

13 August 2018

**Sir John Kingman**  
**FRC Review Secretariat**  
**Victoria 1, 1<sup>st</sup> Floor**  
**Victoria Street**  
**London**  
**SW1H 0ET**

Submitted via email to: [FRCReview@BEIS.gov.uk](mailto:FRCReview@BEIS.gov.uk)

**RE: Independent Review of the Financial Reporting Council: Call for Evidence**

Dear Sir John,

BlackRock<sup>1</sup> is pleased to have the opportunity to respond to the Independent Review of the Financial Reporting Council (FRC).

BlackRock supports a regulatory regime that increases transparency, protects investors, and facilitates responsible growth of capital markets while preserving consumer choice and assessing benefits versus implementation costs.

Overall, we do not believe there needs to be wholesale changes to the FRC's mission and operations, or to the regulatory framework that surrounds the oversight of accounting, audit, corporate governance, and stewardship in the UK. The FRC should look to fulfil its objective of ensuring a strong flow of investment into UK companies by focusing on the core function of overseeing accounting, audit, and corporate reporting with a view to improving investor confidence.

We welcome the opportunity to comment on the issues raised by this Review and will continue to contribute to the thinking of the Independent Review on any issues that may assist in the final outcome.

We welcome further discussion on any of the points that we have raised.

Yours faithfully,

**Amra Balic,**  
Managing Director,  
Head of Investment Stewardship,  
EMEA  
[amra.balic@blackrock.com](mailto:amra.balic@blackrock.com)

**Antony Manchester,**  
Managing Director,  
Public Policy EMEA  
[antony.manchester@blackrock.com](mailto:antony.manchester@blackrock.com)

---

<sup>1</sup> BlackRock is one of the world's leading asset management firms. We manage assets on behalf of institutional and individual clients worldwide, across equity, fixed income, liquidity, real estate, alternatives, and multi-asset strategies. Our client base includes pension plans, endowments, foundations, charities, official institutions, insurers and other financial institutions, as well as individuals around the world.

# BLACKROCK

---

## The FRC's mission and role

BlackRock supports robust and reliable company disclosure and accounting practices, as corporate reporting forms the foundations of investors' information pool. To this end, we believe there is a role for an oversight body to ensure high standards by companies and their auditors. We believe the FRC should remain the body to fulfil this role.

Regarding the FRC's mission and role, we would emphasise the FRC's stated objective of "[ensuring] a strong flow of investment to UK companies".<sup>2</sup> We agree this objective is the correct one for the FRC. As such, **the FRC's primary focus should be on ensuring robust, high-quality oversight of accounting, audit practices, and corporate reporting.** By doing this, the FRC will maintain investor confidence, contributing to its stated aim of ensuring investment into UK companies.

The FRC should therefore refocus on strengthening its efforts on this core objective. BlackRock is supportive of measures, such as additional resourcing and personnel, which would support the FRC in doing so.

In addition, we would like to emphasise that **it is not, and should not, be the role of the FRC to ensure a complete fail-safe prevention of companies from failing or going into administration.** Any expectation along these lines would be unrealistic. Companies operate in competitive markets and have to take risks due to normal business uncertainties in pursuit of profit, and are therefore at risk of failure. Further, in financing these companies, investors' capital is at risk. Whilst robust disclosure, accounting, and auditing practices may help company management and investors to evaluate and mitigate business risks, they will not, in isolation, eliminate the prospect of failure.

## Accounting and audit oversight

We agree that **the FRC could take a more proactive approach to its oversight of accounting and audit practices.**

In general, auditors effectively apply the relevant accounting rules for the companies they review. In many instances, there is legitimate room for interpretation as to which accounting rule or practice to adopt. Risks arise when company management adopt a series of individually legitimate accounting practices which, taken together, give rise to a misleading picture of a company's health. This is exacerbated if auditors condone this behaviour, to the point where it becomes embedded in management practices, in the auditor's view of a company's business model, and where the auditors lose sight of the need for accounts to give a true and fair representation of a company's financial position. In fact, we believe audits should proactively highlight such cases in their assessment of companies' reports.

For example (this is illustrative and by no means exhaustive), it may happen that companies and auditors disregard the spirit of standards such as International Accounting Standard (IAS) 1 (presentation of financial statements) and IAS 8 (accounting policies, changes in accounting estimates and errors):

- IAS 1 requires that "when items of income or expense are material, an entity shall disclose their nature and amount separately".<sup>3</sup> In practice, there are instances in which this is not applied. Important one-off income items may not be disclosed, or their nature not properly explained (for example disclosures on disposals of Property, Plant and Equipment may be made as required, but without clarification that the transaction is a sale and leaseback).

---

<sup>2</sup> The FRC Mission, FRC Website, available at: <https://www.frc.org.uk/frc-for-you/frc-mission>

<sup>3</sup> <https://www.iasplus.com/en/standards/ias/ias1>

- IAS 8 requires that errors are clearly disclosed or explained. However, in practice this is often not done in a clear manner.<sup>4</sup> Errors are frequently not clearly or explicitly signposted and acknowledged as errors by companies, nor are they flagged by auditors.

