State on 21 March 2018 did commit to that. The regulatory model should be first and foremost implementing the laws that Parliament has already passed. Parliament and the courts determine what the public interest is.

The ‘multi-stakeholder’ ‘collaborative model’ driving the FRC from the large corporates, asset management and accounting firms has clearly not worked for the public interest. It has become a complex arrangement suiting various lobbying interests.

It is also important that the FRC does not get involved in the decisions as to how IFRS will be endorsed post EU exit (see Point Two of Introduction of the call for evidence).

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<sup>5</sup> Journal of Business Law, Issue 6 2017

<sup>6</sup> Source PQ HL5096

<sup>7</sup> The Actuary - [www.theactuary.com/archive/old-articles/part-5/discipline-board-mired-in-controversy/](http://www.theactuary.com/archive/old-articles/part-5/discipline-board-mired-in-controversy/)

<sup>8</sup> House of Lords audit inquiry 2010/2011. Carillion inquiry BEIS/DWP 2018

In addition to the structural problem, there are other defects in FRC conduct over the years, including being a public body, but without adhering to the requirements of being one. The FRC made up its own rules over time<sup>9</sup>. It is clear that the FRC has been subject to the Government Resources and Accounts Act 2000 since at least 2011<sup>10</sup>. But it has not, and we believe still has not met all of the requirements.<sup>11</sup>

The government also admitted the effect of this in May 2018 in terms of managing public money:- *“As such the full requirements of the managing public money guidance were not applied to the FRC”*.<sup>12</sup>

This then covered the procurement of legal advice: *“The selection of firms for enforcement cases was not the subject of a public tender. Since being confirmed as a public sector body the FRC has been working with the Department to review all internal processes and practices in order to ensure that they comply with managing public money guidance”*.<sup>13</sup>

Public body rules also require consent from the Treasury of salaries greater than that of the Prime Minister. The FRC Chief Executive earned more than 2.5 times that of the Prime Minister<sup>14</sup>. There is no evidence of that having been approved by the Treasury.

The risk of ‘bodies being buried’ is sufficiently high to warrant the wind up of the existing body. This includes problems with:-

- public money rules in general
- conflicts of interest
- approach to procuring legal advice
- procurement issues (including EU rules for procurement of public contracts and recruitment (including Cabinet Office Rules).
- setting of salaries
- recruitment which has not been publicly advertised
- Freedom of Information
- potential claims on the FRC for any regulatory defects.

### 3. Solutions and remedies - avoiding current and past mistakes

#### a) The FRC replacement bodies must have a statutory basis in primary legislation ; dealing with their purpose, governance and conduct

Firstly, it has to be said that the ‘comply or explain’ model of the Governance Code, doesn’t sit with a central government designated regulator dealing with standards and enforcement; given that the law is ‘comply or else’.

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9 HL 4991

10 PQ HL8591

11 PQ HL8259, HL7589

12 PQ HL7591

13 PQ HL7589

14 PQ HL 4994

The current position is a legacy of the FRC setting itself the objective of being a 'market-led' body and carving out a niche for itself as if it were such a private sector body, whilst in law and reality it was always a public body.

Second, standard setting should be separate from enforcement. That is a basic principle of the justice system generally, with the **separation of powers**. There needs to be the possibility of constructive tension between the two functions which, for example, gives scope for criticism of standards by the enforcer in such a way that the system can correct the relevant failure.

The FRC has been hamstrung as a champion of standards whilst admitting it has little control of them<sup>15</sup>. Despite that weakness, the FRC then set GAAP (Generally Accepted Accounting Principles) for all UK companies and has copied the IFRS model into UK-GAAP; whilst the parties best placed to have global influence on global accounting standards, are global auditors and global companies.

Finally, what also needs to be addressed, is the fact that the model being pursued is at odds with the legal basis (see below) for accounting and audit. Despite recent denials by the FRC, prior FRC documents have openly admitted this (see below).

### **b) The 'auditor expectation gap' - regulatory capture has to be addressed**

The 'Expectation Gap', the difference between what an auditor is expected to do and what an auditor actually does, is essentially synthetic. It could be described as an auditor defence tactic.

We set out below how there are at least three structural dislocations:-

- the standards and the law (affects preparers and auditors)
- the conduct criteria and threshold for the 'Accountancy Scheme'
- the FRC redefining the role of accounts away from governance

The matter can easily be resolved by the new regulator setting out the law clearly in the way that might be expected by a public body, as opposed to transplanting positions that have originated from the accounting profession itself

### **c) Standards and the law – addressing the dislocation**

The definitive case involving auditor duties, the 'Caparo' case, can be portrayed as a case that auditors can't be sued. That is wrong. The issue at stake in that case was merely who is the rightful plaintiff to be suing the auditors.

There were actually two Caparo cases; the public case (where Caparo Industries the acquiror was the plaintiff, and another one settled privately (where Fidelity Plc - an engineering company not the fund manager - the acquiree, was the plaintiff)<sup>16</sup>.

The core aspects of Caparo are essential to the delivery of proper statutory accounts and statutory audit. The audit in law is designed to serve shareholders and creditors by serving the company ('stewardship') in a protective manner. The FRC has been running a model (accounting standards) where the auditor is serving 'users' – leaving out the company, thus coming adrift from Company Law. LAPFF supplies two pieces of evidence five years apart from the FRC itself.

