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Dear Sir John,

Independent Review of the Financial Reporting Council – Call for Evidence

Thank you for the opportunity to respond to the Call for Evidence in relation to your Independent Review of the Financial Reporting Council (FRC).

Public confidence in corporate Britain is low, and there is an evident need to restore trust. All participants in corporate Britain have a responsibility for rectifying this, including the large accountancy firms, but also including the regulator. It is clear that effective and proportionate regulation is an essential component of a well-functioning economy.

The FRC has undertaken a wide range of initiatives since its inception seeking to promote transparency and integrity in business. Its introduction of the Stewardship Code, the evolution of the Corporate Governance Code and establishment (with the Market Participants' Group) of the Audit Firm Governance Code are examples of this, as are its project based initiatives such as the Culture Coalition. Many of these initiatives should be recognisable, maintained and evolved in a future system.

However, the current regulatory landscape is complex and unclear. The FRC itself has, over time, acquired powers and responsibilities that do not make for a coherent or clear overall role and purpose. The current arrangements are challenged by commentators on the grounds of impact and independence.

Your Review provides the opportunity to overhaul the system and establish greater clarity in relation to corporate oversight (encompassing stewardship, governance, accounting and reporting and audit). It also provides the opportunity for clarification and rationalisation of the regulatory landscape.

The prime responsibility for governance of a company rests in the boardroom with company directors, who are ultimately accountable to investors, within a framework of law. The distinct responsibilities of directors, investors and auditors need to be reinforced by strong regulatory standards that are effectively enforced. This should include extending the regulator's authority to all directors evenly, regardless of their membership of accountancy professional bodies, reflecting the unitary nature of the boardroom.

It is inevitable that in a market economy there will be corporate failures. The regulator's role must, of course, include holding individuals to account if their behaviour or conduct falls short of expected standards in relation to governance. However, the regulator should also focus on ensuring a culture of learning that identifies areas of improvement in both governance and reporting which can be shared across corporate Britain. In this regard, examples of intervention in other industries might be considered (such as the aviation industry).

The ultimate goal should be to restore public confidence and ensure the financial stability and effectiveness of capital markets, while fostering an environment within which business can take appropriate risks in order to deliver economic growth, jobs, income and profit.

The future regulatory framework has to be set in a wider global context of comparative regulatory regimes seeking to attract investment and protect investors and other stakeholders, recognising the interconnectedness of business and global regulation. This is particularly important as Britain grapples with the challenges of Brexit.

Alongside a clearer regulatory framework, it is essential that a regulator takes proactive action to identify and help close any ‘expectation gaps’ that might exist between what prevailing rules and standards prescribe and what the public expects them to govern – be that in the field of audit or on wider corporate governance matters. Where necessary this needs to include correcting misconceptions of stakeholders, commentators and the wider public.

Regulation should be proportionate, potentially with higher standards applying to companies which embrace public interest or systemic risk. The regulator also has a role to play in ensuring that it remains attractive to high quality individuals either in taking on the significant responsibilities of directorship or embarking on a career in auditing.

This Review presents the opportunity for a step change in corporate regulation. We set out below the qualities that a strong and effective corporate regulator should demonstrate and elaborate on these in the Appendix to this letter.

1. **Clarity of purpose**

   The regulator should have a clear purpose, namely to promote public confidence in corporate Britain, in particular listed and other companies of societal importance, and by doing so help ensure the stability and effectiveness of capital markets and the economy more generally. It should be a force for identifying and promoting best practice.

2. **Independence**

   The regulator should be manifestly independent, of those it regulates and of government. It should have strong leadership that reinforces this independence and should be able and equipped to stand up to external pressure.

3. **Ability to enforce**

   The regulator should not only set principles and rules to ensure consistently high standards of behaviours across corporate Britain, but have the ability to enforce them effectively. This means having appropriate and sufficient powers in place and the right capability to intervene and use those powers.

4. **Authority and capability**

   The regulator should carry authority and respect. To do so it must have capability across its governance, leadership and staff encompassing a broad range and depth of skills and experience relevant to its areas of responsibility.

