

## Response to FRC consultation on re-organisation: from Professor Stella Fearnley

I am disappointed that the FRC is proposing an internal reshuffle when something much more fundamental is needed. The failure of the FRC to take an effective lead in the UK's interests regarding both the accounting and auditing problems associated with the financial crisis, and market concentration in the audit market, indicates that it has not served its UK stakeholders well. The FRC has focused on narrative disclosure and audit committees rather than facing up to the fundamental underlying accounting and auditing problems. The FRC has been blinkered by endorsing the global ambitions of the IASB and the IAASB, which have combined to encourage a tick box, complicated, compliance driven system for accountants and auditors to follow. This has given compliance with the rules precedence over the true and fair view<sup>1</sup> and resulted in misleading audited financial statements being issued by banks.

The FRC has also failed effectively to serve the non-listed and not for profit sectors by focussing on 'think large first' and has created an auditing and accounting environment for SMEs and not for profit bodies which is onerous and costly. The FRC has persisted in trying to impose IFRS for SMEs on its constituents when it is clear from the number of attempts and consultations that have taken place that there is little appetite for it. It has also proposed doing away with accruals accounting for micro companies which would seriously confuse users.

I have been concerned for some considerable time that the FRC, with its responsibilities for accounting, auditing and corporate governance in the listed company sector, is detached from the UK Listing Authority, and this makes no sense. There are two government departments (BIS and the Treasury) involved which creates unnecessary bureaucracy. The FRC should be disbanded and its key activities relating to listed companies should be put under a separate securities commission with overall responsibility for market regulation, oversight of standard setting and enforcement of accounting and auditing activities. These naturally fit together. The AADB should be abolished as its remit is too limited. Qualified accountants and firms in the listed market should be treated like any other party suspected of committing an offence, and if they are found guilty, it should be up to the professional bodies to decide on their continuing membership. Licences to audit listed companies should be issued by the securities regulator and could be withdrawn in the event of failure. The Treasury should reconsider the location of the oversight and standard setting for the actuarial profession. This does not fit comfortably in a financial reporting and auditing environment. A single securities regulator with responsibility for accounting and auditing would speak with more authority on behalf of the UK than the present muddled arrangements.

The SME and not for profit sectors have been badly served by the FRC for a long time. In order to focus on the needs of these sectors, a separate independent commission should be set up specifically to serve the interests of these sectors in terms of accounting, auditing and other regulatory burdens. This commission could also oversee the work of accountants in the sector, but statutory powers would be needed as oversight by agreement with the accountancy professional bodies has been fraught with problems. The professions could retain the issuing of audit licences except for listed companies and advise the commission on the needs of the SME and not for profit sectors.

As the FSA is being re-organised after failing to discharge its responsibilities in the supervision of banks, the time is right to disband the FRC. It is a poor reflection on the FRC that the major accounting and auditing problems we face, as well as the problems of audit market concentration, were flushed out on a political level for the FRC, not by BIS, but by the House of Lords Economic Affairs Committee.

SMF 8 February 2012

<sup>1</sup> See *Reaching Key Financial Reporting Decisions: How directors and auditors interact*. Beattie, Fearnley and Hines 2011.