



Rt Hon. Nicky Morgan MP
Chair, Treasury Select Committee
House of Commons
London
SW1A 0AA
Email: treascom@parliament.uk

13th October 2017

Dear Ms. Morgan,

Re: The FRC should be restructured to ensure independent and robust audit oversight

On the 19th of September, the Financial Reporting Council announced that it had closed its investigation into the conduct of KPMG's audit of HBOS for the year ending 31st December 2007. It concluded that *"there is not a realistic prospect that a Tribunal would make an Adverse Finding against KPMG The firm's work did not fall significantly short of the standards reasonably to be expected of the audit, ..."* .

We are writing to you now in anticipation of the FRC's final report into KPMG's audit of HBOS at the end of October to express our concerns, not just over this judgment, but also over the apparent failure of the FRC to protect the integrity of the UK's accounting and audit system. We would like to share our thoughts on a way forward, which we have published in the attached position paper.

The matter of conflicts of interest at the FRC is not new. It has been flagged in evidence to the House of Lords' Economic Affairs Committee's review of the audit market in 2011; the UK Competition Committee (now the Competition and Markets Authority) in 2012-14; and the need to strengthen the regulators independence and ability to sanction auditors was an area of reform under the European Commission's Audit Reform proposals passed in 2014. Investors have pointed to their concerns on this matter in a range of submissions. The challenge is how to ensure the conflicts are properly managed.

Notwithstanding steps over the years to strengthen the FRC, it remains excessively dependent on the audit profession for both staff as well as funding. Piecemeal changes to its legal basis over the years have left its powers and responsibilities confused, which has been exacerbated by opacity and weak governance structures. Taken together, it is our view that the FRC in its current form cannot be relied upon to provide essential scrutiny of the audit profession, and does not act as an effective deterrent to substandard audits and also corporate reporting.

The HBOS decision in our mind is the latest example of why this matters. An effective oversight and sanctions regime is vital to ensure accounting and audit rules are followed.

Where this is lacking, then trust begins to dissipate. This has damaging consequences for companies wishing to raise capital in public markets, and investors who must take higher levels of risk.

It can also lead to system-wide risk, with harmful implications for financial stability. The Parliamentary Commission on Banking Standards pointed explicitly to problems with accounting standards and audit in their final report, and called for these to be addressed. We believe that reform of the FRC is a vital part of addressing these broader problems.

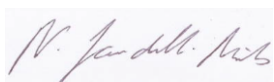
The failures we see with our accounting and audit regulatory regime are solvable, and in our attached paper we put forward some key elements of a successful reform package, including:

- the establishment of an independent public body (and ideally two bodies – one responsible for standard setting and the other responsible for enforcement);
- a clearer and more complete statutory basis ensuring full accountability to Parliament;
- robust governance structures to minimise conflicts of interest, including limits on the participation of audit firm professionals; and
- strengthened and independent funding and full public transparency.

As further scrutiny is applied to the FRC's handling of specific audit failures, new revelations of conflicts of interest are likely. The issue is not superficial, nor is it inconsequential. If we are to ensure a reliable and trusted accounting and audit system in the UK, we must ensure those charged with its oversight are demonstrably independent.

We very much hope that this letter and position paper are helpful as you consider the FRC's final report into KPMG's audit of HBOS, and the broader question of accounting and audit oversight.

Yours sincerely,



Natasha Landell-Mills, Head of Stewardship
Sarasin & Partners LLP



Kieran Quinn, Chair
Local Authority Pension Fund Forum

13 October 2017

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A handwritten signature in black ink, appearing to read 'M G White'.

M.G. White, Director
UK Shareholders' Association

A handwritten signature in blue ink, appearing to read 'R Talbut'.

Robert Talbut
Independent Director & pension fund trustee

cc

Chris Carr, Deputy Director Corporate Frameworks & Accountability, Department for Business,
Energy and Industrial Strategy