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<sup>15</sup> Economic Affairs Committee. HoL. 22 July 2014 – and see later in this document for direct quotation

<sup>16</sup> Presentation of James Leek FCA, CEO of Caparo Industries to the ICAEW London Practitioner Board April 1991

*'UITF [Urgent Issues Task Force] members noted the approved Minutes of the meeting held on 24 March 2010 but commissioned a clarification of the wording of paragraph 4.4 (b) to reflect the point that whereas the UK statutory purpose of the audit of accounts was to protect limited liability entities from overpaying dividends, taxes or remuneration, the IASB was using a different driver for its reporting model<sup>17</sup>.' FRC 2010*

*'Current restrictions on distributions create a rigid link between the amount that may legally be distributed and a company's statutory accounts. This creates an unnecessary obstacle to the development of financial reporting which has adopted as its focus the provision of information that is useful to participants in the capital markets. It cannot be assumed that such information is necessarily appropriate for determining the amount that may be distributed consistently with legitimate public policy objectives<sup>18</sup>.' FRC 2005*

It's hardly surprising that an auditor might have a delivery gap, and fail to meet public expectation, if their regulator is on the wrong track and views the law as an obstacle.

With the strength of evidence from the two examples above, there is little need to produce more evidence of what is significant regulatory failure.

As well as the extracts above, PQ5280 of 12 February, in response to Baroness Bowles, shows that the government did not deny that the FRC was setting standards and not following the law, merely that nothing was done about it. That is a lacuna that can cause inter-alia; Carillion to present itself as solvent, when in fact it wasn't, and certain banks to have the same problem.

However, the construct of an 'expectation gap' has pervaded the highest levels in the FRC.

*"The increased transparency, in both audit and Audit Committee reports will help investors, should they want to, ask relevant and pertinent questions of the board as well as help manage the audit expectation gap."* **Speech of Stephen Haddrill FRC CEO at PCAOB 19 November 2013.**

This statement is at odds with the real issue for investors and the public which is whether the auditor has delivered **the correct opinion**. How talking to the board of the company about the audit report once signed could make any difference to that is difficult to understand. It actually creates an excuse for failure of the opinion.

For a regulator to refer to 'the expectation gap' seems to diminish their own regulatory position by admitting and excusing failure of the party they regulate, and entrenching it as the norm. Any new body will need to address this dislocation.

The FRC does refer to 'stewardship'. However, it has redefined that too.

In law, stewardship is what **accounts** are supposed to **for** the company, its creditors and the shareholders. Instead, the FRC places the word 'stewardship' on what shareholders are supposed to do with the company. The emphasis on the latter is not well served if the accounts are systemically wrong due to the FRC avoiding their stewardship function.

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<sup>17</sup> Minutes of the 101st meeting of the Urgent Issues Task Force (UITF:101) held on 26 May 2010 at Aldwych House, 71-91 Aldwych, London WC2.

<sup>18</sup> Letter from the FRC's Accounting Standards Board to the Department of Trade and Industry, April 2005.



#### d) The FRC has divorced governance from accounting matters

The Cadbury Committee report of 1992 which is the basis of the Corporate Governance Code was entitled “*The Financial Aspects of Corporate Governance*”. The link Cadbury made with accounts and governance could not be clearer. The Preface stated:-

*“It is, however, the continuing concern about standards of financial reporting and accountability, heightened by BCCI, Maxwell and the controversy over directors’ pay, which has kept corporate governance in the public eye.”*

And the FRC - though the FRC did not get responsibility for the Corporate Governance Code until after 2003<sup>19</sup>, - had the following to say in 1990 and 1991, which is clearly linking governance, stewardship and accounting (including pay):-

*“when there is a malaise. it begins in the boardroom; the responsibility for stewardship rests plainly there, and no board that has successfully obscured the reality of its finances by taking advantage of accounting innovations or by convenient interpretation of accounting standards **has discharged its stewardship faithfully to its shareholders or dealt plainly with its creditors**; it is moreover in danger of self-deception”*<sup>20</sup>

And *“The events of the last two years, which have included three major financial disasters, and on occasion the use of financial reporting policies which show company results in an unduly favourable light..., have all caused the financial aspects of corporate governance to command attention in a way that has rarely been occasioned in the past”*.<sup>21</sup>

LAPFF in its response to the FRC’s Code consultation in February stated that the consultation was almost entirely divorced from any reference to accounting matters, including in the context of pay.

However, the open letter to LAPFF from Sir Win Bischoff<sup>22</sup> stated:-

*“The Corporate Governance Code is an essential part of the framework in which companies are directed and controlled. It does not establish the accounting framework under which directors report to shareholders. Accordingly, the Code consultation is **not an appropriate channel of communication for accounting matters.**”*

Given the collapse of Carillion, and the problems with banks, including HBOS, the lack of reference to accounting in the Code consultation is not consistent with the early 1990’s FRC or the Cadbury Code, or the law.

That is because the accounting standards framework is disconnected from all that. However, despite the clear admission from the FRC in 2005 (3(c) above), that the standards and the legal requirements had diverged, the FRC then changed its story following legal opinions from George Bompas QC in 2013 and 2015.

The FRC case following the 2015 opinion rested on the FRC stating that the government agreed with the FRC that the LAPFF position was wrong. However FOI on BEIS revealed that not to be the

<sup>19</sup> Previously under the mutually owned London Stock Exchange and then the FSA.

