

July 2013

Annual Report and Accounts 2012/13

ANNUAL REPORT AND ACCOUNTS OF THE FINANCIAL REPORTING COUNCIL

INCLUDING THE REPORT OF THE INDEPENDENT SUPERVISOR YEAR TO 31 MARCH 2013

The Report of the FRC as the body designated by a delegation order under section 1252 of the Companies Act 2006 and the Report of the Independent Supervisor is presented to Parliament pursuant to sections 1231(3) and 1252(10) of, and paragraph 10(3) of Schedule 13 to, the Companies Act 2006.

The Report of the Independent Supervisor is also presented, pursuant to section 1231(2), to:

- The First Minister in Scotland;
- The First Minister and Deputy First Minister in Northern Ireland; and,
- The First Minister for Wales and is laid before the National Assembly for Wales pursuant to section 1231(3A) of the Companies Act 2006.

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Financial Reporting Council

Annual Report and Accounts 2012/13

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Our Role

The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment.

We promote high standards of corporate governance by setting the UK Corporate Governance and Stewardship Codes and monitoring their impact.

We contribute to high-quality corporate reporting by setting UK standards for accounting, auditing and actuarial work, and by influencing international standards.

We monitor the quality of accounts published by public companies and, where necessary, secure revisions in line with standards.

We monitor and report publicly on the quality of the audit of listed and other major public interest entities and the policies and procedures supporting audit quality at the major audit firms in the UK.

We oversee the regulatory activities of the accountancy and actuarial professional bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

Our Structure

The **FRC Board** has overall responsibility for the strategic direction of the organisation, approving the plan and budget, and approving changes to codes and standards. It is supported by its Nominations, Remuneration and Audit Committees and by:

The **Executive Committee**, responsible for recommending the strategic direction of the FRC to the FRC Board, providing the day-to-day oversight of the work of the FRC, implementing the FRC's annual business plan and advising the Board on the FRC's budget.

The **Codes & Standards Committee**, primarily responsible for advising the FRC Board on maintaining an effective framework of UK codes and standards for corporate governance, stewardship, accounting, auditing and assurance, and actuarial technical standards.

The **Conduct Committee**, responsible for exercising the statutory powers delegated to the Committee in relation to the review of corporate reports, and primarily responsible for corporate reporting reviews, audit quality reviews, monitoring Recognised Supervisory and Qualifying Bodies, professional discipline, and oversight of the regulatory responsibilities of the accountancy and actuarial professional bodies.

Section One

Chairman's Report



This is the first annual report of the Financial Reporting Council since the reforms that brought our eight regulatory bodies into one were approved by Government and Parliament. It is the first in which we are reporting formally to Parliament as the FRC, as well as to all our stakeholders. It is also my last as Chairman, as I will be standing down by the end of the year, when the Department of Business, Innovation and Skills has identified a successor.

Together, these events prompt my grateful thanks to an FRC Board and staff, who have stepped up to the challenge of change, and in particular my admiration for the leadership role played by our Chief Executive, Stephen Haddrill. It has been a huge pleasure to work with him.

These events also prompt reflections on the journey we have been on since I joined the FRC nine years ago. The Council I joined was large, disparate and – despite the able Chairmanship of Sir Bryan Nicholson – reminded me forcibly of those paintings of eighteenth-century battlefields, in which small

skirmishes are taking place right across the terrain with scant understanding of what was going on elsewhere.

In its former structure, the FRC's constituent bodies discharged their responsibilities for, or rather to, the group of professions under its umbrella. Much has changed since. The challenge for the new FRC today is to leave behind the last traces of localised warfare, to demonstrate independence and to exploit the connections between its various responsibilities and activities, and to make the whole greater than the sum of its parts – all in pursuit of its ultimate purpose.

This we have defined, in our "mission statement", as to promote high quality corporate governance and reporting in order to foster investment. That final word is a key expression of economic purpose. The FRC is not here simply to keep accountants, auditors, actuaries and corporate boards in order, or to protect the reputations of the professions within its aegis. At the heart of its mission it is here to help capital markets, and in particular the market for risk capital, function well. And it is here to do this because of the importance of these markets to the health and growth of the economy.

It is fashionable to dismiss the economic role of equity markets as trivial or even perverse. Fashionable, and understandable; but dangerous, and foolish. Of course it is true that equity markets have played a relatively small role in relation to bank recapitalisation, the great policy anxiety of the day. Of course it is also true that equity investors were, in the lead-up to the financial crisis, part of the problem – contributing their short-term focus to the general enthusiasm for gearing. But they were also part of the solution, absorbing rights issues by many companies that helped prevent the contamination of failure spreading from the financial sector to the rest of the corporate sector. Events continue to demonstrate that we need risk capital. And if conventional equity is dismissed as irrelevant, the market will devise ways to make bond-holding risk-bearing instead.

It is natural that governments should pay more attention to debt markets than equity markets, given the scale of their own debt problems. But the

imbalance is regrettable. It is not the FRC's job to act as the voice of equity. Reminding policy-makers of the role of risk capital is, however, one that often seems to fall to us for lack of another voice.

When working well, equity markets are a hugely efficient capital conduit. They enable growing companies to attract risk-bearing finance for investment, and savers to share in the value creation of growing companies. They have played an enormous part in the economic history of the United Kingdom, and have the potential to continue to do so.

Our primary task at the FRC is to help them to do so by trying to ensure that investors in the capital markets have what they need to place their money: effective boards who communicate well; useful annual reports and accounts; robust and easily comparable accounting standards; effective audit and actuarial standards. Not, that is, to place their money without risk, but to place it with reasonable confidence that risk will be taken knowingly and managed as well as it can be.

There is another, essential strand to our thinking, which is that in doing all this we are not seeking to substitute our judgement for shareholders'. In writing the Corporate Governance Code, our aim is to facilitate, not to dictate. After the financial crisis, there was a natural demand for greater regulation, but that carried with it a risk that shareholders' rights would be transferred to regulators, further eroding the attractiveness of providing equity. At the same time, the risk increased that regulation would drive those looking for equity capital out of listed markets, depriving part of the investor base of access to growth opportunities for their savings.

At the FRC we have tried, where we can, to assemble and disseminate best practice rather than reach every time for the rulebook. And we have tried to connect up our other, more formal responsibilities for rule-setting and conduct with the expressed needs of investors: to make, for example our reviews of audit quality of greater use to the chairmen of audit committees and through them to the managers and owners of investments. We continue to insist on consulting fully on changes to the Corporate Governance Code,

resisting additions to it that, however worthy, are not central to its purpose.

Most recently, of course, and at the request of the institutional investors, we have also taken on responsibility for helping to codify and monitor best practice on their part, in the way they engage with the companies in which they invest. It is early days for the Stewardship Code, and the challenges are at least as great as they were in the early days of the Corporate Governance Code which reached its 20th anniversary during the year. But its importance to our central objective is clear.

In his report, Stephen Hadrill details the elements of this landscape on which our energies have been most focused this year as we implement the changes to our powers and structure and begin to see their benefits in terms of the FRC's effectiveness. As this is my last report, however, I have seized the opportunity to take a longer view. There is much unfinished business.

I believe great progress has been made in understanding and promoting high standards of corporate governance over the past nine years. I also believe an understanding of its importance has become greater amongst investors. But the Stewardship Code, as I have noted above, is still a rather fragile success. The pace of signature was encouraging; the extent to which signatories have fulfilled their commitments is patchy.

The long view from the perspective of my nine years' involvement with the FRC gives some comfort that there has been change: the level of engagement between investors and company Chairmen, as opposed to the executive team, has demonstrably increased, at least in the FTSE 100. But the quality of dialogue varies, and investment managers – whose own training has historically placed little weight on corporate governance as an indicator of corporate performance – are only beginning to learn how to make most effective use of those conversations.

Other issues have come to the fore. Nine years ago, despite the reduction in the number of major firms to four, there was little focus on the role of audit, and regulation was concentrated on dealing with

elements of poor performance marring a national picture agreed to be comparatively good. Since the financial crisis, sharper questions are being asked about quality rather than process, and the value of audit to investors. The FRC is continuing to look at these questions, and the most thoughtful leaders of the profession have come to recognise the need to raise their game.

Meanwhile, the limits to effective competition in the audit market remain a matter of concern. The stimulus to audit retendering we have provided in the 2012 version of the Corporate Governance Code has encouraged competition but also highlighted the weaknesses of a market with only four global players. As the Competition Commission has again demonstrated, this is not a problem that can be solved nationally. We have continued to remind government of the need for international contingency planning against the failure of a major firm.

During this nine-year period, following the review by Sir Derek Morris, we were also given some, and only some, responsibilities with respect to the actuarial profession and the quality of actuarial work. We caution government that the patchwork of current arrangements requires more effective joining-up between regulators than has so far been achieved.

This caution, of course, applies to the overarching shape of financial regulation, with its new institutional arrangements. We have taken steps to secure better co-ordination between the FRC and the Bank of England, the new Prudential Regulatory Authority and the Financial Conduct Authority (FCA). Closer co-operation between the FRC and the FCA is still needed if the market is to maintain confidence in the UK regime for corporate governance in the listed sector.

Another area of unfinished business concerns companies' annual reports and accounts. Some investors and companies see them as a product swollen by regulation and (except for the remuneration report) rarely read by anyone. We need to drain more of the bathwater, not to throw out the baby. Annual reports and accounts play a central role in setting out the account of stewardship by the company's

directors. In its Financial Reporting Lab, the FRC is innovating to make reporting more relevant and succinct. During 2013/14 we will report on work with corporates, on a case study basis, involving more radical surgery.

One of my greatest hopes for the next few years is that we will see progress, sustaining the annual report to its proper place as a disciplined distillation and communication of the information and issues of importance to investors. And meanwhile we have tried to take our own medicine: to make, in the words of the Corporate Governance Code, this report and accounts as a whole "fair, balanced and understandable", identifying areas of weakness as well as highlights of progress. We would welcome your views on where, in this intention, we have succeeded – and where we have failed.

Over the past year, we have seen much change around the Board table. Gay Huey Evans joined the Board on April 2012. In July 2012, John Kellas, Rudy Markham and Timothy Walker left the Board and we welcomed Mark Armour, Olivia Dickson, Paul George and Melanie McLaren to the new Board of the restructured FRC. My thanks go to all its members, and to the FRC's small and highly expert staff. But thanks go also to those stakeholders so generous of their time and expertise in helping to keep us on the right road. You help, I believe, to make us a different kind of regulator – independent of those we regulate, but still accountable to the market. Sincerely, if still a bit prematurely, I offer my best wishes to my successor and to the FRC for the future.

Baroness Hogg

Chairman

16 July 2013

Chief Executive's Report



As the Chairman makes clear in her report the reforms to our powers and structure are not an end in themselves: they enable us to be more effective in tackling big issues and lighter on our feet as a regulatory authority.

In our Plan for 2012/13 published in May 2012 we set four goals for our work:

- Monitor the general health of corporate governance and reporting in the UK and make sure that our codes and standards remain fit for purpose in all areas and that planned changes are introduced at the right time.
- Make sure that the UK's approach to corporate governance and reporting is properly understood and appreciated in the EU and internationally.
- Focus on the effectiveness of our monitoring, oversight and disciplinary work, to ensure it is responsive to emerging risks, joined up, transparent and proportionate. We undertook, in particular, to review further the scope of our work and to enhance the speed and effectiveness of our disciplinary work.
- Ensure that FRC reform was introduced effectively.

We have made good progress in promoting these outcomes and responding to emerging issues during a busy and challenging year as we begin to secure the benefits of reform. I have highlighted some of the actions we have taken below. Section Two of this document sets out our assessment of the current state of the nation in the areas we are responsible for and identifies issues for the future.

Corporate Governance

The changes to the Corporate Governance Code made in October 2012 introduced new requirements which have the capacity to contribute to a significant change in the quality of corporate reporting. In particular, we hope that the requirement that the board attest to the annual report and accounts as a whole being fair, balanced and understandable will strengthen the veracity and relevance of every part of the document, and, in undertaking this assessment, that boards will send a signal that they are committed to a culture of openness and truthfulness.

At the same time, we sought to enhance understanding of the risks to the business and the work of both audit committees and auditors. By requiring the board to give a comprehensive report of the audit committee's work, and the auditors to assure by exception that they have no reason to add to the report, the Code now provides a stimulus to greater understanding of audit committee work amongst investors and a new lever for auditors to exercise their authority. We also hope that the audit committee reports will provide a clear agenda for engagement between investors and audit committee chairs, which is at present relatively limited.

The introduction of audit retendering every ten years on a comply or explain basis was also a significant step forward. Our goal is to ensure that companies have the best auditor they can get. Without periodic testing, they cannot know that they have achieved this. We have rejected mandatory audit rotation for the same reason: the incumbent auditor may indeed be the best option.

Each of these changes represents a fundamental step forward. However, we are very aware that the intention of the reforms will be frustrated if

companies respond to the reporting changes with entirely boilerplate formulas. In addition, compliance with Code requirements is not the same as having a culture of good governance flowing through the business. Similarly, retendering, if not pursued with the right commitment, could damage audit quality: for example, if audit committees take the opportunity to drive down fees, not drive up quality. We are monitoring these risks and will promote best practice.

International Influence

Initial criticisms of the UK in Brussels for operating a Code on a comply or explain basis have been countered. We have established both that the Code rests on a sound legal framework and have demonstrated through the recent changes how much progress can be made through a comply or explain approach. The early signs that companies in the UK are embracing audit retendering gave confidence to the European Parliament in challenging proposals for mandatory rotation every six years.

We have also worked hard to influence other EU regulatory bodies, including the European Supervising Authorities for Securities and Insurance (ESMA and EIOPA) and the accounting adviser to the European Commission (EFRAG). Wherever possible, we have forged close partnerships with our counterparts in France, Germany, Italy and elsewhere. The UK is often described as anti-European. This is not true of the FRC and partnerships this year have enabled us to make more powerful interventions in EU debates. In particular, we have sought to explain the serious shortcomings of proposals to introduce mandatory auditor rotations, especially on a short cycle and to expand the role of ESMA on audit. We have also helped to produce more workable rules on the use of auditors to provide non-audit services.

Recognising the FRC's international contribution, it was given a seat on the International Accounting Standards Board's new advisory group comprised of leading standard-setters. Of course, international influence is not a new focus of the FRC. I am delighted to pay tribute, in particular, to the work that Paul George, the Executive Director of Conduct, has done in leading the development of the International Federation of Independent Audit Regulators (IFIAR),

both as Deputy Chair and, for two years until April of this year, as Chairman. In that time IFIAR has evolved into a real force for enhancing audit quality.

Exerting international influence is dependent on the FRC having sound evidence and analysis, strong proposals and the resources to reach out to people. As an organisation of just over 100 people with a wide remit we have worked hard to meet this challenge. We have found resource to open an office in Brussels and will continue to prioritise our EU and international role.

Conduct, Monitoring and Enforcement

Our Governance report (page 29) describes how the new governance structure for our conduct activities operates.

Based on the new structure, we have taken a number of steps to enhance the effectiveness of our conduct activities. We have benefited from the ability, since reform, more easily to share the findings of our review of corporate reports with those monitoring audit quality. This gives us a more holistic picture of risk and the quality of reporting. We are now looking to enhance further our efficiency, through greater coordination, ensuring that the evidence from our conduct activities informs our work on codes and standards. We are also considering methods of enhancing, both within our Conduct work and with Codes and Standards, the effectiveness of our corporate reporting review activities and we are moving to a more assertive approach with companies when necessary to achieve faster conclusions.

During the year we also made a number of changes to enhance the effectiveness of our audit inspections. During the next inspection round, for 2013/14, we will give greater emphasis to the largest public interest entities, thereby ensuring that our inspections are seen as more proportionate to the potential impact of issues arising in respect of these entities. We are enhancing our engagement with audit committees. In addition, we are achieving greater independence from the professional bodies in our inspection activity. Following our structural reform changes, and the necessary legislative changes, we have established an Auditor Regulatory Sanctions regime

and have issued for consultation draft Auditor Regulatory Sanctions Procedure: Sanctions Guidance.

We have faced criticism for not bringing disciplinary cases to tribunal quickly and at reasonable cost. We recognize this and we consulted on, and have now implemented, changes to our Accountancy Disciplinary Scheme to provide a more streamlined disciplinary process. We also consulted on Sanctions Guidance to Tribunals to assist disciplinary and appeal tribunals in determining appropriate sanctions and included proposals for calculating fines. Both consultations related to the Accountancy Scheme, but with the intention that equivalent changes would be made to, and Sanctions Guidance would be issued under, the Actuarial Scheme. Changes to the scheme are, of course, only part of the answer. It is also necessary that the FRC is better focussed in the collection of evidence, reaches a view on whether to go to tribunal in good time and exercises good cost control. Following the appointment of Gareth Rees QC, our Executive Counsel, and the implementation of a new advisory structure to support him, we have brought forward decisions to prosecute or drop cases with a greater level of efficiency and effectiveness.

Following FRC reform, we are now also undertaking supervisory inquiries to increase our effectiveness by responding more quickly to new concerns. A supervisory inquiry is a quick cross-cutting exercise which will typically involve specialists from different parts of our Conduct Division. We have conducted a number of such inquiries since FRC reform and have appointed a new Head of Supervisory Inquiries to lead the work. The inquiry is considered by the Conduct Committee, who may recommend that the issue should be subject to a full Professional Discipline investigation, be dropped or be subject to other remedies within the FRC's powers. This approach reduces the risk of embarking on a full and expensive investigation unnecessarily. Lessons for our codes and standards activities are also captured on a timely basis.

Our regulatory approach

In the light of the reforms to our powers and structure, we have been able to further develop our regulatory

approach, which is based on following principles:

- Ensuring our decisions are based on sound evidence and analysis and that we are transparent in the way we operate.
- Promoting effective consultation with stakeholders, especially investors.
- Ensuring our work is proportionate and justified in the requirements it places on market participants.

Much of our work shows evidence of our commitment to these principles, but I should like to highlight three projects in particular.

We were delighted this year to introduce a new UK financial reporting standard to replace UK GAAP. The key standard is much more accessible, replacing 3,000 pages with just over 300. By being based (but not slavishly) on IFRS for SMEs, it also reduces costs in corporate reporting by harmonising the reporting of subsidiaries and groups and enables growing companies to move more easily to listed status. The standard reflects extensive consultation and we are all grateful for the considerable commitment of time and expertise from our Accounting Council and many stakeholder groups.

Regulators are sometimes accused of treating consultations as a formality. During the course of this year we have consulted on the implementation of Lord Sharman's report on going concern. The responses confirmed Lord Sharman's fundamental proposals, but raised questions about how we proposed to implement the change. We have taken notice of these concerns and have deferred implementation while we address them.

Consultation is necessary, but we must beware of listening to the loudest voices when they may not be right. The voices of investors are of the greatest importance to us but can be divided and less powerfully transmitted than professional interests. We also recognise the importance of strong links with company boards and audit committees and others in the business community. We have committed in our

plan for this year to review our outreach mechanisms and ensure our consultations, which we recognise appear with perhaps too great a frequency, are more accessible to, and generate valuable responses from, our principal stakeholders.

Our People

We have maintained our investment in the development of our people. Following reform, we recruited new members of the FRC's senior team to provide the FRC Board and its Committees with high quality support. In our plan for this year we have also committed to increase our resources to enable us to engage better with investors and to meet new challenges, including on complex technical matters. We are, for example, recruiting a director of investor engagement and additional support for the Financial Reporting Lab to ensure we have a full insight into the complexities of reporting in financial services and have strengthened our ability to review audit work on IT controls.

We have implemented a new pay structure and performance management process to incentivise effectiveness within our new unified structure. The new process is more transparent and makes a clear link between performance and reward. It also reinforces our organisational culture by linking pay and bonuses to our five core values: ensuring that our actions are based on objective evidence, reaching out to our stakeholders, joining up our different strands of work, being decisive when necessary, and showing respect to each other within the organisation and to our external contacts.

We encourage feedback from FRC colleagues on all aspects of our efficiency and effectiveness as an organisation, including through an annual staff survey, quarterly 'pulse' surveys, meetings between staff and Board and Committee members, and cross-FRC groups to look at, for example, our HR policies and opportunities for greater synergies between the work of different teams. There is more work to be done on embedding our core values and on staff development, but the staff surveys give a consistent message that individuals across the organisation take pride in their work as part of the wider FRC.

Managing our finances

We have managed our resources carefully during 2012/13 to ensure that we fulfill our regulatory role effectively and operate within the budget on which we consulted last year. The financial results for the year show that we produced a small surplus, having budgeted for a small deficit.

