

October 2015

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# FRC's Strategy for 2016/19

The FRC is responsible for promoting high quality corporate governance and reporting to foster investment. We set the UK Corporate Governance and Stewardship Codes as well as UK standards for accounting, auditing and actuarial work. We represent UK interests in international standard-setting. We also monitor and take action to promote the quality of corporate reporting and auditing. We operate independent disciplinary arrangements for accountants and actuaries, and oversee the regulatory activities of the accountancy and actuarial professional bodies.

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## **FRC's Strategy for 2016/19**

**Fostering investment and the importance of effective but proportionate regulation will guide our priorities over the next three years. We will concentrate on promoting a step change in audit quality and on driving up standards of governance, stewardship and reporting. Our goal is to ensure that reporting and audit in the UK are world-leading in order to give the greatest possible confidence to investors globally, and by doing so help drive growth. We will work closely with companies, investors and the accountancy and actuarial professions to make the most of the changes to codes, standards and regulations introduced in recent years, while avoiding further changes and removing regulatory burdens wherever possible. We will remain influential in the EU and internationally and continue to invest in our own skills and capabilities.**

## **Our mission and objectives**

The FRC's mission remains to promote high quality corporate governance and reporting to foster investment. We use our powers and influence to encourage companies to produce the information necessary for informed investment; and to encourage trustworthy behaviour by directors and professionals and engagement with them by investors. In addition, we seek to build justified confidence in the UK framework for corporate governance and reporting and to promote a principles-based approach in EU and international fora.

The FRC's strategy for 2013/16 was driven by the lessons of the global financial crisis, in particular the need to improve the management and reporting of risk, encourage companies and investors to take a long-term perspective, and to enhance the quality of audit. Significant changes have been introduced across all areas for which the FRC is responsible. Some have been driven by the FRC, and some by the Government and the EU, notably the Audit Regulation and Directive (ARD).

The FRC believes that, those actions having been taken, there is a need for a change of emphasis. Our priority now is to help companies embed the requirements that have already been introduced to ensure that the intended benefits are secured. In doing so we will bring together companies, investors and the professions to raise the quality of reporting and governance. This way of working has always been a feature of the FRC's approach and will become more prominent over the next three years. We will also identify and address unnecessary restrictions and burdens that constrain growth and innovation. At the same time, we will not shirk from taking enforcement action against organisations or individuals where it is necessary.

Our mission is aligned with economic growth. High quality governance and reporting support the efficient operation of the capital markets and help attract investment to the UK. In pursuit of that mission, our objectives are to promote:

- Corporate governance and corporate cultures that support the long-term success of companies.
- Effective investor stewardship and engagement between companies and investors.
- Clear and concise corporate reporting that meets user needs.
- High quality auditing that is valued by investors.
- Actuarial work that is underpinned by sound standards.

Annex A sets out our current view of the main actions we should take in 2016/19 in pursuit of our mission. We will consult on our Draft Plan and Budget for 2016/17 and our broad priorities and resources for 2017/18 and 2018/19.

## **Our regulatory approach**

In pursuing our mission and objectives in 2016/19 our overall approach will be to:

- Complete implementation of the ARD. We will need to ensure that our new responsibilities as the UK's competent authority for audit regulation are delivered effectively. Working with the major audit firms to drive further improvements in audit quality, our aim is that by the end of the strategy period at least ninety percent of FTSE 350 audits will require no more than limited improvements as assessed by our monitoring programme.
- Complete the update of the framework for actuarial standards – implementing a standard to cover a broader range of actuarial work and refocussing our specific Technical Actuarial Standards.
- After completing the changes already in hand, seek not to change the codes and standards for which we are responsible for at least the remainder of the strategy period, and longer if possible. In particular, we intend to avoid making further changes to the UK Corporate Governance Code in the next three years. We will, however, continue to monitor application of the codes and standards to assess their impact and to identify whether any change is needed.
- Minimise the compliance costs associated with our regulatory requirements and activities. We will assess the impact of our work in each area of our responsibilities. This will inform our priorities and help us reduce the overall cost of regulation.
- Place greater emphasis on best practice, education and other non-regulatory approaches to help secure continuous improvement in the quality of information and behaviour, including through our corporate reporting and audit quality review activities.
- Deepen and widen our non-regulatory approach by strengthening our engagement with our stakeholders, and in particular with investors. We will build on existing initiatives such as the Financial Reporting Lab and our current initiative on corporate culture.
- Collaborate with other regulators and standard-setters, including the accountancy and actuarial professional bodies, to identify common objectives and to reduce the risk of inconsistent requirements being imposed on those we regulate. We will review whether,

in the light of the significant regulatory change in insurance and pensions and the introduction of independent standards, independent oversight of the actuarial profession remains necessary and appropriate.

