

FTSE100 Chairs' conversation with investors

Audit Committee Institute

Ten points of view from our FTSE100 Chairs' conversation with investors – 7 March 2017

We were delighted that our FTSE100 Chairs' group were joined by Jessica Ground (Global Head of Stewardship at Schroders) and David Pitt-Watson (Executive Fellow at London Business School and member of KPMG's Public Interest Committee) to discuss investor community – audit committee relationships, and how audit committee oversight is evolving against the regulatory landscape. Here we highlight ten perspectives that emerged from the discussion.

1. Investor engagement

A recurring observation is that despite recent regulatory reforms being designed to provide 'hooks' for greater engagement, dialogue between audit committee chairmen and the investor community is relatively uncommon. There may be a number of reasons for this – not least that many time-pressed individuals will, unless there is a known problem, *"take it as read that the numbers are audited"*. It is also the case that some institutional investors prefer one meeting with the CEO and board chair rather than multiple meetings with board committee chairs.

Furthermore, whilst analysts do allocate time and attention to accounting and financial reporting, most are not trained accountants and neither are the governance/stewardship professionals. *"Companies should endeavour to ensure that their annual reports can be understood by people who are not trained accountants"*. The audit committee's role in ensuring that the annual report is fair, balanced and understandable is relevant here.

2. Remuneration committee interaction is more of an investor priority

One audit committee member recalled how – when taking on a remuneration chair role – institutional investors were *"much keener to talk"*. There is a widespread view from both audit committee chairs and elements of the investor community that the focus on remuneration issues continues to impact the ability of some institutional investors to divert limited resources to a dialogue about audit and accounting issues. Remuneration remains topical, but does the balance need redressing?

3. Enhanced audit reports

The reporting of graduated findings – how cautious or optimistic estimates are – within the audit report is highly regarded by many in the regulatory and investment communities. *"Recognising that there are judgements behind the numbers has to be a positive thing."* However, despite the reporting of graduated findings being hailed

as bold, progressive and having the potential to *"enhance the degree of trust"*, it is somewhat surprising that such reports are not more common. There is no requirement to go beyond the Financial Reporting Council (FRC) standards, but audit committees might want to actively consider – and talk to shareholders – about what sort of audit report they want. ([ACI document on the audit report journey](#))

4. One size does not fit all

A reluctance by some to pursue audit reports with graduated findings may simply reflect that not everyone wants or needs to be in the vanguard of change. The first full year of reporting on viability and the lack of variation in time horizons provides another example where *"some preparers might have sought safety in numbers"*. With two-thirds of companies choosing three years (and the remainder mainly electing five years), the lack of variation between (say) mining and retail might be considered surprising given their very different business cycles.

5. Different individuals may also have different areas of focus

One audit committee chair cited how the significant audit risks identified in the audit report might not exactly match the significant financial reporting concerns addressed in the audit committee's own report. Others reflected how there can be a *"disconnect between the CFO view and the audit committee chair"*. Some held the view that investors are not always asking the right questions around this.

6. Audit plays a very important role – other regulatory interests should not overshadow this

The FRC's willingness to address issues such as corporate culture was generally considered to be a positive development. However, there was some concern that a broader regulatory ambit might lead to *"an unnecessary and unhelpful compliance culture"*. Some attendees questioned whether the FRC should be expanding their remit in this way rather than maintaining their focus on audits, audit quality and the audit firms. *"The essence of*

the audit is that the company is being run for its shareholders – we need to make sure we don't lose the heart of what we do."

7. Investors are especially interested in alternative performance measures (APMs)

This is seen as an area of concern among investors, with banks and pharmaceuticals being specifically highlighted as having the tendency for *"giving earnings without any of the bad stuff"*. The FRC's focus on raising standards around the use of APMs ([Thematic review of APMs](#)) has generally been well received and there are already indications that progress has been made in the current reporting cycle. A broad theme that emerged was that APMs need to be used carefully as they have the potential to *"give the wrong headlines"* and, where there is little consistency in the choice of APM from year to year, they can *"lose credibility"*. Sometimes APMs seem to be *"the numbers we wish we had produced"*.

8. Audit firms and the question of independent external representation at board level

It was noted that some investors are concerned about audit firms, their governance and operations, given that despite mandatory rotation, the reality for many large multinational companies is that the choice of audit firm is still fairly limited. With a perceived disparity in the quality of independent non-executives within the audit firms, the question arose as to whether *"we can look forward to audit firm boards with more independent non-executive and employee representation"*. *"Would a board with a majority of independent external members be more focused on the importance of audit to society and the economy at large?"*

9. Audit quality is paramount

Audit committee members present were united in citing *"quality over cost"* in respect of their choice of auditor, and quality remains high on the regulator agenda. Audit quality needs to remain at the forefront of regulator focus, and it is incumbent on audit firms to ensure that any progression made in areas such as outsourcing to shared services centres is not also to the detriment of service or audit quality. It was confirmed that KPMG audit partners would see their compensation packages impacted by poor Audit Quality Review Team (AQRT) reviews.

10. BEIS Green Paper: Corporate Governance Reform

There was some scepticism as to whether the measures proposed in the recent BEIS Green Paper *Corporate Governance Reform* would meet the Government's underlying objective of creating an environment that gives the UK an international competitive advantage, make the UK an attractive place in which to invest and help ensure we have an economy that works for everyone. *"Will these measures really ensure good corporate conduct where the views and needs of employees, suppliers and pension beneficiaries are given appropriate consideration?"*

It was accepted that individual behaviours – and the relationship between companies and stakeholders – provide the company with its *"licence to operate"*. At the heart of this is the question of directors' responsibilities which, as

set out in section 172 of the Companies Act 2006, are to act in a way most likely to promote the success of the company for the benefit of the members while having regard to a wide range of other matters (including the interests of employees, the impact of the company's operations on the community and the environment, etc.). Attendees noted that it is this latter point that gives rise to certain challenges, for example the extent to which directors have such regard (which at one end of the spectrum might verge on accountability and at the other might merely be to be cognisant of such matters). One suggestion was that consideration could be given to *"some form of ombudsman or similar body who would look at instances where poor standards of business life was brought to their attention"*.

Hosts	
Timothy Copnell	Audit Committee Institute
Michelle Hinchliffe	KPMG
Paul Korolkiewicz	KPMG
David Littleford	KPMG
Tracey Stead	Audit Committee Institute
Adrian Stone (Chair)	KPMG
Karen Wightman	KPMG

Forthcoming ACI events:

Conversation with a regulator: Tuesday 16 May 2017 –

7:45am, breakfast served at 8:00am, closing by 9:30am. *Sir Win Bischoff, chairman of the Financial Reporting Council, joins us as the FRC's remit is in the spotlight via Theresa May's 'fairness in the boardroom' agenda and the upcoming review of the UK Corporate Governance Code.*

Conversation about terrorism as a business risk:

Thursday 29 June 2017 – 7:45am, breakfast served at 8:00am, closing by 9:30am.

Sir Bernard Hogan-Howe, former Commissioner of the Metropolitan Police Service, joins us to look at an issue gaining increased prominence on the agenda of many boards – the intensifying terrorism threat to business.

All events are taking place at Number Twenty, Grosvenor Street, W1K 4QJ. To view our full calendar of complimentary discussions and seminars, please browse our [2017 events programme](#).



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