* * *

In summary, the time is right to reshape this whole landscape to develop a more effective regulator and a much clearer, codified approach to corporate oversight – to ensure Britain is a world leader in business regulation which is essential to attracting global investment. This should clarify the responsibilities of directors, boards, investors and auditors and provide the framework and power by which they may be held to account as the Sarbanes-Oxley Act did in the USA in 2002. Whilst Sarbanes-Oxley sits in a different legal context and cannot be copied exactly, the overall spirit of strengthening, rationalising and codifying law and regulation in this area provides a powerful precedent.

In the Appendix to this letter, we have set out more detail on our views. In doing so, we have not sought to answer each of the questions in your Call for Evidence individually but have responded collectively to the broad themes of your questions. We would however be very happy to elaborate on the contents of this letter and its Appendix, and look forward to engaging further as your Review continues.

Yours sincerely,

Bill Michael
Chairman and Senior Partner

Appendix

Below we set out in more detail the principles that should underpin the regulator and the new regulatory framework, making reference to the headings from the Call for Evidence.

Clarity of purpose: the regulator should have a clear objective to promote public confidence in corporate Britain

(This section covers questions in the Call for Evidence under "purpose and function" (Qs 1-6) and "FRC and corporate failure" (Qs 27-30))

The regulator should have a clear purpose, namely to promote public confidence in corporate Britain, in particular listed and other companies of societal importance, and by doing so help ensure the stability and effectiveness of capital markets and the economy more generally. It should be a force for identifying and promoting best practice.

Purpose and function

The regulator should have a clearer and more consistent purpose, set in statute.

This should be to promote public confidence in corporate Britain, in particular listed and other companies of societal importance, and by doing so help ensure the stability and effectiveness of capital markets and the economy more generally.

It should achieve this by defining the standards to which companies and their boards, auditors and investors should adhere; having a learning culture which encourages innovation and improvement; and maintaining the ability to monitor and hold market participants to account when necessary.

Regulation needs to be effective but proportionate, balancing the needs of incentivising the right kinds of behaviour and effective oversight on the one hand, and, on the other, protecting and promoting the UK's position as an attractive place in which to invest and do business.

The remit of the regulator should continue to encompass stewardship, corporate governance and reporting, and auditing. This breadth enables a consistent approach to standard setting and oversight of critical related aspects of the governance of corporate Britain. Importantly, however, this needs to be accompanied by enhanced frameworks, more proactive monitoring and greater powers to intervene before extreme events (such as corporate failure) occur (see *Ability to enforce* below).

It will be necessary for the regulator to act in close co-operation, and in a timely manner, with other regulatory bodies (e.g. the FCA, the PRA, sector specific agencies and so on) where there are overlapping or adjacent responsibilities, working with others to define precisely where the boundaries lie.

We have no strong views on any name for the future regulator other than noting that the current name, with its specific reference to "financial reporting", is particularly narrow if the purpose of the regulator is to be focussed on wider aspects of corporate regulation. The strengthened regulator should therefore be renamed in line with its primary purpose to enable better understanding of its role and responsibilities.

Promoting a culture of learning and innovation

Fostering a culture of learning is essential to drive continuous improvements in the technology, processes and behaviour that support strong corporate governance.

The regulator should work on the principle of incentivising key parties to get more things right in the first place and creating a regulatory environment that seeks to identify opportunities for learning when things have gone wrong, rather than solely apportioning blame and seeking to punish. This should include promoting best practice and innovation. This will help to incentivise greater openness and transparency from all interested parties and improve the ease of sharing best-practice. The regulator could look to the example set by other regulators which promote learning – from best practice and also from what has gone wrong.

For example, the Civil Aviation Authority (CAA) operates a rigorous safety assurance regime in relation to the licensing of pilots, the assurance of airlines, of aircraft design and manufacture, of airports and of air traffic control. All these issues are brought together in a comprehensive safety plan. Monitoring takes place through extensive data, mandatory monitoring and expert observation and inspection. The CAA also has a strong culture of learning, taking detailed lessons from any air accident reports, taking learning from aircraft incidents elsewhere in the world and also looking at safety learning from other spheres of activity. It increasingly aims to create a holistic picture of safety issues, joining the learning from its assurance work and from incidents.

