

# The Feeble Financial Reporting Council

*by Eric Chalker*

In seven years of dealing with the FRC on behalf of the UK Shareholders' Association, it was at best a disappointment. Over time, I came to see it as wholly unhelpful to the needs of private investors and even hostile to them. Now, at the request of the government, it is being examined by Sir John Kingman.

This is the body that wanted to do away with printed annual reports – an initiative which appalled the great majority of private investors, including those who use the internet. We were able to kill that idea, but to most of what we sought it turned a polite but completely deaf ear.

Over the years, UKSA lobbied the FRC repeatedly for its assistance in improving the lot of private investors. Of greatest importance were our representations on the disenfranchisement of increasing numbers because shares have been driven into nominee accounts by government requirements (ISAs and SIPPs) and by stockbroker practice. Shockingly, when I mentioned at an FRC open meeting, in the context of the EU's Shareholder Directive, that changes to shareholder rights would do nothing for investors in nominee accounts because in English courts they don't qualify as shareholders, the FRC chairman, Sir Win Bischoff, said to me afterwards, "I didn't know that."

Despite the fact that private equity investments now exceed in value those of insurance companies, pension funds and the like, the FRC refused to lift a finger to facilitate, let alone increase, the ability of individual investors to hold company directors to account. Despite the fact that, mostly, it is only private investors who put their own money at risk when buying company shares, the FRC consistently preferred to focus solely on the concept of 'stewardship' exercised by intermediaries, mostly with none of their own money at stake. Stewardship is a blanket that has worn thin and become riddled with holes.

## **A failing relationship**

In February 2016, after years of trying but failing to persuade the FRC to respond to its concerns, UKSA decided to make them public, with a statement on its website, still there, headed, "The Financial Reporting Council is failing private investors." Attached to this was the letter sent by UKSA to comment on the FRC's draft plan for 2016/17, calling on it yet again to include action to enable and improve private investors' ability to exercise the rights given to all shareholders by the Companies Act. Both items can be found [here](#).

In November last year, the FRC gave a roomful of private investors a lengthy and comprehensive presentation on its activities. 'Lifting the lid on the FRC' it was called. Numerous questions and observations were made by those attending, many of them critical. Unsurprisingly, a lot of these related to audit quality, an aspect of its responsibilities in which the FRC has conspicuously failed over many years, as a result of which investors continue to lose money because certified accounts have subsequently been shown to be false. Despite these comments being recorded, there is no evidence yet that the occasion was in reality anything more than a public relations exercise.

## **Sir John Kingman's Review**

Sir John Kingman's approach to the review is to be applauded. His call for evidence can be found [here](#). As I am no longer in a representative capacity, I have not tried to answer specific questions, but have sent him the following observations.

- The FRC is too large. Its responsibilities should be limited to the governance and financial reporting of listed companies, including those on the Alternative Investment Market. It should have a narrower focus, with a sharper cutting edge. For punishment of wrong-doing, the FRC should be driven by suitably qualified lawyers, empowered and able to act more swiftly than has been the case.
- It is a mistake to see the function of audit as little more than checking directors' adherence to approved

reporting standards. To correct this, supervision of audit must be separated from oversight of corporate governance and given to a body of lawyers concerned solely with the interests of shareholders, not left to the conflicted interests of accountants. All senior members of the accountancy profession should be barred from senior positions in the FRC, because it is evident they are conflicted.

- Executive and senior administrative positions should be filled from outside the civil service, to get rid of the bureaucratic, box-ticking mentality that has been prevalent, the cause of too much paperwork with too little focus on what really matters.

*A striking example of this was the regulatory requirement for directors to produce a strategy report, occupying just three pages in the regulation itself, turned by the FRC into 30 pages of 'guidance' plus four appendices: how to turn something simple into something complex.*

- The power to impose fines should be unlimited, exercised in accordance with capacity to pay and the effect of the offence on investors; investors' interests should never be prejudiced by fining companies. The FRC should have the right to retain the fines it levies and it should also be given the power to issue orders for investors to be compensated in appropriate circumstances.
- Above all else, the FRC must devote resources to the particular needs of private investors, strengthening their ability to hold directors to account at general meetings, disallowing the practice of repeated attempts to deprive individuals of their right to receive material by post, ensuring that their opinions are not drowned by institutional proxy votes and that attempts by chairmen to minimise legitimate questioning are not allowed, coupled with constant search for ideas to improve private investors' status. A minimum ten per cent of the FRC board should be chosen by representative bodies of private investors. There must be at least one executive, at a senior level, with responsibility for matters of concern to private investors.
- The FRC must of course be a statutory body, answerable to Parliament.

Eric raises many interesting and valid points. With reference to the market for external audit services, members will by now know that the Competition and Markets Authority (CMA) has launched an investigation into the market for external audit services. The CMA has issued a consultation paper on the subject which can be accessed via the following link:

[\*Invitation to comment document\*](#)

This gives a very good summary of the issues raised by the dominance of the Big Four. It also summarises the main options for market reform and the pros and cons of each one. UKSA will be responding to the consultation.

The FRC has come in for heavy criticism recently and, as Eric says, is currently the subject of a full review by Sir John Kingman. Sir John and his team are due to report and make recommendations later this year. Possibly because it has been stung by the severe criticism, the FRC has taken strong action in a number of recent cases of reporting and audit failure. In June Russell McBurnie, former Finance Director at RSM Tenon, was excluded from the accountancy profession for five years for extensive misconduct in preparing financial statements. In July Steve Denison, PWC's audit partner responsible for BHS, was obliged to remove himself from the register of statutory auditors for fifteen years, effectively ending his career. Stern action by the FRC may be overdue but it still sends an important message to those it regulates.

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