During the year we benefited from an increase in the number of organisations in the funding groups that contribute to our preparers levy, and hence an increase in total receipts. This gave us the flexibility to invest slightly more in resources for some of our high priority projects, and we were able to add a small amount to our reserves. Operating our funding on a non-statutory basis agreed with Government is cost-effective and commands widespread support from the markets. We have continued to communicate the importance of our work to those who provide our funding and to address, in particular, the financial risks associated with our disciplinary schemes

Looking ahead

As this Report makes clear we are very aware that the environment in which we operate is continually changing. Developments in products and capital markets, institutional change and uncertainty and a muted economic outlook all form part of the business context in which we operate and seek to influence.

Big challenges need a longer term perspective than a one-year plan can provide. The FRC's current Plan has been prepared over a three year time horizon, 2013-16. It sets out what we propose to deliver during the year and indicates where we expect key projects to continue or begin beyond the annual planning horizon. This will enable us to communicate more consistently our medium and long term plans and ensure that we maintain a broad and forward-looking perspective. We will provide detail on the key projects and activities as they emerge and evolve. Success criteria are established before individual projects are commenced and impact assessments undertaken when we issue new codes, standards or guidance.

Conclusion

As intended, we have derived real benefit from pulling together the different parts of our organisation. The recognition that audit is a key part of good governance, combined with our ability to use the Code to address audit quality and reporting as on retendering, is but one example. Joining up our conduct work to get straight to the heart of emerging problems and bringing together the conduct experience with standard-setting are also proving invaluable.

I am immensely grateful for the commitment, energy and patience shown across the FRC as people pulled together to make it work. And I am also delighted that top-class people have continued to want to take part in our advisory groups. I am particularly grateful for the contributions made by our Councils to the reform of UK GAAP, the introduction of bold changes on auditor reporting and the thorough review of the future of actuarial regulation – as reflected in Section Two of this Report.

Stephen Haddrill

Chief Executive Officer

16 July 2013

Section Two The state of corporate governance and reporting in the UK

This section gives our assessment of the current state of corporate governance, corporate reporting, audit and actuarial practice in the UK, and the action we are taking and our plans for the future in each of these areas.

Corporate Governance

Good corporate governance and reporting are essential to the effective operation of free capital markets. Good governance improves boards' ability to enhance performance effectively as well as providing accountability to shareholders.

Recent Developments and our Current Assessment

The UK Corporate Governance Code celebrated its twentieth anniversary in 2012. Over that period it has made a strong contribution to the generally high corporate governance standards and practice in the UK.

The Code has a history of success in pushing out the boundaries of best practice, such as the separation of the roles of the chairman and chief executive, the independence and professionalism of the audit committee and regular review of the board's effectiveness. The flexibility inherent in the Code's "comply or explain" approach has enabled those boundaries to be pushed; it is important that such flexibility is retained. We are pleased that the European Commission has recognised the important role that national "comply or explain" codes have to play in raising governance standards across the EU.

A mechanistic approach to complying with the Code is not sufficient to guarantee good governance. Boards need to drive the right culture into the management of the business. This need has been demonstrated in the problems experienced in the banking sector,

both in terms of business strategy and in holding to the spirit of the rules such as in relation to LIBOR.

The need for boards and investors to take a longer term view in order to benefit companies and savers and strengthen capital markets is also a message that has been repeated frequently in 2012. It comes through strongly in the recommendations of the Kay review, and in Lord Sharman's review of how companies assess their going concern status. The European Commission has also identified its importance in promoting growth in its Green Paper on long-term financing. A long-term perspective by boards is also necessary when they seek to provide changes in culture, not just in process or practice.

Our latest annual monitoring report on the implementation of the Corporate Governance and Stewardship Codes was published in December 2012. Aggregate compliance with the UK Corporate Governance Code across FTSE 350 companies stands at 97 per cent. While non-compliance is very much in the minority, it is important that the explanations are clear so that shareholders can understand the reasons why the board has taken the actions it has, and can consider whether their interests are being properly looked after.

Our review found the standard of explanations to be variable. Companies are generally better at setting out the background and actions taken to mitigate any governance concerns than they are at explaining the rationale for their decisions. In a few cases they do little more than assert that the actions taken are the most appropriate for the company. We hope that, by having set out the features of a clear explanation in the introduction to the 2012 edition of the Code, we will be able to report that the quality of explanations improved in 2013. If not, we will need to consider whether further action is needed.

We found further improvement in the overall quality of reporting on principal risks and uncertainties, and the majority of companies are now attempting to explain their business model. There are also more examples of companies reporting some of the outcomes of, or follow up to, their board evaluations. We will be looking to build on this progress in 2013-14, with updated

guidance on risk management and a report on how board evaluation practice has developed in the ten years since it was first promoted in the Code.

Reporting by some audit committees on their activities, on the other hand, has remained uninformative. For this reason, we introduced new provisions in the 2012 edition of the Code to encourage more fulsome reporting on the significant matters considered by the committee, including the effectiveness of the audit process.

On stewardship, there has been an increase in the number of asset owners signing up to the Stewardship Code, although the numbers remain small in comparison with asset managers. We hope that the clarification of the respective responsibilities of managers and owners in the 2012 edition will encourage more owners to commit to the Code. Regardless of whether they are signatories or not, the direction given by owners to their investment managers is of crucial importance. There is some evidence that more owners are discussing stewardship with their managers, although it is less clear to what extent it is then reflected in mandates or, in turn, in the contacts those managers have with investee companies.

Chairmen and senior investors reported that they have had to engage more and some companies reported more regular contact with shareholders on a broader range of issues. That said, many considered that this was because those investors that already engaged were doing more, rather than because more investors were becoming involved.

Whilst there have been some welcome developments in the market, such as the good practice guide produced by the Institute of Chartered Secretaries and Administrators and 2020 Investor Stewardship Working Party, the quality of reporting by investors on how they have applied the Stewardship Code is variable. We have, therefore, strengthened the wording in some parts of the 2012 Code to make it clearer what information should be disclosed. The statements made by signatories to the code are particularly important, as they enable companies to understand the approach to stewardship taken

by their major shareholders and - in the case of statements made by asset managers - assist potential clients in identifying managers whose approach is compatible with their own.

Overall voting levels at annual general meetings continue to increase, and more asset managers now disclose at least some details of their voting records. Voting on remuneration reports attracted most attention during the course of the annual general meeting season. It remains to be seen what impact the Government's new legislation introducing a binding vote on the remuneration policy, will have on voting patterns and on engagement in advance of the annual general meeting. Some have predicted that pressure on investor resources could become acute towards the end of 2013 as companies start consulting on their remuneration policy ahead of the new vote, squeezing out engagement on broader issues of strategy and governance. It would be unfortunate if that was to be the case, and companies and investors are encouraged to plan ahead.

Key Issues for the Future

Despite our confidence in the overall quality of governance, we are concerned about how to ensure boards and shareholders have a sufficiently long term focus; the perennial question of how to set executive remuneration in a way that is seen as fair reward for good performance; and wider concerns about governance in the banking sector. In these instances the UK Corporate Governance Code operates alongside regulation which the Government is reforming. We expect to engage fully in the debate in Europe on long term finance. In our response to the Commission's Green Paper we expressed concern at the way the European equity markets are shrinking, and said regulators and policy makers must be aware of the risk of unintended consequences across the whole range of market and corporate regulation. Public equity markets should not bear an unfair burden.

We will consult on whether changes are needed to how the Code addresses remuneration in the light of the new legislation, and will respond to the recommendations of the Parliamentary Commission

on Banking Standards that we should assess whether or not the director nomination process was effective in getting the necessary degree of constructive challenge on bank boards. We believe that the Code itself should continue to be applicable to all companies and that, as a general rule, any governance issues specific to the financial sector are best addressed through the specific framework for regulating that sector.

There have also been significant changes in ownership structure since 1992 that have created some challenges that were not anticipated when the “comply or explain” approach was devised. One of these is the increase in recent years in the number of Premium listed companies with controlling shareholders. The pure “comply or explain” approach can be less effective in these cases, where the majority shareholder is in effect reporting to themselves, and for this reason the Financial Conduct Authority is considering proposals to give greater protection to the minority shareholders of such companies.

While this is a relatively recent development, underlying changes in the ownership of listed companies in the UK - and in particular the declining share held by UK-based long-term investors - go back much further.

The impact of these changes has been significant in many respects. In terms of corporate governance, the critical mass of investors with a long-term perspective who are willing and able to engage with boards has to be established internationally, not just within the UK. Establishing a critical mass that enables the chain of accountability from companies through to savers to work as it should, in a difficult economic environment, is possibly the greatest challenge. This is the over-arching objective of the Stewardship Code.

We believe that more effective collective engagement can maximise investors’ resources and provide a basis for higher quality engagement with companies, and welcome the market’s efforts to develop an investor forum as recommended by Professor Kay. The European Commission has announced that it will look to develop guidance to increase legal certainty on the relationship between investor cooperation on governance issues and the rules on acting in concert.

The development of a stewardship culture among investors is not something that happens overnight. It requires cultural and behavioural change rather than prescription. While it appears that stewardship is firmly on the investment agenda and there is some evidence that leading investors are looking to engage more effectively both individually and collectively, stewardship needs to develop further if we are to reach the critical mass needed.

As emphasised in the revised Stewardship Code, this is not something that can be delegated to proxy advisors or other third parties; and, just as the quality of governance within companies is determined by the board, it needs senior management within institutions to provide leadership and commitment.

Some concerns were heard from companies about the influence of proxy advisors on the outcome of votes at the annual general meeting. It is not clear from the available evidence that larger investors routinely follow advisors’ recommendations, although they may not be representative of all investors. We emphasised in the 2012 edition of the Stewardship Code that outsourcing to external service providers does not absolve investors from exercising their stewardship responsibilities. We also welcome ESMA’s initiative to bring together the proxy advisors to develop a voluntary code of conduct for the industry.

Corporate Reporting

Good reporting meets the needs of investors for relevant and clearly-communicated information on companies’ governance, business models, strategies and performance and supports effective company stewardship.

Ensuring high quality corporate reporting depends primarily on boards, preparers and auditors playing their part in delivering reports that are, in the words of the UK Corporate Governance Code, ‘fair, balanced and understandable’ and meet the needs of investors.

Our work to review and promote the quality of reports and the framework of international and UK standards together play a crucial part in helping deliver reports that meet those criteria.

Our current assessment

We will publish the 2012/13 Corporate Reporting Review (CRR) activity report in September. We reviewed fewer reports and wrote to fewer companies this year than last. In part, this reflects the complexity of the issues we faced and the more robust approach we have started to implement in our engagement with companies. Generally, responses to our informal enquiries remained constructive. However, this year a small number of companies were unco-operative until we threatened the use of our statutory powers to require timely and comprehensive information.

Additional disclosure is no substitute for inappropriate accounting which does not comply with the relevant standards. Comprehensive disclosure is, however, required to support critical judgements made by management where they have a material impact on the reporting. As forewarned in our 2011/12 activity report, covering, in the main December 2010 accounts, this year we challenged companies on specific aspects of impairment reporting including the descriptions of the underlying assumptions and the methodologies by which they were determined by management. Similarly, we challenged the sufficiency of disclosures supporting investment property valuations securing more granular information in companies' future reporting.

Common areas of questioning were broadly the same as last year and included business reviews, cash flow statements and impairment. Revenue recognition, ranging from the point at which revenue is recognised to the bland or boilerplate descriptions, which do not reflect the business model of the company, remained an issue in a number of instances. These matters were particularly sharp in fast growing companies.

In general we found the quality of reporting to be good. Despite the concerns we expressed last year about the reporting by some smaller listed and AIM quoted companies, we did not see an improvement in our 2012/13 reviews. The issues here tended to

reflect a straightforward failure to follow appropriate standards, for example, inappropriate netting or misclassification of cash flows. On occasion, we had to remind boards of their legal responsibility to prepare accounts that comply with the law and accounting standards.

Issues requiring the need for a Review Group of Financial Reporting Review Panel members were more complex, often involving larger listed entities, and including areas where considerable professional judgement is required, relating, for example, to specific arrangements which illustrate the tension that can exist between following the standards and providing a true and fair view.

Particularly following our comments last year, where we welcomed signs that boards were eliminating unnecessary detail in their reports and accounts, we were disappointed not to see more progress in removing what might be considered clutter, for example, immaterial disclosures. We continue to support efforts to reduce boilerplate reporting – cutting out immaterial information and encouraging boards to make their disclosures company specific where they are genuinely important.

Looking Ahead

There are three areas of focus for us in the years ahead: we want to ensure that the implementation of the new UK accounting standard is well supported; we want to see quality being the watchword for international standards; and we want reports to become an easier read.

In March 2013, we published our new accounting standard for non-listed companies in the UK and Republic of Ireland. The standard is important to the non-listed sector as it provides such companies with succinct financial reporting requirements. The standard comes into effect for reporting on 2015 calendar year-ends, but allows those who want to adopt it earlier to do so.

Additionally, we have published a standard that sets out disclosure exemptions for subsidiary and ultimate parent accounts and we will publish our proposals for insurance accounting shortly.

We are supporting the update of Statement of Recommended Practice (SORPs) and working with stakeholders to develop a new XBRL taxonomy for companies using UK GAAP.

We will look to review the accounting for small entities, including the future role of our standard for smaller entities, as proposals are made to implement the revised EU Accounting Directive. We will also consider the accounting for the smallest of entities (micro entities) as the Government develops its legislative proposals.

International accounting standards

Convergence between IFRS and US accounting standards is no longer the primary focus. This provides an opportunity to ensure future standards are of the highest quality in terms of delivering relevant information to investors. The FRC believes that the IASB is right to look at its conceptual framework. In recent years, the IASB has placed less weight on the concepts of prudence and stewardship. We have argued strongly for these key considerations to be restored.

There are times, however, when some progress must be made ahead of the completion of the perfect and highest quality answer. This is particularly true in relation to the development of IFRS 9, the financial instruments standard, which we encourage the EU to adopt as soon as possible. We were pleased that the Parliamentary Committee on Banking Standards (PCBS) agreed with us on this.

The EU is at the same time reviewing its IFRS endorsement process and is to research the impact of IFRS adoption. We support these reviews; the time is right to ensure that Europe is best represented in international debates whilst being able to hold firm to its principles.

'Cutting clutter'

Annual reports and accounts have grown rapidly in recent years in terms of their length and opacity. We are pleased, therefore, that the IASB has started work on a new disclosure framework and plans to issue guidance on materiality. We will also review the role

of materiality in implementing accounting and audit standards, and ensure that in our own monitoring of corporate reports we focus on significant matters.

The Financial Reporting Lab was set up in 2011 to help companies and investors come together to improve the value of corporate reports. It has now produced six reports on a range of topics including reporting by Board remuneration committees, financial disclosure regarding debt and cash flows, and financial risk disclosure. In addition to exploring what might be considered to improve rather more-established areas of reporting (for example on debt and cash flows), the Lab is also playing a role in implementation of new requirements. For example, it has turned its attention to audit committee reporting, and is working with companies and investors on the implementation of new reporting requirements under the UK Corporate Governance Code. Its work is also helping to influence specific policy making (specific aspects of remuneration reporting developed by BIS, and the development of a disclosure framework by the IASB).

The Department of Business, Innovation and Skills (BIS) has also focussed on enhancing corporate reporting and will shortly publish new Regulations for narrative reporting that first apply to corporate annual reports in respect of years ending September of this year. Companies, within the scope of the Regulations, will be required to prepare a Strategic Report which will be separate from the Directors' Report. The basic information required in the Strategic Report will mirror that currently required in the Business Review which is being replaced.

We are taking this opportunity to update the existing Reporting Statement on the Operating and Financial Review with the benefit of the experience gained by the Corporate Reporting Review team in monitoring the quality of business reviews. When doing so, we aim to produce more streamlined guidance that reflects developments in narrative reporting, considers ideas around splitting of core and supplementary information, and both allows flexibility and encourages experimentation by companies in communicating their information clearly. We have engaged with both preparers and investors at an early stage to incorporate their views.

Within the EU there is growing pressure to legislate to require companies to produce more information of relevance to stakeholders of all kinds. The FRC supports this when the information is material to the needs of shareholders. However, we are concerned that policymakers should not push companies over the line into producing an annual report that is less useful to investors because it is overburdened with material that serves the needs of others.

Audit and Assurance

Good audit makes a vital contribution to investor confidence in financial statements and the effective operation of the capital markets.

We believe that good audit and audit committee reporting underpin effective engagement between boards and investors. Auditors, along with boards and investors, should operate within a regulatory framework that encourages them to put their stewardship role first so that good stewardship and their interests are fully aligned.

As a key part of our mission we maintain a regulatory framework for auditing, including technical and ethical standards, and inspect and report publicly on the quality of audit in the UK. We also prioritise our work to influence EU policies on audit so that they serve the interests of investors; and play a leading role in working effectively with the International Auditing and Assurance Standards Board (IAASB). We have welcomed the Competition Commission investigation into the UK audit market and the potential measures to enhance competitiveness.

In much of our work to promote an effective UK audit market and high quality auditing we cooperate closely with the UK accountancy professional bodies, whose members are in the front line in meeting the high standards that we and the professional bodies set. We are, therefore, reporting in some detail on our statutory oversight of the professional bodies in their

role as Recognised Supervisory and Qualifying Bodies – complemented by our role in providing independent disciplinary arrangements for public interest cases, including cases relating to audit.

Our current assessment of audit quality 2012/13

In May 2013, we published our annual report on Audit Quality Inspections undertaken in 2012/13, a copy of which can be found on the FRC's website.

Our overall assessment was that:

- Our 2012/13 inspection results showed an improvement in the overall standard of audit work subject to our inspections, especially in the audits of FTSE 350 companies.
- This improvement was not uniformly spread across all the firms and types of entities.
- Audit firms need to maintain and in some cases enhance their focus on professional scepticism and the effectiveness of their independence and ethical policies and procedures.

Our work also confirmed the key role served by audit committees in encouraging audit teams to demonstrate the extent of their challenge, for example in relation to key judgments and consideration of alternative approaches, and in ensuring that management provide all relevant information.

The UK audit inspection regime is one of the most transparent in the world. We strongly believe that the transparency of our inspection findings contributes to behavioural improvements of both auditors and audit committees and encourages confidence among investors.

Key messages from the report

To continue to improve audit quality the report contained the following key messages for audit firms:

- Controls and procedures should be in place to ensure that audit efficiencies are not achieved at the expense of audit quality.

- While recognising the progress that has been made in embedding the exercise of professional scepticism in audit work and the culture of firms, further improvements are required and there should be greater consistency.
- For audits in the financial services sector, firms should strengthen their testing in respect of loan loss provisioning and general information technology controls.
- Firms should reconsider the adequacy of their independence and ethical procedures and the training they provide to staff at all levels. Auditor independence is also an important factor for audit committees to consider.
- Firms should reconsider the robustness of their internal monitoring processes.
- Group auditors need to ensure they are sufficiently involved in all stages of the work on parts of the business audited by other auditors.

This year's report draws attention to issues relating to the audit of those companies where the substantive operations and general, financial and corporate management are in a different country to that of the group auditor (sometimes referred to as "letterbox companies"). We also face a challenge in influencing audit quality where a significant part of the audit work on larger group audits is performed outside the UK and is therefore outside of the scope of our inspections. We believe this is an area to which we need to devote more attention.

Looking forward

The financial crisis has provided us with an opportunity to take stock and look hard at measures to help improve confidence in the value of audit at a time when policy-makers and the profession may be more open to change and are taking a longer-term approach than previously.

The changes to the UK Corporate Governance Code are designed in part to improve transparency of audit committee reporting on how audit quality is assessed. To provide practical support the Financial

Reporting Lab is running a project on reporting by audit committees in annual reports which will address the interaction with auditor reporting.

During 2012, we conducted an extensive outreach programme leading to a 2013 consultation on improving the audit report so that it provides information for investors on the context in which the audit has been conducted. The proposal attracted strong support and revised requirements were published in June of this year.

Beginning with 30 September 2013 year ends, audit reports for companies that apply the UK Corporate Governance Code will step beyond the binary pass/fail reporting model to provide insights on the significant judgements made by the auditor on the scope of its work, how its assessment of the risks of material misstatement shaped the audit strategy and how it allocated resources and directed the engagement team, as well as how it applied the concept of materiality in planning and performing the audit.

Although such information has typically been communicated to the audit committee by the auditor, we felt disclosing such information to investors falls more naturally in the auditor's report domain. We hope that the enhancements will provide a better basis for engagement by investors with companies about the audit.

Introducing these changes now means we introduce such requirements before the IAASB has updated its standards. However, this step importantly completes the circle for UK companies as it complements enhanced reporting by boards and their audit committees in respect of corporate reporting under the UK Corporate Governance Code. We will continue to support the IAASB as it moves to make equivalent changes to its ISAs.