Corporate failure

Good corporate governance should provide a framework within which a calculated strategy towards risk can take place. In a market economy it is inevitable that, on occasion, some companies will fail.

The regulator's role should not be to prevent all corporate failure. This could stifle innovation and appropriate risk taking. It also sets an unrealistically high objective that creates a potential (further) gap in expectations.

However, enhancements (as set out under *Ability to enforce* below) should strengthen the framework for corporate governance, including stronger supervision and powers over those responsible for the effective management of companies, and thereby reduce the risk of failure. Where there is a systemic risk from corporate failure, or a clear public interest, the Review should consider the role the regulator should have, within the wider framework of regulation, to mitigate this.

To achieve this, the regulator might be tasked with responsibility for more proactive monitoring – for example assessing sectoral and (at least for the largest listed companies and others with particular market significance) corporate risk, and intervening if necessary. In this regard, the regulator might seek to harness external information indicating concern over corporate governance and performance, as well as mechanisms for different stakeholders – be it those connected with the companies themselves (for example, management and directors), investors, regulators or auditors – to raise concerns ("red flags"). However, it is not sufficient simply to identify such concerns, and consideration would be needed as to appropriate intervention mechanisms if such concerns are identified.

Independence: the regulator should be put on a statutory basis, accountable to Parliament

(This section covers questions in the Call for Evidence under "the FRC's legal status and relationship with government" (Qs 34-36) and "governance and leadership" (Qs 37-41))

The regulator should be manifestly independent, of those it regulates and of government. It should have strong leadership that reinforces this independence and is able and equipped to stand up to external pressure.

We believe that the regulator should be put on a statutory footing with statutory independence, accountable to Parliament.

As the regulator with responsibility for corporate governance, its own standards should be of the highest level. It must demonstrate absolute independence from government and those it regulates. It should be a focal point the public and investors look to in order to enforce effective regulation of corporate Britain.

The regulator should be a trusted adviser to government on the matters within its purview, but act independently of government with a structure that minimises the politicisation of its functions. It should be confident in promoting what is good about corporate Britain, be prepared to correct uninformed criticism, and command the respect of all stakeholders in doing so. The regulator must be publicly accountable and systems should be in place, e.g. through regular appearances before Parliamentary Select Committees, to ensure it is delivering on its objectives and responsibilities.

Its Board should bring knowledge and experience of the specific areas of the regulator's responsibility, as well as broader commercial and business experience (see *Authority and capability* below). Board members should be absolutely independent from the companies they regulate to ensure they are independently minded and robust in guardianship of the regulator's core purpose.

The Review should consider how to protect this independence. Whilst this might be achieved by maintaining the current governance structure but putting in place further requirements upon Board members to prevent perceptions of conflicts of interest (regardless of whether perceived or actual), consideration should also be given to more fundamental change.

For example, the existing governance structure could be overhauled and replaced with a model similar to the US' Securities and Exchange Commission. This could include:

1) A smaller Board or group of Commissioners (perhaps appointed by the Secretary of State), comprising highly regarded and experienced individuals, retained on a full-time basis for a fixed term, potentially renewable but with a finite limit to service. Whilst serving, these individuals might be required to give up all connections to the companies they regulate. A shift to this approach would need to consider the right incentives to attract high calibre individuals.
2) Underlying divisions to support each pillar of the regulator's activity (stewardship, corporate governance, corporate reporting (including accounting), audit and enforcement) with rationalisation of subsidiary boards / committees.
3) Internal oversight of the regulator's own integrity and the effectiveness of the activities it undertakes, reporting directly to the Commissioners.

Consideration might also be given to periodic reviews of the regulator (say every three years) to provide assurance to Parliament, government and stakeholders that the regulator is discharging its remit effectively and efficiently.

Ability to enforce: the regulator should have appropriate powers across corporate governance, financial reporting and audit regulation

(This section covers questions in the Call for Evidence under "impact and effectiveness" (Qs 7-26) and "powers and sanctions" (Qs 31-33))

The regulator should not only set principles and rules to ensure consistently high standards of behaviours across corporate Britain, but have the ability to enforce them effectively. This means having appropriate and sufficient powers in place and the right capability to intervene and use those powers.

