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By email: effectivestewardship@frc.org.uk

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Dear Stephen

**EFFECTIVE COMPANY STEWARDSHIP: ENHANCING CORPORATE REPORTING
AND AUDIT**

ICAEW is pleased to respond to your request for comments on *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

EFFECTIVE COMPANY STEWARDSHIP: ENHANCING CORPORATE REPORTING AND AUDIT

Memorandum of comment submitted in March 2011 by ICAEW, in response to the Financial Reporting Council consultation paper Effective Company Stewardship: Enhancing Corporate Reporting and Audit published in January 2011

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Effective Company Stewardship: Enhancing Corporate Reporting and Audit* published by the Financial Reporting Council (FRC).

WHO WE ARE

2. ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the FRC. As a world leading professional accountancy body, we provide leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. We are a founding member of the Global Accounting Alliance which has over 775,000 members worldwide.
3. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. We ensure these skills are constantly developed, recognised and valued.

MAJOR POINTS

4. We welcome the opportunity to comment on this consultation paper and it is our desire to work constructively with the FRC to develop effective workable proposals which support greater transparency. We want to be part of developing solutions to meet the needs of investors but we believe that these must be proportionate. Therefore it will be important to undertake impact assessments for any proposals before they are adopted and the scope of proposals must be carefully considered. We also strongly support the comments on page 18 of the consultation paper regarding the need for safe harbour provisions for directors, officers and auditors in relation to making or giving assurance on forward looking statements. We consider that this is a fundamental building block in developing workable proposals and producing disclosures that are of real value and vital in order to allow more innovation to occur.
5. The consultation paper is a challenging read because it covers a wide range of issues relating to corporate governance, regulatory structures, company law, auditing and financial and narrative reporting. There is already a plethora of UK, EU and international initiatives, both statutory/regulatory and voluntary in relation to many of these areas either published or in development, including some, eg, in the Cutting the Clutter initiative, published by the FRC. Joined-up thinking across these initiatives would be helpful to commentators and conducive to real progress.

Chapter One: Introduction

6. Chapter One suggests uncertainty regarding the scope of the proposals and whether they should just apply to listed companies or some other broader grouping. We consider that it would be appropriate to restrict the proposals to listed companies plus some other types of entity such as building societies. However, given that International Standards on Auditing (UK and Ireland) (ISAs) apply to all audits of financial statements, it is necessary to consider the implications of a possible expansion of auditors' responsibilities for audits of entities falling outside the scope of any changes in audit practice proposed by the FRC. It is likely that additional costs will not be justified for many entities and therefore the FRC should be clearer regarding the scope of its proposals.
7. We share and support the aspiration to see the best in corporate reporting adopted across the whole of the market place to create greater value for investors and serve the public interest better. We also support the creation of a 'financial reporting lab' where new reporting ideas could be explored, tested and trialled without adverse liability consequences. We would be

very willing to help in establishing such an arrangement. Our more specific comments are covered under each of the key recommendations.

Chapter Two: Key Recommendations

8. We detail our comments on the key recommendations from paragraph 29 onwards.

Chapter Three: Narrative Reporting

9. We agree that the annual report should communicate high quality and relevant narrative and financial information. The International Accounting Standards Board (IASB) has recently defined the qualitative characteristics that make for useful financial information: relevance and faithful representation are identified as the most important. Relevance is essential; if financial information is to be of use, it must provide users with what they need. A company may possess millions of items of data, only a few of which will be relevant to capital providers individually. Only in aggregate, usually, will the data be meaningful, and that will require the information to be filtered and subject to decisions about appropriate levels of aggregation and presentation.
10. The objective of reporting information in the narrative report is also key. We have witnessed in recent years increasing demands, often from governments or regulators, but also non-governmental organisations (NGOs), for the disclosure of various ancillary types of information in annual corporate reports to meet public policy objectives. Extending the scope of annual reports in this way risks adding disparate data that obscures useful information and ultimately reduces relevance. Thus, while the onus is on companies to provide relevant information in their annual report, governments and regulators also have a vital part to play in ensuring the annual report is not treated as a repository for other, disparate information; a start might be to conduct an early review into what information currently disclosed in the annual report could be presented in a different place or at a different time. We are keen to help develop thinking on this in conjunction with relevant stakeholders.
11. A clear focus is essential to achieving high quality financial information. A coherent document requires a clearly defined audience, and we support identification by the IASB of capital providers as the primary user group for its standards. We disagree with reference to 'the market' as the primary user group in FRC's recommendation, and strongly suggest that the more appropriate term 'capital providers' is used instead.
12. Considering these factors, it would appear that, while well targeted, the first key point is drawn more narrowly than the FRC intends. A more appropriate wording may be:

'The annual report and financial statements should communicate relevant and faithfully represented narrative and financial information to capital providers'.
13. Investors and capital markets require reliable in-depth information about companies, the risks that they face and their strategies. However, the annual report alone is not, and can never be, the sole repository for all of the information that investors and capital markets need. While the annual report remains the bedrock of the process of communication between companies and investors, this consultation paper perhaps pays too little attention to other communications of importance to investors and capital markets. These include, for example, interim management statements, investor presentations and ad hoc regulatory announcements which are made available to all market participants. All these communications taken together should provide a fair and balanced view.
14. Surprisingly the consultation paper makes virtually no reference to analysts' presentations as a source of information. Many analysts' presentations are routinely web cast both live and recorded. A key element to this form of communication is that directors face questions from investors and this is becoming an increasingly relevant source of information for all investors. Perhaps it is precisely because analysts' presentations are not prescribed by regulation that

they are so valuable for investors. Ensuring that such presentations are always available to all investors online and can be downloaded would contribute to improving transparency, but their existence and value also offers a comment, perhaps a critical one, on the role of the annual report and whether it is seen more as a compliance exercise than a means of communication.

15. Consideration will need to be given to how the proposals in the consultation paper will affect the existing statutory liability regime for issuers of securities under section 90A of the Financial Services and Markets Act 2000 and the safe harbour provisions. This regime which has been in place in revised format since 1 October 2010 applies to all information published by, or the availability of which is announced to the market by, 'recognised means' which is very different from the previous regime which only applied to periodic financial disclosures. For UK listed companies 'recognised means' include Regulatory Information Services (RIS) or other means required or authorised to be used when an RIS is unavailable. The key point to liability is that the 'information' is published on an RIS. Perhaps the breadth of the definition of 'information' should not be underestimated when considering the scope and operation of Key Recommendation 4 to encourage companies to take advantage of technological developments to increase the accessibility of the annual report and its components. We strongly support the comments on page 18 of the consultation paper regarding the need for safe harbour provisions for directors, officers and auditors in relation to making or giving assurance on forward-looking statements. We consider that this is a fundamental building block in developing workable proposals and producing disclosures that are of real value.

Chapter Four: Assuring Integrity

16. We welcome the focus in the consultation paper on strengthening the role of audit committees and the need for greater transparency of their activities including what they do regarding the external audit process. In principle we support more information being made available by audit committees about their discussions with auditors, to provide:
- evidence that auditors are performing their duties in a way that is relevant to users' needs;
 - more information about the way in which audit committees handle their governance responsibilities; and
 - greater clarity around the judgements the company has made in the accounts.
17. We agree with the FRC that there should certainly be a dialogue with the audit committee regarding the matters set out in the bullet points on page 15 of the consultation paper. External auditors already have a duty to report matters of significance to those charged with governance, in particular as a result of ISAs 260 and 265, but we support action to promote best practice in this area, both for audit committees and external auditors. This communication is usually to the audit committee, for whom auditors typically produce a report. We support greater transparency for users of accounts regarding this detailed dialogue.
18. We have commented in detail on these matters in our response to the European Commission's Green Paper on Audit Policy: Lessons from the Crisis ([ICAEW Rep 136/10](#)).
19. We support the need to consider the role and value of audit at this time, and not just in relation to the financial services sector. In particular we consider there is a possible role for auditors in enhancing the relevance and reliability of companies' risk reporting through appropriate reporting arrangements for this information.
20. Professional scepticism and the need for appropriate judgement is fundamental to audits carried out in accordance with the clarified ISAs, as we have made clear in our response to the Auditing Practices Board (APB) consultation ([ICAEW Rep 112/10](#)) on the subject carried out last year. Our view is that audits carried out with a sceptical mindset in accordance with the clarified ISAs should be sufficient to demonstrate high audit quality to relevant stakeholders and the level of work will be appropriate given the risks identified by auditors in accordance