<sup>20</sup> Financial Reporting Council “The State of Financial Reporting” November 1991

<sup>21</sup> Financial Reporting Council “The State of Financial Reporting” November 1992

<sup>22</sup> <https://www.frc.org.uk/getattachment/5c4407b0-f7b9-4d22-9e95-3791ca0042f4/FRC-reply-to-LAPFF-Consultation-response.pdf>

case<sup>23</sup>. Indeed the FOI reveals the government rebuking the FRC for trying to put that into a press release. Mr Bompas stated that the law required a determination of what is distributable based on the numbers in the accounts, and for that there are two formulae to arrive at the number, a profits test and a net assets test.

The FOI reveals that the government merely confirmed that “the Companies Act does not require the separate disclosure of a figure for distributable profits”. That is clearly true given that determining the number requires applying two formulae in the Act. Indeed, if the number was already in the accounts the Act would not need to specify the formulae needed to arrive at the number.

### e) The Conduct criteria – the need to address more dislocation – changing the words

A further dislocation that needs to be addressed is around conduct criteria.

A problem exists in the FRC policies, ‘The Accountancy Scheme’, which forms the basis for conduct action (on accounting firms and members).

The scheme states from 1 July 2013:-

*“Misconduct means an act or omission or series of acts or omissions, by a Member or Member Firm in the course of his or its professional activities (including as a partner, member, director, consultant, agent, or employee in or of any organisation or as an individual) or otherwise, **which falls significantly short of the standards reasonably to be expected of a Member or Member Firm or has brought, or is likely to bring, discredit to the Member or the Member Firm or to the accountancy profession**”<sup>24</sup>.*

That replaced the scheme which had stated:-

*“In considering the question of whether the conduct of a Member or Member Firm **may have fallen short of the standards reasonably to be expected of him or it, regard shall be had in particular to any law, whether statutory or otherwise, or regulation of any sort, and to any charter, bye-law, rule, regulation or guidance which applies to him or it**”<sup>25</sup>.*

The 1 July 2013 replacement drops reference to the law, and has downgraded the threshold from ‘may have fallen short’ to ‘falls significantly short’ and has changed ‘which’ to ‘may’.

Remarkably, the amended scheme has been used with retrospective effect, including KPMG’s audit of HBOS<sup>26</sup> for the year ended 31 December 2007. However cases against other firms for the same period, settled on the higher test, merely because the case was not strung out for so long as to gain the benefit of the change.

The FRC’s approach therefore creates two tracks, a judicial one based on the Companies Act, and one of following standards. That can be summarised

**Judicial track** Law: failure to execute statute and contract: consequential loss: negligence

**FRC pre-2013** Law: falls short of standards: misconduct

**FRC post-2013** Falls significantly short of standards: misconduct

<sup>23</sup> FOI on BEIS (attached)

<sup>24</sup> FRC - Accountancy Scheme effective 1 July 2013

<sup>25</sup> FRC - Accountancy Scheme effective 18 October 2012

<sup>26</sup> FRC PN 47/17



In the case of Barings, the negligence was the consequences that followed as a result of the auditor not identifying the fraud of Nick Leeson at the point that the fraud was £1m, i.e. the auditor was accountable for the loss getting bigger.

Contrast that with the >£20bn losses in HBOS which have not triggered a disciplinary outcome by the FRC. Indeed, were the accounts of HBOS to have fulfilled their stewardship function, it seems unlikely that Lloyds would have purchased it.

Also, despite an attempted rebuttal by the FRC, by attributing a position to the UK government, a Freedom of Information request on the Department of Business and PQ 5281 has revealed that the government had not confirmed what the FRC had claimed it had.

#### **f) The passing of the 2006 Companies Act – addressing yet more dislocation**

Section 393 Companies Act, ‘the true and fair view’, has been an objective requirement since the 1947 Companies Act so that the outcome is the standard, not following standards (the input).

However, when the 1985 Act was amended to accommodate IFRS, the wording of the Act was changed by the Statutory Instrument which copied text from (non-statutory) auditing standards which had just been adopted by the FRC. The text was ‘true and fair view in accordance with standards’.

Despite considerable resistance from the FRC, the error was spotted by investor bodies and the correct text was reinserted as s393 Companies Act 2008.

However, the FRC then sought legal opinion and produced guidance on the ‘true and fair view’ (T&FV)<sup>27</sup>. The text the FRC used does not accord with the statute. The statute is a ‘true and fair view of the assets, liabilities, financial position and profit or loss’, i.e. the numbers in the accounts. The FRC version fails to refer to the numbers as the target, meaning that the T&FV test becomes merely subjective ‘mood music’ for the accounts as a whole, relying on words not numbers. This urgently needs to be addressed by the new body that replaces the FRC.

#### **g) No regulatory body should use private sector law firms that undertake any defence work for companies or auditors and 32 years is too long for one person to be part of a regulatory system**

Mr Fleck of Herbert Smith was at the FRC or the predecessor subsidiary body, the Auditing Practices Board, from 1986 until leaving the Financial Reporting Review Panel at some time in Spring 2018 (departure not publicised). Given that length of time and that he was advising firms during this period (PQ 7046), we find the tenure unacceptable.

Mr Fleck progressed from being a member of the Accounting Practices Board (APB), chair of the ABP, Chair of the Conduct Committee, Chair of the Financial Reporting Review Panel (FRRP) and then a member of the FRRP after having been Chair. In 2011 he was the co-signatory to the FRC’s ‘true and fair’ paper. He was also the chair of the FRC Conduct Committee at the time of the changes to the threshold for misconduct referred to above.