An effective regulator must have the appropriate powers and the ability to enforce them. The frameworks and powers through which the FRC operates are inconsistent and sometimes unclear. There should be consistency in its standard setting role, its monitoring activity, and its enforcement powers and activities across all its areas of responsibility. Its powers should be proportionate and focused on those areas that present the most risk. They should reflect a balance between *ex ante* actions to set standards and improve quality, ongoing proactive monitoring and *ex post* action to sanction those failing to meet the standards.

As stated in the section on clarity of purpose, while there will always be a need for enforcement and sanction, underpinning all of the regulator's activities should also be efforts to shift to a culture of learning and improvement. The role of the regulator should be to drive constant learning across the corporate sector to support continuous improvement in governance, financial reporting and audit. This should also mean constantly updating the regulatory framework to ensure its relevance.

Below we set out the principles that should underpin the regulator's oversight approach under key pillars of effective regulation of corporate Britain: corporate governance, stewardship, financial (and other) reporting and audit regulation.

Corporate governance

High standards of corporate governance begin and end in the boardroom. We believe that the "comply or explain" principle has much to commend it, and that the UK Corporate Governance Code (Code) sets an international benchmark. However, recent high profile corporate failures raise questions as to whether the standards articulated within the Code are being upheld. In turn this raises questions as to whether a principles based code alone is sufficient, and whether appropriate frameworks are being applied by companies in seeking to fulfil the principles of the Code. The regulator must have stronger powers to intervene where a board is manifestly failing to meet the high standards expected.

It follows that the Review should consider the context of the framework for the regulation of corporate governance. It should balance the need to deliver mechanisms to ensure more effective corporate accountability, with the importance of maintaining the UK as an attractive market in which to establish companies and invest.

In some areas, recent changes – such as the requirement for Directors to explain how they have had regard to their obligations under s172 of the Companies Act – may prove helpful. However, these developments are as yet untested and there is always a danger of "boilerplate" disclosure. We believe that more can be done to ensure that expectations created by the principles of the Code are delivered more consistently in practice.

This could include a Corporate Governance Code enshrined in UK law and underpinned by more detailed standards. For example, we believe that the Review should consider international examples, such as Sarbanes-Oxley in the United States with its associated public reporting requirements for companies (for example in relation to internal controls over financial reporting), to identify the appropriate framework for the UK that reflects the interests of investors and the public. Whilst this inevitably comes at a cost, we believe that ultimately the benefits are likely to outweigh these costs in the medium term.

Such a code could be supported by an enforcement regime that is proportionate to the degree of risk (e.g. a stronger regime for systemically important companies / sectors, as per the Senior Managers Regime for financial services). It might investigate opportunities to promote excellence in corporate governance through incentives such as a rating system (as per Ofsted) or governance awards. In parallel, the framework must recognise the roles and responsibilities of other sectoral regulators, ensure clarity of responsibilities and encourage close co-operation.

Importantly, the Review should consider the application of the clarity of the regulator's accountability regime and the ability to extend its oversight and enforcement powers in the boardroom beyond just those directors with financial qualifications to all directors evenly, reflecting the unitary nature of the boardroom.

Investors

Whilst primary responsibility for corporate governance may rest with the directors of a company, they are accountable primarily to shareholders who have an important role to play (both on their own behalf and on behalf of the ultimate asset owners) in promoting the long term success of a company. This has been recognised by the FRC through its establishment of the Stewardship Code, a positive development which has brought about increased engagement between investors and companies, although there is more that could be achieved.

Whilst various bodies representing investors do exist, the challenge for standard setters and regulators is the absence of a single voice representing investor views, particularly given the extent of overseas ownership of large listed companies. Whilst individual investors will of course have different views on occasion, on many matters there may be alignment.

At the moment, investors have the opportunity to influence companies through direct engagement and the formal ability, *inter alia*, to approve director appointments, remuneration and audit appointments in general meetings.

