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The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies.

A company limited by guarantee registered in England  
Registration Number: 4025281

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11 June 2019

To whom it may concern,

**Independent Review of the Financial Reporting Council – Initial consultation on the recommendations**

We welcome the opportunity to respond to the Department for Business, Energy and Industrial Strategy's Independent Review of the Financial Reporting Council – Initial consultation on the recommendations.

The Quoted Companies Alliance *Financial Reporting Expert Group, Corporate Governance Expert Group and Legal Expert Group* have examined the proposals and advised on this response from the viewpoint of small and mid-size quoted companies. A list of Expert Group members can be found in Appendix A.

Overall, we broadly accept the recommendations produced by Sir John Kingman within the Independent Review of the Financial Reporting Council (FRC). Bearing in mind the small and mid-size companies we represent, **we especially welcome the recommendation for the new regulator to place emphasis on proportionality, having due regard for the size and resources of all who are regulated.** As the small and mid-size quoted company community make up the vast majority of public markets, the new regulator must reflect this by balancing the costs and benefits of any regulatory action.

The new regulator must place proportionality at the heart of its approach, taking into account the needs and size constraints of smaller companies when developing and introducing new standards and regulation. Doing so, will ensure that companies are not overloaded with requirements and will be a key component in stimulating the growth of smaller companies, as well as the UK economy as a whole.

If you would like to discuss our response in more detail, we would be happy to attend a meeting.

Yours sincerely,

A handwritten signature in blue ink, appearing to be "D2L".

Tim Ward  
Chief Executive

## Chapter 1 – FRC structure and purpose

### **Q1 What comments do you have on the proposed objective set out in Recommendation 4?**

Overall, we broadly support the Review’s proposal for the new regulator’s strategic objective. However, we do feel that the proposed objective does not capture the role of the new regulator in its entirety. We outline some of the issues below.

#### **The focus on financial information**

The focus on “financial information” is too narrow and in general excludes any focus on non-financial information. This narrow focus fails to address users’ needs for high quality, reliable and accurate non-financial information. The new regulator’s responsibility for the oversight of corporate reporting and corporate governance must not restrict itself to a sole focus on financial information and we wholeheartedly endorse the recommendations numbered 29 and 30.

#### **Wider public interest**

Reference to “the wider public interest” is vague and, somewhat, aspirational. Recent corporate failures have become more apparent due to their ‘public interest’. The FRC’s inability to remain responsive to changes in the external environment when identifying public interest entities (PIEs) has, in our view, been one of its shortfalls. It should be the new regulator’s duty to discern PIEs accurately and consistently.

#### **Exclusion of individuals**

In terms of holding to account, there is no reference to individuals, just to companies and professional advisers. It is essential that individuals are recognised within the strategic objective, as company directors and audit committee members are often culpable when issues arise in companies. This is reiterated within Section 172 of the Companies Act 2006, which states that company directors have a duty to promote the success of the company. We wholly support the recommendations numbered 36-38 in this regard, whilst being mindful of the need to avoid overlap in the legislative regimes which apply to individuals. Ultimately, the regime should be a fair one which does not open the prospect of ‘double jeopardy’ for those suspected of falling short of their duties.

### **Q2 What comments do you have on the duties and functions set out in Recommendations 5 & 6?**

Generally speaking, we agree with the duties and functions set out in Recommendations 5 & 6.

However, in regards to the duties and functions set out in Recommendation 6, and, specifically, the promotion of the UK Corporate Governance Code, we would encourage that the new regulator recognises that the QCA Corporate Governance Code is used by the vast majority of companies on AIM and is a more appropriate and proportionate framework for smaller quoted companies. The legislation should recognise that there is more than one corporate governance code used by publicly quoted companies on UK markets, and, in our view, the regulator’s function should be to promote good governance rather than to espouse one particular corporate governance code to the exclusion of others.

### **Q3 How do other regulators mitigate the potential for conflict between their standard setting roles and enforcement roles as set out in Recommendation 14?**

Having recommended in the Independent Review of the FRC that the new regulator separates its standard setting and enforcement functions, we are disappointed to see that the recommendations have not included this. We believe that the inclusion of this question echoes the Government's concerns around the inherent conflicts between a regulator having both standard setting and enforcement functions.