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<sup>27</sup> FRC True and Fair view 2011

Given that, we also think it is relevant that not only George Bompas QC for LAPFF has challenged the FRC orthodoxy, but so has a former colleague from the same firm, the former Senior Partner of Herbert Smith, Mr Edwards Walker-Arnott<sup>28</sup>.

It was the opinions for the FRC in 2008 and 2013 that were roundly refuted by Mr Bompas QC.

But even without a QC, a review of the content of the FRC's 2011 'True and Fair' paper when compared to the statute, shows that in no part of that document is the actual text for the relevant statute (s393 CA 2006) transcribed properly. Whereas the True and Fair View standard applies to the specified numbers in the accounts, the FRC paper refers to "accounts as whole" and other variations of that.

#### h) A regulator should enforce not promote

The FRC has some of the same 'promotional' defects that the Financial Services Authority (FSA) had. In contrast, in the USA neither the Securities and Exchange Commission (SEC) nor the Public Company Accounting Oversight Board (PCAOB) campaign that they are a 'magnet' for capital, they get on with their primary purpose of regulating.

The FRC also states it has this regulatory effect "*the effect of our work is to ensure a strong flow of capital into the UK that is beneficial to the economy and to society as a whole*" and "*We promote the strength and trustworthiness of the UK's corporate sector and capital markets internationally to help the UK remain a magnet for global capital*".<sup>29</sup>

This is not only not its function, it's not actually what occurs given that the FTSE index is dominated by outward, not inward investment. In contrast, the governance of the Competition and Markets Authority is a model for dealing with complex vested interests.

Essentially, the FRC's multi-stakeholder model is confusing and too removed from the law, inevitable if some influential parties are not appreciative of the law, and might prefer it were different.

The new regulatory body should avoid these pitfalls and be established to enforce regulations and not have promotional functions.

## 4. Structural solutions

**To address these failings the Forum believes the following structures for a new regulatory framework are needed:**

- Preferably standards and enforcement should be in different bodies (as in fact the FRC was prior to 2004).
- Accounting Standard setting must be a free standing body, a **UK-Financial Accounting Standards Board**, with the objective of 'setting accounting standards that conform to both Company Law and Capital Markets Law. It should be directly accountable to Parliament.
- Auditing oversight should follow the **US PCAOB model**. It should also be directly accountable to Parliament. The objective should be 'oversight of auditors to protect investors and the public'. Parliament should determine the public interest coverage of the "UK-PCAOB"<sup>30</sup>.

<sup>28</sup> See footnote 5

<sup>29</sup> <https://www.frc.org.uk/getattachment/931ad43d-62f1-4726-8ca3-d665e7e9824e/The-FRC-About-Us-Leaflet-February-2018.pdf>

<sup>30</sup> i.e. which unlisted companies, charities, etc are important enough to also be under this oversight.

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Auditing standards should be totally separate from accounting standards as directors - to whom the latter apply - are not auditors, and to avoid the danger of a “feedback loop” (where auditing standards become the “tail wagging the dog”)

- Auditing and director enforcement issues relating to company law breaches should be accommodated within the Insolvency Service as a ‘**Companies Commission**’. The emphasis should be dealing with situations where there has been failure to demonstrably achieve justice and to enable the system to be corrected where necessary. That can only be a central government function. The Air Accidents Branch is a model where accidents are investigated wholly independently of industry interests. That should apply here too.
- The Companies Commission should also inspect accounts, a function currently delegated by SoS to the FRC’s FRRP/Conduct Committee.
- Actuarial Standards may be able to resource share with the UK Financial Accounting Standards Boards (FASB).
- **The Governance Code** should be subject to consultation once the above issues are defined, to find a better home for that function. There are valid arguments that a ‘comply or explain’ system can’t be run by government.

### Governance Code

- The Australian Stock Exchange (ASX)’s Corporate Governance Council. This council has a broad based membership and functions similarly to the post-Cadbury model pre-FRC.

### Transitional issues

- In any transition period, senior roles must be recruited afresh.

## 5. Responses to specific consultation questions

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

It certainly is not. The objectives must be set out in primary legislation for each successor body.

The mission, as stated on the current FRC website<sup>31</sup>, to '*promote transparency and integrity in business*' is misplaced in the same way that the FSA's aspirational objectives to 'promote UK financial services' was misplaced. However, the FSA's flawed objective was in statute. The FRC's objective seems to have been self-created by the FRC's own board, changing as time has passed. Regulators should be dealing with bad cases, not gilding lilies.

The relevant issue is about public protection and enforcement; mainly parts of the Companies Act and capital markets law. Also see response to Q4 below, regarding the PCAOB which states its objective far more authoritatively as "*Protecting investors through audit oversight*".

The January 2014 FRC document 'The FRC and its Regulatory Approach' states "*The FRC's mission is to promote high quality corporate governance and reporting to foster investment. Why have we landed on this mission?*"<sup>32</sup>

The current mission document also states "*The effect of our work is to ensure a strong flow of capital into the UK that is beneficial to the economy and to society as a whole*".

That isn't actually reflective of the way that the UK capital market works, most of the assets on the London market are located overseas, so there are no capital flows into the UK, other than dividends. The concept of '*landing on a mission*' is also an odd thing for any regulator to say. That statement alone makes the case for statutory objectives, not for the FRC to make them up internally.

We also note that Companies Act 2006 created new criminal sanction for auditors, we see no evidence for the FRC having a scheme to deal with those.

### Q2: Does the FRC's name remain right?

No. For several reasons.