Recent debate has also focused on auditor rotation. In our view what are most important are the quality of the audit and the usefulness of the reports of the auditors and the audit committees. In our view regular retendering on a 'comply or explain' basis as set out in the UK Corporate Governance Code will encourage companies to appoint the right auditor

for their business without artificially limiting their choice or inhibiting audit firms' ability to challenge and innovate.

We have continued our work to maintain an appropriate UK framework of auditing standards. In June 2013 we revised the audit standards to adopt changes to the corresponding ISAs issued by the IAASB with regard to enhancing the auditor's risk assessment procedures for entities with an internal audit function, and to prohibit the use by external auditors of direct assistance by internal audit staff. We have also consulted on a proposed update of guidance to auditors on the audit of financial instruments. The guidance is intended to reflect lessons learned in the financial crisis.

In addition to these developments, we are looking more widely, by obtaining the views of stakeholders and policy makers, at the current value of audit and the drivers of confidence in audit.

We seek to enhance confidence by not only focusing on audit scope and auditor behaviour, but by helping those who influence audit policy and form public opinion as well as other stakeholders including investors to reach a common understanding of the drivers of the value of audit and its purpose, benefits and beneficiaries, including:

- the duties and responsibilities of the auditor;
- the reasonable expectations of and limitations to the role of the auditor;
- quality of audit delivery;
- the need for trust and justified confidence by beneficiaries; and
- the need for transparency of the auditor's work.

A common understanding will help inform the FRC's work across codes and standards and conduct, and it will enable others to consider whether the current audit model remains appropriate and is likely to do so, or whether legislative and regulatory changes may be needed to foster greater reassurance from audit. This work is linked also to development of our Audit

Quality Framework to provide updated guidance to audit committees in assessing audit quality.

We also recently joined with The Institute of Chartered Accountants of Scotland (ICAS) to commission research to explore the mix of attributes, competencies, professional skills and qualities that need to be combined to produce a high quality audit in the public interest in the context of the modern business environment.

Looking further forward, together with investors, companies and auditors we will need to address the question of whether audit is providing a necessary challenge across areas that go beyond the current focus on financial statements. We have ourselves focused on testing audit quality against the current requirements, centred on financial statements. We will need to consider how the wider role of audit can contribute to confidence more generally.

Audit Regulation: Oversight of Professional Bodies, Third Country Auditors and Local Audit

Current Assessment

While key elements of the regulation of statutory audit are undertaken directly by the FRC – the inspection of the audits of public interest entities and the investigation and disciplining of auditors in cases that raise important issues affecting the public interest in the UK - audit regulation is undertaken otherwise by professional bodies recognised by the FRC for this purpose and subject to oversight by the FRC, under delegated statutory powers from the Secretary of State.

The FRC has a statutory obligation to report each year to the Secretary of State on the exercise of its oversight of audit regulation by the recognised bodies. That report is at Appendix A. The main points are set out below.

We have reviewed and made recommendations to the recognised professional bodies on all aspects of their procedures and practices for audit regulation since the powers were first delegated to the FRC in 2004. We consider that our programme of oversight and the

reporting of our findings have led to improvements over the years in the sharpness and quality of audit regulation and has had a positive effect long term on the quality of audit and auditors.

All the bodies devote substantial resources to their regulatory responsibilities and have adequate procedures in place to monitor and enforce compliance with their regulations. We continue to see much regulatory practice of a high standard. In many cases our recommendations are aimed at encouraging the bodies to adopt best practice rather than at correcting major failings. We see no reason at present to take enforcement action against any RSB or RQB, or to initiate the process of withdrawing recognition.

In 2012/13 we undertook monitoring visits to the four bodies that have both a recognised audit qualification and are recognised to supervise statutory auditors: the Association of Chartered Certified Accountants, Chartered Accountants Ireland, the Institute of Chartered Accountants in England and Wales, and the Institute of Chartered Accountants of Scotland.

Our visits focused on the following areas:

- The processes and practice for handling complaints and disciplinary cases involving auditors;
- The processes and practice for monitoring the audit work undertaken by statutory auditors;
- The processes and practice for awarding the Audit Qualification;
- The arrangements for recording and reviewing the practical training undertaken by students for the audit qualification;
- The progress made by the bodies in implementing recommendations made in prior years.

The main aspects of regulatory activity that gave us specific concerns were:

- Complaints handling. We made recommendations aimed at ensuring that complaints are handled without undue delays.
- Audit monitoring. We found that, where poor audit practice persists within firms, the follow up to audit monitoring visits undertaken by some bodies is not always as rigorous as we consider appropriate.
- Audit qualification. We made recommendations to some bodies aimed at ensuring that the systems and procedures for the granting of the audit qualification are robust and that these qualifications are granted only to those individuals who have sufficient recent audit work experience.
- Records of students' practical audit experience. We made recommendations directed at improving the quality and accuracy of records.

Regulation of Third Country Auditors

The European Union sets specific requirements for the regulation of the auditors ("third country auditors" or TCAs) of companies from outside the EU that issue securities traded on EU regulated markets. The FRC is responsible for applying these requirements, including monitoring the quality of a TCA's audit work in some circumstances where the firm is not separately subject to equivalent external monitoring. The issue is important because of the number of issuers incorporated outside of the EU whose securities are traded on a UK regulated market.

We consulted last year on how we should undertake the monitoring function, and are now putting place proportionate arrangements for external monitoring. We will complete our first inspections of TCAs in the second half of 2013. However, carrying out inspections of audit firms widely scattered across the world and with typically only one or two relevant audit clients is extremely challenging and poses particular challenges and risks:

- Local confidentiality requirements in some cases make it difficult or impossible to access audit working papers. We seek to work with local regulatory authorities to overcome these problems;
- Carrying out international inspections requires us to overcome language problems, security issues and differences in local audit practices. These challenges result in additional costs which in particular cases can be disproportionate to the benefits that can be achieved through effective audit monitoring;
- It is important to make clear to investors what the FRC can and cannot do and we are working with the FCA to make sure this information is available. For example, third country auditors in jurisdictions that the EU has either judged to have “equivalent” systems of audit regulation or granted “transitional” status are outside the scope of FRC external monitoring.

Local Audit and Accountability Bill

This Bill, currently before Parliament, includes new provisions for the regulation of the auditors of the accounts of local and some other public authorities. In essence the legislation makes parallel arrangements for local audit to the regulatory arrangements in the Companies Act. The Government has made clear that, assuming the Bill becomes law, it envisages delegating responsibility for oversight of local audit regulation to the FRC, and that the FRC will also take principal responsibility for inspecting the quality of the audits of major local bodies.

We will therefore continue to work closely with the Department for Communities and Local Government and other interested parties to develop the detailed regulatory arrangements necessary for a smooth transition from the existing arrangements managed by the Audit Commission to the new structure. This includes ensuring that the FRC has the necessary expertise and experience to undertake this additional role effectively.

Actuarial Regulation and Standards

High quality actuarial practice and the integrity, competence and transparency of the actuarial profession benefit all those who rely on or are affected by actuarial advice.

Although the actuarial profession is relatively small, with fewer than 10,000 qualified actuaries working in the UK, there is a broad public interest in the quality of UK actuarial practice. Actuaries mainly advise UK insurers, and trustees or sponsors of pension schemes, whose combined assets are estimated at nearly three trillion pounds.

Following the Morris Review in 2005, the FRC assumed responsibility for independent oversight of the actuarial profession. The FRC does this on the basis of voluntary arrangements with the Institute and Faculty of Actuaries (IFoA). The IFoA has the primary responsibility for the regulation of its members acting in their professional capacity, subject to independent FRC oversight. The IFoA sets an ethical code (the Actuaries’ Code). The FRC operates an investigation and discipline scheme for cases involving IFoA members which raise or appear to raise important issues affecting the public interest. This scheme operates alongside the IFoA’s own disciplinary scheme.

The FRC also sets technical actuarial standards (TASs) recognised by the IFoA for use by its members, and in legislative and regulatory requirements for actuarial work and reporting. The FRC is also the prescribed body under pensions legislation for maintaining Actuarial Standard TM1, which specifies the actuarial methods and assumptions to be used in producing Statutory Money Purchase Illustrations.

Our Current Assessment

We reported in 2012 that confidence in actuarial information and the actuarial profession - from insurance directors, pension trustees and actuaries themselves - is high and had increased since our previous survey in 2010.

Our oversight of the IFoA during the year primarily focused on its:

- development of a vision and programme of work to support the further embedding of the ethical principles in the Actuaries' Code;
- response to our recommendations on conflicts of interest in pensions and the need for greater regulatory engagement with actuarial firms. The IFoA has amended its ethical standards for pensions, and consulted on a package of measures to support quality assurance in actuarial firms.

The IFoA's proposals on quality assurance in actuarial firms will initially be voluntary even for employers of actuaries who hold practising certificates. These proposals are a good start, which we hope will prove successful in helping actuarial firms improve quality assurance processes, improve the IFoA's ability to understand and report on the actuaries of its members and actuarial firms, and in reassuring the public about the quality of actuarial work.

In connection with our TASs, preliminary feedback from our post-implementation assessment suggests that our standards are broadly accepted by practitioners. Users say they have noticed an improvement in the quality of communication of actuarial information and advice, which may be attributable to a number of factors including our standards.

Looking ahead: review of actuarial regulation

Notwithstanding the progress made in actuarial regulation since assuming our responsibilities, the FRC has this year undertaken a review, with the IFoA and other bodies, to consider whether the framework for actuarial regulation remains appropriate; adequately addressing the risks of poor quality actuarial work. The review was carried out against the backdrop of our experience in regulating and overseeing the actuarial profession over the past 7 years, significant changes in financial services regulation and the continuing fallout from the financial crisis of 2007/8. As a result we have established a forward agenda for our actuarial regulation activities.

Our findings are as follows:

Working with other regulators

The FRC relies on other bodies to implement its standards and recommendations, and monitor and influence actuarial quality directly. The IFoA requires its members to comply with the TASs, responds to FRC recommendations on a comply or explain basis, and works closely with the FRC on other regulatory initiatives and issues. There is some recognition of FRC standards in PRA/FCA rules and guidance (on generally accepted actuarial practice), in pensions and tax legislation, and in the monitoring activities of these and other bodies.

However, although we have some bilateral dealings with these bodies, on which we are seeking to build through formal Memorandums of Understanding, there is no coordinated monitoring of actuarial quality or assessment of the risks to which actuarial work is subject across all the organisations involved. Consequently, we have agreed with the IFoA and the other statutory regulators that we should establish a senior level group, to coordinate our respective regulatory activities in relation to actuaries and actuarial work. The group will seek to:

- develop a shared understanding of actuarial regulation in the public interest;
- identify emerging risks and agree how to deal with them;
- provide input on the need for and content of new standards
- provide input on the operation of any monitoring arrangements and the findings of monitoring activities;
- identify and collaborate on research activities and specific projects, such as on modelling and the scope and quality of peer review; and
- obtain input in respect of international developments.

Access to information

We have found little evidence that actuaries are moving in significant numbers into new sectors (insurance and pensions continue to be dominant) or that the work of actuaries has changed significantly in recent years apart from an increased focus on risk and capital assessment/management in insurance, driven at least in part by regulation.

However, the above conclusion has to be seen in the context of available data on the actuarial work that is carried out in each sector. This limits our understanding of what actuaries are doing and our ability to assess changes in risks arising from changes in the work and roles of actuaries. Therefore, we have asked the IFoA to improve our access to relevant data and trends to provide an evidence base for a review of the position on a regular basis. To give shape to this collaboration we have proposed a new agreement on the regular sharing and reporting of data and research relevant to actuarial regulation.

The scope of FRC regulation, including Technical Actuarial Standards (TASs)

We have concluded that we should continue to set technical standards for actuarial work, oversee the IFoA's regulation of its members acting in their professional capacity, and operate an investigation and discipline scheme for IFoA members, provided this can be done within a collaborative regulatory framework.

The scope of mandatory application of the TASs has developed incrementally. Our Generic TASs consist of high level principles which are intended to be applicable across a wide range of actuarial work and reporting. The scope of their mandatory application was initially limited to work which is reserved to actuaries, or to work which is covered by our Specific TASs. As we have issued Specific TASs for Pensions, Insurance, Transformations and Funeral Plans, the scope of the Generic TASs has progressively increased.

However, the Generic TASs still do not apply to all actuarial work, and our criteria for whether to issue Specific TASs have been driven to a large extent by

considerations of whether to extend the scope of the Generic TASs rather than the need for specific standards.

Consequently, as part of our planned review of the TASs in 2014, we will develop and seek views on proposals to restructure the TASs so that we have:

- high level principles which are recognised as applicable across all professional actuarial work; and
- more narrowly focused specific standards where there is a need for additional requirements in the public interest beyond the high level principles and the requirements of the IFoA and the statutory regulators.

We have also considered the current standard-setting framework in which the FRC sets technical standards for actuarial work, and the IFoA sets ethical and conduct standards for its members, including in particular the Actuaries' Code. On balance, we think this is the right structure, although the Morris Review had recommended that the FRC should have a reserve power to set ethical standards; and there have been some calls for more detailed guidance on methodologies, which would be more detailed than our existing TASs.

We will work with the IFoA to amend our existing agreement to enable the IFoA to issue guidance on recommended methodologies, subject to the FRC being satisfied that this will support actuaries in following the TAS. We will also make specific provision for the FRC to include ethical and conduct content in its standards, together with procedures and safeguards to ensure that we remain fully joined-up with the IFoA.

We will consult on this new framework during 2013/14.

Ensure the integrity and coherence of UK, European and International actuarial regulation

Although international actuarial standards are still at an early stage of development, they have the potential to affect the framework in the UK, and we are keen

to influence their development. We have concluded that we should work more closely with the IFoA to influence the work of the International Actuarial Association and the Groupe Consultatif Actuariel Européen, including through FRC staff sitting on key committees.

We will also seek to extend our influence with other international bodies such as the International Association of Insurance Supervisors (IAIS) and the European Insurance and Occupational Pensions Authority (EIOPA); and work with other UK bodies which have an interest in actuarial work, through our UK Forum on International Actuarial Standards.

Professional Discipline

The FRC reforms during 2012 had a particular impact on the Accountancy and Actuarial Discipline Board (AADB) because it was accompanied by other substantial changes which took place. In October 2012, when the AADB ceased to operate, the team which investigated and prosecuted cases on behalf of Executive Counsel formally became part of the Conduct Division as Professional Discipline (PD).

The significant changes which affected the investigations and prosecutions into misconduct affecting the UK public interest conducted by PD were as follows:

- An amended Accountancy and Actuarial Schemes were published for public consultation
- Sanctions Guidance for FRC Tribunals was approved by the FRC and the Conduct Committee
- The Case Management Committee (“CMC”) began to operate to monitor all investigations and prosecutions conducted by the PD team.
- New Executive Counsel was appointed
- The PD team was restructured with new recruits and a larger team
- New procedures were introduced to control expenditure and the timing of investigations

The changes to the two Schemes will come into effect in 2013 and, although they are wide-ranging, can be summarised by reference to the following matters: a change to the definition of misconduct to ensure the FRC investigates the right type of cases, the ability to conduct enquiries before initiating an investigation, new arrangements for monitoring individual cases by members of a Case Management Committee, a new power to issue interim orders, amendments to reduce the potential for delay, enhanced independence from the professional bodies by removing the requirement to consult with them before deciding to commence an investigation, amending the procedure for making future changes to the Scheme, and provisions to facilitate the early resolution of disciplinary cases without the need for a tribunal hearing.

We have consulted on and introduced Sanctions Guidance for tribunals. The Sanctions Guidance is intended to introduce a consistent and predictable framework for Tribunals to follow in cases where it is required to impose sanctions on Members and Member Firms. It is not intended to be prescriptive but it sets out some principles and criteria which should be followed. Whilst the message was intended to convey the view of the FRC that there was a need for higher financial penalties when appropriate and in the most serious cases it stressed that this was guidance and the ultimate decision is for the Tribunal.

In March 2012 Gareth Rees QC was appointed Executive Counsel to be responsible for investigations and prosecutions under the Schemes. We have introduced new internal rules to ensure that the control of expenditure is improved and the progress of investigations is maintained even when external problems intervene. There has been a strong and positive response from the accountancy and actuarial professions which reflects an improved reputation for our disciplinary work.

The progress of cases in 2012-13 has improved. The number of cases being completed has increased and the momentum of that improvement will continue over the next few years. The following is a summary of the outcome of some cases:

- Cases concluding with a Settlement:

Geoffrey Stuart Pearson, February 2012: Exclusion Five Years

Timothy Hunt, May 2012: Exclusion Six Years

James Corr, February 2013: Exclusion 8 Years

Peter Miller, February 2013: Exclusion 6 Years
- Two Formal Complaints were served in the Farepak case. The first of these alleged misconduct against, Willaim Rollason, a member of the ICAEW who was a director of Farepak Ltd. He made admissions to acting recklessly in a way that was contrary to the Fundamental Principle of Integrity (as set out in the ICAEW Guide to Professional Ethics) in relation to a misleading memorandum. The Tribunal imposed a Severe Reprimand and a Fine of £15,000 and ordered £50,000 costs.
- Investigations which were completed which did not lead to a Formal Complaint:

Equitable Life; three separate related investigations were concluded.

Lehmans CASS

Lehmans Repos
- A four week contested Tribunal hearing in the MG Rover case took place in March 2013. This was the first contested hearing for over six years

The momentum will continue with plans to increase and strengthen the team to ensure it has the resources and the quality to conduct effective investigations in cases of misconduct which affect the UK public interest.

Section Three FRC Governance

Directors' Report

The Directors have pleasure in presenting their report and financial statements for the year ended 31 March 2013.

The Financial Reporting Council Limited is a not-for-profit organisation incorporated in England and Wales, with its primary operations based at:

Aldwych House,
71-91 Aldwych,
London WC2B 4HN

Compliance with the UK Corporate Governance Code

The Board is committed to high standards of governance and believes that its UK Corporate Governance Code (the Code) is the appropriate benchmark for how it conducts itself to the extent that it is applicable to the FRC.

The Board complies in full with the Code either by detailed compliance with the individual requirements or by explaining how the underlying principles have been met.

The FRC does not have shareholders in the usual sense. However, it has a wide range of stakeholders and conducts an extensive dialogue with them through an annual open meeting, the annual business plan, the annual report and individual consultation documents.

Principal Activity and Regulatory Model

The aim of the FRC is to promote high quality corporate governance and reporting to foster investment. The principal activities exercised in support of this aim are set out on page 6 and comprise setting codes and standards, monitoring the quality of corporate reporting and audit, oversight of the regulatory activities of the professional bodies and operating disciplinary schemes. These activities are carried out by the Board and its Conduct Committee and Codes & Standards Committee supported by the Councils and the Monitoring and Case Management Committees. The Board, the Committees, Councils and former Operating Bodies were supported by the FRC's staff (the "Executive").¹

The FRC seeks to maximise the effectiveness of its activities at a controlled cost. It has developed a regulatory model to support its overall objective. The regulatory model is explained in the individual sections.

¹ Up to 2 July 2012 the activities were exercised by the Board and by the FRC's former Operating Bodies (the Accounting Standards Board, the Auditing Practices Board, the Board for Actuarial Standards, the Professional Oversight Board, the Financial Reporting Review Panel and the Accountancy and Actuarial Discipline Board).

The Board

Directors of the FRC from 2 July 2012

		Date appointed to Board
Baroness Hogg	Chairman	1 November 2007
Glen Moreno	Deputy Chairman	18 November 2010
Stephen Haddrill	Chief Executive	16 November 2009
Mark Armour	Non-executive Director	2 July 2012
Peter Chambers	Non-executive Director	1 November 2007
Elizabeth Corley	Non-executive Director	1 April 2011
Olivia Dickson	Chairman, Actuarial Council & Non-executive Director	2 July 2012
Paul George	Executive Director, Conduct	2 July 2012
Richard Fleck	Chairman, Conduct Committee & Non-executive Director	7 October 2008
Gay Huey Evans	Non-executive Director	1 April 2012
Nick Land	Chairman, Audit & Assurance Council & Non-executive Director	1 April 2011
Roger Marshall	Chairman, Accounting Council & Non-executive Director	1 November 2010
Melanie McLaren	Executive Director, Codes and Standards	2 July 2012
Sir Steve Robson	Non-executive Director	1 November 2007
Keith Skeoch	Non-executive Director	1 March 2012
Jim Sutcliffe	Chairman, Codes & Standards Committee	15 June 2009

The following Directors stood down on 1 July 2012:

		Date appointed to Board
Rudy Markham	Non-executive Director	1 November 2007
John Kellas	Chairman, POB	8 June 2011
Timothy Walker	Chairman, AADB	27 May 2008

Under the terms of the FRC's Articles of Association, all Directors are members of the FRC and each has undertaken to guarantee the liability of the FRC up to an amount not exceeding £1. There are no other members and no dividend is payable.

The Deputy Chairman acts as the Senior Independent Director.