- Continue to hold individuals and organisations to account where this is necessary in the public interest, and do so in a timely and cost-effective way.
- Contribute to the quality of EU and international standard-setting and regulation, promoting the importance of regulatory principles and the 'comply or explain' approach rather than detailed prescription. This includes working constructively with fellow regulatory authorities in Europe and other jurisdictions to monitor effectively the quality of reporting and auditing in a manner consistent with this approach.
- Improve the clarity and consistency of communication of the outcomes we seek and whether they have been achieved. We will identify key indicators on which we will report in our annual report and accounts. We will publish every year reports setting out in more detail our overall assessment of the quality of corporate governance and stewardship, corporate reporting, and auditing. We will update as necessary the actuarial 'Risk Perspective'.

Across all our work we are guided by the principles of good regulation embodied in the Regulators' Code and our own core values. We seek at all times to make the most of the breadth of our role, to reach out to our stakeholders to secure their expertise, to be evidence based to ensure our decisions are soundly reached and respected, to be decisive to ensure problems are addressed in a timely manner; and to show respect to others, recognising the value in different perspectives. We will continue to recognise the essential role of the professional bodies in promoting high standards.

In pursuing this approach we will be alert to opportunities to enhance the effectiveness of the current regulatory framework. For example, one priority will be to find ways to secure the full benefits intended from the Stewardship Code. Another is to develop reporting frameworks which will enable companies to balance the competing demands from an increasingly broad range of stakeholders for greater transparency and clear and concise reporting. Fresh thinking will be required.

## **Our organisation and resources**

### **Organisation**

We recognise that the FRC itself needs to continue to evolve if we are to remain effective and efficient.

The 2013/16 strategy built on the reforms to our powers and structure instituted in 2012. We have since operated as a unified regulator, enabling us to deliver our objectives and priorities in a coherent and joined-up way and to develop a more cost-effective approach. We are now considering how to deliver our new responsibilities as the competent authority for audit regulation to best effect, including whether our governance and structure remains fit for purpose.

We recently commissioned an independent review of our corporate reporting and audit quality review activities. The review confirmed that we have been able to drive substantial improvements in the quality of reporting and auditing and were a benchmark for international regulators, but identified a number of areas where we could carry out these activities more effectively. We will consult where this results in any significant changes to our published Operating Procedures.

We will continue to consult annually on our priorities and budget, and to take every opportunity to deliver our responsibilities as efficiently and effectively as possible.

### **People**

The FRC has a wide, and increasing, range of responsibilities. It is important that we prioritise clearly and continue to focus on principles and outcomes. To do so effectively our people need the extensive and in-depth skills needed to identify the big, underlying issues and the confidence to tackle them. An effective approach to driving up standards by working constructively with market participants means continuing to invest in our Financial Reporting Lab, developing similar approaches in other areas and ensuring good, early communication with companies, investors and the professions on difficult issues. That requires high calibre people.

Over the period of our next three year strategy we will, therefore, continue to invest in the development of our people, including through leadership programmes, management capability and communication skills. We will continue to recruit, develop and value colleagues with the necessary strong technical skills. Further recruitment will be necessary as we take on additional responsibilities. We will also focus on diversity, both as an employer and in our



governance arrangements. The FRC will seek to understand and respect the perspective of colleagues – and stakeholders - from different backgrounds.

## **Funding**

We have expanded since the 2012 reforms as a result of the new responsibilities we have been required to undertake and the need to tackle complex regulatory issues. We need to expand further as we assume our new responsibilities in relation to audit, and for this we will need to be adequately resourced. It is also important that we have adequate reserves to give us the means to tackle emerging issues of concern to our stakeholders and to underpin our non-statutory funding.

Since 2009 the Government has progressively withdrawn its contribution to the FRC's funding and will from 2016 no longer provide any direct contribution. It is our intention to secure from the audit profession the necessary resources to fund our new role as the competent authority for audit regulation, building on the existing contribution from the accountancy professional bodies and the major audit firms, and securing additional contributions from those groups as necessary. We will consult on this and on our levies on other groups.

## **Annex A – Priorities for 2016/19**

### **Corporate governance and investor stewardship**

The FRC sets the UK Corporate Governance Code. The Code is based on the underlying principles of good governance including the exercise of judgement, accountability, transparency, probity and a focus on the sustainable success of an entity over the long-term. It includes a clear principle that boards should provide annual reports and accounts that present a fair, balanced and understandable assessment of the company's position and prospects; including by explaining where the provisions of the Code have not been complied with.

The FRC also sets the UK Stewardship Code. This Code sets out the principles of effective stewardship by institutional investors, which help build confidence in the system and give force to the 'comply or explain' approach as well as increasing accountability to clients and beneficiaries.

During 2016/19, our overall objectives will be to promote:

- Corporate governance and corporate cultures that support the long-term success of companies.
- Effective investor stewardship and engagement between companies and investors.

We will continue to publish an annual assessment of the quality of UK corporate governance and stewardship and will:

- Introduce the limited changes to the UK Corporate Governance Code linked to the implementation of the EU Audit Regulation and Directive (ARD) in 2016.
- Aim to avoid introducing any further additions to the UK Corporate Governance Code over the three year period, and longer if possible.
- Complete our project to review with market participants how boards can most effectively establish company culture and practices that embed good corporate behaviour; and initiate any future best practice projects based on the same approach.
- Focus on promoting effective investor engagement, including by monitoring reporting by Stewardship Code signatories and encouraging advisers and intermediaries to help to facilitate engagement.