Notwithstanding, we note that other regulators mitigate the potential conflict through several means, they are as follows:

- Establishing a distinct and robust governance structure that recognises the conflicting activities undertaken; and
- Stringent and clearly defined departments and teams to ensure that neither function can influence one another within the new regulator. Erecting information barriers is necessary and the new regulator should outline this within its governance in a transparent way.

**Q4 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

In line with Recommendation 5, in taking forward the recommendations within this chapter it is important to ensure that everything is proportionate to the size of the entity subject to investigation. The new regulator should look to enforce proportionally sized sanctions and fines on the Big 6 versus smaller audit firms. Even supposing that a smaller audit firm participates in a joint audit, as proposed in the CMA's recommendations, the larger firm and the smaller firm should not attract the same level of sanctions or fines; everything should be proportionate to the size of the entity subject to investigation.

In addition to this, there should be sufficient representation of small and mid-size quoted companies on the new regulator's board. This will ensure that the new regulator develops a proportionate approach across all of its workstreams.

**Chapter 2 – FRC: Effectiveness of core functions**

**Q5 How will the change in focus of CRR [Corporate Reporting Review] work to PIEs [Public Interest Entities] affect corporate reporting for non-PIE entities?**

The developments made by the FRC to date on improvements in financial reporting for small and mid-size quoted companies could perhaps be lost if it was to only focus on PIEs. In order to overcome this, consideration should be given to the restrictive nature of the definition of PIEs. That is, the current definition only captures EEA incorporated entities on the LSE Main Market (outside of credit institutions and insurers). Consideration needs to be given over whether the new regulator, and the UK Government, are only concerned with the impact on the UK market by EEA entities rather than all entities listed on the LSE Main Market. Additionally, if the focus is solely on PIEs, no consideration will be given to AIM and NEX listed companies, which is fundamentally important.

Furthermore, we believe that a delegation arrangement similar to that for inspections with the Recognised Supervisory Bodies (RSBs) should be considered to cover entities which are not PIEs. This will allow the new regulator to prioritise its work on higher risk entities and also ensure there is a more proportionate response for non-PIEs. This approach of a two-tier system for PIE and non-PIEs is reciprocated in Accounting Standards (FRS 102 and IFRS for SMEs), which apply different requirements for smaller entities. This will help the

number of non-PIE accounts to be reviewed, and, in turn, drive up the quality of reporting for smaller, non-PIEs.

**Q6 What are your views on how the pre-clearance of accounts proposed in Recommendation 28 could work?**

We strongly support Recommendation 28 that the new regulator should introduce a pre-clearance procedure in advance of the publication of accounts. There are many benefits in companies and auditors seeking advanced approval of accounting treatments on challenging matters, as opposed to waiting for these issues to be identified retrospectively. Whilst implementing such a programme could encounter difficulties, the benefits to users would significantly outweigh the costs.

However, in doing so, the new regulator would need to carefully manage the process for pre-clearance by setting out the requirements clearly and would need to ensure that the fee levied is not prohibitive for entities using the function. Due regard must be given to the size of entities seeking to use the pre-clearance of accounts function when determining the fee.

**Q7 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

We have the following points to raise regarding some of the recommendations in this chapter:

**Recommendation 18**

We welcome the recommendation that the UK's definition of a PIE should be reviewed. As the definition currently stands, it is overly rigid and is not flexible enough to respond to external changes.

**Recommendation 23**

On the whole, we agree that the new regulator should promote brevity in corporate reporting, as the longer corporate reports are, the more difficult it is to locate and extract useful information. However, the new regulator is restricted in its capacity to do this to a certain extent. This is because the content of the financial statements part of annual reports is determined by the Accounting Standards.

Additionally, the "front half" of the annual report has become increasingly overloaded, with more and more content being introduced, which makes it difficult to find useful information. The new regulator could mitigate against this by publishing examples of best practice.

**Recommendation 26**

We believe that this recommendation will, on balance, encourage companies to perform more thorough responses to queries. However, the new regulator should have a duty to assist companies in this regard.

**Recommendation 29**

The extension of the corporate reporting review to cover the entire annual report, including corporate governance reporting, is a considerable task. This will require the new regulator to commit additional resource and means that reviews will take significantly longer.