During the year the Board considered its composition measured against the requirements of the Code. The Board concluded that at least half the Board excluding

the Chairman, comprises independent, non-Executive Directors. It reached this decision by considering not only the circumstances set out in the Code but also, given the functions of the FRC, any relationships or significant links with those regulated by the FRC.

As the Directors of the FRC are also its members, the submission of Directors for re-election would not be meaningful. The Board have agreed to put in place an alternative to annual re-election: its annual effectiveness evaluation includes consideration of the continuation of each of the Directors and the

Secretary of State has been invited to consider the continuation of the Chairman and Deputy Chairman on an annual basis.

The terms of appointment which apply to all Directors are published on the FRC website.

The Role of the Board

The Board is responsible for the philosophy and overall strategy of the FRC and its management and culture as well as determining the nature and extent of the significant risks to be taken in achieving the FRC's strategic objectives.

Regulatory powers reserved to the Board include the issuing and maintenance of codes and/or standards for corporate governance, stewardship, corporate reporting, accounting, auditing, assurance services and actuarial work; the exercise of the functions of the Secretary of State under Part 42 Companies Act 2006 and the exercise of the functions of the Independent Supervisor appointed under Part 42 Companies Act 2006.

Other matters reserved to the Board include

- Approval of annual plan and budget and review of performance against the plan and budget;
- Approval of annual levy proposals;
- Approval of the Annual Report and Accounts;
- Ensuring a system of internal controls and risk management;
- Approval of changes to the FRC's corporate and/or governance structure;
- Appointments of Directors of the FRC (save for the Chairman and Deputy Chairman);
- Approval of the membership and terms of reference of Board Committees; and
- Determination of the remuneration of the non-executive Directors.

The Schedule of Matters Reserved to the Board was reviewed in June 2012 when substantive amendments were made to reflect the FRC reforms and later in December 2012 when it was decided that no amendments were required.

The Board is supported by three governance committees - Audit Committee, Nominations Committee and Remuneration Committee - and by the Executive Committee, Codes & Standards Committee and Conduct Committee. The Schedule of Matters reserved to the Board and the terms of reference for each of the Committees together with the FRC's Articles of Association are published on the FRC website.

Attendance at Board meetings during the year is shown below, with the attendance shown as a proportion of the numbers of meetings individual Directors were eligible to attend:

Baroness Hogg	7/7
Glen Moreno	6/7
Stephen Haddrill	7/7
Mark Armour	6/6
Peter Chambers	7/7
Elizabeth Corley	7/7
Olivia Dickson	5/6
Richard Fleck	7/7
Paul George	6/6
Gay Huey Evans	7/7
John Kellas	1/1
Nick Land	6/7
Rudy Markham	1/1
Roger Marshall	6/7
Melanie McLaren	6/6
Sir Steve Robson	7/7
Keith Skeoch	5/7
Jim Sutcliffe	6/7
Timothy Walker	1/1

During the year the Board focused on the FRC's work in pursuit of the four broad objectives in the FRC's Plan for 2012/13, while taking account of emerging developments and reviewing the risks associated with each of the objectives, including:

Monitor the general health of corporate governance and reporting in the UK and make sure that our codes and standards remain fit for purpose in all areas and that planned changes are introduced at the right time.

- The Board reviewed the outcomes from the FRC's work to monitor the quality of corporate governance, reporting and auditing which informed its work to promote effective engagement between boards and investors, promote more useful and relevant corporate reports and the value of audit.
- The Board reviewed the coherence and relevance of the current arrangements for oversight of actuarial practice and took steps to clarify the boundaries of the FRC's role in maintaining actuarial technical standards and overseeing the regulatory activities of the Institute and Faculty of Actuaries as part of the wider UK regulatory regime.
- Specific regulatory decisions included approving the revised UK Corporate Governance and Stewardship Codes, updated and more succinct UK accounting standards to replace UK GAAP, and updated auditing standards designed to enhance the usefulness of audit reports.

Make sure that the UK's approach to corporate governance and reporting is properly understood and appreciated in the EU and internationally.

- The Board paid close attention to EU developments and visited Brussels in April 2012 and again in April 2013 to engage with the EU Commission, Parliament and other stakeholders.

- The Board also reviewed the FRC approach to influencing international accounting and auditing standards and monitored the work undertaken; and supported the FRC's successful candidacy for the newly-established Accounting Standards Advisory Forum.

Focus on the effectiveness of our monitoring, oversight and disciplinary work, to ensure it is responsive to emerging risks, joined up, transparent and proportionate. We undertook, in particular, to review further the scope of our work and to enhance the speed and effectiveness of our disciplinary work.

- The Board monitored the FRC's work to enhance the coherence, effectiveness and transparency of its conduct activities. The Board's work was supported by the Conduct Committee and was informed by the activities of the Conduct Committee in pursuit of its own statutory responsibilities.
- The Board approved the new accountancy disciplinary scheme and auditor regulatory sanctioning regime.

Ensure that FRC reform was introduced effectively.

- The Board took a close interest in the implementation and development of the Committees, Councils and executive team within the new structure, and the establishment of effective governance and operational arrangements for discharging the FRC's reformed statutory powers.
- The Board also undertook a survey of stakeholder views of the FRC's effectiveness, which informed the development of the organisation's priorities for 2013/16, preparing for the first time a medium term perspective for its objectives.

A summary of the key decisions by the Board during the year include the following approvals:

- reforms to the FRC's governance structure, terms of reference of the Committees and Councils within that structure and transparency arrangements including the publication of Board and Council minutes;
- amendments to the Corporate Governance Code, Guidance on Audit Committees and the Stewardship Code;
- revisions to ISAs (UK and Ireland) 260, 610, 700, 705, 706 and 720A;
- publication of Bulletin 2012/1 "Compendium of Illustrative Auditor's Reports on Irish Financial Statements";
- issue of FRS 100, FRS 101 and FRS 102;
- amendments to the Pensions TAS and AS TM1;
- proposed revisions for consultation to the guidance issued in 2009 for directors on 'going concern and liquidity risks';
- proposed Auditor Regulatory Sanctions Procedure for consultation;
- amendments to the Accountancy Scheme;
- MoU's with the FCA and PRA;
- publication of Corporate Governance Monitoring Report;
- scope and governance of the actuarial regulation review;
- FRC approach to influencing IFRS;
- scope of the FRC audit quality review work;
- 2013/14 Plan & Budget and Levies.

During the year the Board conducted an evaluation of its effectiveness. The evaluation was carried out by the Deputy Chairman on a forward looking basis before the implementation of the reform of the FRC. The conclusion of the evaluation was that

the following year should be spent clarifying the roles of the Executive, the Board and its committees within the new governance arrangements and to set and communicate clearly the FRC's priorities following the reforms. The FRC's Governance Bible was developed in order to clarify the roles of the Board and its Committees and supporting Councils and Committees and the FRC's priorities were communicated clearly in its 2013/14 Plan.

Mr Moreno, Deputy Chairman, also conducted an evaluation of the Chairman's performance and gave feedback to the Chairman and reported to the Board. The evaluations also included a consideration of the continued appointments of each of the Directors.

An independently facilitated Board performance evaluation with the benefit of what has been learnt from the first year following the FRC reforms is now underway and will be reported on in our next annual report.

Directors' Emoluments

The remuneration of Directors, including the Chair and Deputy Chair, is determined and reviewed by the Board. The Board determines the remuneration of non-executive Directors by assessing the responsibility, workload and time commitment to the role and by calculating a daily rate of fees comparable to the fees paid by other regulators and in relation to comparable roles within the public sector.

During the year the Board reviewed Board member fees and determined the following fees from 2 July 2012:

- Non-executive Director fees - £25,000
- Deputy Chairman fees - £35,000
- Additional fees for membership of the Conduct Committee or Codes & Standards Committee - £10,000
- Chairs of Audit and Remuneration Committees - additional fees of £5,000
- Chair of the Conduct Committee - £90,000

- Chair of the Codes and Standards Committee – £60,000;
- Council Chairs - £50,000 plus any supplemental fees determined by the Remuneration Committee for work falling outside a Chair's normal duties

The total remuneration and benefits received, including (for the executive Directors) pension contributions, are shown in the following table, which has been subject to audit (See also note 4 to the Financial Statements).

	2012/13	2011/12
Baroness Hogg	120,000	120,000
Glen Moreno	33,750	30,000
Stephen Haddrill	447,081 (1)	403,504 (1)
Eric Anstee (to 31 May 2011)	0	3,333
Mark Armour (from 2 July 2012)	18,750	0
Peter Chambers	37,800	20,000
Elizabeth Corley	23,750	20,000
Olivia Dickson (from 2 July 2012)	37,500	0
Paul George (from 2 July 2012)	273,078 (1)	0
Richard Fleck	90,000	70,000
Gay Huey Evans	26,250	0
John Kellas (to 1 July 2012)	17,500	60,406
Bill Knight	0	70,000
Nick Land	53,750	20,000
Rudy Markham	5,000	20,000
Roger Marshall	59,375	87,500
Melanie McLaren (from 2 July 2012)	252,000 (1)	0
Dame Barbara Mills (to 28 May 2011)	0	11,667
Sir Michael Rake (to 31 December 2011)	0	15,000
Sir Steve Robson	26,250	20,000
Keith Skeoch (from 1 March 2012)	28,750 (2)	1,667
Sir John Sunderland (to 31 May 2011)	0	3,333
Jim Sutcliffe	60,000	60,000
Lindsay Tomlinson (to 31 October 2011)	0 (3)	0 (3)
Timothy Walker (to 1 July 2012)	33,231	60,000
Total	1,643,815	1,096,410

If the Directors were appointed during the year the amounts payable are for the period from the date of their appointment. The amounts paid to Richard Fleck, Bill Knight, Roger Marshall, Dame Barbara Mills, John Kellas, Jim Sutcliffe and Timothy Walker included the remuneration payable in respect of their roles as Chairs of Operating Bodies under the pre-reform structure.

- 1 The only Directors during this period who are entitled to receive pension benefits are the Chief Executive and the Executive Directors of Conduct and Codes & Standards in respect of whom contributions were paid to a personal pension arrangement (see note 4 to the financial statements).
- 2 As from 1 April 2012, Keith Skeoch waived 100% of his remuneration in favour of charity.
- 3 From 1 April 2010 Lindsay Tomlinson waived 100% of his remuneration.

Directors’ insurance and indemnities

The Company purchased and maintained throughout the financial year directors’ and officers’ liability insurance in respect of itself and for its Directors and Officers. This gives appropriate cover for any legal action brought against the Company or its Directors or Officers.

Committees of the Board during the reporting period

Executive Committee

The Executive Committee is responsible for

- Recommending strategic direction to the FRC Board;
- Providing day to day oversight of the work of the FRC, its operational policies and protection of the FRC reputation;
- Overseeing the implementation of the FRC business plan;
- Advising the FRC Board on the budget, business plan, Board agenda and management of the organisation; and

- Debating and resolving issues affecting the Codes and Standards and Conduct divisions.

The Executive Committee was appointed on 2 July 2012 and met 10 times during the year on a formal basis and more often on an informal basis. Membership of the Committee and attendance at the formal meetings was as follows:

Stephen Haddrill	9/9
Paul George	8/9
Melanie McLaren	9/9
Anne McArthur	9/9
Graham Clarke (from 1 November 2012)	6/6
Mridul Hegde (from 1 November 2012)	6/6

During the year the Executive Committee recommended strategic direction to the Board through its work on the 2013/14 Annual Plan & Budget and on discrete issues reserved to the Board; reviewed progress and expenditure against the 2012/13 Plan & Budget; reviewed the FRC’s performance management processes and developed proposed changes to the appraisal and pay review processes which were effected following approval by the Remuneration Committee; reviewed the FRC’s diversity policy and developed proposals for diversity monitoring; and worked on its own development to ensure effective leadership of the FRC Executive.

Conduct Committee

The Conduct Committee is responsible for

- exercising the functions delegated to the Conduct Committee by the Secretary of State under the Companies Act 2006 and the Companies (Audit, Investigations and Community Enterprise) Act 2004;
- advising the Board on the exercise of the functions delegated to the Board by the Secretary of State under the Companies Act 2006;
- advising the Board on the approach to be taken to non-statutory oversight of the actuarial and accountancy professions;

- overseeing the FRC's conduct work with the objective of promoting high quality corporate governance and reporting;
- exercising the functions delegated to the Conduct Committee in accordance with the Accountancy and Actuarial Schemes;
- deciding whether to commence a supervisory inquiry, determine the scope of any such inquiry and what, if any, action to be taken on its conclusion;
- identifying and assessing the current, emerging and potential risks to the quality of corporate governance and reporting in the UK and approving the adequacy of actions to mitigate those risks; and
- appointing members of the Financial Reporting Review Panel, the Monitoring Committee and Case Management Committee.

The Conduct Committee was appointed on 1 April 2012 and met eleven times during the year. Membership and attendance was as shown below:

Richard Fleck (Chair)	11/11
Paul George	11/11
Lillian Boyle	11/11
Peter Chambers	9/11
Hilary Daniels	7/11
Mark Eames	10/11
Gay Huey Evans (from 1 January 2013)	3/3
Jan Kamieniecki	11/11
John Kellas	11/11
David Lindsell (to 31 July 2012)	0/3
Lois Moore	11/11
Malcolm Nicholson	8/11
Joanna Osborne	9/11
Philip Taylor	10/11
Timothy Walker (to 17 October 2012)	2/6
Ian Wright* (from 1 September 2013)	0/7

* Acting Deputy Chair, FRRP, receives papers and is invited to meetings as necessary.

During the year the Committee appointed the members of the Monitoring Committee, the Case Management Committee and the Financial Reporting Review Panel (full membership details are published on the FRC website); agreed the Conduct work plan for 2012/13 and reviewed progress against the plan; reviewed the various procedures and processes within Conduct and approved amended Corporate Reporting Review Operating Procedures, recommended changes to various processes and advised the Board on the scope of corporate reporting and audit monitoring, third country auditor monitoring work, the Accountancy and Actuarial Schemes, the Auditor Regulatory Sanctions Procedure and its oversight of the regulation of the accountancy profession; approved the 2012 Corporate Reporting Review Annual Report for publication; and decided to investigate two matters under the Accountancy Scheme.

Codes & Standards Committee

The Codes & Standards Committee is responsible for

- advising the Board on maintaining an effective framework of UK codes and standards for governance, accounting, auditing and actuarial work;
- monitoring international developments to ensure appropriate and effective UK input into international standard setting;
- identifying and assessing the current, emerging and potential risks to the quality of corporate governance and reporting in the UK and approving the adequacy of actions to mitigate those risks;
- approving operating plans for the FRC's codes and standards activities and overseeing the quality of work and delivery of the principal elements of those plans;
- overseeing the work of the Councils in accordance with the strategic direction provided by the FRC Board, ensuring that the resources of the whole of the FRC relevant to a particular issue are properly deployed; and

- appointing members to the Accounting, Audit & Assurance and Actuarial Councils and overseeing the appointment of any groups by the Councils.

The Codes & Standards Committee was appointed on 1 April 2012 and met seven times during the year. Membership and attendance was as shown below:

Jim Sutcliffe (Chair)	7/7
Keith Barton (from 29 May 2012)	5/5
Olivia Dickson	4/7
Peter Elwin	5/7
Nick Land	6/7
Roger Marshall	4/7
Melanie McLaren (from 11 June 2012)	5/5
Steve Robson (from 1 January 2013)	1/2
Keith Skeoch	4/7
Allister Wilson	5/7

During the year the Committee appointed the members of the Accounting Council, the Actuarial Council and the Audit & Assurance Council (full membership details are published on the FRC website); agreed the Codes & Standards work plan for 2012/13 and reviewed progress against the plan; advised the Board in relation to various codes, standards and guidance and the IASB conceptual framework; agreed priorities in relation to international influencing; considered how the FRC could encourage shorter and more relevant annual reports with the benefit of the work of the Financial Reporting Lab; agreed governance arrangements for the project on XBRL taxonomies for UK GAAP; and reviewed risk to the codes and standards framework and emerging issues.

Nominations Committee

The Nominations Committee is responsible for leading the selection process and making recommendations to the Board for Directors of the FRC (except for the Chair and the Deputy Chair who are appointed by the Secretary of State) and co-opted members of the Conduct and Codes & Standards Committee; approving the selection process for members of the Councils and the Case Management Committee and Monitoring Committee; and overseeing the selection process and approving the appointments of General

Counsel, Executive Counsel and the Convener to the disciplinary schemes. Up to 2 July 2012 the Committee was also responsible for overseeing the selection process for members of the Operating Bodies and for appointing and reappointing members of the Operating Bodies.

Members of the Nominations Committee:

Baroness Hogg (Chair)	
Glen Moreno	
Stephen Haddrill	
Mark Armour	(from 2 July 2012)
Peter Chambers	
Elizabeth Corley	
Olivia Dickson	(from 2 July 2012)
Richard Fleck	(from 2 July 2012)
Gay Huey Evans	
Nick Land	
Rudy Markham	(to 2 July 2012)
Roger Marshall	(from 2 July 2012)
Sir Steve Robson	
Keith Skeoch	
Jim Sutcliffe	(from 2 July 2012)

The Committee undertook extensive work in 2011/12 as part of its contribution to the FRC reforms. This included recommendations to the Board in relation to the appointments of Gay Huey Evans, Mark Armour, Olivia Dickson, Paul George and Melanie McLaren who joined the Board during the current year. The limited business undertaken by the Committee during the current year was conducted in writing and confirmed at Board meetings.

The Committee reviewed and agreed proposals for an Actuarial Council of 11 members up to 31 July 2013, 5 reappointments to the AADB and the appointment of a Deputy Chair to the Financial Reporting Review Panel and as a member of the Conduct Committee.

Remuneration Committee

The Remuneration Committee is responsible for determining and reviewing the remuneration policy for the FRC. It set the remuneration of the Chief Executive

and the Chairs and members of the Operating Bodies, and reviewed and/or approved the remuneration recommendations of the Chief Executive for the senior management team including the Executive Directors.

The Committee met three times during the year. Membership and attendance was as shown below:

Peter Chambers	3/3
Baroness Hogg	3/3
Nick Land	3/3

Following its review of the FRC's reward policy in 2011/12, the Committee exercised oversight of the implementation of the new arrangements. This included making recommendations to the Board on a company-wide bonus for the Executive.

The Committee approved the budgetary limits for the salary review and bonus pool for FRC Staff, approved and reviewed the remuneration of the Chief Executive, the Executive Committee and the Executive Counsel and reviewed his salary and bonus recommendations in relation to the Senior Management Team. The Committee also reviewed the annual fees of the Case Management Committee and Monitoring Committee members.

Audit Committee

The Audit Committee assists the Board in fulfilling its responsibility for monitoring the quality and integrity of the accounting, auditing and reporting practices of the FRC. The Committee's purpose is to scrutinise the FRC's accounting and financial reporting and the audit of the FRC's financial statements.

The Committee met four times during the year. Membership and attendance was as shown below:

Rudy Markham (Chair to 1 July 2012)	1/1
Nick Land (Chair from 2 July 2012)	4/4
Mark Armour (from 1 January 2013)	1/1
Sir Steve Robson (from 2 July to 31 December 2012)	3/3
Keith Skeoch (from 1 January 2013)	0/1

Date of Meeting	Main Items of Business	Also Considered
May-12	Annual report and accounts for 2012	Expenditure approval matrix
	Audit findings report	Professional discipline risk reports
Aug-12	Annual report and accounts for 2012	New banking relationship
	Letter of Representation	
Dec-12	Review of case cost controls	Financial performance & revised
	Proposal to appoint new auditor	forecast
Feb-13	Plan for 2013 audit	Indicative budget for 2013/14
	Further review of case cost controls	

During the period up to the date of this report, the Committee reviewed the draft Annual Report 2012/13, considered the reporting from the auditor and recommended approval of the Annual Report to the Board. During this process the Committee met the auditor without the management being present. The Committee reviewed the Annual Plan and Budget 2013/14 and recommended the funding requirements for 2013/14 to the Board.

The FRC's external auditor PKF (UK) LLP announced a merger with another firm in December 2012. The other firm provided non-audit services to the FRC. As a result PKF (UK) LLP resigned as the FRC's auditor.

The Committee recommended to the Board that the provision of external audit services be put to tender and undertook an open and competitive tendering process during January 2013 involving three firms. Following this process, the Committee recommended to the Board the appointment of haysmacintyre as the FRC's external auditor. The Board formally appointed haysmacintyre as external auditor for the year ended 31 March 2013 in February 2013.

The Committee reviewed and approved the audit plan for 2013 put forward by haysmacintyre and probed them on their planned audit process.

The FRC is a small organisation with a relatively small proportion of its staff having a role in the financial reporting and control processes. The Committee reviewed the need for an internal audit function and concluded that it would be neither necessary nor cost-effective for the FRC. Internal audit activities were undertaken by external sources during the year as and when required.