The term 'financial reporting' is abstract and distracts from the core subject of 'accounting' (i.e. the numbers). It also distracts from audit which is also about the internal books (CA 2006 s386) for control purposes as well as the numbers.

Also much actuarial work isn't about 'financial reporting' either, it is about determining mortality rates and other inputs for pension funds and insurers to make funding, contribution and pricing decisions. Similarly governance (the Code) is not merely about 'reporting' either, it is the mechanism by which companies are owned and controlled.

In contrast, the US system has functionally accurate descriptions of what each regulator does, e.g. 'Financial Accounting Standards Board' and 'Public Company Accounting Oversight Board'.

<sup>31</sup> FRC About us" brochure, as at June 2018

<sup>32</sup> The FRC and its Regulatory Approach FRC 2014.

**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?**

No (to 'functions and structure'), and it is questionable whether the current structure (i.e. post 2005) has ever been fit for purpose. Yes (there is a case for structural change) and functions should be separated and transferred to other regulators. (See Part 4 for more detail).

Given that the public interest is in stopping failed audits, which carries insolvency repercussions, there is an argument for investigatory powers to rest in a 'Companies Commission'.

That would therefore align director investigation and auditor investigation, removing self-regulation of auditors from the professional bodies. We believe that a separate consultation may be needed to determine the future and location of the Governance Code. But it should not go to the FCA.

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

Australia has a model that more closely resembles the pre-2005 UK position. The US has a separate Financial Accounting Standards Board and Public Company Accounting Oversight Board. Neither of those countries display the risks that the UK has been prone to in more recent years. Relating back to Q1 and Q2, the US regulators are also named in a way that better describes their functional roles.

In broad terms, the post Dearing FRC worked well and was potentially at the top end on a global comparison and certainly there were less scandals than the USA. The UK position since 2005 has not only been worse than it was, but has become worse than the USA, with the USA also getting better.

Recent problems for UK companies relating to auditing and accounts have included: BT (Italy), Autonomy (acquired by HP), Tesco, Quindell, Carillion, Co-op Bank and SIG plc.

**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?**

On the matter of audit competition, the FRC was pushing against the direction of the Competition Commission Inquiry following the House of Lords Report 'Auditor Competition and their Role' of 2010/11. It sought to make rotation and tendering of audit a matter of 'comply or explain'.

On the matter of its ability to influence the wider debate on issues, including its powers, we note that it was unable to influence the Secretary of State who stated to Parliament that he disagreed with the FRC's Chief Executive requesting more powers, as the FRC could work with the powers it already possessed, and better co-operate with others

*"I do not agree with Mr Haddrill that there is something that is preventing vigorous action being taken, and my expectation is that they will work with their fellow regulators. It is important that we have a joined-up system here."*

*"I do not think we should wait and absolve it [the FRC] from using the powers that it has, by discussing with them, whether it is the Insolvency Service or the FCA. The powers that they need are there if they do it jointly. That is what they should do."*<sup>33</sup>

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

We don't see any evidence that what is there is effective. We believe that the announcement from the FRC in June 2018 that 50% of KPMG's audits were an unacceptable decline in quality, is very much a delayed reaction given that 50% was an increase from an already unacceptable base of 35%, both are systemically worrying numbers.

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

The one area where there is some strength has been with the staffing of the 'Governance Code' function of the FRC. That may be because the recruitment model has been different, and that a 'can't do/defensive' approach by recruiting from auditing firms had been less of an issue. It may also be that there was benefit in having Civil Service trained appointments for those roles.

**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 agree there is a culture problem. Whether it is feeble or timid, or consciously misdirected are different issues. LAPFF raised this area in its response<sup>34</sup> to the FRC's February 2018 consultation on the Governance Code, because the consultation document placed great stead in 'culture'. LAPFF received an open letter of 28<sup>th</sup> March 2018 from the FRC<sup>35</sup> which tried to pull apart the LAPFF analysis, which the FRC had already placed on its website. That letter merely reinforced concerns about culture and accuracy of research, as words had been changed in citing LAPFF.

For example, on the subject of the FRC's public body status as determined by the ONS. LAPFF questioned whether all board members knew of this status given there was no reference in the public board minutes from November 2007 until December 2018. LAPFF stated:-

*"Unless all the board were told which the board minutes don't show, we can only conclude that there may have been a 'board within a board', with executives and some non-executives knowing more than others."*

LAPFF made that statement as both FRC board member Sir Brian Bender (the former DTI Permanent Secretary) and FRC CEO Stephen Haddrill, the DTI official who headed the FRC reforms of 2004/2005, were each in positions to know this before their arrival at the FRC<sup>36</sup>.

The FRC's response, signed by Sir Winfried Bischoff changed that, the key qualification 'unless' was left out and 'may have been' was changed to 'was':-

<sup>33</sup> Work and Pensions Committee and Business, Energy and Industrial Strategy Committee, Oral evidence: Carillion, HC 769, Wednesday 21 March 2018

<sup>34</sup> <https://www.frc.org.uk/getattachment/3d2e2cae-1ef8-4cca-b5c2-f0372ef904f4/Local-Authority-Pension-Fund-Forum-response;.aspx>

<sup>35</sup> <https://www.frc.org.uk/getattachment/5c4407b0-f7b9-4d22-9e95-3791ca0042f4/FRC-reply-to-LAPFF-Consultation-response.pdf>

<sup>36</sup> FOI on ONS ONS/FOI/2017/3410 shows the issue being dealt with by the Permanent Secretary.