with the ISAs. Our response to the APB discussion paper contains a detailed assessment of the various ways in which regulators, professional bodies and firms can help support auditors approaching their task with the appropriate sceptical mindset. ICAEW is keen to develop further our work on audit scepticism and judgement.

21. We are not clear from the consultation paper if there is a proposal to extend ISA 720 The Auditor's Responsibility in Relation to Other Information in Documents Containing Audited Financial Statements and ISA 200 Overall Objectives of the Independent Auditor and the Conduct of the Audit in Accordance with International Standards on Auditing. If this is the suggestion then we believe this should be subject to a formal consultation in the usual way.
22. We are concerned about the suggestion of enhancing the requirements in ISA (UK and Ireland) 720. We fully supported the APB's adoption of the clarified ISAs, keeping any UK additions to the absolute minimum. The FRC needs to consider any proposals, for example on this standard or ISAs 260 and 265, in the light of this APB policy on the setting of auditing standards and also evidence it gathers regarding the implementation of the clarified ISAs in practice. We consider that any proposals for amending standards should only be based on this information once it is available following the completion and review of clarified ISA audits.
23. We agree that audit committees have a key role regarding auditor independence and the provision of non-audit services, and we support recent changes made by the FRC and the APB to strengthen arrangements in this area and provide greater transparency regarding the provision of non-audit services. The FRC's guidance for audit committees will lead to more and better information being provided to investors on auditor independence matters. With respect to the heading of this section on page 15 of the consultation paper, we note that there should not be any circumstances that inhibit auditors being challenging in the appropriate way. If there are, auditors will need to act to remove these circumstances.
24. We agree that effective two-way dialogue between regulators and external auditors is helpful in regulated sectors and in particular we support recent actions by the Bank of England and the FSA in the financial services sector. There might well be other regulated sectors where similar arrangements would be useful and we would welcome further discussions with the FRC on this.

Chapter Five: Fostering Quality Improvements

25. There already exist powers available under various pieces of legislation such as the Companies Act 2006 and the Insolvency Act 2006 which provide for further investigations, regulatory action and even disciplinary action if there is a public interest concern in a case. The suggestion of providing an enhanced role for the FRC in this respect seems to be adding an additional layer of review at additional cost and so we would not support an automatic review by the FRRP or the AADB, whenever there is a corporate failure. We are not clear that investigations into corporate failure fall within the FRC remit when the failure may be nothing to do with reporting or auditing. We are not convinced that the FRC's remit for corporate governance extends to assessing where directors have failed in their duties to a company or its shareholders.
26. The concept of a 'financial reporting lab', where new financial reporting ideas could be explored, tested and trialled without adverse liability consequences is a good suggestion provided that it can be achieved in a cost-effective and accountable way. We would be pleased to help develop this idea.