The Committee commissioned the external auditor to review certain aspects of the system of internal financial control. The review extended to an outsourced revenue collection agent. No major control points were identified during this review, although some improvements were identified, which led to changes in finance procedures. The Committee approved the report.

The Committee reviewed the effectiveness of key internal financial controls during the period and the major areas of risk identified by the Board. It also probed the actions being taken to mitigate those risks. This included a review of the system for monitoring disciplinary case costs: the Committee identified opportunities for enhancement which were then introduced.

The Committee considered and approved a change to the accounting policy on the treatment of the annual grant the FRC receives from Government on the basis that the terms of the grant receivable by the FRC had changed: although the grant continues to support both the revenue and capital expenditure, it no longer contains a specific capital element.

Managing our risks

Risk management is integral to the FRC's business planning and reporting systems and forms part of our day-to-day management practice. It is led from the FRC Board and provides a focus for the procedures and activities of the organisation.

In managing risk we consider the likelihood of a risk materialising and the potential impact. We identify mitigating actions to reduce the likelihood and where appropriate develop contingency plans to manage their impact.

We have developed our approach to reporting our principal risks to implement the recommendations of the Sharman Panel of Inquiry. Our aim is to identify the risks that might significantly compromise our ability to function as a going concern, and risks that would not immediately impact on our day to day operations but might seriously undermine our credibility and

effectiveness as a regulatory authority. In particular, we have regard to the need to use the powers that have been delegated to us where we believe this is justified; and where we are, therefore, accepting a risk that we might be successfully challenged.

The Board has identified the following principal risks and uncertainties that could impact our overarching aim:

Risk description	Mitigating action
<p>The FRC is subject to sustained criticism by Government or other major stakeholders in the event of a systemic or a major corporate failure where we are seen to have failed to make effective use of our powers and resources or fail to respond appropriately</p>	<p>Following the reforms to the FRC’s powers and structures, announced jointly with Government in 2012, the FRC has reaffirmed the scope and purpose of its regulatory role and the way in which it targets its monitoring and enforcement work. It has based its activities on an assessment of current and emerging risks to guide its response to economic disruption or developments in the capital markets relevant to its responsibilities.</p>
<p>The high level of concentration in the audit market results in significant reputational impact and burden on FRC resources in the event that one or more of the Big Four audit firms leaves the market</p>	<p>The FRC has worked with the Competition Commission, audit firms and other regulators better to understand the effects of concentration in the audit market and promote an effective response to the adverse consequences of a major audit firm withdrawing from the UK market, including requesting the development of contingency plans.</p>
<p>The effective framework for the regulation of corporate governance and reporting, as promoted by FRC, is jeopardised by ‘prescriptive’ regulation from the EU</p>	<p>The FRC at Board and executive level has actively engaged with EU developments, including a strong effort and engagement on the debates on audit reform, corporate governance and the company law action plan and on policy towards International Financial Reporting Standards.</p> <p>The FRC works closely with Government, other UK regulatory authorities and stakeholders; and maintains good relationships with EU and other national authorities and international standard-setters. Building on its thought-leadership and technical expertise, the FRC focuses its influencing work on the major issues that impact on the quality of the regulatory environment in the UK.</p>
<p>The FRC’s structure and powers are not adequate or sufficient to promote high quality corporate governance and reporting to foster investment</p>	<p>Following the reforms announced in 2012 the FRC has kept the adequacy of its structure and powers under review and has sought to meet the principles of good regulation in all aspects of its work, including the proportionate use and effective targeting of its regulatory powers and a commitment to accountability and transparency.</p>

Risk description	Mitigating action
<p>The guidance, standards and codes that the FRC issues are not adequate, effective or achieve the desired impact and/or outcome, or impose disproportionate burden on those that are subject to FRC regulation</p>	<p>The FRC targets its code and standard-setting activities on the basis of its views on the major risks to the quality of corporate governance and reporting in the UK. As part of this on-going process during 2012/13 the FRC reviewed and updated the UK Corporate Governance and Stewardship Codes; has introduced updated UK accounting and auditing standards; and has, with the Institute and Faculty of Actuaries, reviewed the adequacy of the current arrangements for actuarial regulation.</p> <p>The FRC's Financial Reporting Lab provides a facility through which investors and preparers can jointly identify areas where reporting can be better focused to meet users' needs.</p>
<p>The FRC's actions to address the perceived shortcomings in the quality and value of audit prove to be either inadequate or disproportionate</p>	<p>The FRC has taken a number of actions to foster high quality audit, including reviewing the current role and accountability of auditors; and maintains comprehensive and transparent arrangements to monitor and report on the quality of audit in the UK.</p>
<p>Decisions made by the FRC are subject to judicial review or challenge because it has failed to follow its procedures or has otherwise exposed itself to serious but legitimate challenge.</p>	<p>The FRC takes regulatory decisions within the statutory powers delegated by Parliament, our published procedures and the principles of natural justice and ensures appropriate publicity for its decisions. The FRC has engaged stakeholders in developing the scope and targeting of, and procedures for, its conduct functions following the FRC reforms. It carefully assesses the opportunities to promote positive outcomes and minimise the risks associated with its regulatory activities, including auditor sanctioning and disciplinary arrangements.</p>
<p>The FRC fails to attract, motivate and retain individuals of the right calibre to carry out its regulatory activities to the necessary high standard.</p>	<p>To support its reformed structure and powers, the FRC has recruited senior and experienced Board, Committee and Council members; and strengthened its senior executive team.</p> <p>The FRC invests in its staff to promote a strong and effective regulatory culture across the organisation based on well-established organisational values.</p>

The Directors have also identified that a failure to manage these risks effectively could also give rise to two additional principal risks to our financial position:

Risk description	Mitigating action
The FRC fails to secure adequate funding under the current non-statutory arrangements to ensure our operational effectiveness	The FRC consults annually on its plan and related budget, maintains good communications with its funding groups and addresses any issues that are raised promptly and effectively. The FRC would seek statutory backing for its levies if the current arrangements proved ineffective.
The FRC is faced with a claim it cannot meet from its reserves for damages and/or costs in respect of its regulatory activities or costs under the disciplinary schemes	The FRC has increased the level of its general reserves that could be drawn on to mitigate the impact of a significant claim against it. It carefully monitors the risks associated with disciplinary cases, and has improved the efficiency of handling such cases,

Going concern

The FRC’s activities, together with the business and financial review are set out above and at page 45.

The financial position of the FRC, its cash flows and liquidity position are shown later in the financial statements. In addition, note 10 to the financial statements includes a description of the FRC’s financial risk management approach.

The directors have a reasonable expectation that the FRC has adequate financial resources and reserves to continue to operate for the foreseeable future. The directors believe that the FRC is well placed to manage its liquidity risks successfully despite the current uncertain economic outlook. The FRC prepares an annual budget supported by regular revised forecasts of both income and expenditure and these are reviewed by the Board. Cash flow forecasts are prepared on a monthly basis. Thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Beyond the management of these financial risks the directors consider and manage risks that over the longer term might impact on the FRC's credibility and effectiveness as a regulator, including those which might affect funding and/or the recoverability/incurrence of costs beyond the level of its reserves. Those key risks are highlighted at page 41-43.

People

The FRC is committed to promoting equality and diversity in all areas of our work as an employer and a regulator, irrespective of gender, disability, ethnicity, sexual-orientation, nationality, age or religion. The FRC is an inclusive employer and values diversity among its employees.

These commitments extend to recruitment, selection and appointments, training, flexible working arrangements and performance appraisal. We regard it as a fundamental right for everyone to be able to work in an environment which is free of harassment and discrimination. The FRC's policies outline our approach to equality, diversity and inclusion, flexible working and health & safety. The policies are supported by the FRC's Citizenship Values which were introduced during the year and following consultation with staff and will be strengthened further by diversity monitoring following a review of the diversity policy during the year.

The FRC's commitment to promoting equality and diversity extends to the membership of the Board and its Committees. The Board satisfies this commitment by keeping under review the mix of skills and experience required on the Board and its Committees, identifying the specific skills required of any new appointment. Particular attention is paid to gender diversity and, although no specific targets are set, 30% of the Board's members, 38% of the Conduct Committee's members, 22% of the Codes & Standards Committee's members and 50% of the Executive Committee's members are women.

Impact on the environment

We are conscious of the impact of our work on the environment and the increasing expectation that organisations should manage this impact. We take steps to reduce energy, water and office waste, and during the year we further increased the amount of office waste that is recycled. We also aim to maintain procurement policies which favour sustainable products and services in order to reduce our environmental impact.

Disclosure to auditor

The Directors, at the date of this report, confirm that, as far as each Director is aware, there is no relevant audit information of which the FRC's auditor is unaware. Each Director has taken all steps that he/she ought to have taken as a Director in order to make himself/herself aware of any relevant audit information and to establish that the FRC's auditor is aware of that information.

The Directors consider that this annual report is fair and balanced in that it provides, in a form which is readily understandable, the information necessary for users to assess the financial performance, activities and prospects of the FRC.

BY ORDER OF THE BOARD

Anne McArthur

Company Secretary

16 July 2013

FINANCIAL REVIEW

Our total operating expenditure is managed in three main categories:

- Core operating costs
- Audit quality review costs
- Disciplinary case costs

Core operating costs represent the cost of our key regulatory functions and corporate costs. These are funded through the levy system on both listed and large private companies and public sector organisations, plus contributions secured under established arrangements with the accountancy and actuarial professions and Government.

Audit quality review costs are recovered from the accountancy professional bodies and other audit bodies. Disciplinary case costs are recovered from the accountancy professional bodies for accountancy cases and from the actuarial funding groups for actuarial cases.

For the year to 31st March 2013 total operating expenditure was £25.5m comprising:

Total Expenditure £m	Actual 2012/13	Budget 2012/13	Actual 2011/12
Core operating costs	16.1	15.6	16.0
Audit quality review costs	3.2	3.4	2.9
Accountancy disciplinary case costs	5.8	4.0	3.7
Actuarial disciplinary case costs	0.4	0.9	0.1
Total	25.5	23.9	22.7

Total expenditure in 2012/13 was £1.6m higher than budget, with the largest contributory factor being accountancy disciplinary case costs. The number and complexity of the cases undertaken during the year were greater than anticipated. Additionally, the Rover case went to tribunal during the latter part of the year. We have sought during the year to accelerate the progress on some of the older cases.

Core operating costs were higher than budget in total with higher staff and depreciation costs being only partially offset by savings in other areas.

Audit quality review costs were below budget for the year as we were able to carry out the required number of audit inspections with fewer staff than budgeted.

The budget for actuarial case costs assumed that one specific case would require significant expenditure during the year. Whilst the investigation is progressing, the level of expenditure in the year was lower than expected.

Compared to prior year, total expenditure increased by £2.8m (12.3%) with the majority of this (£2.4m) being due to disciplinary case costs (both accountancy and actuarial). Within core operating costs, staff costs were up by £0.8m as additional resources were engaged to focus on high priority projects, offset by savings in both the external costs of FRC Reform and in IT support.

The table below analyses total expenditure by type of cost:

Total Expenditure £m	Actual 2012/13	Budget 2012/13	Actual 2011/12
Staff costs	13.7	13.4	12.6
Fees of non-executives, council and committee members	1.3	1.4	1.4
IT and facility costs	1.9	1.9	1.9
Travel and conferences	0.6	0.6	0.6
Legal, professional and audit fees	0.6	0.7	1.1
Contribution to EFRAG	0.3	0.3	0.3
All other costs	0.9	0.7	1.0
Sub Total	19.3	19.0	18.9
Accountancy and actuarial disciplinary case costs (external fees)	6.2	4.9	3.8
Total	25.5	23.9	22.7

The reformed structure of the FRC came into effect on 1st July 2012. At that time our internal reporting was amended to reflect the new structure. Departmental managers have responsibility for managing the costs of their departments in line with budgets agreed at the start of the year including staff and other variable costs. The costs of the FRC leadership team that cover the range of our activities plus facility costs and IT are not allocated to the Codes & Standards or Conduct divisions, and are treated instead as a corporate overhead.

The breakdown of total expenditure by department in the new structure is as follows:

£m	Actual 2012/13	Budget 2012/13	Actual 2011/12
Codes & Standards			
Executive Directorate	0.6	0.6	0.0
Accounting & Reporting Policy	1.8	1.9	2.1
Corporate Governance	0.4	0.4	0.4
Audit & Assurance	0.9	0.6	1.0
Actuarial Policy	0.7	0.7	0.9
Financial Reporting Lab	0.2	0.1	0.0
Codes and Standards Sub total	4.6	4.3	4.4
Conduct			
Executive Directorate	1.0	1.0	0.0
Corporate Reporting Review	1.6	1.7	1.7
Professional Oversight	0.5	0.7	1.1
Professional Discipline: Internal Costs	1.3	1.2	1.3
Accountancy and Actuarial case costs	6.2	4.9	3.8
Actuarial Conduct	0.4	0.4	0.4
Audit Quality Review	3.2	3.4	2.9
Conduct - Sub total	14.2	13.3	11.2
Corporate	6.6	6.3	7.1
Total	25.4	23.9	22.7

The Executive Directorate cost centres for both Codes & Standards and Conduct are newly created in 2012/13 to reflect the new FRC structure. Prior year comparators have not been restated; however, an estimated £0.6m of Professional Oversight costs within the Conduct Division related to Directorate activities in 2011/12.

Revenue

The draft plan and budget is published each year for comment by interested parties including levy payers, professional bodies and Government. The funding requirements for each of the FRC's activities are set out each year in the draft budget and levy payers are invited to comment on the rates at which levies will be set in order to fund our activities.

The grant from Government and the amounts to be collected from the professional bodies are agreed at the start of the year as part of the consultation process.

The amount of funding required for our audit quality review and accountancy disciplinary activities is estimated at the start of the year, with the amounts ultimately recovered being based on the actual net expenditure incurred.

Other income streams, from publications and professional services, for example, are included in total revenue.

During the year 2012/13 the FRC received total funding of £25.4m from the following sources:

£m	Actual 2012/13	Budget 2012/13	Actual 2011/12
For Core Operating Costs			
Publicly traded companies	5.0	4.8	4.8
Large private entities	2.5	2.2	2.1
Public sector organisations	0.4	0.4	0.5
Insurance funds	1.1	0.9	1.25
Pension funds	1.1	0.9	1.25
Accountancy professional bodies	4.5	4.7	4.7
Actuarial profession	0.3	0.3	0.3
Government	0.5	0.5	0.5
Publications	0.4	0.4	0.5
Professional services: income	0.2	0.3	0.1
Sub Total	16.0	15.4	16.0
For Audit Quality Review			
Accountancy professional bodies	2.4	2.8	2.4
Professional services income	0.8	0.6	0.5
Sub Total	3.2	3.4	2.9
For Accountancy Disciplinary Case Costs			
Accountancy professional bodies	5.8	4.0	3.7
For Actuarial Disciplinary Case Costs			
Insurance funds	0.2	0.45	0.05
Pension funds	0.2	0.45	0.05
Sub Total	0.4	0.9	0.1
Total	25.4	23.7	22.7

Collection of levies from publicly traded companies and large private entities exceeded budget by £0.5m in total due to an increase in the number of organisations making payment.

The shortfall of £0.2m in the amount due from the accountancy professional bodies was due to a lower than budgeted contribution received from CIMA.

The amount received from the accountancy professional bodies to fund audit quality review was lower than budget, due in part to reduced expenditure on staffing and also to higher than expected professional services fee income generated.

The amounts received in respect of accountancy disciplinary cases were higher than budget, reflecting increased expenditure on cases. For actuarial cases, the amount spent and received was lower than budget.

Reserves

As set out above, our total income and total expenditure were broadly matched at around £25.4m and £25.5m respectively. As we also earned £0.2m of interest on our investments after tax, the net result for the year after tax was a surplus of £0.1m. This amount has been transferred to reserves.

Total reserves comprise four different funds split between general reserves for both Accountancy and Actuarial activities and case fund reserves for Actuarial and Corporate Reporting Review cases. The movement in reserves is set out in the table below.

£m	Balance at 31st March 2012	Change in Year	Balance at 31st March 2013
General reserves			
Accountancy, audit, corporate governance	3.1	(0.4)	2.7
Actuarial	0.4	0.5	0.9
Sub total	3.5	0.1	3.6
Case funds			
Corporate Reporting Review	2.0	0.0	2.0
Actuarial Discipline	2.0	0.0	2.0
Sub total	4.0	0.0	4.0
Total	7.5	0.1	7.6

General reserves are maintained in order to enable the FRC to meet its obligations should there be unexpected reductions in funding received or to meet unexpected but necessary increases in core operating costs.

Case fund reserves are maintained to enable the FRC to meet higher than expected expenditure on legal fees in investigations or disciplinary actions over and above the amounts included in funding plans in any given year.

Section Four Financial Statements and Notes

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and the group and of the surplus or deficit of the group for that period.

In preparing these financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether the financial statements have been prepared in accordance with IFRSs as adopted by the European Union;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company and the group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions, to disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and the group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of the financial statements and other information included in annual reports may differ from legislation in other jurisdictions.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE FINANCIAL REPORTING COUNCIL LIMITED

We have audited the financial statements of The Financial Reporting Council Limited for the year ended 31 March 2013 which comprise the Consolidated Income Statement, the Consolidated and Company Statement of Recognised Income and Expense, the Consolidated and Company Balance Sheets, the Consolidated and Company Cash Flow Statements and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an Auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' Report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2013 and of the group's result for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

David Cox (Senior statutory auditor)

Fairfax House

for and on behalf of haysmacintyre,

Statutory Auditor

15 Fulwood Place

London

WC1V 6AY

16 July 2013

THE FINANCIAL REPORTING COUNCIL LIMITED

Consolidated Statement of Comprehensive Income for the year ended 31 March 2013

	Notes	2012/13			2011/12		
		Accounting auditing and corporate governance	Actuarial standards and regulation	Total	Accounting auditing and corporate governance	Actuarial standards and regulation	Total
		£'000	£'000	£'000	£'000	£'000	£'000
OPERATING EXPENDITURE	3	(23,138)	(2,366)	(25,504)	(20,664)	(2,045)	(22,709)
Interest income	7	126	33	159	84	20	104
NET OPERATING EXPENDITURE		(23,012)	(2,333)	(25,345)	(20,580)	(2,025)	(22,605)
REVENUE	8	22,555	2,876	25,431	20,009	2,852	22,861
(Deficit)/ Surplus before taxation		(457)	543	86	(571)	827	256
Taxation	9	(25)	(7)	(32)	(21)	-	(21)
(DEFICIT)/ SURPLUS AND TOTAL COMPREHENSIVE INCOME FOR THE YEAR		(482)	536	54	(592)	827	235

The notes on pages 58-72 form part of these financial statements.

THE FINANCIAL REPORTING COUNCIL LIMITED

Consolidated Statement of Financial Position

	Notes	31 March 2013 £'000	31 March 2012 Restated £'000	1 April 2011 Restated £'000
ASSETS				
NON-CURRENT ASSETS				
Intangible assets	11	109	203	242
Property, plant and equipment	12	647	568	733
		756	771	975
CURRENT ASSETS				
Trade and other receivables	13	3,429	2,555	1,989
Investments	14	5,500	2,000	1,550
Cash and cash equivalents	15	2,990	7,175	6,842
		11,919	11,730	10,381
TOTAL ASSETS		12,675	12,501	11,356
LIABILITIES				
CURRENT LIABILITIES				
Trade and other payables	16	(4,649)	(4,189)	(3,081)
Current tax liabilities	9	(32)	(21)	(8)
		(4,681)	(4,210)	(3,089)
TOTAL ASSETS LESS CURRENT LIABILITIES		7,994	8,291	8,267
NON-CURRENT LIABILITIES				
Trade and other payables	17	(124)	(499)	(734)
Long term provisions	18	(318)	(294)	(270)
		(442)	(793)	(1,004)
NET ASSETS		7,552	7,498	7,263
EQUITY				
RETAINED EARNINGS AND OTHER RESERVES				
Accounting, auditing and corporate governance		4,663	5,145	5,737
Actuarial standards and regulation		2,889	2,353	1,526
		7,552	7,498	7,263

Approved by the Board and authorised for issue on 16 July 2013 and signed on its behalf by:

Baroness Hogg
Chairman

The notes on pages 58-72 form part of these Financial Statements.