The FRC should carefully monitor those grey areas where accounting standards leave room for interpretation, using the Financial Reporting Review Panel and Audit Quality Reviews to hold auditors robustly to account in cases where they may have certified unusual policies which resulted in a partial view of a company's position. To an extent, this will be facilitated by increasing the FRC resources and personnel available to carry out this work.

The FRC's effectiveness could be reinforced by extending its powers to hold *all* company directors to account for accounting and corporate reporting practices. As the Call for Evidence notes, at present the FRC is only able to instigate direct action against those directors with accounting or actuarial qualifications. This creates scope for regulatory arbitrage whereby company directors may relinquish their membership of the relevant professional body to avoid disciplinary action. Equally, we believe it is the responsibility of all directors to ensure fair and accurate company reporting.

## Corporate governance and stewardship

Effective oversight of a company's governance structures and the stewardship activities of an investor in this company sit naturally alongside oversight of audit quality and corporate reporting. Governance structures and controls should be reflected in a company's public reporting, which in turn enables better analysis of the company by investors, which should contribute to better stewardship. Given that audit quality and corporate reporting are central to good governance, we would re-emphasise that strengthening the FRC's oversight on audit and reporting – which we consider to be its core functions – should be the sole focus of the Review. The FRC's oversight of corporate governance and stewardship is secondary to its mission. In our view, higher quality corporate reporting through strengthened oversight will lead to higher quality corporate governance and better informed stewardship.

BlackRock sees the FRC's UK Corporate Governance Code (the Code) as an effective set of principles, especially in light of the most recent revisions which go some way towards refocusing on the board's key responsibilities. Its trademark 'comply-or-explain' approach gives the Code the practicality needed to be effective. The latest version of the Code reinforces this by laying out very clearly that it is both the board's responsibility to use this flexibility wisely, and the investor's to assess thoughtfully differing company approaches towards compliance with the Code. As stated in our response to the FRC's 2018 consultation on revisions to the Code, we believe the Code should be a tool enabling investors to hold boards to account for the quality of their oversight, rather than a compliance checklist detailing standardised processes and parameters.<sup>5</sup>

Having said that, we strongly recommend the FRC conduct less frequent reviews of the Code itself. Instead, it should focus on reviewing a company's corporate governance reporting versus its actions and behaviour including assessing explanations provided for alternative approaches, and even perhaps alerting investors to when these explanations are not considered to be robust.

We do not believe there needs to be any material changes in the FRC's approach towards oversight of stewardship. While the FRC can and should review signatories' statements on compliance with the Stewardship Code to ensure a robust process around these activities, in our view, it is ultimately the end user of stewardship (i.e. the asset owner) that needs to be comfortable that its agent is executing its duties in line with the expectations set in the contract

---

<sup>4</sup> <https://www.iasplus.com/en/standards/ias/ias8>

<sup>5</sup> BlackRock (2018) Response to FRC Consultation on Proposed Revisions to the UK Corporate Governance Code, available at: <https://www.blackrock.com/corporate/literature/publication/frc-proposed-revisions-to-the-uk-corporate-governance-code-030218.pdf>

# BLACKROCK

---

between the asset manager and asset owner. The FRC can contribute to strengthening stewardship activities through ensuring higher quality corporate reporting for investors.

Bearing these points in mind, we strongly believe that oversight of governance and stewardship should remain with the FRC. Transferring this to another oversight body would not only separate functions which sit naturally together (audit, corporate reporting, corporate governance, and stewardship), but could also risk corporate governance and stewardship becoming a compliance exercise, rather than a nuanced assessment. We believe the solution is not to separate oversight of corporate reporting and practices but, rather, to improve the FRC's oversight by clarifying its role and responsibilities, and by augmenting its resourcing.

## Conclusion

Overall, we do not believe there needs to be wholesale changes to the FRC's mission and operations, or to the regulatory framework that surrounds the oversight of accounting, audit, corporate governance, and stewardship in the UK.

The FRC should look to fulfil its objective of ensuring a strong flow of investment into UK companies by focusing on the core function of overseeing accounting, audit, and corporate reporting with a view to improving investor confidence. This means robustly holding auditors and companies' boards and management to account for the decisions they take regarding disclosures. We would be supportive of measures that would aid the FRC in doing this, such as improving resources and staffing, and extending sanctioning powers in making all company directors responsible for corporate reporting.

Oversight of corporate governance and stewardship activities sit naturally alongside oversight of accounting, audit, and disclosure practices. Any issues in these areas are best addressed by increasing the quality and reliability of company disclosures. We commend the good work done by the FRC to date on the UK Corporate Governance Code, and would not recommend fundamental changes to its approach, nor a transfer of oversight responsibility to another body. The 'comply-or-explain' approach currently taken by the Code is appropriate and effective, and the FRC has a role in ensuring that companies' approach to the Code is satisfactory. We would however recommend that the FRC review the Code less frequently, focusing more on companies' corporate governance reporting. Similarly, The FRC's approach to oversight of stewardship should not fundamentally change; it is ultimately for end-users of stewardship to determine whether stewardship activities of their agent are being undertaken to their satisfaction.