Chapter Six: The legislative and cost implications of the FRC's proposals

27. The brief impact assessment contained in Chapter 6 is light on the cost implications of the Key Recommendations. We believe that a full and detailed impact assessment should be undertaken before further consultation is undertaken. It is stated in Chapter 6 of the consultation paper that the benefits in terms of increased confidence in corporate reporting outweigh the costs involved in such additional regulation. However, there is no detailed information to support this conclusion, not only on costs but also on what tangible benefits there are for companies and investors which would cause companies that are deemed to be compliant with the law but just not doing as good a job as they might to up their game in this area. We consider that the FRC should embark on a more extensive cost/benefit exercise as part of the next stage of its process. Issues regarding scope, as referred to in paragraph 6 above, should be an important part of this exercise, as should obtaining clear evidence from users of information that additional costs incurred, for example as a result of additional reporting, are justified.
28. With regard to the proposal to provide for reviews or investigations in the event of future corporate failures covering a company's governance, accounts and audit to '...ascertain whether further investigations or regulatory actions are necessary...' we agree with the general need for all relevant parties to review the circumstances of corporate failures in order to understand lessons that can be learnt. However, we would not support an automatic review e.g., by the FRRP or the AADB whenever there is a corporate failure. There could be a potential problem with such investigations which extend regulatory scope and seek to apportion blame. It may be a natural consequence that annual reports will become enmeshed with legal boiler-plate as all parties, including advisers, protect their existing and future positions. We understand why such investigations and reviews are suggested but we doubt they will be helpful in bringing about meaningful change in behaviours or outcomes. There are already suitable and robust mechanisms in place that can lead to reviews and disciplinary action where there is a public interest concern.

RESPONSES TO KEY RECOMMENDATIONS

Recommendation 1

Directors should take full responsibility for ensuring that an Annual Report, viewed as a whole, provides a fair and balanced report on their stewardship of the business.

29. We agree in principle, but believe that this responsibility is already embodied in current requirements. It is hard to imagine that the ordinary readers of financial statements do not think that this is what boards already do.
30. Directors are responsible under the Companies Act 2006 for presenting annual accounts that show a 'true and fair' view, and, among other things, for providing a business review that gives a balanced and comprehensive analysis of the development, performance and position of the company's business. Financial statements prepared under International Financial Reporting Standards (IFRS) are intended to allow capital providers to assess 'how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources'. As such we believe that the elements of this recommendation are already in place, and that further rules are unnecessary. The emphasis should be on driving up quality, so that more companies achieve the standards already met by companies acknowledged as being high quality.
31. Moreover, the current requirements, targeted at tangible elements of the annual report and financial statements, are clearly defined and it is reasonably straightforward to assess the success of the directors in meeting them. We would not support any suggestion to introduce an alternative regime based on the difficult to interpret concept of the 'Annual Report, viewed as a whole'. Such a modification to the current requirements would at best make no

appreciable difference to reporting, while at worst, it could frustrate management efforts to present useful information in the front part of the annual report.

Recommendation 2

Directors should describe in more detail the steps that they take to ensure:

- **the reliability of the information on which the management of a company, and therefore directors' stewardship of the company, is based; and**
- **transparency about the activities of the business and any associated risks.**

- 32.** It is difficult to judge the merits of this recommendation without more clarity about what is intended. We also assume that the recommendation should have referred to 'significant' risks, not 'any' risks. In any case, we doubt that requiring disclosure of this information would be effective. It is likely to be met simply by generic – in some cases, very lengthy – disclosure that contributes nothing to the provision of useful information and may actually obscure other, more informative disclosures. The publication of information that is reliable and which contains details of a company's activities and key risks is already required and we fail to see how stewardship would be improved by new requirements in this area. We would welcome more information about the views of particular users consulted by the FRC in this context.
- 33.** We also note that the Listing Rules already require listed companies with a Premium listing to have 'adequate procedures, systems and controls to enable it to comply with its obligations' under LR7 (Principle 2). If the FRC means to refer to a wider concept than this, we suggest that 'reliability' is not the most appropriate term to use in this context. The IASB uses the term 'faithful representation' and it may be preferable for consistent terminology to be employed in the recommendation. Disclosure should not be used as an alternative to regulatory enforcement: if companies are obliged to do something, then regulators should enforce those rules rather than using disclosure as a proxy for enforcement.
- 34.** While transparency of the business model and risks is important, disclosures in this area have been improving in recent years and it seems premature and possibly counter-productive to introduce new mandatory requirements that might frustrate development of good practice. Again, there is a danger here of encouraging generic statements of little value to users.