REGISTERED NUMBER: 2486368

THE FINANCIAL REPORTING COUNCIL LIMITED

Parent Company Statement of Financial Position

	Notes	31 March 2013 £'000	31 March 2012 Restated £'000	1 April 2011 Restated £'000
ASSETS				
NON-CURRENT ASSETS				
Intangible assets	11	109	203	242
Property, plant and equipment	12	647	568	733
		756	771	975
CURRENT ASSETS				
Trade and other receivables	13	3,429	1,590	1,223
Investments	14	5,500	2,000	1,550
Cash and cash equivalents	15	2,990	7,175	6,842
		11,919	10,765	9,615
TOTAL ASSETS		12,675	11,536	10,590
LIABILITIES				
CURRENT LIABILITIES				
Trade and other payables	16	(4,649)	(3,224)	(2,315)
Current tax liabilities	9	(32)	(21)	(8)
		(4,681)	(3,245)	(2,323)
TOTAL ASSETS LESS CURRENT LIABILITIES		7,994	8,291	8,267
NON-CURRENT LIABILITIES				
Trade and other payables	17	(124)	(499)	(734)
Long term provisions	18	(318)	(294)	(270)
		(442)	(793)	(1,004)
NET ASSETS		7,552	7,498	7,263
EQUITY				
RETAINED EARNINGS AND OTHER RESERVES				
Accounting, auditing and corporate governance		4,663	5,145	5,737
Actuarial standards and regulation		2,889	2,353	1,526
		7,552	7,498	7,263

Approved by the Board and authorised for issue on 16 July 2013 and signed on its behalf by:

Baroness Hogg
Chairman

The notes on pages 58-72 form part of these Financial Statements.

REGISTERED NUMBER: 2486368

THE FINANCIAL REPORTING COUNCIL LIMITED

Consolidated and Parent Company Statement of Changes in Equity for the year ended 31 March 2013

		Accounting, auditing and corporate governance		Actuarial standards and regulation		Total
		General reserve	Corporate reporting review legal costs fund	General reserve	Case costs fund	
		£'000	£'000	£'000	£'000	
At 31 March 2011		3,307	2,000	86	1,440	6,833
Prior year adjustment	1b	430	-	-	-	430
At 1 April 2011 (restated)		3,737	2,000	86	1,440	7,263
Surplus and total comprehensive income for 2011/12		(592)	-	267	560	235
At 31 March 2012 (restated)		3,145	2,000	353	2,000	7,498
(Deficit)/ Surplus and total comprehensive income for 2012/13		(482)	-	536	-	54
At 31 March 2013		2,663	2,000	889	2,000	7,552

Consolidated and Parent Company Cash Flow Statement for the year ended 31 March 2013

	Notes	2012/13 £'000	2011/12 £'000
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash (absorbed)/ generated from operations	20	(471)	807
Corporation tax paid		(21)	(8)
Total cash (outflow)/ inflow from operating activities		(492)	799
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property, plant, equipment		(319)	(60)
Purchase of software		-	(36)
Investment in money market deposits		(3,500)	(450)
Interest received		126	80
Total cash outflow from investing activities		(3,693)	(466)
NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS		(4,185)	333
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF PERIOD	15	7,175	6,842
CASH AND CASH EQUIVALENTS AT THE END OF PERIOD	15	2,990	7,175

Cash and cash equivalents comprise cash at bank and other short-term highly liquid bank deposits with an original maturity of three months or less. Other short term deposits with an original maturity of over three months but less than one year are shown under Investment in money market deposits.

The notes on pages 58-72 form part of these financial statements.

1. Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the FRC's financial statements.

a) Basis of Preparation

The FRC has prepared its financial statements in accordance with International Financial Reporting Standards (IFRSs) and interpretations issued by the International Accounting Standards Board (IASB) as adopted by the European Union.

These financial statements are prepared on an historical cost basis.

As at the date of approval of these financial statements, a number of standards and interpretations were in issue but not yet effective (and in some cases had not yet been adopted by the EU). The adoption of these standards is not expected to have a material impact on the financial statements.

b) Presentation of Financial Statements

To reflect that the FRC's expenditure is met by contributing organisations, the Directors have presented the Consolidated Statement of Comprehensive Income and the notes thereon therefore in the order first of the FRC's operating expenditure followed by its revenue which is principally the contributions received from its funding groups.

During the year, it was identified that the nature of the government grant receivable by the FRC had changed over time in that, although the grant continues to support both revenue and capital expenditures, it no longer contains a specific capital element. This therefore has led to a change in the accounting regarding government grants (see note d). From 2008/09 government grants no longer specifically provided for the purchase of assets and as a result £430,000 has been released from deferred income as at the beginning of the year. The impact of the change in accounting on the current year income statement is an increase in income of £87,000 (2012: decrease £2,000).

The presentational and functional currency is the British Pound Sterling.

c) Consolidation

Consolidated financial statements have been prepared for the year. The FRC has one subsidiary, The Accountancy and Actuarial Discipline Board Limited (AADB). The activities of AADB have now been absorbed within The Financial Reporting Council Ltd and AADB has no surplus or deficit for the year. An application has been made to Companies House to strike off AADB.

The company has taken advantage of the exemption provided under Section 408 (3) of the Companies Act 2006 not to publish its individual parent company Statement of Comprehensive Income and related notes.

d) Revenue Recognition

The FRC has a variety of sources of revenue and accounts for them as described below:

- Revenue in respect of levies is accounted for on a receipts basis as they are voluntary contributions.
- Revenue in respect of government grants that do not relate to the purchase of assets is recognised over the period to which the grant is intended to relate, usually a specified financial year. Where government grants relate to the purchase of assets, revenue is recognised on a systematic basis over the useful economic lives of the related assets, with any unamortised grant recognised as deferred income.

- Revenue is received from participants to fund specific activities, so that:
 - Revenue receivable in respect of Audit Quality Review costs is recognised as the costs to be recovered are incurred in each financial year.
 - Revenue receivable in respect of Accountancy disciplinary case costs is recognised as the costs to be reimbursed are incurred in each financial year.
 - Revenue receivable in respect of Corporate Reporting Review legal costs is recognised at the level of costs incurred in the preceding financial year once their recoverability has been established (see note 6.1).
- Revenue in respect of publications and professional fee income is recognised on sale of goods or delivery of services.

e) Property, Plant and Equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any accumulated impairment losses.

Office equipment includes cost of software that is an integral part of the asset function. Depreciation is provided on all property, plant and equipment at rates calculated to write off the cost, less estimated residual value, over their expected useful lives, as follows:

Office equipment	3 Years	straight line basis
Fixtures, fittings & furniture	10 years	straight line basis
Leasehold improvements	shorter of lease term and useful life	straight line basis

If events or changes in circumstances indicate the carrying value may not be recoverable then the carrying values of property, plant and equipment are reviewed for impairment.

The gain or loss arising on the disposal or retirement of an asset is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognised in the Statement of Comprehensive Income.

f) Intangible assets

Costs associated with acquiring, developing, tailoring and installing identifiable and unique software products that will generate economic benefits beyond one year are recognised as intangible assets. Costs include any employee costs incurred in bringing the asset into use.

Capitalised software costs are amortised on a straight line basis over their estimated useful life considered to be three years from the time the software is brought into use.

g) Impairment

At each Statement of Financial Position date, the FRC reviews the carrying amounts of its assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

Recoverable amount is the higher of fair value less costs to sell, and value in use. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

No impairment charge has been recognised during the year.

h) Leases

Leases of property, plant and equipment where the lessee has substantially all the risks and rewards of ownership are classified as finance leases. The FRC does not have any finance leases. All leases are operating leases. Total rentals payable under operating leases are charged to the Statement of Comprehensive Income over the term of the lease on a straight line basis. The benefits from lease incentives including rent free periods are spread over the lease term on a straight line basis.

i) Taxation

The FRC is only subject to corporation tax on its interest receivable income. There are no temporary differences between the recognition of that income in the financial statements and the tax computation. Accordingly, there is no provision for deferred tax.

j) Collection of the UK share of the IASB funding requirement

The FRC acts as an agent for the International Accounting Standards Board (IASB) by issuing invoices and collecting monies on its behalf in respect of the UK contribution to the IASB. The FRC pays over to the IASB the agreed amount up to the amount collected. Accordingly, these amounts are not accounted for within revenues and costs of the FRC (see note 19).

k) Financial Instruments

Financial assets and financial liabilities are recognised on the FRC's Statement of Financial Position when it becomes a party to the contractual provisions of the instrument.

Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and other short-term highly liquid bank deposits with an original maturity of three months or less.

Money market deposits

Money market deposits comprise bank deposits with an original maturity of more than three months but less than one year and these are disclosed within current investments.

Trade receivables

Trade receivables do not carry any interest and are stated at their nominal value. Appropriate allowances for estimated irrecoverable amounts are recognised in the Statement of Comprehensive Income when there is objective evidence that the asset is impaired.

Financial liabilities

Financial liabilities are classified according to the substance of the contractual arrangements entered into.

Trade payables

Trade payables are not interest bearing and are stated at their nominal value.

l) Employee Benefits

Pension Costs

The FRC makes contributions to personal pension schemes. The amount charged to the Statement of Comprehensive Income in respect of these schemes is the total contributions paid and accrued.

Holiday Pay

The FRC accrues for holiday pay which is earned but not taken by the employees as at the year end.

m) Provisions and contingencies

Provisions are recognised when the following three conditions are met:

- (i) The FRC has a present obligation (legal or constructive) as a result of a past event;
- (ii) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (iii) A reliable estimate can be made of the amount of the obligation.

The amount of the provision represents the best estimate of the expenditure required to settle the obligation at the end of the reporting period. Contingent liabilities, including liabilities that are not probable or which cannot be measured reliably are not recognised, but are disclosed unless the possibility of settlement is considered remote.

Contingent assets are not recognised, but are disclosed where an inflow of economic benefits is probable.

Dilapidations

Provision is made for the estimated costs of dilapidation repairs. Estimated costs of removing leasehold improvements are provided and capitalised, such expenditure being amortised over the term of the lease.

Case costs

The legal and professional costs of Accountancy and Actuarial disciplinary cases and Corporate Reporting Review cases incurred in the period are included in the accounts on an accruals basis. Provision is made for the future costs of any disciplinary cases only where the contract is onerous, the costs are unavoidable and represent a present obligation under IAS 37 at the Statement of Financial Position date.

Fines

Fines receivable in respect of Accountancy disciplinary cases are due to the relevant participant body under the Accountancy Scheme and are not recognised in the accounts as the fines are received by the FRC acting solely as collection agent.

Fines receivable in respect of Actuarial disciplinary cases are retained and included within revenue in the period in which the fines become due and collectable.

2. Significant judgements and key sources of estimation uncertainty

The preparation of financial statements requires the use of estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. Although these estimates and associated assumptions are based on historical experience and the management's best knowledge of current events and actions, the actual results may ultimately differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis.

Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision only affects that period or in the period of the revision and future periods if the revision affects both current and future periods.

Judgements and estimates have been made in the following areas:

Provision for dilapidations

Provision for dilapidations is calculated by estimating costs of removing leasehold improvements and related repairs which may arise at the end of the lease. This estimation is carried out by an independent chartered surveyor on a regular basis. See note 18 for further details.

Litigation cost provision

The directors have considered the likelihood of potential litigation costs and believe that a provision is not required.

3. Operational Expenditure

	Group 2012/13			Group 2011/12		
	Accounting auditing and corporate governance	Actuarial standards and regulation	Total	Accounting auditing and corporate governance	Actuarial standards and regulation	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Staff and related people costs (note 4)	13,579	1,053	14,632	12,453	1,182	13,635
Other operating charges (note 5)	3,771	919	4,690	4,477	751	5,228
Accountancy and Actuarial case costs	5,788	394	6,182	3,734	112	3,846
Total operational expenditure	23,138	2,366	25,504	20,664	2,045	22,709

4. Staff and related people costs (including directors)

	Group	
	2012/13 £'000	2011/12 £'000
Permanent staff:		
Salaries	10,312	9,727
Social security costs	1,390	1,303
Other pension costs	1,172	911
Total permanent staff costs	12,874	11,941
Other people related costs:		
Seconded staff and contractors	321	239
Fees to operating body and committee members	1,199	1,235
Other costs	238	220
Total staff and related people costs	14,632	13,635

The average number of permanent staff employed in the financial year was 114 (2011/12: 102) in total. Of this the average number of persons so employed under: Accounting, auditing and corporate governance including Audit quality review and Accountancy disciplinary cases was 106 (2011/12: 95) and Actuarial standards and regulation was 8 (2011/12: 8).

The FRC does not operate a pension scheme. The other pension costs shown in the above table are payments to personal pension schemes.

Directors' emoluments

	Group	
	2012/13 £'000	2011/12 £'000
Fees (included in staff costs)	1,568	1,062
Other pension costs	76	34
Total directors emoluments (see page 34)	1,644	1,096
Social security costs	197	135
	1,841	1,231

Three Directors are entitled to receive a pension benefit. The contributions paid by the Company to the Chief Executive's personal pension arrangement were £34,658 (2011/12 £33,812).

The contributions paid by the Company to the Director of the Conduct Division's personal pension arrangement were £21,114 (2011/12 £nil).

The contributions paid by the Company to the Director of the Codes & Standards Division's personal pension arrangement were £20,250 (2011/12 £nil).

Details of the emoluments of the directors are contained in the Directors' Report on page 33.

5. Other operating charges

	Group	
	2012/13 £'000	2011/12 £'000
Other operating charges include:		
Amortisation (note 11)	94	75
Depreciation (note 12)	240	285
Operating leases		
- land and buildings	456	452
- office equipment	7	8
Other facilities, IT and website costs	2,020	1,915
Travel & subsistence, conferences, meetings & hospitality	555	503
European Financial Reporting Advisory Group (EFRAG) contribution	287	309
Foreign exchange gain	(2)	-
Recruitment, research & training	386	460
FRC Reform and legal & professional fees	450	1,002
Auditor's remuneration:		
- audit	40	35
- non-audit services	-	12
Publications and subscription services	157	172
Total Operating charges	4,690	5,228

A new external auditor, haysmacintyre was appointed during the year following a tender process with three firms. This followed the merger of BDO with the previous auditor, PKF, to avoid a conflict of interest as BDO are acting as expert witness in a number of accountancy disciplinary case investigations. The fee includes £34,500 payable to haysmacintyre and £5,500 paid to PKF before their resignation. The non-audit services provided by PKF in the previous year related to a secondment from PKF which was terminated when PKF were appointed as auditors (see page 46).

6. Costs funds

6.1 Corporate Reporting Review legal costs fund

Contributions have been received from Government to enable the Corporate Reporting Review team to take steps to pursue compliance with the accounting requirements of the Companies Act 2006, including applicable Standards, and to investigate departures from those standards and requirements. Those funds may be used only for this purpose and may not be used to meet other costs incurred by the FRC. The FRC may be liable to repay the balance on the Legal Costs Fund to the contributors if it ceases to be authorised by the Secretary of State for BIS for the purposes of section 456 of the Companies Act 2006.

Since the costs of Review Team investigations in a financial year cannot be budgeted with sufficient certainty, funding contributions to make good expenditure on the Legal Costs Fund are sought in the financial year following the expenditure.

	Group and Company	
	2012/13 £'000	2011/12 £'000
The fund is represented by:		
Investments/ Cash at bank and in hand	2,000	2,000

6.2 Actuarial case costs fund

The actuarial case costs fund is used to fund investigations into potential misconduct by actuaries and any related prosecution.

	Group and Company	
	2012/13 £'000	2011/12 £'000
The fund is represented by:		
Investments	2,000	2,000

7. Interest income

Interest on the Corporate Reporting Review Legal Costs Fund and the Actuarial Case Costs Fund is used to offset core operating costs. For the Corporate Reporting Review, interest should be used first to bring the fund back up to £2m if there has been any net diminution and then any excess is set against the core operating costs.

	Group	
	2012/13 £'000	2011/12 £'000
Bank interest:		
Accounting, auditing and corporate governance		
– General	94	65
– Case Costs Fund	32	19
	126	84
Bank interest: Actuarial standards and regulation		
– General	-	1
– Case Costs Fund	33	19
	33	20
	159	104

8. Revenue

Revenue analysed by related category of cost is as follows:

	Group 2012/13			Group 2011/12		
	Accounting auditing and corporate governance	Actuarial standards and regulation	Total	Accounting auditing and corporate governance	Actuarial standards and regulation	Total
	£'000	£'000	£'000	£'000	£'000	£'000
Core operating activities	12,846	1,939	14,785	12,571	1,913	14,484
Audit quality review	2,379	-	2,379	2,370	-	2,370
Accountancy and actuarial disciplinary case costs	5,788	394	6,182	3,734	112	3,846
Actuarial case costs fund	-	543	543	-	827	827
Income from publications	552	-	552	645	-	645
Professional fee income	990	-	990	689	-	689
	22,555	2,876	25,431	20,009	2,852	22,861

9. Taxation

Corporation Tax at an effective rate of 20% (2011/12: 20%) on interest income of £159,000 (2011/12: £104,000).

	Group	
	2011/12 £'000	2010/11 £'000
	32	21

Tax is payable only on interest earned.

10. Financial risk management

The FRC's operations expose it to some financial risks. The management continuously monitors these risks with a view to protecting the FRC against the potential adverse effects of these financial risks. There has been no significant change in these financial risks since the prior year.

Fair value of financial instruments

The FRC's financial instruments in both years comprise cash and cash equivalents, current investments, loans and receivables including short-term debtors and creditors that arise directly from its operations.

The principal purpose of these financial instruments is to generate revenue to fund future operating costs including case costs. The FRC has no gearing or other financial liabilities apart from creditors. It is, and has been throughout the year under review, the FRC's policy that no trading in derivative financial instruments shall be undertaken.

The carrying value of the trade receivables, trade payables and cash and cash equivalents approximate to their fair value.

Credit Risk

It is the FRC's management policy to assess its trade receivables for recoverability on an individual basis and to make provisions where considered necessary. In assessing recoverability the management takes into account any indicators of impairment up until the reporting date. To reduce the risk of loss, the bank deposits are spread across a range of major UK Banks.

The age analysis of trade receivables not impaired is:

	Group and Company	
	2013 £'000	2012 £'000
Not past due date	299	91
Past due date more than six months but not more than one year	20	36
	319	127

The average trade receivable period is 41 days (2012: 22 days). The trade receivables that are neither impaired nor past due date are made up of three balances (2012: two). The FRC does not hold any collateral or other credit enhancements as security for its trade receivables. No other receivables were past due date at the year-end (2012: nil).

Depositing funds with commercial banks exposes the FRC to counter-party credit risk. The amounts held at banks at the year-end were with banks with solid investment grade credit ratings. Since the year-end one bank, holding £3.0m at 31 March 2013 has had its credit rating reduced to below investment grade. As at the date of this report, the deposit outstanding with this bank had reduced to £1.55m.

Interest rate risk

The FRC invests the majority of its surplus funds in highly liquid short term deposits with an original maturity no greater than eighteen months. The average interest rate on short term deposits is 1.33% (2012: 1.08%) and none of the deposits have an original maturity of more than one year.

For a change in interest rates of 1%, the gross interest earned would change by approximately £100,000.

Liquidity risk

The FRC maintains sufficient levels of cash and cash equivalents and manages its working capital by carefully reviewing forecasts on a regular basis to determine the requirements for its day-to-day operations.

The age analysis of trade payables is as follows:

	Group and Company	
	2013 £'000	2012 £'000
Not past due date	216	877
Past due date by no more than three months	-	43
	216	920

The average creditor payment period is 24 days (2012: 22 days).

11. Intangible Assets

	Group and Company
	Software £'000
Cost at 1 April 2011	242
Additions	36
Cost at 31 March 2012	278
Additions-	
Cost at 31 March 2013	278
Amortisation at 1 April 2011	-
Charge for year	75
Amortisation at 31 March 2012	75
Charge for year	94
Amortisation at 31 March 2013	169
Net book value at 31 March 2013	109
Net book value at 31 March 2012	203

12. Property, plant and equipment

	Group and Company			
	Leasehold improvements	Office equipment	Fixtures, fittings & furniture	Total
	£'000	£'000	£'000	£'000
Cost at 1 April 2011	699	1,280	606	2,585
Additions	-119	1	120	
Cost at 31 March 2012	699	1,399	607	2,705
Additions	-	59	260	319
Cost at 31 March 2013	699	1,458	867	3,024
Depreciation at 1 April 2011	456	1,033	363	1,852
Charge for year	73	161	51	285
Depreciation at 31 March 2012	529	1,194	414	2,137
Charge for year	73	107	60	240
Depreciation at 31 March 2013	602	1,301	474	2,377
Net book value at 31 March 2013	97	157	393	647
Net book value at 31 March 2012	170	205	193	568

13. Trade and other receivables

	Group		Company	
	2013 £'000	2012 £'000	2013 £'000	2012 £'000
Current:				
Net trade receivables	319	127	319	127
Intercompany receivable	-	-	-	240
Prepayments	617	771	617	771
Accrued income	2,186	1,205	2,186	-
Other receivables	307	452	307	452
	3,429	2,555	3,429	1,590

Accrued income represents amounts receivable from the Accountancy professional bodies in respect of Accountancy disciplinary case costs. This amount was invoiced and paid after the year end.