**FRC version**

LAPFF: ...we can only conclude there was a 'board within a board', with executives and some non-executives knowing more than others (p5).

FRC: The FRC Board has always been kept informed of developments regarding classification and there is nothing to suggest otherwise in the minutes to which you refer. Furthermore, there is no suggestion in the minutes that the Executives "run" the Board and you provide no evidence to substantiate that assertion. Executive Directors take certain matters forward in accordance with Board decisions and keep the Board informed on progress, which is the way Boards and Executives typically work.

The FRC response to LAPFF was not 'feeble or timid'. Indeed it is stronger than responses we have seen from the FRC in dealings with the parties it regulates.

The FRC displayed a similar approach with a letter from Paul George to Sarasin Asset Management.<sup>37</sup> We note that Mr George's view of accountability to Parliament in his letter consisted of the FRC's Annual Report being laid before Parliament. Not only must there be more to accountability than that, we have been unable to find such documents in the Parliamentary Archive.

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

The vision can't be about making the FRC a 'beacon', the issue is improving the regulatory environment. We agree with the Foreword to the call for evidence which is that the regulatory system needs to be a beacon, i.e. without pre-supposing a future for the FRC in its current form.

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

See Q1-4, the FRC seems to be confused and misplaced about what its mission actually is.

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

It's clear there is a lack of confidence in audit when Parliament has to intervene, as it has done first with the banks, then Carillion. The improvements must come from a proper regulatory structure, in particular dealing with the pervasive myth of an 'Expectations Gap'.

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

The FRC's processes are not sufficiently transparent to draw a conclusion. However, as well as ineffectiveness, there has been distraction from significant concern about audit quality.

The Institute of Accountants in England and Wales (ICAEW) set up an 'Audit Quality Forum' (AQF) in 2004 as a result of investor concerns then about audit quality. In more recent years the disquiet about the quality of audits has not been dealt with. The subject matter has instead turned to events such as '*How can business reduce inequality*', '*Is business paying its fair share of tax*', '*who's*

<sup>37</sup> <https://www.frc.org.uk/getattachment/279da04c-e86d-4670-a1c6-4094ff4232a8/Natasha-Landell-Mills-231017.pdf>

*culture is it anyway*' and *'can business ever get it right'*, These subjects have little to do with audit quality. NB: The Deloitte website 'IAS Plus' describes the AQF as 'Run by the FRC and the ICAEW'.

This is merely another symptom of an organisation that has lost its way, and seems to be more concerned with 'spin' than substance.

**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”?**

LAPFF wrote to the largest six accounting firms in 2017, putting the LAPFF position as it was clear that the FRC has some pre-existing guidance on parts of the Companies Act that were inconsistent with the line it has pushed since the 2013 opinion of George Bompas QC. The FRC intervened, called a meeting of those firms and co-ordinated a joint response<sup>38</sup>. There was no transparency on that meeting or process, and the answers given were not credible.

The bulk of connections at the FRC staff and board level appear more slanted towards KPMG and PwC.

The Financial Reporting Review Panel of 25 people, had at least eight serving or former PwC or KPMG partners on it.<sup>39</sup> The two executive members of the FRC board, other than the CEO, in March 2018 were from KPMG and PwC<sup>40</sup>.

The FRC also appears to have operated non-advertised recruitment at senior levels, in effect a revolving door, and some of those people are still present in the FRC. We note that the role 'Director of Financial Reporting' was created in September 2007, and taken by a PwC financial services partner. The relevance of that being that we now know that Northern Rock, a PwC client, was in financial difficulty from July 2007, and we now know that the financial crisis was a capital crisis (balance sheet problems) where liquidity was merely the symptom. The accounting profession would have a clear interest in arguing that the crisis was not a balance sheet problem.

There are also issues with sharing the same legal advisers as the Big 4 at any time of tenure. Standards in public life require avoidance of the appearance of a conflict, not merely a conflict itself. PQ7046 deals with the fact that Richard Fleck has been a member of various FRC and predecessor operating boards - at key places and key times – having served for over 32 years from 1986 to 2018.

Mr Fleck biography on the Herbert Smith website in 2005 (19 years into his membership of the auditing practices board) states, that he *'advised Andersen, PricewaterhouseCoopers, and KPMG on accountancy, audit and liability matters. He also advises the major accounting firms on matters which affect the accountancy profession generally.'*

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

There is general criticism of a lack of transparency and effectiveness, hence conclusions are difficult for this question, given that the public don't know what cases were not pursued. For

<sup>38</sup> <https://www.frc.org.uk/getattachment/5c4407b0-f7b9-4d22-9e95-3791ca0042f4/FRC-reply-to-LAPFF-Consultation-response.pdf> Para 12.

<sup>39</sup> Vials, Hitchins, Bennett, Dolson, McPhee, Nelson, Priestley and Wright.

<sup>40</sup> Melanie McLaren PwC, Paul George KPMG.

example, there was unusual transparency as a result of the Kelly Review into the failure of Co-op Bank, revealing the audit had been passed by the FRC, shortly before it failed, but papers disclosed indicated inadequate audit of the purported 'good book' of that bank<sup>41</sup>. That transparency occurred as KPMG passed the FRC findings to the audit committee of Co-op Bank and that then came into the scope of the Kelly Review.

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

It most certainly would, and the issues are particularly important in the case of insolvency. Carillion has been tremendously damaging, and despite the FRC concluding in June 2018 that 50% of KPMG audits were not acceptable, Sky News reported that the FRC had passed the audit of Carillion: *"One source said that KPMG's audit of Carillion had initially been included in a sample of audits reviewed by the regulator and had been given a satisfactory rating, but had then been removed from the FRC's report"*<sup>42</sup>.