**Recommendation 30**

The reference within this recommendation to “investor information” is rather vague. Additional clarity needs to be given on what this information is, why it is being produced and the benefits of it. Moreover, the information that it will likely cover, such as forward-looking information and KPIs, is inherently difficult to police. The distribution and type of investor often varies with the size of the company and this should be taken into account in this matter and all others that involve investor inputs or outputs.

### **Recommendation 32**

We agree with the recommendations that the board and the Government should continue to monitor the enforcement function closely. However, we are disappointed that further overhaul of the new regulator’s enforcement approach has not been recommended, as it is this that has been one of the key drivers behind the FRC’s failings. The new leadership of the Enforcement team should re-consider how the enforcement role is overseen.

## **Chapter 3 – Corporate failure**

**Q8 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

We have the following points to raise regarding some of the recommendations in this chapter:

### **Recommendation 45**

The duty of alert for auditors to report viability or other serious concerns already exists within the Auditing Standards (ISA 250 Section A and Section B). Any further duty of alert will need to be considered alongside this existing requirement and should be subject to further consultation.

### **Recommendation 52**

In regard to viability statements, we welcome the Review’s recommendation to review and reform this form of reporting with a view to making them more effective. We are of the opinion that the key impediment to the effectiveness of viability statements is that companies too often provide vague boilerplate statements because they are not held to account on the content included within them. If the new regulator begins to hold companies to account on their viability statements this will help to make a transition away from boilerplate reporting and encourage originality.

Furthermore, viability statements are often produced as longer-term going concern statements that focus on liquidity rather than communicating how a company will continue to remain in good financial standing and be adaptive to any potential risks to its business model. If viability statements can be reviewed and reformed to cover more on this, it will engender a greater focus on a company’s long-term approach and internal processes, which will in turn create more value for investors.

## **Chapter 4 – The new regulator: oversight and accountability**

**Q9 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

In regard to Recommendation 57, we are of the opinion that excluding existing employees from holding positions that relate to their previous employer could severely limit the level of skill and experience that is necessary to make the new regulator effective.

#### **Chapter 5 – Staffing and resources**

**Q10 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

We have no comments.

#### **Chapter 6 – Other matters**

**Q11 Are there specific considerations you think should be borne in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

We have no comments.

#### **Chapter 7 – Interim Steps**

**Q12 Are there specific considerations you think we should bear in mind in taking forward the recommendations in this chapter? Are there other ideas we should consider?**

We have no comments.

#### **Conclusions**

**Q13 What evidence or information do you have on the costs and benefits of these reforms?**

The amount of resource needed to implement these reforms is going to be significant and it will cost a sizeable amount. If the reforms are going to be funded through the participants in some way, this must be proportional to the size and resources of those contributing.

**Q14 What further comments do you wish to make?**

Any changes that the new regulator will adopt have to be proportionate for the market, corporate and public sector entities and practitioners. The changes made should address the issues raised within the Review only. Changes should not be extended to other areas which are outside of the Review's remit.

Given that the distribution and size of investor often varies with the size of corporate entity, investors should not be viewed as large, global entities only. To do so will encourage a continuing homogenous demand for corporate reporting and related subjects, to the detriment of smaller companies and other types of investors.

The changes should be made in conjunction with the recommendations raised by both the CMA market study and Sir Donald Brydon's review into the quality and effectiveness of audit. Doing so would help to eradicate the potential consequences of a disjointed approach, so as not to result in duplication of effort or excessive additional regulatory burden and multiple new rules being created.

## **Appendix A**

### **The Quoted Companies Alliance *Financial Reporting Expert Group***

|                               |                                  |
|-------------------------------|----------------------------------|
| Matthew Howells (Chair)       | Smith & Williamson LLP           |
| Rochelle Duffy (Deputy Chair) | PKF Littlejohn LLP               |
| Edward Beale                  | Western Selection PLC            |
| Matthew Brazier               | Invesco Asset Management Limited |
| Ben Courts<br>Elisa Noble     | BDO LLP                          |
| Anna Hicks                    | Saffery Champness LLP            |
| Mark Hodgkins                 | Trackwise Designs LLP            |
| Clive Lovett                  | Bilby PLC                        |
| Laura Mott                    | Haysmacintyre                    |
| Claire Needham                | KPMG LLP                         |
| Matthew Stallabrass           | Crowe UK LLP                     |
| Jon Wallis                    | Grant Thornton UK LLP            |
| Peter Westaway                | Deloitte LLP                     |