14. Investments

	Group and Company			
	General Accounts £'000	Actuarial Case Costs Fund £'000	Corporate Reporting Review Legal Costs Fund £'000	Total £'000
At 31 March 2012	2,000	-	-	2,000
Net cash (outflow)/ inflow for year	(500)	2,000	2,000	3,500
At 31 March 2013	1,500	2,000	2,000	5,500

The carrying value of the money market deposits is not significantly different from fair value. See note 6 regarding Costs Funds.

15. Cash and cash equivalents

	Group and Company			
	General Accounts £'000	Actuarial Case Costs Fund £'000	Corporate Reporting Review Legal Costs Fund £'000	Total £'000
At 31 March 2012	3,534	1,641	2,000	7,175
Net cash outflow for year	(544)	(1,641)	(2,000)	(4,185)
At 31 March 2013	2,990	-	-	2,990

See note 6 regarding Costs Funds.

16. Trade and other payables: current

	Group			Company		
	2013 £'000	2012 £'000	2011 £'000	2013 £'000	2012 £'000	2011 £'000
Trade payables	216	920	111	216	920	111
Other taxation and social security	775	661	682	775	661	682
Accruals	2,919	1,917	1,683	2,919	952	917
Deferred income	443	471	309	443	471	309
Other payables	296	220	296	296	220	296
	4,649	4,189	3,081	4,649	3,224	2,315

17. Trade and other payables: non-current

	Group and Company		
	2013 £'000	2012 £'000	2011 £'000
Accruals	43	151	262
Deferred income	81	348	472
	124	499	734

18. Long Term Provisions

	Group and Company	
	2013 £'000	2012 £'000
Leasehold improvements and dilapidations		
Balance at 31 March 2012	294	270
Amount charged to Statement of Comprehensive income	24	24
Balance at 31 March 2013	318	294

A provision has been made for obligations under the lease at Aldwych House. These obligations are to remove the leasehold improvements and return the property at the end of the lease in August 2014 to its original state and to meet the tenant repairing clause for dilapidations. This provision is based on an estimate by an independent surveyor. This provision has not been discounted as the effect of discounting is not material.

19. Significant transactions with other standard setters

The FRC raises the UK contribution to the funding of the IASB by issuing invoices and collecting monies on its behalf. The FRC does not make a charge for providing this service. The amount of monies collected during the year was £860,000 (2011/12: £865,000), of which £65,000 (2011/12: £105,000) remained to be paid over by the FRC to the IASB as at 31 March 2013.

20. Cash flow statement – cash generated from operations

	Group and Company	
	2013 £'000	2012 £'000
Surplus on ordinary activities before taxation	86	256
Adjustments for:		
- Interest income	(159)	(104)
- Depreciation and amortisation	334	360
- Provision for dilapidation	24	24
- (Increase) in trade and other receivables	(874)	(646)
- Increase in trade and other payables	118	917
Net cash (outflow)/ inflow from operations	(471)	807

21. Commitments

There were no capital commitments outstanding at 31 March 2013 (2012: nil).

Total commitments for the FRC under operating leases relating to the leasehold property for each of the following periods were as follows:

	Group and Company	
	2013 £'000	2012 £'000
Payments due within one year	453	453
Payments due within two to five years	160	617
	613	1,070

Total commitments for the FRC under operating leases other than those relating to leasehold property were as follows:

	Group and Company	
	2013 £'000	2012 £'000
Payments due within one year	9	1
Payments due within two to five years	20	13
	29	14

22. Subsidiary undertaking

The FRC has one wholly owned subsidiary, The Accountancy and Actuarial Discipline Board Limited (AADB), a company incorporated in England & Wales, which as explained in note 1(c) has been consolidated. AADB has no surplus or deficit for the year. An application has been registered with Companies House to strike off AADB.

23. Related party transactions

This disclosure is on a consolidated and company basis.

Key Management Compensation

The Directors represent key management personnel for the purposes of the FRC's related party disclosure reporting and their compensation is as disclosed in note 4.

Transactions with subsidiary entities

The FRC entered into the following transactions with The Accountancy and Actuarial Discipline Board Limited (AADB) during the year:

- Amounts receivable from AADB £7,642,000 (2011/12: £5,368,000)
- Contributions made by FRC towards costs of the AADB £7,642,000 (2011/12: £5,368,000)

Balances due from AADB are included in trade and other receivables (see note 13).

Transactions with related parties

The related party transactions are transacted in the normal course of business.

24. Liability of members

The members of the FRC have undertaken to contribute a sum not exceeding £1 each to meet the liabilities of the Company if it should be wound up.

Appendix 1 Fulfilling our Statutory Responsibilities

Statutory Audit Regulation

Appendix 1 reports on:

(i) the FRC's statutory oversight of the regulation of auditors by recognised professional bodies in 2012/13.

(ii) the FRC's statutory responsibilities as the Independent Supervisor of Auditors General.

(i) Statutory Oversight of the Regulation of Auditors

1. INTRODUCTION

1.1. Section 1252(10) of, and paragraph 10(3) of Schedule 13 to, the Companies Act 2006, requires the FRC to report once in each calendar year to the Secretary of State on the discharge of the powers and responsibilities delegated to the FRC under sections 1252 and 1253 of the Companies Act 2006.

1.2. Until 2 July 2012 the Professional Oversight Board (POB), then an operating body of the FRC, had statutory responsibility for this oversight and reported each year to the Secretary of State. This is, therefore, the first occasion that we report on the statutory audit regulatory functions of the Financial Reporting Council. However, for simplicity we refer to work in previous years as though it had been undertaken directly by the FRC.

1.3. As part of the revised delegation of powers in 2012, the FRC received the following additional enforcement powers in 2012:

- To direct an RSB or RQB to take specific steps to meet its statutory obligations.
- To impose a financial penalty on an RSB or RQB where it has not met a requirement or obligation on it.

1.4. These powers expand and enhance the powers of enforcement against an RSB or an RQB which fails to meet its statutory obligations, which were previously limited to:

- Seeking a High Court order requiring the RQB or RSB to take specific steps to secure compliance with a statutory obligation.

- Revoking the recognition of the RSB or RQB, following due process, where it appears to us that a body has failed to meet an obligation under the Act.

1.5. We consider that we now have an appropriate graduated range of enforcement powers that should enable us to address both serious and lesser failures by the recognised bodies. We have not yet had occasion to use our formal enforcement powers.

2. MONITORING OF RECOGNISED SUPERVISORY BODIES AND RECOGNISED QUALIFYING BODIES

2.1. Audit firms that wish to be appointed as a statutory auditor in the UK must be registered with, and supervised by, a Recognised Supervisory Body (RSB). Individuals responsible for audit at registered firms must hold an audit qualification from a Recognised Qualifying Body (RQB).

2.2. The following are both RSBs and RQBs:

- Association of Chartered Certified Accountants (ACCA)
- Institute of Chartered Accountants in England and Wales (ICAEW)
- Chartered Accountants Ireland (CAI)¹
- Institute of Chartered Accountants of Scotland (ICAS)

¹ The Chartered Accountants Regulatory Board (CARB) carries out all the functions of the CAI as an RSB, in accordance with the CAI Bye-laws.

- 2.3. In addition²:
- Association of Authorised Public Accountants (AAPA) is an RSB³
 - Association of International Accountants (AIA) is an RQB
- 2.4. We exercised oversight primarily by:
- Understanding and documenting how each body meets all the statutory requirements for continued recognition, and making recommendations;
 - Reviewing and testing the way in which each body's regulatory systems operate in practice, and making recommendations;
 - Evaluating the effectiveness of specific aspects of the regulatory system.

3. 2012/13 MONITORING

- 3.1. We carried out a monitoring visit to all RSBs and RQBs other than the AIA, to test how they had applied regulatory requirements in practice, in particular where there had been a significant change in the year. Most visits consisted of five days' fieldwork at the recognised body involving two staff members. However, in the case of three of the RSBs our visits lasted for two weeks because the areas we selected were ones where there was considerable activity to review. During our visits we also reviewed the bodies' responses to recommendations made in prior years.
- 3.2. As an independent expert had been commissioned to review the AIA's recognised professional qualification (RPQ) and its examinations, it was agreed that we would not carry out a further monitoring visit in 2012 (see paragraphs 7.13 to 7.18 below).
- 3.3. The FRC's Audit Quality Review (AQR) team also undertook some oversight functions in relation to inspections by the monitoring units of the RSBs of smaller auditors of public interest entities. It approves the inspection methodology used to assess a firm's policies
- and procedures supporting audit quality and the assignment of inspectors to undertake this work; and it reviews the monitoring units' inspection reports on each firm.
- 3.4. We focused our 2012/13 RSB and RQB visits on the following areas:
- The RSB processes and practice in respect of (a) complaints, paying particular attention to the handling of complaints where the matter is considered to be high profile or falls just below the threshold of the criteria for an investigation by FRC's Accountancy Disciplinary Scheme; and (b) disciplinary cases. We reviewed the files and case papers for a sample of complaints and discipline cases that were closed during 2011 and 2012. Many of the files and documentation we reviewed were on paper but the bodies are increasingly using electronic work papers to record the investigation of complaints. Electronic work papers take more time to review but provide a clearer trail to show that the correct procedures have been followed and the necessary management supervision carried out. We also observed a small number of hearings at the bodies where disciplinary cases were considered by a tribunal.
 - The processes and practice for audit monitoring by the RSBs. We focused on the monitoring of (i) audit firms with at least one public interest audit client falling within the scope of the AQR team, (ii) firms whose audit work had significantly improved or deteriorated compared to their previous monitoring visit; and (iii) firms subject to conditions imposed on their audit work by a regulatory committee. We reviewed the work papers and reports for a sample of audit monitoring visits completed in 2012. Electronic work-papers are increasingly being used to record audit monitoring visits.
 - The processes and practice in respect of (a) the award of the Audit Qualification, and (b) student progression and the recording and review of practical training records. We tested the working of these processes in practice by reviewing (i) applications for a sample of

² The Chartered Institute of Public Finance and Accountancy (CIPFA) was recognised as an RQB in 2005, subject to conditions, but did not at that time develop fully the examinations and arrangements for practical training needed for the award of the statutory auditor qualification. CIPFA's RQB status is therefore in abeyance and we did not carry out a monitoring visit in 2012/13.

³ The AAPA, which was formed in 1978 to represent auditors individually authorised by the then DTI, was recognised as an RSB in 1991 following the Companies Act 1989. It became a subsidiary of the ACCA in 1996, since when its members have been supervised by the ACCA. We therefore reviewed the AAPA's regulatory responsibilities as part of our review of the ACCA. The AAPA had 49 registered auditors, as at 31 December 2012.

individuals awarded the audit qualification and (ii) practical training records for a sample of students admitted to membership in 2012.

- The progress made by the bodies in implementing our recommendations made in prior years.

4. INFORMATION REQUIREMENTS AND PUBLIC REPORTING

4.1. We maintain up-to-date documentation of all the bodies' regulatory systems. All RSBs and RQBs are required to provide an annual regulatory report, which includes statistical information on their regulatory activities during the year. We include some of this information in our annual publication "Key Facts and Trends in the Accountancy Profession"⁴. In addition we asked each body to provide us with an annual Regulatory Plan for 2012, covering both RQB and RSB requirements, and, more recently, for 2013. Whilst both the regulatory reports and the regulatory plans provide much useful information for our oversight role, they do not in all cases address key risks, future plans and challenges as fully as we would like.

4.2. Against this background we agreed with all the bodies to supplement the information in their annual reports and regulatory plans in the following ways during 2013:

- Regular meetings between the FRC's Oversight team and each body, specifically to discuss current issues and future developments;
- Discussions between the Chief Executives of the Chartered accountancy bodies and the FRC's Conduct Committee about their regulatory strategy and plans; and
- All the bodies to inform us of any urgent, or emerging significant issues relevant to their role as an RSB/RQB as soon as they arise, with a view to ensuring that our views are taken fully into account before decisions are taken.

5. RESULTS OF 2012/13 MONITORING – MAIN POINTS

5.1. Where appropriate we refer in this report to the individual bodies to which significant findings and recommendations apply. However, we invite all the bodies to consider the relevance of our findings to their situation. We also look carefully at the manner and speed with which individual bodies have responded to our previous recommendations, and again refer to individual bodies where we judge that they have not responded promptly or adequately to recommendations, and where significant issues persist.

5.2. This report contains a number of comments, findings and recommendations that are expressed in general terms because they are thought to be of relevance generally. It should not be assumed that they apply to all recognised bodies.

5.3. All the bodies devote substantial resources to their regulatory responsibilities. We consider that all the bodies have adequate procedures in place to monitor and enforce compliance with their regulations. We continue to see much regulatory practice of a high standard and in many cases our recommendations are aimed at encouraging the bodies to adopt best practice rather than at correcting major failings. We see no reason at present to take enforcement action against any RSB or RQB, or to initiate the process of withdrawing recognition.

5.4. However, in a report such as this the emphasis is on aspects of regulatory activity at certain recognised bodies that give us specific concerns. In particular:

- On **complaints**, we have made recommendations aimed at ensuring that complaints are handled without undue delays: that the progress of investigations of complaints is adequately monitored by the use of appropriate case management systems, and that any emerging delays are addressed promptly by prioritising staff workloads or by bringing in additional staff resources. In addition, both parties to the complaint should be kept informed of progress on a regular basis, and

⁴ Key Facts and Trends in the Accountancy Profession, 11th Edition. Available at <http://frc.org.uk/Our-Work/Publications/Professional-Oversight/Key-Facts-and-Trends-in-the-Accountancy-Profession.aspx>

given information about any delays and how long they may persist (see paragraphs 6.1 to 6.4);

- On **audit monitoring** we found that, where poor audit practice persists within firms, the follow up to audit monitoring visits is not in all cases as rigorous as we consider appropriate at all bodies. (see paragraphs 6.5 to 6.9);
- On the **audit qualification**, we made recommendations to some bodies aimed at ensuring that the systems and procedures for the granting of the audit qualification are robust and that these qualifications are granted only to those individuals who hold sufficient audit hours to meet the requirements (see paragraphs 7.1 to 7.8); and
- On records of **students' practical audit experience**, we made recommendations directed at improving the quality and accuracy of records, and at the bodies encouraging firms to monitor, review and approve student training records on a more regular basis (see paragraphs 7.9 to 7.12).

5.5. We also considered the bodies' responses to recommendations made in our previous reports. Overall, the bodies respond positively to our recommendations. However, some recommendations involve change over the longer term, which means that it is not always possible to assess whether changes made are sufficient until a year or later. In other cases our recommendations have prompted bodies to carry out their own review of their processes. It often takes some time before the recommendations of such a review are known. That said, as discussed in sections 6 and 7, there are examples where progress has been slower than we consider necessary.

5.6. The main points in relation to individual bodies from our 2012/13 monitoring work, including our review of progress in response to prior year recommendations, are as follows:

- **ACCA:** we found that the arrangements for the investigation of complaints had not been effective in relation to a significant number of the case files closed in 2011 and 2012 which we reviewed, that the system was at

the relevant time under-resourced and that this led to unacceptable delays in handling cases. We were pleased to note that the ACCA took serious measures to address 'legacy' cases and also to have an effective properly resourced system for handling new cases from 2011. In addition, we consider that it is extremely important that the ACCA successfully implement their new case management system, which will enable more effective monitoring and manager oversight of all complaints;

- **ICAEW:** We were concerned to learn that the ICAEW had incorrectly awarded the audit qualification to some 700 individuals who were not entitled to that qualification and, in the case of two individuals, incorrectly given "Responsible Individual" status, that is the right to sign an audit opinion,. The ICAEW reported this to us following an internal review ahead of our planned review of this area. Whilst the errors were significant and regrettable, we commend the ICAEW for acknowledging the problem and taking urgent sensible steps, agreed with the FRC, to resolve the issues and minimise the impact on individuals, firms, confidence in audit, and on the reputation of the ICAEW.
- **ICAS:** We found that much of ICAS's regulatory work is of a high standard. We found no significant weaknesses in any of ICAS's regulatory arrangements. We support the outcomes of ICAS's own recent reviews relating to the handling of complaints and investigations. These reviews were aimed at enhancing the complaints and investigation processes by making them more efficient and procedurally simple.
- **CAI:** We have queried over several years whether the Chartered Accountants Regulatory Board (CARB), the regulatory arm of Chartered Accountants Ireland, would meet its statutory obligation to monitor all its audit firms undertaking UK audits within six years of April 2008. In response, CARB put a substantial effort into addressing this problem. This is bearing fruit and, based on their recent progress and their plans for 2013/14, we are reasonably confident that, with continued focus, they will meet their statutory obligations.

- **AIA:** As noted above, we commissioned an independent review of the audit qualification offered by the Association of International Accountants. The independent reviewer concluded that the ways in which the AIA tests the prescribed subjects and delivers its courses meet the Companies Act requirements.
- 5.7. We give more detail in Sections 6 and 7 below on our main findings and recommendations. Our work focuses on specific areas each year. Our assessment of how the bodies apply their regulatory systems is done on a sample basis. Accordingly we may not be aware of all errors and weaknesses in each body's systems and procedures.

6. MAIN ISSUES IDENTIFIED AT THE RECOGNISED SUPERVISORY BODIES (RSBS)

Complaints and discipline

- 6.1. Schedule 10 of the Companies Act 2006 sets out the requirements all RSBS must meet relating to complaints and discipline including:
- The RSB must have effective arrangements for the investigation of complaints against (a) persons who are eligible under its rules for appointment as a statutory auditor; and (b) the RSB in respect of matters arising out of its functions as a supervisory body.
 - The RSB must demonstrate that the rules and practices of the body relating to (a) the admission and expulsion of members, (b) the grant and withdrawal of eligibility for appointment as a statutory auditor, and (c) the discipline it exercises over its members are fair and reasonable and include adequate provision for appeals.
- 6.2. The last occasion on which our monitoring visits covered complaints was in 2009/10. One of the major findings from those monitoring visits was the length of time taken to fully investigate and close a considerable proportion of the complaints we reviewed. We identified two main underlying reasons: a failure of supervision and of effective progress-chasing procedures, and a lack of staff resources leading to excessive workloads of investigating officers and managers, high staff turnover and inefficient working practices. With this in mind our 2012/13 review of complaints focused on cases closed in 2011 and 2012 which had been opened several years earlier. In addition, our samples also included complaints where the underlying matter was considered to be high profile or fell just below the threshold of the criteria for an investigation by the FRC's Accountancy Disciplinary Scheme and disciplinary cases which are the final stage of the complaints process.
- 6.3. At each of the RSBS we found examples of complaints where there had been delays. We recognise that some complaints will take a considerable time to investigate due to external factors. Accordingly, by delays we mean that the body had not made reasonable progress with the complaint so far as it lay within its powers to do so.
- 6.4. At two RSBS our reviews indicated that delay was a more significant problem.
- 6.4.1. At ICAEW these delays appeared to be linked to the introduction of a new case management system which diverted staff resources away from their usual caseload. Implementation of the new system is now complete and management are confident that it will help to minimise delays in the future by providing much better management information.
- 6.4.2. At ACCA we found that arrangements for the investigation of complaints had not been effective in relation to many of the case files we reviewed. This is not to say that no investigations took place, but rather that the investigations were subject to excessive delays and under-resourced. The level of resource applied to these cases appeared to have a substantial bearing on the length of the delays. ACCA put a strategy in place in 2011 covering how it would handle all the complaints it receives. This strategy distinguished between new cases and older or legacy cases but the approach taken to legacy cases, including the use of outsourcing had only limited success and led to the position where some of these cases were not actively investigated for extended periods. Although ACCA considers that it

acted to deal with long-standing complaints as quickly as possible, it is disappointing that we found cases closed in 2011 and 2012 after significant delays when we first raised this issue in 2009 in relation to cases closed in 2007 and 2008. We have agreed a number of recommendations with ACCA. The fulfilment of these recommendations relies substantially on the successful implementation of a new case management system which ACCA hopes will deliver the following benefits:

- Better analysis and reporting of the time taken to handle cases highlighting those complaints that have been open for over twelve months;
- A clear record of manager review of cases and manager approval of key actions;
- Greater management focus on the development of suitable key performance indicators and on ensuring that targets are met;
- A clear trail that ACCA's processes have been fully completed; and
- Prompts to investigating officers to contact complainants on a regular basis to update them on the progress of their complaint.