**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?**

This issue is currently being considered by the Competition and Markets Authority, and we would not like those issues to distract from the Kingman inquiry.

However there are aspects of FRC actions, such as extending IFRS, which are complex and need the level of resource the Big 4 have, to SMEs as oligopolistic. The problem is the risk that the FRC has identified with the global interest of those firms ahead of the public interest. In contrast, Australia introduced an additional standard over and above IFRS to deal with loan losses, and inherent losses in mark to market assets<sup>43</sup>. We have seen no evidence of the FRC referring to or considering that model for the UK.

**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?**

See Part 3 b), c and d). We set out how the FRC has contributed to a delivery gap sheltering under the guise of an 'expectation gap'. We believe that the legislative/judicial construct for audits has become disconnected from the 'standards' based model the FRC has pursued. It merely requires looking at settled cases - where they have come to Court - to identify the different emphasis; e.g. Barings vs Coopers & Lybrand. Core issues of creditor protection alongside limited liability status, creates a set of circumstances where the economics does not change, nor should expectations change of how audits and accounts deal with that.

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

The FRC has admitted it doesn't. In evidence to the House of Lords Economic Affairs Committee on 22 July 2014 into Going Concern, Lord McFall extracted this answer:

<sup>41</sup> Para 11.1-11.7 of the Kelly Review.

<sup>42</sup> <https://news.sky.com/story/carillion-auditor-kpmg-and-rivals-in-turmoil-over-frc-verdict-11408959>

<sup>43</sup> Guidance Note AGN 220.2 - Impairment, Provisioning and the General Reserve for Credit Losses

**Lord McFall of Alcluith:** Okay, fine. Was the “prudent” aspect, which Lord Lawson mentioned, reinstated?

**Stephen Haddrill:** This is early days. The conceptual framework of the International Accounting Standards Board is the criteria that it uses when it is writing the standards. It has agreed to put “prudent” back into the criteria but then it has to flow through into the rewriting of standards and so on over time.

**Lord McFall of Alcluith:** This is an uphill struggle. I have been taking evidence on this for seven or eight years, and the evidence that I get says, “Look, we are in a sense loners. **It is like pushing water uphill trying to change IFRS**”. Is that really the situation?

**Stephen Haddrill:** Any international discussion is a long—

**Lord McFall of Alcluith:** So the answer is yes?

**Stephen Haddrill:** The answer is yes.

This is of direct relevance to Carillion. In a letter from Sir Win Bischoff to the joint chairs of the BEIS/DWP Select Committee of 21 March 2018, he is responding to their questioning of Carillion’s “reverse factoring”. In simple terms the issue is that Carillion delayed paying its creditors whilst they were paid by a bank instead, essentially a bridging loan. What therefore appears to be trade creditors in the IFRS accounts is really bank debt.

We read the (five page long) letter as both reliant on IAS 39 (IFRS) and defensive of it. This is precisely the type of issue that the post-Dearing FRC had resolved, substance over form and basic common sense. The FRC response *“the growth in the use of SCF arrangements and their increased complexity may have reached a point where the International Financial Reporting Standards should explicitly and more comprehensively address them. We will consider this further and present our findings to the International Accounting Standards Board.”*

That response does several things; firstly it betrays the myth that IFRS is a “principles based system”. If it was principles based (and based on the correct principles) it would not take lobbying of another body to put right. It should be possible to achieve the right outcome in first instance.

Secondly, it demonstrates that the FRC is not in control of the system it is using to regulate.

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

The FRC’s successor needs to return to the position of pre-IFRS UK GAAP, with prudence, and substance over form, as set out in the Companies Act 2006. The UK capital market is the largest single user of IFRS. The USA does not use IFRS, nor does Japan. It’s something of a myth that IFRS is a “global” system. However, the UK has both championed it, and been a “guinea pig” in being the largest market actually using it for both group and company accounts. It is the company accounts function that does not fit with capital maintenance.

The governance of the FRC does not appear to have been challenged by the FRC, but it has quite significant issues.

For example, the IFRS Foundation - expensively - lost a case in the High Court in 2004 and in the words of the judge had relied on “false evidence<sup>44</sup>”. Despite that, that individual who gave the false evidence to the Court, Mr Kurt Ramin, was still receiving documents from US courts served on him at the IASB Head office in 2008<sup>45</sup>. He had arrived at the IASB in 1997 as a PwC partner on secondment. The 2008 US Court case shows that he had a secret interest in the IPO of a company that was seeking translation work from the IASB. He was commercial director, and as the UK Court case shows, that included commissioning translation services.

The IFRS foundation had governance issues as well. As a UK registered entity it was required to file with Companies House. The Daily Telegraph reported MEPs’ concerns *“According to documents filed at Companies House, Mr Padoa-Schioppa, for example, stepped down from the foundation in February 2013 – two years after he’d died. Some directors hadn’t had their appointments registered at all. Meanwhile, for a few years the address for the foundation’s legal correspondence was a private flat in Wapping, east London.*

*...MEPs, who voiced concerns not just about the filing mess but about the IFRS accounting system itself. They also had deep concerns about the fact that those responsible for overseeing the rules, including the foundation’s standard-setting arm, the International Accounting Standards Board (IASB), are almost all from the Big Four accountancy firms. The European Commission has announced a review of all the issues.*<sup>46</sup>.