However, the regulator should consider how investor views may be better obtained and reflected in regulation, and at the same time how the regulator might promote more proactive intervention by investors when they have concerns, particularly where those concerns are in areas on which a formal resolution is not required. We referred above to the ability of third parties to raise concerns – or red flags – and this mechanism would, of course, encompass investor concerns.

Financial and other reporting

Confidence in the relevance and quality of corporate reporting is critical to the broader question of stakeholder confidence in corporate Britain. This includes the broader question of whether the content of corporate reports meet shareholder and other user needs, as well as the specific question of the appropriateness of accounting standards, We recognise that there are criticisms in certain quarters of accounting standards, but also believe that IFRS have the benefit in ensuring some global consistency for (non-US) companies. However, we do not consider this further since the issue of IFRS standards is beyond the scope of your Review.

However, recognising that IFRS do not cover every eventuality, there is more that can be done to build on the existing work of the FRC in this area. Improvements should focus on ensuring financial reporting continues to be investor-led, and with regard to the body of stakeholders who rely upon it.

As part of this, the regulator may want to continue to consider how existing tools could be used more effectively to improve transparency and deliver value for investors. This could include:

- More rapidly convening experienced stakeholders to align common understanding and consistent accounting and reporting treatments in areas of emerging concern, or areas of differing interpretation of the relevant accounting standards.

- Promoting the role of the Financial Reporting Lab as an important forum for investors, preparers of financial statements and the regulator to come together to identify and share areas of concern and best practice, balancing as always conciseness and clarity with the increased volume of material included in annual reports. Consideration could also be given to extending the Lab’s work to cover other aspects of the FRC’s role, for example in relation to corporate governance and audit.

- Re-examining the candidness of risk disclosures (and in particular the viability statement) to reduce the use of "boilerplate" text and ensuring that companies provide more clarity on the medium-term risks to the business and the strategy for managing those risks. As an example, in relation to the viability statement, consideration might be given to disclosing the nature of "what it would take for a company to fail" or, put another way, how events would have to vary from those assumed before a particular event, such as company failure, occurred.

Audit regulation

Audit is a core pillar of the effective operation of the capital markets.

In our view the FRC has extensive powers in relation to the monitoring and regulation of audit. Its introduction of the Audit Firm Governance Code, system of thematic reviews to supplement engagement and firm-wide quality reviews and, more recently, the introduction of its Audit Firm Monitoring Approach represent positive approaches to audit oversight.

Notwithstanding the above, and unprecedented levels of investment by audit firms in audit methodologies and technology enabled tools, confidence in the audit process and the audit profession (which the FRC oversees as competent authority) has been eroded in recent years, and the profession is faced with a number of criticisms from stakeholders. These criticisms extend not just to audit quality and the relevance / value of audit, but also to questions over the level of concentration and choice (particularly in the large audit market) and the objectivity and independence of / management of conflicts by the audit profession. In particular, whilst the capabilities enabled by the multi-disciplinary nature of the largest accounting firms bring significant benefits in investment and specialisms required to deliver quality audits, the scale of the non-audit business of these firms is itself a cause for concern in some quarters. However, a clear focus in addressing these concerns has to be enhancing audit quality, or at least not involving solutions which are to the detriment of audit quality.

Against the background of these criticisms, recognition of improvements in audit quality and audit firm governance over the last ten years tends to be lost and there is a danger that the UK is seen as an outlier in audit quality internationally – which we do not believe to be the case. Nor do we believe that there is a necessary connection between audit quality and market structure. Audit quality is difficult to define for universal acceptance. We believe that more could be done to obtain an understanding of what stakeholders in the audit process mean by audit quality, how this is best measured and communicated and the implications for audit monitoring and reporting of quality results. Whilst there are many studies on audit quality, there is a lack of consensus on this, which means that assessments of audit quality tend to be based solely on compliance with auditing standards, and consequently the potential for a checklist approach to auditing.

Whilst there is a significant responsibility on audit firms to remediate any identified deficiencies in audit quality and to invest and seek continuous improvement – a responsibility which we readily accept – we believe the regulator has an important role to play in enhancing public confidence in the audit process.