Recommendation 3

The growing strength of Audit Committees in holding management and auditors to account should be reinforced by greater transparency through:

- **fuller reports by Audit Committees explaining, in particular, how they discharged their responsibilities for the integrity of the Annual Report and other aspects of their remit (such as their oversight of the external audit process and appointment of external auditors); and**
 - **an expanded audit report that:**
 - includes a separate new section on the completeness and reasonableness of the Audit Committee report; and**
 - identifies any matters in the Annual Report that the auditors believe are incorrect or inconsistent with the information contained in the financial statements or obtained in the course of their audit.**
- 35.** The reference to audit committees holding auditors to account is perhaps misleading and, at least, requires further expansion. It is also surely the responsibility of the whole board to hold management to account not simply the audit committee. We broadly support what the FRC is seeking to achieve with this recommendation. However, careful consideration will need to be given to the detail of what is disclosed and where. In general we would support the detailed

information, as suggested, being provided in the audit committee report rather than in the audit report and it will be necessary to avoid any system that in practice leads to less helpful boiler-plate reporting. The system needs to encourage healthy open communication between auditors and audit committees, and transparency regarding this, which we would fully support.

- 36.** While we fully support the importance of audit committees and share the aim to see a more widespread recognition of the importance of audit committees in the governance process we would not wish to see this occurring if it diminished the importance of the board as a single unitary structure. An audit committee is a sub-committee of the board and exists to assist the board in discharging the board's duties. Therefore, it may be worth clarifying that it is the board that should report on how the audit committee has discharged its duties in much the same way that existing legislation and Listing Rules require the board to report to shareholders on remuneration issues.

Fuller reports by audit committees

- 37.** We agree that fuller reporting by the audit committee on how it has discharged its responsibilities for the integrity of the Annual Report and its role in the appointment of the external auditor would provide a greater understanding of the mechanisms that audit committees use to discharge their responsibilities. In particular more information about the audit process (both external and internal) may be useful for some investors. Greater focus on the drafting of audit committee reports could have the potential to impact internal procedures in a positive way and so we welcome the greater transparency that Recommendation 3 could bring about. Good audit committees already strive towards fuller and more comprehensive reports and this recommendation has the potential to help the rest to become better.
- 38.** We support greater transparency of audit committee activities and agree with the principle of the proposed audit committee report as set out on pages 16 and 17 of the consultation paper, subject to giving careful consideration to the detail of what is disclosed and where. In general we support the detailed information, as suggested, being provided in the audit committee report, although many of the matters should already be covered elsewhere. For example management should outline key judgements (under IAS 1), in which case the audit committee report could simply cross-refer to this disclosure. It would be useful in this context if the FRRP would undertake one of its very useful periodic studies on compliance in relation to paragraphs 122 and 125 of IAS 1, to shed some light on whether disclosures are sufficient or in what way they could be improved. The system needs to encourage healthy open communication between auditors and audit committees and we fully support transparency in this way. Given its responsibility for these matters, we agree with the FRC that it is appropriate for the audit committee to report on them rather than the external auditors.
- 39.** The FRC should also recognise the danger that audit committees will switch from spending their time actually doing the vital work that is expected of them under the UK Corporate Governance Code to spending it instead considering how they describe their activities in annual reports. More disclosure about audit committee and auditor activities may also not mean that better information is supplied to users of accounts. Regulating directors to disclose additional information may be counterproductive and detract from the provision of quality information.
- 40.** Additional reporting and other requirements will also change the dynamics between audit committees and boards, internal audit teams, and external auditors. We believe that it would be worthwhile to explore the full implications for these relationships before changes are made. This is especially the case for audit committees in smaller listed companies who may find it extremely difficult to transition to an enhanced role.