The former Chairman of the FRC, Sir Bryan Nicholson was a member of the IFRS Foundation from 2006 to 2011, as was Mr Samuel DiPiazza, former CEO of PwC for the same period, which was the former employer of Mr Ramin, and co-defendant in the matter that had gone to the UK High Court.

**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?**

The regulatory system needs to get a grip on the basic numbers being right first.

**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 do not see a role for voluntary oversight.

**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?**

We believe that the issue of the Code should be subject to a separate consultation once the statutory elements of the FRC’s successor bodies has been settled.

**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?**

<sup>44</sup> Askeri vs IASC Foundation [2004] EWC 2939 Ch

<sup>45</sup> Landgren vs Ramin, Eastern District of Columbia 2008

<sup>46</sup> <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/10700353/Watchdog-is-called-to-account.html>



LAPFF engages with companies globally and includes trustees (as members of administering authorities – i.e. the pension funds) in meetings. LAPFF will engage privately, and where appropriate publicly, with public voting positions and press statements, albeit as a last resort. There has been a tendency to promote ‘behind closed door’ engagement, which can be self-limiting, as well as a cover for not actually doing anything effective. Few asset managers have the skills or inclination to take decisive action where needed. Cf. the Myners Review of 2001.

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

Yes. We believe there has been persistent foot-dragging on critical investigations due to conflicts of interest between the FRC investigatory staff and the audit profession, both in terms of initiating and vigorously prosecuting wrong-doing.

**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?**

Substantial reform is the best solution.

**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 do not comment as this is probably a subject for wider separate consideration. It is somewhat anomalous that actuarial standards sit within the FRC.

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

This has been covered in prior answers. First, the FRC must get the law right. Second, there needs to be ‘Farnborough approach’ (air accident investigations) into large corporate failures, where in those cases all commercial self-interest is excluded from the investigation process.

**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?**

The cases of Carillion and Co-op Bank are clear examples of where the FRC itself is giving false assurance, i.e. the FRC conclusions are worse than doing nothing.

**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?**

The capital maintenance regime of Part 23 Companies Act 2006 is a prudential regime. The FRC has intentionally departed from that see Part 3 d).

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

It sits in a confused framework of defective standards that can mask insolvency. LAPFF did not support the introduction of the ‘viability statement’ as it appeared to side step the problem of properly assessing going concern status when there are defects in the accounting standards regime. What happened with Carillion has borne that out.



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

See response to Q32 for a joint answer. See also response to Q29 above where the FRC has abdicated powers by its limited interpretation of company law.

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

The FRC seems incoherent about its powers. The Chief Executive told the BEIS/DWP Select Committee that it was 'one of the most effective audit regulators in the world.'

However it had asked for more powers which the Secretary of State said to the same committee it did not need.

**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?**

The FRC seems to have limited itself to dealing with the voluntary scheme relating to professional misconduct by members of the accounting institutes, rather than the wider range of criminal and civil issues that may arise. This seems to have been made worse by the changes to the Conduct Committee terms that occurred in 2013. See Part 3 d).

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

Yes. The FRC has actually been a public body since 1990 without a break (source: ONS Public Body database).

**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?**

A good example might be the Competition Commission. However, enforcement and standards may need a different relationship, which fits with the argument for more than one body.

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

This question can largely be answered by repeating that the FRC needs to be wound up and new bodies created. That said the arguments of 'confidentiality' are not particularly compelling given that the Courts operate with full transparency. The FRC seems to have overused the confidentiality argument. Its approach to Freedom of Information (FOI) requests is a clear manifestation of this.

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

LAPFF does not support the current leadership. The current CEO presided over both the formation of the FRC in its current form, and has then presided as CEO from 2009 to date. In LAPFF's view the current chair has not led effectively on the subjects that are now of concern, accounting standards, and auditing standards. Any ex-senior banker who has signed accounts in the period before and after the banking crisis may have difficulties. There are other issues with the Board, e.g. audit committee member of Tesco, which has had accounting issues.

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

The structure clearly hasn't worked. The structure of the successor bodies should be properly considered as part of a legislative solution.

**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?**

Not applicable in view of the need for a disbanding and new regulatory structure. See also response to Q38 above.

**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?**

See response to Q 36 above.

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

This should flow from the statutory objectives of the successor bodies. The current FRC executive structure is no longer an appropriate way forward.

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

Separating bodies will make it easier to better hypothecate income. On the basis that the accountancy bodies already have public interest chartered status conferred on them, then the need for any other standards and enforcement is a reflection of a degree of failure of that self-regulatory model. On that basis, all of the funding for auditing standard setting should come from professional firms. Enforcement should be funded from fines that do not flow back to accounting institutes, which has hitherto been the case.

Accounting standards could be funded by a levy in much the same way that the Takeover Panel is, with a degree of hypothecation from Companies House sources of income, given that private companies also use accounting standards. However, the current model has been made overly complex by the accounting profession, so until such time the environment is stable and value for money, the accounting profession should carry the full cost.

**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?**

This should flow from the new statutory bodies. The current FRC does not display the qualities needed of a regulator.

**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?**

Significant conflicts arise from the legacy of being a 'market led body'.

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

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The problems with the FRC historically, which have been revealed by the press, Parliamentary inquiries, Parliamentary Questions and Freedom of Information (FOI) requests makes the issue of FOI particularly relevant as there may be too much at stake in defending the current body from full transparency for past action, meaning it is in the best interests of all for it to be wound up, with new bodies starting afresh.