In relation to audit, the regulator's primary objective should be to promote audit quality. In that regard, it should be prominent in responding to calls from politicians, other stakeholders or market commentators' suggestions for market reform in ensuring that potential changes which might be to the detriment of audit quality are articulated and resisted where necessary.

In addition, we believe that the regulator has a key role in ensuring an understanding of shareholder (and potentially wider) needs from the audit process and convening an appropriately experienced and broad-based group to form a consensus view on how these needs might best be met. At present there is an existing and increasing expectation gap as to the role of audit in, for example, the prevention of corporate failure, the detection of fraud and, increasingly, the identification and reporting of governance and control weaknesses. More broadly, some commentators believe that assurance needs to extend beyond financial information. These are not questions on which the audit profession can unilaterally define the solution but we are in need of a mechanism by which they can be resolved, and the regulator has a critical role to play as a contributor and enabler.

The regulator needs to ensure that auditing standards and related guidance remain relevant as audit technologies evolve – particularly in relation to data analysis. For example, as technology provides the opportunity to consider entire transaction streams, standards and guidance are less important in existing areas of sampling methodology but much more important in terms of dealing with exceptions.

Crucially, the regulator has an important role to play in ensuring that the environment for auditing is such that it remains an attractive profession for talented individuals interested in making a public interest contribution in their career. The importance of audit is, in many respects, demonstrated by the current focus on its adequacy. However, in order to be an attractive career, there needs to be delicate balance between communicating the achievements and strength of audit in the UK relative to the rest of world, and identifying areas for improvement while encouraging collaboration to achieve success. A second aspect is, as with other facets of enforcement as a corporate regulator, ensuring that the regime is both effective and proportionate (see below).

Enforcement

Key to effective enforcement is the existence of appropriate standards against which the actions and behaviours of organisations and individuals can be assessed. In audit, these standards are detailed and evident. In other areas – such as the management of a company and reporting externally – this is less the case. We believe the initiatives above may strengthen the standards in these areas.

However, a second aspect is the power to hold to account. Again, for auditors and members of professional (accountancy and actuarial) bodies, these powers are clear (in the Audit Enforcement Procedure, the Accountancy Scheme and the Actuarial Scheme).

However, for others who are not members of such bodies, the powers to hold to account are less defined and fragmented. The regulator should have the power to establish an equivalent and proportionate regime which allows it to hold all individuals to account by virtue of the roles and responsibilities that they hold rather than on the basis of their membership of a professional association (which can always be surrendered).

Where there have been clear failures (for example in corporate governance or financial reporting), the Review should ensure the regulator has powers to sanction. For example, in relation to financial reporting the approach adopted under Sarbanes-Oxley in the US is one that places personal responsibility on the CEO and CFO of a company to sign-off on the accuracy financial statements and introduces a range of sanctions if they know the financial statement does not meet the requirements.

However, it is critical that a proportionate approach should be adopted in holding organisations and individuals to account. This needs to recognise that decisions made at a point in time – often when circumstances are changing and information is emerging – will always be more difficult to make than when looked at with knowledge about how events turned out.

Consistent with our views above (see *Clarity of Purpose*), in this regard it is important that the enforcement regime is focussed on improvement rather than simply punishment, and that sanctions should be proportionate between the parties involved. It should be remembered that future events are unpredictable and both standards and societal expectations evolve. Therefore the use of hindsight must be avoided. Culpability should be assessed based on standards and expectations applicable at an appropriate point in the past, rather than at the point of consideration in enforcement proceedings. There will always be a spectrum of causes for failure including:

- Criminality (at one extreme end of the spectrum)
- Negligence and poor judgement
- Well-intentioned judgement that turned out to be wrong based on events
- A matter that was not reasonably predictable or foreseeable (at the other extreme end of the spectrum)

Clearly the most significant penalties should be reserved for the former end of the spectrum. An overly zealous approach focussed solely on punishment is unlikely to be effective in the long term if it deters individuals from taking on important roles or, indeed, appropriate risk.

Actuarial oversight

KPMG does not have a strong view on whether actuarial oversight should remain part of the functions of the enhanced regulator. This could be a responsibility that is given to another organisation (such as the Faculty of Actuaries) to help to drive a clear focus for the regulator on corporate governance.