Expanded audit reports

- 41.** As stated above, we support greater transparency regarding the key issues that are considered in the communication between external auditors and audit committees but consider

that it is appropriate for such disclosure to be made in an audit committee report rather than the external audit report. However, we see merit in the FRC proposal for auditors to report on the completeness and reasonableness of the audit committee report, subject to detailed consideration of the implications of this, not least the audit committee's involvement in the appointment of the external auditors. We would welcome further discussions with the FRC and the APB regarding these implications. With respect to completeness, it will be important for the FRC to publish a clear set of criteria. Determining reasonableness can be a challenge for auditors in performing assurance engagements, but in this case it should be easier given their detailed understanding of the subject matter.

42. Our recent responses to the BIS and European Commission consultations on narrative reporting ([ICAEW Rep 109/10](#) and [ICAEW Rep 10/11](#)) include our views regarding the auditor's role regarding narrative information and the possibility of additional and separate assurance on this information. There is already a requirement that auditors read the annual report to ensure its consistency with the information published in the financial statements and we do not believe it would be problematic for auditors to report, as suggested in the paper, on matters that are incorrect or inconsistent with the financial statements or their understanding, based on work they have carried out in the normal course of the audit. Beyond this, we do not consider that information outside the financial statements should in general be included in the remit for statutory audit.
43. If management commentary were to be included in a separate document, it may perhaps be easier to devise an assurance report, tailored to that specific information, without the risk of deadening the information by making it more cautious or generic. We support allowing investor-driven innovation in this area and we therefore support a voluntary rather than a statutory approach to this type of reporting. In our view the profession, rather than regulators, should take the lead in developing appropriate services to meet the needs of investors.

Recommendation 4

Companies should take advantage of technological developments to increase the accessibility of the Annual Report and its components.

44. We agree that the internet offers a powerful channel for the communication of corporate information. However, we are unsure what is intended by this recommendation. Quoted companies must maintain a website and are required to publish their annual reports and financial statements there (Companies Act 2006 Section 430) and we believe that this is a useful service for investors. A central mechanism for publication of regulated financial information for listed companies, the RIS system, already exists, but as a system it is defective in terms of modern technology. It does not accept submission of PDF documents, which is the primary form in which information such as annual reports is usually published to ensure it remains stable, and its search facility is difficult to use. If improving the electronic availability of information is the objective, then updating the RISs must surely be the first step. In terms of a central repository for financial information relating to listed companies, the National Storage Mechanism (NSM) has only just commenced, but its operation to date is not auspicious: it is disorganised and unhelpful.
45. It is not clear from the consultation paper whether the FRC is referring solely to listed or quoted companies, or whether it would require unquoted companies to publish their financial statements on their websites. We would be strongly opposed to such a proposal. Companies House is an effective repository for unquoted company information and its functions do not need to be replicated.
46. We assume that 'technology developments' are intended to encompass XBRL. While we welcome some of the developments towards the publication of financial statements in XBRL format and believe that this can represent useful information for users, we suggest that the existing deficiencies in RISs and the NSM be addressed before any work is commenced to investigate systems for XBRL reporting. XBRL is only just starting to be used for the

consolidated financial statements of listed companies in the US, as mandated by the SEC, but the US GAAP taxonomy for XBRL has developed in a very different way to the IFRS taxonomy and it is not clear that the IFRS version is sufficiently operational to meet all information and regulatory needs. This must be proved before companies are required to incur the associated costs.