### **The Quoted Companies Alliance *Corporate Governance Expert Group***

|                                    |  |
|------------------------------------|--|
| Will Pomroy (Chair)                | Hermes Investment Management Limited           |
| Tracy Gordon (Deputy Chair)        | Deloitte LLP                                   |
| Edward Beale                       | Western Selection PLC                          |
| Nigel Brown                        | Gateley  |
| Amanda Cantwell<br>Julie Stanbrook | Practical Law Company Limited                  |
| Jo Chattle                         | Norton Rose Fullbright LLP                     |
| Richie Clark                       | Fox Williams LLP                               |
| Jonathan Compton                   | BDO LLP  |
| Louis Cooper                       | C/o Non-Executive Directors Association (NEDA) |
| Edward Craft                       | Wedlake Bell LLP                               |
| Tamsin Dow                         | Hogan Lovells International LLP                |
| Peter Fitzwilliam                  | Mission Marketing Group PLC                    |
| David Fuller                       | CLS Holdings PLC                               |
| Nick Gibbon                        | DAC Beachcroft LLP                             |
| Nick Graves                        | Burges Salmon                                  |
| Ian Greenwood                      | Korn Ferry                                     |
| David Hicks                        | Charles Russell Speechlys LLP                  |
| Alexandra Hockenhull               | Hockenhull Investor Relations                  |

|                                  |                              |
|----------------------------------|------------------------------|
| David Isherwood                  | BDO LLP                      |
| Daniel Jarman<br>Kalina Lazarova | BMO Global Asset Management  |
| Colin Jones                      | Candid Compass               |
| Damien Knight                    | MM & K Limited               |
| Peter Kohl                       | Kerman & Co LLP              |
| James Lynch                      | Downing LLP                  |
| Marc Marrero                     | Stifel                       |
| Efe Odeka                        | UHY Hacker Young             |
| Darshan Patel                    | Hybridan LLP                 |
| Sahul Patel                      | FIT Remuneration Consultants |
| Phillip Patterson                | PricewaterhouseCoopers LLP   |
| Jack Shepherd                    | CMS                          |
| Carmen Stevens                   | Jordans Limited              |
| Peter Swabey                     | C/o ICSA                     |
| Melanie Wandsworth               | Faegre Baker Daniels LLP     |
| Kerin Williams                   | Prism Cossec                 |

**The Quoted Companies Alliance *Legal Expert Group***

|                                |                                     |
|--------------------------------|-------------------------------------|
| Mark Taylor (Chair)            | Dorsey and Whitney                  |
| Maegen Morrison (Deputy Chair) | Hogan Lovells International LLP     |
| Danette Antao                  | Hogan Lovells International LLP     |
| Paul Arathoon                  | Charles Russell Speechlys LLP       |
| Daniel Bellau                  | Hamlins LLP                         |
| Ashmi Bhagani                  | Pillsbury Winthrop Shaw Pittman LLP |
| Philippa Chatterton            | CMS                                 |
| Paul Cliff                     | Gateley                             |
| Simon Cox<br>Julie Keefe       | Norton Rose Fullbright LLP          |
| Murdoch Currie                 | Bates Wells & Braithwaite LLP       |
| Kate Francis                   | Dorsey and Whitney                  |
| Francine Godrich               | Focusrite Plc                       |
| Stephen Hamilton               | Mills & Reeve LLP                   |
| Sarah Hassan                   | Practical Law Company Limited       |
| David Hicks                    | Charles Russell Speechlys LLP       |
| Alex Iapichino                 | Majestic Wine Plc                   |
| Nichols Jennings               | Locke Lord LLP                      |
| Martin Kay                     | Blake Morgan                        |

|                               |                           |
|-------------------------------|---------------------------|
| Jonathan King                 | Osborne Clarke            |
| Nicola Mallet<br>David Willbe | Lewis Silkin              |
| Nicholas McVeigh              | Mishcon De Reya           |
| Catherine Moss                | Shakespeare Martineau LLP |
| Nicholas Narraway             | Hewitsons LLP             |
| Kieran Rayani                 | Stifel                    |
| Jaspal Sekhon                 | Hill Dickinson LLP        |
| Donald Stewart                | Kepstorn                  |
| Kieran Stone                  | Memery Crystal            |
| Gary Thorpe                   | Clyde & Co LLP            |
| Jane Wang                     | Fasken                    |