Authority and capability: the regulator should have the confidence to take a leadership role and capability to support this

(This section covers questions in the Call for Evidence under "funding, resources and staffing" (Qs 42-44))

The regulator should carry authority and respect. To do so it must have capability across its governance, leadership and staff encompassing a broad range and depth of skills and experience relevant to its areas of responsibility.

Capability and capacity

The enhanced regulator should carry authority and respect and have the leadership, capability and capacity to carry out a more demanding set of roles and duties. If we set the highest expectations of regulation then it must be recognised that this will require the best talent available. It follows that the regulator needs to be funded sufficiently to attract and retain the talent necessary to achieve this.

Whilst the skills required can only be determined once any enhanced role and responsibilities of the regulator are defined, these need to encompass not only subject matter expertise but also appropriate sector knowledge.

In terms of enabling the regulator to attract and retain talent this involves offering the appropriate remuneration and other incentives, but also establishing an environment where senior and experienced individuals in their fields view a temporary or permanent role at the regulator as an important and exciting career opportunity. In turn, we believe this is likely to require the regulator being held in high esteem by all stakeholders, respecting rather than challenging its decisions and working collectively with it to achieve a common goal of public trust and confidence in corporate Britain.

The framework needs to exist whereby there is transparency which promotes confidence in the independence of leadership and staff within the regulator, but which nevertheless recognises that in complex and often highly technical areas (for example of accounting and audit) the highest levels of skills and experience may reside in those regulated. This is necessary to enable, for example, employment of senior individuals from the large audit firms in a way that contributes to the strength of regulation and oversight without compromising independence. In large part this depends on confidence in leadership, but could be improved by greater transparency – for example on the backgrounds of those employed by the regulator (or at least monitoring / oversight activities) and how they have been deployed.

Similarly, we support continuing the existing practice of using experts from outside of the FRC (such as the Review Group used in the Corporate Reporting Review process). This provides a useful model for enabling practical involvement by experienced professionals who are likely to be peers of those responsible for the underlying subject matter of the review. The regulator should give consideration to how this could be extended.

Funding

We believe in the principle that the regulator should be funded by those it regulates.

However, in practice, the regulation of audit represents a cost to the corporate supply chain which, ultimately, needs to be recovered by suppliers (ie audit firms) from audited companies. In this regard, it would make sense for the levy simply to be applied to companies. This would avoid the risk of larger numbers of audit firms (albeit primarily at the smaller end of the market) being deterred from entering or continuing in a regime subject to regulatory scrutiny simply to avoid this aspect of the costs of that regulation and the uncertainty as to its ability to recover them from companies that they audit.

Concluding remarks

(This section covers questions in the Call for Evidence under "other matters" (Q 45))

Small and Medium-sized Enterprises (SMEs)

Our comments have focussed primarily on regulation in relation to listed and other companies of societal importance. However, corporate Britain comprises a much wider range of entities from this group through SMEs to micro-companies at the other end of the spectrum. Given the importance to economic prosperity and employment in the UK, it is important that this constituency is not overlooked simply because of the profile of larger companies. Whilst this might argue for separation of responsibility for regulation of smaller companies and, where applicable, for their financial reporting obligations and audit, we believe that this might introduce an inconsistency in approach – particularly to standard setting.

However, the regulator needs to ensure appropriate focus and proportionality, and it may well be that this should include individuals or departments within each area of the regulator's responsibilities focussed on the particular needs of smaller business. Whilst the responsibility for standard setting should be retained, using existing structures for oversight, such as the professional accountancy bodies in relation to audit and accounting matters at the smaller end of the market, would enable the regulator to focus on areas where there is greater public concern.

Transition

The transition from the current arrangements to the future will need to be managed carefully. Above, we have set out our proposals to define the landscape for corporate Britain and put forward a clearer focus and set of responsibilities for the reformed regulator. We recognise that in the current climate, with limited prospects of parliamentary time and other constraints, this may be implemented over a period of time, but it may be possible to use interim steps to support the transition towards the new system.