47. The consultation paper states that the FRC believes that 'companies should provide information in a user-friendly and accessible manner' and that the annual report and accounts should be 'posted on a company's website, rather than produced in print.' In principle we welcome progress towards a paperless environment in financial reporting. However, we are not clear in what way encouraging companies to cease to print annual reports would make information more user friendly or accessible, given that multiple channels of delivery (by definition) will at least make the information more accessible. The proposal may have the effect of depriving some investors of their preferred form of communication, or, of transferring the printing costs from companies to investors, for whom the cost is likely to be more material. This proposal needs further research and consideration.
48. Furthermore, encouraging companies to choose how and where they provide particular information and disclosure may actually make it harder for investors to find information. Some investors find it helpful to know that they can find a particular piece of information in a certain section. This should not be perceived as a barrier to innovation and improvement in reporting.
49. Moreover, as noted above, consideration may need to be given to how the proposals in the consultation paper will affect the existing statutory liability regime for issuers of securities under section 90A of the Financial Services and Markets Act 2000 and the safe harbour provisions. This will be of key importance to issuers and investors and potentially third party advisers as well. These may be key considerations in the decision to allow companies to decide how and where they provide particular information. We strongly support the comments on page 18 of the FRC paper regarding the need for safe harbour provisions for directors, officers and auditors in relation to making or giving assurance on forward-looking statements. We consider that this is a fundamental building block in developing workable proposals and producing disclosures that are of real value.

Recommendation 5

There should be greater investor involvement in the process by which auditors are appointed.

50. We agree that communication to investors on the external auditor appointment process will be enhanced with more transparent reporting by audit committees. The FRC's proposal for audit committees to report on the process, as set out in the first bullet on page 18, seems a good one in order to provide greater transparency. However, investors are not a homogenous group and we would be cautious about any proposals which gave greater powers and levels of engagement to some investors over and above others. We are unclear how this recommendation to provide investors with greater involvement in auditor remuneration and appointment is intended to work. We are also wary about creating any system whereby only certain investors were consulted in the auditor appointment process. With respect to this recommendation, we consider that the communication to investors on the external auditor appointment process will be enhanced with more transparent reporting by audit committees on the process.
51. There is already a mechanism in the annual general meeting that allows investors, should they choose, to support or block the re-appointment of the auditor. Sections 489-491 Companies Act 2006 set out the law on appointment of auditors of public companies. Shareholders may appoint, or vote against the appointment of, auditors by ordinary resolution at an accounts meeting (defined in section 437(3) Companies Act 2006). We do not subscribe to the view, nor do we think that there is any evidence to show, that auditor independence is compromised by the existing limited management role in the appointment or re-appointment of auditors. The

fact remains that shareholders confirm auditor appointments and should shareholders wish to vote against any appointment the mechanisms already exist to do that. If investors are not satisfied with the current arrangements, it is valid for the FRC to seek to discover why they are not content to exercise their voting power.

52. Neither are we convinced that there is any evidence to show that investors actually want greater involvement in the process by which auditors are appointed. The meaning behind 'involvement in the process' is vague and could cover a multitude of differing scenarios. We believe that the current position is clear and provides investors and companies with clarity and certainty with an ultimate vote on appointment for all shareholders, irrespective of size, to engage on this issue should they choose. Where shareholders are not readily able to exercise their existing voting rights this should be addressed separately.

Recommendation 6

The FRC's responsibilities should be developed to enable it to support and oversee the effective implementation of its proposals.

53. We agree that the FRRP and the Audit Inspection Unit (AIU) play important roles in assessing the quality and application of accounting and auditing standards. We understand that the FRRP will want to review the narrative content in annual reports and accounts, most of which has now been restructured to fall within the directors' report as a result of the liability regime, and therefore falls within the FRRP remit, and the AIU will review the auditor's consideration of the narrative content in annual reports. We believe that the FRC has sufficient powers and is effective in using them. We do not understand in what respects the FRC disagrees.

Recommendation 7

The FRC should establish a market participants group to advise it on market developments and international initiatives in the area of corporate reporting and the role of assurance and on promoting best practice.

54. The FRC has consistently demonstrated it is already in a very good position to ascertain market developments and international initiatives in corporate reporting and the role of assurance and on promoting best practice. In particular it can draw on the many senior figures with varied interests in corporate reporting which serve on its existing operational boards.
55. In general we doubt whether establishing a permanent market participants group is necessary, especially as it may tend to limit the scope of open and inclusive public consultation. We feel that such groups work best in times of crisis when a 'temperature' needs to be taken quickly and efficiently.

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