Audit monitoring

- 6.5. The focus of our review was to see what progress had been made regarding issues that we had raised in our previous reviews of audit monitoring. These include the need for effective and decisive action following an unsatisfactory visit to improve audit quality, so that it is clear within a reasonable timescale either that a firm is making a sustained improvement in the quality of its audit work or there is a process underway to remove the firm's audit registration.
- 6.6. We reviewed a sample of 60 audit monitoring visit files across all the RSBs. The sample was smaller than on previous occasions because we were following up the issues from previous review. In order to focus on the effectiveness of follow-up action where possible we selected visits to firms with a regulatory history that included one or more past visits with unsatisfactory outcomes. We

also, where possible, selected visits to firms with clients falling within the scope of the FRC's Audit Quality Review (AQR) team.

6.7. Against this background, our main conclusions were as follows:

- Much of the audit monitoring work we reviewed was of high quality and carried out by experienced inspectors with the expert knowledge to identify weaknesses in a firm's audit work or firm-wide procedures.
- Each body has taken initiatives to improve audit quality. However, it is not yet clear that these initiatives have been successful at bringing permanent improvements. We recognise that it is difficult to measure how far the standard of audit work has improved because RSBs review different firms each year and the sample of firms is not random.
- We continue to have concerns whether action taken in response to persistent poor quality audit work is in all cases sufficient to have the required effect on audit quality. This concern is underlined by the numbers of audit monitoring visits that continue to be graded as unsatisfactory. We acknowledge, however, that changing this is complex and will continue to work with the relevant bodies to bring this about.
- We have encouraged ACCA to test a number of ideas and techniques whereby ACCA might carry out more frequent monitoring throughout the period during which a firm is subject to conditions. This might involve the submission of additional information to ACCA for review or a more frequent dialogue between a firm and ACCA.
- Only ICAEW and ICAS currently have firms with audit clients that fall within the scope of the FRC's AQR team. Based on the audit monitoring files we reviewed, this relationship appears to work well. We have recommended that in the case of these audits the bodies should require their reviewers to document their reviews by detailing the work undertaken by the audit firm and to provide revised documentation for their reviewers accordingly.

- 6.8. In 2010/11 we asked each body to develop a three-year action plan for raising audit quality at the smaller audit firms, designed to identify the issues underlying the results of monitoring, and to set out the steps they would take to address them. We will review the results of that initiative later in 2013. We note that other priorities and staffing constraints at CARB have meant that CARB has so far implemented only elements of their plan. We have recommended that CARB further implement their three year plan during 2013.
- 6.9. We also asked the bodies to work together towards greater consistency in the grading systems they use. As part of this work CAI, ICAS and ICAEW trialled the process of inspectors giving a grading for each file they review, as well as for the monitoring visit as a whole – ACCA already operates this system. File gradings provide a good measure of audit quality and the trial was largely successful, though some differences in gradings systems remain.
- Prior year recommendations: meeting the Statutory Audit Directive requirements on audit monitoring.
- 6.10. The Companies Act, reflecting provisions in the Statutory Audit Directive (SAD), introduced a requirement from April 2008 that RSBs should conduct a quality assurance (QA) review of the audit work at each registered firm at least once every six years, and of auditors of public interest entities at least once every three years.
- 6.11. We therefore monitor the progress of all the bodies towards meeting this requirement. Last year we reported that we were not confident that Chartered Accountants Ireland, through the Chartered Accountants Regulatory Board (CARB), would meet its statutory obligation to inspect all audit firms undertaking audit work in the UK at least once in the six years from June 2008⁵, without further decisive action.
- 6.12. We first queried in 2008 whether CARB was deploying sufficient resources to meet its statutory obligation and have monitored progress since. In 2012 we said that CARB would need to complete and process visits at a faster rate than it has previously achieved to meet the 2014 deadline. By the end of 2011 CARB in the current cycle had only inspected 59 audit firms with UK audits out of a population of some 320 firms. We estimated that CARB would need to visit and report on some 100 firms with UK audits in 2012 and 115 in 2013.
- 6.13. The main reason for the small number of completed audit monitoring visits has been a major review of the audits of certain financial institutions in the Irish Republic, which started in mid-2010, and has absorbed very significant staff resources. This review has taken longer than originally envisaged. Whilst it is still not fully concluded, we understand that the bulk of the work has now been completed and this has allowed CARB to release many of its inspectors back to carrying out audit monitoring visits during 2012/13.
- 6.14. We are pleased to report therefore that CARB has made substantial progress during 2012/13 in addressing this problem. This has been achieved by:
- The return of more inspectors to mainstream monitoring work;
 - The assistance of monitoring staff from ICAS in carrying out visits;
 - The recruitment of additional inspectors and a new Head of Quality Assurance to lead the inspection team;
 - A simplification of the reporting process for visits that receive an adequate or satisfactory grading; and
 - The introduction of desk top reviews instead of on site visits for audit registered firms which have no current audit clients and none during the previous two years.
- 6.15. CARB completed 126 audit monitoring visits during 2012. Our review of a sample of these visit files found that the quality of work had been maintained. On this basis their forecast of 100 monitoring visits in 2013 and 27 during the first three months of 2014 appears achievable and

⁵ The position is complicated because CAI is recognised in both the UK and the Republic of Ireland. Because of later implementation of the Directive, the ROI requirement is to carry out QA reviews of each registered audit firm at least once in the six years from May 2010.

would allow the requirements of the Directive to be met in respect of firms with UK audit clients. CARB therefore deserves credit for their efforts to catch up the previous large back-log of inspections within the required cycle.

- 6.16. One side effect of the small number of audit monitoring visits completed during the years prior to 2012 is that some audit registered firms did not receive a visit for periods of ten years or more or had never previously been visited. The consequences vary widely from firm to firm but in our view there are cases where the absence of visits allowed firms to continue to carry out poor quality audit work undetected for longer than would have otherwise been the case. Had such firms been visited on a more normal frequency then a poor or declining standard of audit work is likely to have been identified at an earlier date.

7. MAIN ISSUES IDENTIFIED AT THE RECOGNISED QUALIFYING BODIES (RQBS)

Award of the Audit Qualification

- 7.1. Schedule 11 of the Companies Act 2006 states that an individual is entitled to the recognised professional qualification (Audit Qualification) if they have:
- Completed a course of theoretical instruction in the prescribed subjects;
 - Passed an examination testing:
 - Theoretical knowledge of the prescribed subjects; and
 - Ability to apply that knowledge in practice.
 - Completed at least three years of approved practical experience, including
 - Two thirds (2 years) of the training having been carried out at a registered audit firm;
 - Part being trained in statutory audit work; and
 - A substantial part being trained in statutory audit work or work similar to statutory audit work.

“Part” has generally been interpreted as a period of approximately 6 months and a “substantial part” as 12 months.

- 7.2. In past years the bodies awarded the audit qualification only to those members who applied for it. In some cases an individual would apply many years after the date of qualification, perhaps triggered by a wish to seek approval to sign audit reports on behalf of a registered audit firm. We recommended that the bodies should award the audit qualification to all new members who met the requirements of their body in full and were eligible to receive it, in part to promote the audit qualification as an achievement in its own right, and in part to minimise the difficulties which can arise when trying to verify the supporting evidence many years later, particularly for the practical training required.
- 7.3. In response ICAEW awarded the audit qualification to around 25,000 members in 2011 based on records held centrally. ICAS also made a ‘bulk’ award to some 950 members. Because of the scale of these awards we decided to review the way this had been done as part of our monitoring visits.
- 7.4. Prior to our visit ICAEW carried out an internal review of the bulk award. This review identified significant errors, meaning that the audit qualification had been awarded to some 700 individuals who were not entitled to it. Consequently we agreed with the ICAEW that in consultation with the FRC they should carry out a programme of remedial action. This involved:
- A further internal review to identify all individuals who were incorrectly awarded the audit qualification. This identified 713 such individuals;
 - Letters to all relevant individuals to remove the wrongly awarded audit qualification;
 - A press release acknowledging the error and setting out the steps taken.
 - Reviews of the audit work of two individuals who were awarded the audit qualification in error and subsequently applied for and were awarded Responsible Individual (RI) status,

enabling them to sign audit reports on behalf of their Registered Audit firm.

7.5. We are pleased that the ICAEW brought this issue to our attention prior to our visit. Whilst the errors were significant and regrettable, the ICAEW acted responsibly and quickly to acknowledge the problem and to take sensible steps agreed with the FRC to resolve the issues and minimise the impact on individuals, firms, confidence in audit and on the reputation of the ICAEW.

7.6. At ICAS we reviewed a sample of individuals awarded the audit qualification as part of the bulk award. We found no cases where the audit qualification had been awarded to individuals who were not eligible because of insufficient audit experience.

7.7. Our work in this area has highlighted the risks in managing volumes of data that are much larger than usual. In this particular area we do not expect there to be a need for any RQB to repeat this exercise. There will continue to be small numbers of applications from members who qualified prior to 2008. The relevant body will assess the quality of the supporting evidence in each case.

7.8. Our main concerns in relation to the award of the audit qualification are that:

- The audit qualification may be awarded to those who qualified several years ago, on the basis of inadequate or poor quality evidence;
- The distinction between (a) the audit qualification and (b) responsible individual (RI) status (or, in the case of the ACCA, holding a practising certificate with audit) may be insufficiently understood. The audit qualification is awarded on the basis of past experience and is not an assessment of current audit competence. RI status on the other hand requires that an individual has the necessary current level of competence to conduct statutory audits; and
- Students do not always record their practical audit work experience accurately, and the information they record is not subject to regular review and approval by mentors and training principals, as required. This increases the risk

that the audit qualification is awarded on the basis of inaccurate or unreliable information.

Review and approval of practical training

7.9. We reviewed a sample of practical training records at three of the RQBs. Each student is required to maintain a record of their practical work experience obtained during their training contract. A satisfactorily completed record of practical work experience is a key requirement for admission to membership. The completion requirements for the record of each body (ICAEW – Evidence of Technical Work Experience and Audit Qualification Application Form; ICAS - Achievement Log and Chartered Accountants Ireland – CA Diary) are different but they all have the following purposes:

- Students record the total amount of practical training obtained and the total amount of audit work experience distinguishing between statutory audit work and other audit work similar to statutory audit work;
- Students record the gaining of competencies during the period of the training contract and/or provide a narrative description of the work they have completed; and
- Mentors and/or training principals review the student records on a regular basis and approve the records to confirm that the nature and analysis of the work experience is accurate and supported by narrative and that specific competencies have been achieved.

7.10. Records of practical work experience are reviewed by ICAEW and Chartered Accountants Ireland at the end of the period of the training contract to ensure that the requirements for admission to membership have been met. ICAS maintains a closer scrutiny of student training records whereby its teaching staff review a sample of Achievement Logs after the first year of training contracts, and review all Achievement Logs after the second and third years. They comment on any individual deficiencies which must be addressed before that student is admitted to membership.

7.11. We reviewed approximately 80 practical training records across the three RQBs. In

a number of cases we found that the quality of information recorded and the frequency of review were disappointing. Against this background our main findings were as follows, though not all the points apply to all three RQBs.:

- Supporting narrative information was sometimes of poor quality, for example. the narrative was not audit specific, or was a factual account of work without any reflection by the student on what he had learned from the work experience or how it had contributed to the development of professional skills;
 - The analysis of work included experience counted as audit days when the nature and environment of the work experience described meant that this was not appropriate;
 - Some audit work experience was reviewed and approved by individuals who did not hold the audit qualification;
 - Some practical experience was approved without adequate supporting evidence; and
 - Overall there was a lack of regular reviews and monitoring of students' work experience. For example a single review after three years makes it much more difficult for a reviewer to confirm reliably that a student has achieved specific competencies. Based on our sample we consider it likely that this is the experience of a significant proportion of students. In failing to arrange and carry out reviews on a six-monthly or annual basis, neither students nor firms formally meet their body's practical training requirements.
- 7.12. Given these findings we welcome assurances from the bodies about the importance that they attach to practical training and that they will reinforce their efforts to remind and guide students and firms about the procedures that should be followed. We will review in a subsequent visit whether this is leading to improvements in practice. Nevertheless, we have made recommendations to some bodies that they should also re-design their training records and improve the functionality of their on-line systems in ways which lead and encourage students to complete records to a high standard, and encourage firms to

undertake regular reviews. This is relevant in particular at Chartered Accountants Ireland, which intends to include improvements to their CA Diary as part of a wider upgrade of their IT systems. In particular this should change the current position whereby the system defaults to recording audit days as statutory audit days unless the student remembers to consider whether this is correct, which builds in a significant risk that statutory audit days are over-stated. All bodies should also make clear that poor quality training records may delay students from qualifying as members.

Prior year recommendations: review of AIA qualification

- 7.13. We reported last year that, whilst the AIA had made significant efforts to address our previous concerns relating to the standard of the Professional Level 2 Auditing paper, and to the marking scheme for that paper and others, in our view there were still significant weaknesses in its examinations; and that following discussions with the AIA, we had decided to instruct an independent expert to review its examinations and related matters supporting their qualification.
- 7.14. The terms of reference were for the expert to undertake a review of the extent to which AIA's recognised professional qualification (RPQ) meets the requirements of the Companies Act 2006. These requirements state that the qualification must be restricted to persons who have completed a course of theoretical instruction in the prescribed subjects and passed an examination which tests theoretical knowledge of the prescribed subjects and an ability to apply that knowledge in practice, and which is at least of degree standard.
- 7.15. The expert (an experienced auditor and examiner), assisted by a specialist in the assessment of qualifications, reviewed information provided by AIA, conducted interviews with examiners, moderators and AIA staff and Council members and attended a meeting of the AIA's Qualifications Committee. The work included:
- Matching Companies Act requirements to AIA's syllabus and educational entry requirements;

- Assessing whether the examinations are of degree standard;
 - Assessing the testing of the subjects prescribed in the Companies Act in general, and audit papers in particular;
 - Reviewing the delivery of courses;
 - Reviewing the granting of exemptions and the time limits for taking examinations.
- 7.16. It was difficult for the expert to draw conclusions on how the AIA's systems and requirements were working in practice in some areas (for example on student progression), as the last student to complete the AIA's RPQ was in 2002. There are currently ten UK based students enrolled on the AIA's RPQ course, and we understand that some of these students sat AIA examinations in May 2013.
- 7.17. The expert concludes that the structure of the AIA's RPQ meets the Companies Act requirements for recognition, insofar as the syllabus is mapped to the prescribed subjects, and that the examinations are a sufficient test of theoretical knowledge and of the ability to apply that knowledge. His report does not identify significant weaknesses relating to the standard of the Professional 2 Auditing paper. He also notes that the recognition of the AIA as an awarding body approved by Ofqual gives confidence in the assessment processes.
- 7.18. Whilst the expert does not consider that fundamental changes are required to the AIA's RPQ, he identifies what he considers to be a number of deficiencies in the delivery and the monitoring of the RPQ and makes recommendations which he considers will help to address these deficiencies. These include:
- an over-simplistic approach to determining how far practical application is tested at the Foundation level and more advanced levels of the exams,
 - the need for a peer review of final draft examination papers to help make the process more robust,
 - a lack of knowledge about student pass rates and progression,
 - an unduly prescriptive approach to exemptions,
 - an apparent lack of clarity regarding the role of the AIA Qualifications Committee.
- We have asked the AIA to prepare an action plan which shows how they will address his recommendations.
- Prior year recommendations: exemptions**
- 7.19. We have made a number of recommendations in recent years to ICAEW, ACCA, CAI and AIA on the award of exemptions. In 2012, we reviewed progress in implementing our recommendations on the award of exemptions at ACCA only. We will review progress at the other RQB's in 2013.
- 7.20. In respect of ACCA our overall conclusion was that the processing of applications for exemptions had improved and that ACCA's exemption policies and procedures are being followed by staff on most occasions. However, we also consider that some of ACCA's current exemption policies do not ensure that students meet the same standards as that required by ACCA's examinations. In this connection ACCA has confirmed that it is committed to producing more detailed reporting on student performance in relation to exemptions awarded and is undertaking a full review of its exemption policies and processes during 2013. We look forward to receiving the conclusions of this review.
- 7.21. During 2013 we intend to discuss collectively with the RQB's the ways in which they meet the requirements of the Companies Act, with a view to identifying good practice and ways in which recognised bodies might strengthen current requirements, processes and practices. One area where such a discussion is likely to be valuable is the award of exemptions to RPQ students.

(ii) Report of the Independent Supervisor of Auditors General

1. INTRODUCTION

- 1.1. This is the first report of the Financial Reporting Council (FRC) as the Independent Supervisor of the Comptroller and Auditor General (C&AG)

and the other Auditors General, in respect of their work as statutory auditors of companies under the Companies Act 2006 (2006 Act). The Statutory Auditors (Amendment of Companies Act 2006 and Delegation of Functions etc.) Order 2012 names the FRC as the Independent Supervisor. Previously the Professional Oversight Board, then an Operating Body of the FRC, was the appointed Independent Supervisor under the Independent Supervisor Appointment Order 2007 (SI 2007/3534).

- 1.2. Section 1228 of the 2006 Act requires the Independent Supervisor to report on the discharge of its responsibilities at least once in each calendar year to the Secretary of State, the First Minister of Scotland, the First Minister and the Deputy First Minister in Northern Ireland, and to the First Minister for Wales. This report meets the statutory reporting requirements.
- 1.3. The Comptroller and Auditor General (C&AG) and the other Auditors General are eligible for appointment as the statutory auditors of companies under the 2006 Act, subject to meeting certain conditions.
- 1.4. One of those conditions is that an Auditor General is subject to oversight and monitoring by an "Independent Supervisor" in respect of statutory audit work. To date only the C&AG has entered into the necessary arrangements with the FRC and undertakes statutory audits under the 2006 Act. The year to 31 March 2012 was the fourth year in respect of which staff at the National Audit Office (NAO) undertook statutory audit work, auditing the accounts of 23 companies. This is a minor part of the NAO's work but enables the NAO to undertake the statutory audit of companies that are owned by Government Departments and other public bodies whose financial statements it audits. The responsibilities of the Independent Supervisor do not extend to the other work of the C&AG.

2. SUPERVISION ARRANGEMENTS

- 2.1. Section 1229 of the 2006 Act requires the Independent Supervisor to establish supervision arrangements with any Auditor General who wishes to undertake statutory audit work, for:

- Determining the ethical and technical standards to be applied by an Auditor General;
 - Monitoring the performance of statutory Companies Act audits carried out by an Auditor General; and
 - Investigating and taking disciplinary action in relation to any matter arising from the performance of a statutory audit by an Auditor General.
- 2.2. These supervision arrangements are set out in a Statement of Arrangements and Memorandum of Understanding (MOU) between the FRC and the C&AG, and include a requirement for the monitoring of the C&AG's statutory audit work by the FRC's Audit Quality Review (AQR) team, on behalf of the Independent Supervisor.

3. REPORTING REQUIREMENTS

- 3.1. We report below in accordance with the requirements of Part 4 Appointment of the Independent Supervisor, Article 19 (a) to (e), Article 20 and Article 21 of SI 2012/1741 Statutory Auditors (Amendments of Companies Act 2006 and Delegation of Functions etc.) Order 2012 which came into force on 2 July 2012.

(a) Discharge of Supervision Function

- 3.2. The supervision arrangements require that the C&AG and relevant NAO staff follow technical and ethical standards prescribed by the FRC when conducting statutory audits and sets out the investigation and disciplinary procedures that would apply were there a need to discipline the C&AG in his capacity as a statutory auditor. The relevant standards are those set by the FRC for auditors generally.
- 3.3. We meet periodically with senior staff responsible for the audit practice of the NAO on behalf of the C&AG. We have familiarised ourselves with the NAO procedures to discharge these responsibilities and keep abreast of any changes.

(b) Compliance by Auditors General with duties under 2006 Act

- 3.4. As noted above, to date only the C&AG has undertaken statutory audits, all of which have been of companies within the public sector.

3.5. The AQR inspection in 2012/13 of the C&AG's statutory audit work comprised:

- Updating its understanding of the processes and procedures supporting audit quality that applied to these audits; and
- Reviewing the performance of 2 of the 23 statutory audits carried out by NAO staff in respect of financial periods ending on 31 March 2012.

3.6. Progress has been made in addressing the prior year inspection findings but there are a limited number of areas where further action is required.

3.7. In respect of the individual audits reviewed no significant concerns were identified.

3.8. On the basis of the findings of the AQR, and subject to the NAO's action plan to deal with those findings, in our view the NAO has policies and procedures in place that are generally appropriate to the conduct of its Companies Act statutory audits.

3.9. We found no evidence that any Auditor General was in breach of duties under the 2006 Act.

(c) Notification by Auditors General under Section 1232 of the 2006 Act

3.10. No Auditor General was required to notify the Independent Supervisor of any other information under Section 1232 of the 2006 Act.

(d) Independent Supervisor's Enforcement Activity

3.11. We issued no enforcement notices and made no applications for compliance orders in 2012.

(e) Account of Activities relating to the Freedom of Information Act

3.12. We received no requests for information under the Freedom of Information Act in our role as the Independent Supervisor.

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