- Implement those parts of the EU Shareholders Rights Directive for which the FRC is responsible in a way that minimises costs for companies and investors.

## **Corporate reporting**

An important theme of our work in this area has been to promote clear and concise reporting. This has included publishing guidance on the Strategic Report, reports on our reviews of corporate reports and accounts and the work of the Financial Reporting Lab. Our aim is to encourage all those involved in the financial reporting process to focus on communication and the clear presentation of information and materiality.

During 2016/19, our overall objectives will be to promote:

- Clear and concise reporting that meets users' needs.
- High quality and relevant standards coming from international standard-setters.

We will publish an annual assessment of the quality of UK corporate reporting, based primarily on our own reviews and evidence from stakeholders, and will:

- Direct our corporate reporting review work towards encouraging improvements in the quality of reports, and increase the transparency of that element of our work.
- Build on the work of the Financial Reporting Lab and extend the collaborative approach to other aspects of our work on reporting.
- Provide thought leadership on how reporting frameworks should respond to technology and the developing interests of investors and other stakeholders. Aspects under consideration include: the digital world; communication principles across corporate reporting; the role and scope of preliminary reports; and following up the FRC's project to improve the quality of reporting by smaller listed and AIM companies.
- Continue to influence EU and international developments: contributing to the work of the IASB/ IFRS Foundation; direct involvement in EFRAG; influencing developments in ESMA and IOSCO; and contributing to the development of integrated reporting.
- Undertake a post-implementation review of UK GAAP towards the end of the strategy period.

## Audit

The FRC is taking forward a series of reforms designed to improve justifiable confidence in audit. For this to succeed we need to see a number of different interests and incentives work together. The FRC has a role in encouraging boards and audit committees to take a close interest in audit; and in setting high quality auditing standards, which we monitor and enforce. It is essential that within audit firms there is a culture of commitment to delivering consistent and rigorous audit quality.

During 2016/19, our overall objectives will be to promote:

- High quality auditing that is valued by investors.
- High quality and relevant standards coming from international standard-setters.
- Successful implementation and embedding of the ARD.

We will issue an annual assessment of the quality of audit in the UK, and will:

- Implement the ARD in 2016, with a clear delineation of responsibility between the FRC and the professional bodies. In support of this we will consult later in 2015/16 on aspects of the new arrangements, including delegation to and oversight of the audit professional bodies, and sanction and enforcement procedures.
- Establish sound ethical reporting and technical standards for auditors based on clear overarching principles and meeting with the requirements of ARD. We are currently consulting on these standards.
- See through the impact of recent changes in extended audit committee and auditor reporting, which focus on making the audit transparent, and assess the consequences of retendering and rotation, in particular whether firms are competing on quality and innovation. In doing so we will engage more with audit committees and investors.
- Support the important role of audit firm and network firm culture in promoting audit quality, including by issuing a revised Audit Firm Governance Code in 2016/17.
- Ensure our Audit Quality Review (AQR) activities promote improvements in audit quality by putting more focus on identifying and promoting good practice. Our aim is that by the end of the strategy period at least ninety percent of FTSE 350 audits will require no more than limited improvements as assessed by our monitoring programme.

- Re-scope our AQR activities to increase monitoring of smaller audit firms (due to ARD) and to commence inspections of local authority and health body audits (in accordance with the Local Audit and Accountability Act), both in 2018/19.

We will also consider:

- The consequences for the post-ARD arrangements on our non-statutory oversight of the accountancy profession and the disciplinary scheme we run for its members; and
- How best to promote and support quality in assurance carried out in the public interest; in collaboration with other regulators and the professional bodies. This will be important as new banking and insurance regulatory frameworks are implemented.

## **Actuarial work**

Actuarial work is central to many financial decisions in insurance and pensions and is an important element in other areas requiring the evaluation of risk and financial returns. High-quality actuarial work promotes well-informed decision-making and mitigates risks to users and the public.

The FRC agreed with the Institute and Faculty of Actuaries (IFoA) to oversee the professional body and to set technical actuarial standards. The Joint Forum on Actuarial Regulation (JFAR) was established in 2013 by the FRC, the IFoA, the FCA, the PRA and The Pensions Regulator to coordinate the identification of, and response to, public interest risks to which actuarial work is relevant.

During 2016/19, our overall objective will be to promote actuarial work that is underpinned by sound standards.

We will:

- Complete by the end of 2016/17 our ongoing work on the new framework of Technical Actuarial Standards; seeking thereafter to maintain the framework in response to identified emerging risks and changes in the regulatory environment. In doing so we will:
  - Work with the IFoA and JFAR to continue and develop risk identification, monitoring and mitigation, taking the steps set out in our 'Risk Perspective';
  - Collaborate with the IFoA and other bodies to develop guidance to promote high quality actuarial work; and

- Continue to influence international standard-setting bodies and regulators.
- Taking account of these activities and other developments such as significant regulatory change in insurance and pensions and the introduction of independent standards since the agreement of the framework almost ten years ago, consult on whether independent oversight of the actuarial profession remains necessary and appropriate.



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